Hearing on Tax Reform and Small Businesses: Growing our Economy and Creating Jobs

---

HEARING

BEFORE THE

SUBCOMMITTEE ON TAX POLICY

OF THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED FIFTEENTH CONGRESS

SECOND SESSION

May 23, 2018

Serial No. 115-TP04

COMMITTEE ON WAYS AND MEANS KEVIN BRADY, Texas, *Chairman*	
SAM JOHNSON, Texas DEVIN NUNES, California DAVID G. REICHERT, Washington PETER J. ROSKAM, Illinois VERN BUCHANAN, Florida ADRIAN SMITH, Nebraska LYNN JENKINS, Kansas ERIK PAULSEN, Minnesota KENNY MARCHANT, Texas DIANE BLACK, Tennessee TOM REED, New York MIKE KELLY, Pennsylvania JIM RENACCI, Ohio KRISTI NOEM, South Dakota GEORGE HOLDING, North Carolina JASON SMITH, Missouri TOM RICE, South Carolina DAVID SCHWEIKERT, Arizona JACKIE WALORSKI, Indiana CARLOS CURBELO, Florida MIKE BISHOP, Michigan DARIN LAHOOD, Illinois BRAD R. WENSTRUP, Ohio	RICHARD E. NEAL, Massachusetts SANDER M. LEVIN, Michigan JOHN LEWIS, Georgia LLOYD DOGGETT, Texas MIKE THOMPSON, California JOHN B. LARSON, Connecticut EARL BLUMENAUER, Oregon RON KIND, Wisconsin BILL PASCRELL, JR., New Jersey JOSEPH CROWLEY, New York DANNY DAVIS, Illinois LINDA SÁNCHEZ, California BRIAN HIGGINS, New York TERRI SEWELL, Alabama SUZAN DELBENE, Washington JUDY CHU, California
GARY J. ANDRES, *Staff Director* BRANDON CASEY, *Minority Chief Counsel*	

SUBCOMMITTEE ON TAX POLICY VERN BUCHANAN, Florida, *Chairman*	
PETER ROSKAM, Illinois DAVID G. REICHERT, Washington JIM RENACCI, Ohio KRISTI NOEM, South Dakota GEORGE HOLDING, North Carolina JASON SMITH, Missouri TOM RICE, South Carolina DAVID SCHWEIKERT, Arizona	LLOYD DOGGETT, Texas JOHN B. LARSON, Connecticut LINDA SÁNCHEZ, California MIKE THOMPSON, California SUZAN DELBENE, Washington EARL BLUMENAUER, Oregon

---

Hearing on Tax Reform and Small Businesses:
Growing our Economy and Creating Jobs

U.S. House of Representatives,
Subcommittee on Human Resources,
Committee on Ways and Means,
Washington, D.C

WITNESSES

Larry Gray
Owner, Alfermann Gray & Co. CPAs, LLC
Witness List

Michael Baach
President and Chief Executive Officer, Philpott Solutions Group
Witness List

John Horne
Owner and President, Anna Maria Oyster Bars
Witness List

Philip Homan
President and Chief Executive Officer, LORAM Maintenance of Way, Inc.
Witness List

John Arensmeyer
Founder and Chief Executive Officer, Small Business Majority
Witness List

WAYS AND MEANS
CHAIRMAN KEVIN BRADY

Subcommittee Chairman Buchanan Announces Hearing on Tax Reform and Its Pro-Growth Impact on Small Businesses

House Committee on Ways and Means Tax Policy Subcommittee Chairman Vern Buchanan (R-FL) announced today that the Subcommittee will hold a hearing on how tax reform is helping small businesses hire more workers, grow, and invest in their local communities. **The hearing will take place on Wednesday, May 23, 2018 in 1100 Longworth House Office Building, beginning at 10:00 AM.**

In view of the limited time to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov, select "Hearings." Select the hearing for which you would like to make a submission, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, **by the close of business on Wednesday, June 6, 2018.** For questions, or if you encounter technical problems, please call (202) 225-3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines

listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.

Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202-225-1721 or 202-226-3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available at http://www.waysandmeans.house.gov/

TAX REFORM AND SMALL BUSINESSES:
GROWING OUR ECONOMY AND CREATING JOBS

Wednesday, May 23, 2018
House of Representatives,
Subcommittee on Tax Policy,
Committee on Ways and Means,
Washington, D.C.

The subcommittee met, pursuant to call, at 10:02 a.m., in Room 1100, Longworth House Office Building, Hon. Vern Buchanan [chairman of the subcommittee] presiding.

Chairman Buchanan. The subcommittee will come to order.

Welcome to the Ways and Means Subcommittee on Tax Policy hearing, "Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs."

Today, we will continue our series of tax reform hearings into how the Tax Cuts and Jobs Act is providing economic growth. Our focus today is on how tax reform is affecting those Main Street businesses, which create most of the jobs in this country and which invest in our local communities.

Last year, we passed the Tax Cuts and Jobs Act to reform our Tax Code into one that is built for growth. We lowered tax rates across the board for individuals, small businesses, and corporations. We introduced full and immediate expensing for most capital-intensive firms of all sizes and we enacted provisions for small businesses, such as expanded availability for cash accounting and flexibility for choosing between pass-throughs and corporate taxation.

These reforms benefit all businesses, big and small, and create an economic opportunity that has spurred the economic growth.

We are seeing results already. Back in 2016, CBO projected that the GDP growth in 2018 would slow from 2.3 percent in the first quarter down to 2.1 percent in the fourth quarter. Now, after growing 2.9 percent in the first quarter of 2018, GDP growth is projected to accelerate to 3.3 percent in the fourth quarter.

At the same time, unemployment forecasts are being revised down. For example, CBO expects the unemployment rate to drop to 3.5 percent by the end of the year. It will be the lowest unemployment rate since 1969.

And that is not all. Investment growth is exceeding expectation. Just last week, The Wall Street Journal reported that capital spending by firms in the S&P 500 grew by 24 percent in the first quarter of 2018, the fastest pace since 2011 and the best first quarter since 1995.

Recent data on small businesses is encouraging. The National Federation for Independent Business reported small business profits at a 45-year record high. The percentage of small businesses that are expanding their employment is at the highest level since 1999. And the percentage of small businesses reporting plans for expansion, increased hiring, and higher wages is at a near record high.

Now we want to hear from small business owners themselves on how tax reform is helping them grow their operation and invest in their workers and local communities. We have a fantastic panel of witnesses before us today, including several current owners of small- and medium-sized businesses.

I look forward to all your testimony.

I now yield to the distinguished ranking member, Mr. Doggett, for the purposes of an opening statement.

Mr. Doggett. Well, thank you very much.

It would have been great if we could have heard from small businesses last year when this tax law was being written. That would have been a far better time when we might have actually had some impact on the contents of the law.

Unfortunately, small businesses, like so many other taxpayers, academics, and experts in this area, were all cut out of the process when a decision was made to rush this bill through without any public hearings.

Now we today, like last week, basically have a public relations exercise to try to put the best face on legislation that was designed to provide a windfall for Wall Street banks and for multinationals and for whom small businesses were basically an afterthought.

If the length of this hearing were designed to reflect the portion of this tax bill that really benefits small businesses, we would need to conclude right now, before you even testify.

For small businesses owners, we have basically a tax bait and switch. After dressing up the pass-through provisions as a big help for mom-and-pop small businesses, we have learned that almost half of the overall benefits from this particular provision go to those who make more than $1 million per year.

And within a few years, two-thirds of the pass-through small businesses will be left with a mere 4 percent of the benefits, while more than half of it will go to those making at least a million dollars each year.

For too many here in Congress, small business seems to be, well, the kind of enterprise Donald Trump runs -- not so many employees, a real estate mogul.

And while continuing to hide his personal tax returns and those for his 500 pass-through entities that may well have benefited significantly from this travesty, we find tucked into the provisions of the final tax bill, tucked in from the conference committee, even though neither the House nor Senate considered them, a special provision tailor made for real estate operations similar to what Trump does -- few employees, but a significant amount of depreciable property.

As one recent study concluded, for small businesses the new pass-through deduction is, quote, "unlikely to generate enough tax savings to hire new employees or make significant operational improvements or capital investments." Indeed, a recent survey of small businesses, another one, found that for about 7 in 10, nothing in the new tax law will result in the hiring of new employees.

Small businesses, I think, deserve a level playing field. We shouldn't be picking winners and losers. Unfortunately, that is exactly what this tax law did.

Since the recession, we know that small businesses have created two of every three private sector jobs. But the focus of this new tax law was to see how much more help we could provide to large multinational corporations.

Most of the small businesses that I deal with in Texas can't afford an offshore tax haven, don't have a jillion offshore subsidiaries. It is just not fair when Pfizer, which has 157 subsidiaries and tax havens, pays such a much lower rate

than the corner pharmacy, even though it is Pfizer that especially needs national security and the economy, the infrastructure, the education that America provides it.

We recently learned how one multinational plans to use the windfall it got from this tax law. Since September of 2017, when Speaker Ryan visited a Harley-Davidson plant up in Wisconsin to tout the gold at the end of the corporate tax break rainbow, what did we learn about Harley-Davidson?

Well, it shuttered its plant. It laid off 350 people. It showered its wealthy shareholders with $700 million in stock buybacks. And it is opening a new factory in Thailand, a factory that will benefit from a new provision, a new incentive for offshoring jobs.

So, I am eager to hear from you. I am sure that there are some exceptions to the rule that we will hear about today. I think overall every small business, including those that might have had some immediate benefit from this bill, will find themselves facing more difficulty with access to capital.

When I visit with small businesses, they want to become bigger businesses, and often one of the obstacles is access to capital.

Well, with more than $2 trillion in debt here being added to the deficit, we are already seeing some increase in interest rates. And we will continue, according to most objective observers, to see that rise in interest rates as so much public debt begins to squeeze out access to private capital.

That is the wrong direction, but we look forward to your insights regarding this new law.

Thank you, Mr. Chairman.

Chairman Buchanan. Thank you.

We will hear from five witnesses today. I would like to recognize the gentleman from Missouri, Mr. Smith, to introduce our first witness.

Mr. Smith. Thank you, Mr. Chairman.

Mr. Chairman, members of the committee, it is my pleasure to introduce Larry Gray from the great State of Missouri, and from the even greater community, my hometown of Salem.

Larry runs a small CPA firm in Rolla, Missouri, and is one of the leading CPAs not only in my district, but across the country. He is well-published, having written hundreds of articles in professional journals, and has served and continues to serve on many IRS boards and professional organizations. Larry is a highly sought speaker traveling the country to teach tax law to other CPAs.

Larry is also a farmer. In fact, his farm is very close to my farm in our hometown. Being a CPA and a farmer puts Larry in a very unique position to talk about the Tax Cuts and Jobs Act, how it is helping family farmers and rural communities. I am just grateful that he took time out of his busy schedule to be here.

Please welcome Larry Gray.

Chairman Buchanan. Next I would like to recognize the gentleman from Ohio, Mr. Renacci, to introduce our next witness.

Mr. Renacci. Thank you, Mr. Chairman.

I am pleased to have a business from my district represented here today. It is my pleasure to introduce Mike Baach, President and CEO of Philpott Solutions Group. Philpott is a small local industrial company whose core competency involves fabricated customized rubber parts.

Northeast Ohio relies heavily on industrial manufacturers such as Philpott, so I am glad Mike is here to represent Philpott and other small businesses in northeast Ohio.

Thank you for being here, Mike, and welcome.

Chairman Buchanan. Now I would like to introduce our next witness, someone I have known and had the privilege of knowing for many years, John Horne.

John is the owner of Anna Maria Oyster Bar in my home district of Manatee County. John is a veteran of the hospitality industry in Manatee County for more than 40 years.

One of the neat things about John, he has worn shorts to work every day for the last 25 years. I asked John, "Why didn't you bring the shorts today?" He said, "Well, it is not quite dignified." So how you can be on vacation and make money, I find that pretty interesting.

He began his career as a busboy on Anna Maria Island, working for a small chain of restaurants. Then in 1996, after 10 years of working his way up the ladder, he took a leap and opened his own business, his own restaurant, Anna Maria Oyster Bars. Now, he has four locations with 330 employees, where they serve great food in a family-friendly environment. Also, he is very active in giving back in the community through youth and education.

Thank you for being here, John. We appreciate the opportunity.

Now I would like to recognize the gentleman from Minnesota, Mr. Paulsen, for the purpose of introducing the next witness.

Mr. Paulsen. Thank you, Mr. Chairman.

I am pleased to welcome with us today Phil Homan to the Ways and Means Subcommittee hearing this morning. Phil is President and CEO of Loram Maintenance of Way, which is headquartered in my district in Hamel, Minnesota. And Loram is a major railroad maintenance and service provider with 1,200 employees across the country.

And, Mr. Chairman, I am looking forward to hearing Phil's testimony this morning as he explains how the Tax Cuts and Jobs Act has positively impacted Loram's employees, their operations, and their plans for the future.

And so I yield back.

Chairman Buchanan. Finally, John Arensmeyer is a founder and chief executive officer of Small Business Majority.

I want to welcome all of you here today. The committee has received your written statements, and they will be made part of the formal hearing record.

Each of you will have 5 minutes to deliver your oral remarks.

We will begin with Mr. Gray when you are ready.

STATEMENT OF LARRY GRAY, OWNER, ALFERMANN GRAY & CO. CPAS, LLC

Mr. Gray. Thank you, Mr. Chairman.

Chairman Buchanan, Ranking Member Doggett, fellow members of the committee, I actually come from a very humble upbringing. My father had a sixth-grade education. He worked in his father's sawmill. Both my grandfathers owned sawmills. And throughout my father's life, he was a pig farmer.

My mother had an eighth-grade education. She was not allowed to go to school beyond the eighth grade, but could work at a local riverfront cafe at the age of 12. Then she went to work in a shoe factory and finished her career in her mid-seventies, managing nearly 100 women in a garment factory.

What these two people instilled in me was a work ethic. My father said work hard, and he set an example for me to follow. My mother said get an education, one that you can take and make a difference and have in your own business.

I tell you this because from these experiences, I have learned life is not always fair nor easy. Neither is being a small business.

At the age of 10, I started mowing and raking hay for local farmers at 1.5 cents per bale. The following summer, I knew that I could make more money. To do this, I needed to hire help. I put together my first hay crew at the age of 11. The going rate at the time was 10 cents a bale to haul the hay from the field to the barn.

I paid my high school hay crew -- someone had to be old enough to drive the truck -- 2 cents per bale that summer, and I did make more money.

That was my first personal experience with small business and employees. My address has not changed since I was 4.

Today, I own a cattle farm running about 300 cow/calf pairs, including 85 acres that has been in the family for over 100 years. My children and grandchildren live and work on that farm. My grandchildren represent a fifth-generation small business.

I give you this background so that you can see I am from the real world, where small business is really small and typically a family affair.

What I see now in the small business arena in rural Missouri is a general sense of economic optimism. I am seeing more clients who are borrowing money to

start a business, to expand a business, or to bring in partners, likely family members.

On behalf of the small business, I would like to thank you, Congress, for this new opportunity to have you as a partner. The business provisions in the Tax Cuts and Jobs Act say America is investing in small business.

Because of the 20 percent deduction, lower individual rates, corporate tax rates 21 percent, not 35, and depreciation/expensing options, small business is set to expand. My employees' taxes should be very simple, maybe free file. The law allows small business to get a 20 percent deduction without complication.

AMT is a much more burdensome process and impacts more of my small business clients than the 20 percent deduction over the phaseout threshold. Most small business in rural Missouri will fall under the threshold amount, so calculations will be more straightforward.

If there has been one true pain point in my small business over the past few years, it is health insurance. My health insurance has gone up exponentially under the Affordable Care.

I am not alone. Many of my small business clients are experiencing the same thing, to the extent many of them no longer have health insurance, finding that paying the penalty is more affordable than affordable care. I am especially seeing that in the 50- to 65-year-old small business clients.

Even factoring in the ACA burden, I personally know that if I can make the same money as I made last year with less tax, it will allow me the security of my business planning to expand. As I add one employee here and one employee there in my small companies, I know that my business is growing. In the small business community, that creates an attitude, which becomes a conversation, and small business will grow.

In closing, I thank you for allowing me to be a part of this hearing. On behalf of small business throughout America, I thank you and the legislative process for good legislation.

There will be corrections and interpretations like any other legislation of this size. In this process, I believe small business will look at the intent of the new tax law as Congress cares about us.

Thank you.

May 18, 2018

Committee on Ways and Means
U.S. House of Representatives
Washington, MO 20515

Attn: Chairman Vern Buchanan
Congressman Lloyd Doggett

Dear Messrs. Buchanan and Doggett,

Thank you, Chairman Buchanan and Congressman Doggett, for allowing me this opportunity to share with you today what I am seeing as a 3rd generation small business owner in rural Missouri.

First, a background on a real-life family of small business owners. I come from a very humble upbringing. Both of my grandfathers owned sawmills. My father had a 6th grade education. He worked in his father's sawmill and was a pig farmer his whole life. My mother had an 8th grade education. She was not allowed to go to school beyond 8th grade but could work at a local riverfront cafe at the age of 12. She then went on to work in a shoe factory and finished her career in her mid-70s managing nearly 100 women in a garment factory. What these two people instilled in me was a work ethic. My father said, "work hard son" and he set an example for me to follow.

I was born in a two-bedroom house, with seven people living there. We had a "one-holer" outhouse. When I was four, we moved into a bigger place: we had six rooms and a "two-holer" outhouse; and no running water. When I stand in my yard today I see that house, and my 95-year-old mom still lives there.

I attended a 1-room schoolhouse my first year of school. It was there I learned about bullying, when a 4th-grader labeled me "greyhound" and threw things at me. I was frequently tormented on the back of the bus. My father taught me not to fight. My mother said, "get your education son; they (the bullies) can't take that away from you". She would say "you can work for yourself and make a difference having your own business." I tell you this because from these experiences I learned life is not always fair, nor easy. Neither is being a small business owner.

At 10 years old, I started mowing and raking hay for local farmers, at 1.5 cents per bale. The following summer, I knew I could make more money. To do so, I needed to hire help. I put together my first hay crew at the age of 11. The going rate at the time was $.10/bale to haul hay from field to barn. I paid my high school hay crew (someone had to be old enough to drive the truck) 2 cents per bale that summer and did make more money. That was my first personal experience with small business and employees.

I saved what I made and bought my first truck for $98 when I was 14 and at 16, I put a down payment on my first 85 acres; a farm my grandpa purchased over 100 years ago. My father was born there, and now, my grandchildren fish on that farm.

I did as my mom said. I went to college, majoring first in engineering and then completing a degree in accounting. While in college I continued working on the farm and in hay fields. During that time, I also held a union brick-layers card, drove over-the-road rigs coast-to-coast, and became proficient in operating heavy machinery. When I graduated college the month before I turned 21, I had paid off the 85 acres and I owed $425 for my college degree. I learned much from my humble upbringing.

While job opportunities from the then top big CPA firms came in, I chose a path in life that would keep my roots in south-central Missouri. I had changed degrees after working for a big company in a big city one summer, and decided I wanted to go back to the country and be in charge of my future, knowing I would make less money in small business. I took a position in a small CPA firm about 30 miles from the farm. I bought out the prior owners many years ago, and just completed my 41st tax season, in the same building I began my career in. My son and daughter both work in the firm with me and represent the 4th generation of small business owners in our family.

When I say roots, my address has not changed since I was four years old. Today, I own a cattle farm, running about 300 cow/calf pairs, that includes that original 85 acres. My children and grandchildren live and work on the farm. My grandchildren will be 5th generation small business owners.

Thank you for allowing me such a lengthy introduction. I give you the background, so you can see that I am from the real world, where small business really is small, and typically a family affair. My personal tax return includes a Schedule F on my 1040 for the farm and K-1s from flow-through entities for real estate, rental, retail business, specified service business, and part ownership in a small C Corp. My return does not look that different from many I see in my practice. And I make under $315,000 per year.

What I see now in the small business arena in rural Missouri is a general sense of economic optimism.

From this past tax season and the last five weeks of appointments with small business owners, the following is a summary of a small community accounting firm working with small business.

My small business clients, after explaining to them how the new law may impact them, were excited to know they were only going to pay on possibly 80% of their business income. Also, they found they would be in a lower tax bracket, resulting generally in them wanting to know how to grow their business. Several were willing to set up planning sessions throughout the year. This year, small business owners are taking a much more proactive approach in tax planning for their businesses.

We are getting more clients wanting us to do financials during the year. Generally, they are asking for money to start a business, expand a business or bring in partners, like a family member.

We are seeing an increase in existing and new small business clients making the decision to outsource much, or all, of their accounting and payroll work. Accounting and compliance is the last thing they want to do. And now, finally they can afford us.

In the past few weeks, we have had annual small business tax return clients become bookkeeping accounts, payroll accounts, accounting accounts and full-service accounts: receiving and paying their bills, payroll, accounting, financials and final tax return. The general reason they are outsourcing, “I need more time to run my company. I can make more money paying an accountant to do the books and use that time to make money”. These clients generally have a higher volume of business and more employees and like other small business owners, they believe the future is now.

To keep up with the additional work flow, I have added a full-time employee to my professional staff at the CPA firm, as well as added an additional full-time employee to assist with a side-business I launched in late 2017. And my family is in the process of setting up a dog breeding facility on the farm, fulfilling a life-long dream of some of my family members.

However, not everyone in Dent County, MO is fairing so well. I live in a county where 40% of the males are unemployed and 24% of the population suffers from mental/abuse disorders. I believe in the future and am investing to make my community a better place to live. I have grandchildren…I must.

As a small business owner, I must believe, or I cannot get up each morning and 'do it' no matter the outcome. The risk and investment, and most importantly, taking away hours before 8 and after 5 from my family nearly every day, that's what being a small business owner is all about.

On behalf of small business, I would like to thank you Congress for this new opportunity to have you as a partner. The business provisions of the TCJA say America is investing in small business. Because of the 20% deduction, lower individual tax rates, corporate tax rate at 21%, not 35% and depreciation/expensing options, small business is set to expand. Economic attitude is positive.

However, still in the back of many business owners' minds that I talk to is the fact that you, Congress, have the right to repeal these tax benefits you have passed.

As a small business owner, every day my family's future is on the line. My biggest fear has not been "I have to look for another job". My biggest fear has been, where will my kids sleep at night if I lose it all… Please keep this thought in mind as modifications are made with regards to small business tax law. Small business may be ready to grow, with some trepidation, but I must believe that if small business does their part right and the economy does grow, that the laws passed to help and allow us to do so will remain in place or get even better.

From a tax preparation perspective, new tax law, for the most part, is very straight forward. For example, my employees' taxes should be very simple, even free-file. But personally, I would rather have a few more tax law complications to work through so there are options when running my business, and the opportunities to be successful.

This law allows small business to get the 20% deduction without complication. Then when these companies grow beyond the threshold, they will know the law, hire more people or buy more qualified property to keep their 20% deduction.

While the learning curve on the 20% QBI deduction makes this new law seem complicated this year, when the new wears off, the 20% deduction computation will be much easier to calculate than AMT, which basically requires running the return a second time to see if AMT applies. AMT is a much more burdensome process and impacts more of my small business clients than will the 20% deduction over the phaseout threshold amounts. Most small business in rural Missouri will fall under the threshold amounts, so the calculation will be straightforward.

If there has been one true pain point in my small business over the past few years, it is health insurance. My health insurance has gone up exponentially under the Affordable Care Act. I am not alone in that regard. Many of my small business clients are experiencing the same thing, to the extent many of them

no longer have health insurance, finding that paying the penalty is more affordable than Affordable Care. I am especially seeing this in my 60-65-year-old clients.

Even factoring in the ACA burden, personally, I know if I can make what I made last year, it allows me the security in my business planning to expand. As I add one employee here and one employee there in my small companies, I know that my business is growing. In the small business community, that creates an attitude, which becomes a conversation and small business will grow.

In closing, I thank you for allowing me to be a part of this hearing. On behalf of small businesses throughout America, I thank you and the legislative process for good legislation. There will be corrections and interpretations, like any other legislation of this size. In that process, I believe small business will look at the intent of the new tax law as "Congress cares about us".

Thank you again for this opportunity.

Larry L. Gray

Larry L. Gray, CPA, CGMA
Alfermann Gray & Co, CPAs LLC

Chairman Buchanan. Thank you, Mr. Gray.

Mr. Baach, you are recognized.

STATEMENT OF MICHAEL BAACH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, PHILPOTT SOLUTIONS GROUP

Mr. Baach. Good morning, and thank you for the opportunity to come in and speak with you this morning.

My name is Mike Baach, and I have served as the president and CEO of Philpott Solutions Group since September 2009. We are headquartered in northeast Ohio, where we have remained since our founding in 1889 by John W. Philpott.

I will retire at our annual shareholders meeting on the 7th, which is almost exactly 2 weeks from this moment. I am very much looking forward to it.

During my time, our team more than tripled the size of Philpott through creative domestic market expansion. Although Philpott's best days are still ahead, I am confident that we are handing off to Dr. Jim Vaughn an even better version of what was already a great Philpott when it was entrusted to me and my team.

A hundred and twenty-nine years ago, Mr. Philpott walked his wooden cart around Cleveland's industrial area, selling his custom-fabricated rubber goods, many of which remain in our core competency. Perseverance and remaining true to Mr. Philpott's customer-centric vision guided our company through two world wars, the Great Depression, and all too many recessions.

Philpott currently employs 40 people, who also own the company. This came about in 1977, when no one in the Philpott family wanted to run the company. They sold Philpott to its employees using an employee stock ownership plan, more commonly referred to as an ESOP.

Each year, we are permitted to contribute up to 25 percent of an employee's compensation into his or her ESOP account, to a maximum of just over $50,000. The cash accumulates in each employee's ESOP account, which is then used to purchase the shares of fellow employees at retirement.

This process assures a near-perpetual employee ownership of Philpott. Having equity in the company has proven to motivate our employees and ensure the best-in-class customer service.

We continue to sell our legacy polymeric parts for industrial applications. Like with other industries in the late 1990s, rubber molders fell into the allure of low labor and tax costs in China.

When we were told by one of our largest customers, "You can either join us in our move to China or we will find someone that will," our choice was clear. We formed contract relationships with manufacturers of three rubber molders in the Shanghai area, and ultimately it forced the closing of our USA factory in 2003.

Parts in China were at least 25 percent less expensive than ours in the USA, despite the added transportation costs and the added China contractors' margin.

However, quality issues grew, which strained our management and financial resources and eventually rose to a level where key customer retention was in jeopardy.

At about the same time, our technical team had a rubber compound reengineering breakthrough that reduced cycle time for producing parts and, thus, closing the gap with the China labor cost.

At the same time, a more business-friendly environment had emerged in Ohio as a result of its Common-Sense Initiative, where unnecessary, overburdensome rules were modified or rescinded.

After weighing the alternatives, we swallowed hard, took a deep breath, and mustered the courage to invest more than $5 million to buy and upgrade a 40,000-square-foot facility in Aurora, Ohio, and equip it with brand new rubber molding equipment.

Although we have a solid plan to eventually be able to match the global cost, this new venture has risk. However, the alternative of not having customers made the decision crystal clear.

Our reshoring process is a bit more challenging than we first anticipated. However, the revenue miss from our plan has been backfilled nicely by the current vibrant economy, which we attribute to tax reform. We

have already created 6 jobs and have plans for 15 to 20 more over the next 3 to 5 years.

As specific benefits of tax reform, we gave every employee a $1,500 bonus in December in addition to the bonus they will also receive.

Our business has grown significantly in 2018, because we sell to other manufacturers, not end users. We usually outperform the market and, as an example, we benefit numerous times in the steel area where it is used for durable goods. We participate five different times in the supply chain.

So, tax reform is helping not only us, but our customers, and our business is growing. And for this, we thank you.

Written Testimony
of
Michael K. Baach, President & CEO
Philpott Solutions Group, Inc.
before the
Ways and Means Subcommittee on Tax Policy
hearing on
"Tax Reform and Small Businesses; Growing our Economy and Creating Jobs"

Good morning Mr. Chairman, Ranking Member and Members of the Committee. I am very pleased and proud to address you this morning regarding the impact of Tax Reform on Small Businesses.

My name is Mike Baach and I am President of the *Philpott Solutions Group, Inc.*, headquartered in Northeast Ohio. Although Philpott is still considered small, our story and contributions to our customers, employees and suppliers' success are broad and vibrant. To fully appreciate the positive impact Tax Reform is having on our business, it is helpful to understand a bit of Philpott's history.

In 1889, John W. Philpott started *The Philpott Rubber Company* in Cleveland, Ohio. Philpott sold fabricated custom rubber parts and other items to local industrial companies, much of which remain our core competency. Mr. Philpott established a culture of being creative and customer-minded while always displaying a positive, energetic attitude. His vision guided our company through two World Wars, the Great Depression and all too many recessions. Because we have maintained John W. Philpott's values, we are confident that our company will remain strong and sustainable long into the future.

I am only the sixth president of Philpott, the position from which I will be retiring at our June 7th annual shareholders meeting I was given the privilege of serving Philpott's highly dedicated employee owners in September 2009. Since then, we have more than tripled in size by diversifying to become participants in the supply chain in many growth sectors of the USA market. This has included serving the industrial, residential and commercial construction, durable goods and oil and gas sectors, nearly all of which are owned or operated in the United States.

I mentioned employee/owners, who now total about 40. Philpott is owned almost exclusively by our employees. This came about when in 1977 there were no Philpott family heirs who wanted to run the company. The Philpott family sold Philpott to its employees through a then new provision in the tax code called an Employee Stock Ownership Plan, more commonly referred to as an ESOP[1]. Each year, the company is permitted to contribute up to 25% of an employee's compensation to his or her ESOP account up to a maximum of just over $50,000, without tax liability to the employee. The amount of each annual contribution is at the discretion of the company's Board, which in our case strives to reward each employee the maximum allowable contribution. The cash in each employee's ESOP account is then used to purchase shares of fellow employees at retirement, the value of which is determined by an independent appraiser following a certified audit of our prior year's financial results. This assures that the ownership of Philpott remains with our employees. As owners of the company, Philpott employees have vested interests in being creative and customer-minded with the same positive, energetic attitude that our founder established.

[1] An ESOP is a defined contribution plan, a form of retirement plan as defined by 4975(e)(7)of the IRS tax code, which became a qualified retirement plan in 1974.

Our *Philpott Rubber & Plastics Company* continues our legacy business by selling custom manufactured polymeric parts for industrial applications. Over time, customers demanded lower pricing for these parts by threatening to buy what they viewed as commodity products from global sources, primarily China and India. We viewed their behavior of running to regions whose producers had lower tax and labor costs as short sighted. However, we were left with no choice but to move much of our production offshore when we were told by one of our largest customers, "you can either join us our move of our some of our product production to China, or we will find someone that will!" Our compliance with these customers' demands, unfortunately, also forced Philpott to close its rubber molding factory in 2003.

Because of the relatively small scale of Philpott's production needs, we established contract manufacturing partnerships with three (3) rubber molders in the Shanghai area. To make it easier for our China-based customers to buy from us, we were eventually required to establish the *Philpott [Beijing] Science & Technology Development Company, Ltd*., a Wholly Foreign-Owned Enterprise or WFOE[2] under China's foreign investment business registration laws.

Admittedly, our China-made products cost substantially less than those that we could make in the USA. This was due to the incredibly low labor costs and modest income taxes paid by our contract manufacturer on his profits in China. Over time, more and more problems emerged, primarily due to inconsistent product quality. Despite the expense for adding third-party inspection of parts before they were shipped from China and repeated trips by our executives for meetings with our China manufacturing contractors' management, prices of parts manufactured in China remained at least 25% less expensive than we could produce in the USA. However, even though our customers' allure of perceived lower cost of parts made globally, Philpott's management and financial resources were increasingly strained in managing global quality issues.

In 2014, more than decade after Philpott initiated its outsourcing program, our Board of Directors directed Philpott management to investigate reshoring molding operations to the USA. Our technical team eventually discovered a rubber compound whose chemistry resulted in manufacturing cycle times substantially reduced from those we had been using, including in China. This would allow us to partially close the gap in the labor component of parts we could make domestically. Our analysis also included the elimination of costs for transportation, custom, insurance and duties on products imported from China as well as the indirect cost of quality. On a one-off basis, landed costs for China produced parts still remained less.

In 2015, the China product quality became intolerable and placed Philpott at risk of losing significant business. Although the lower labor and tax rate advantages of manufacturing in China remained, the certain loss of customer loyalty was unacceptable. At that time, Philpott management also believed that the long debated federal tax reform would eventually happen. We were confident that such tax reform would stimulate growth of the companies that operate in the market sectors we served, thus creating additional business opportunities for us. All of this gave us the courage to invest more than $5,000,000 to buy and upgrade a 43,000 square foot building in Aurora, Ohio, which we then equipped with brand new rubber molding equipment.

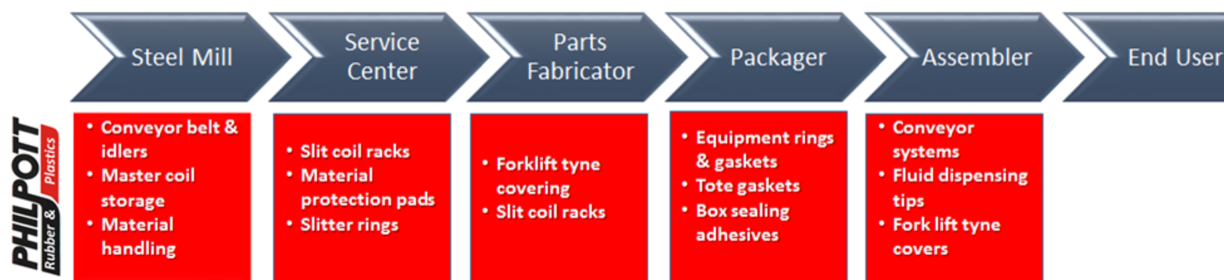
---

[2] A **WFOE** is an investment vehicle for a business in mainland China where foreign individuals or corporate entities can incorporate a foreign-owned limited liability company. WFOE's do not require involvement of a mainland Chinese investor, unlike most other investment vehicles in China companies.

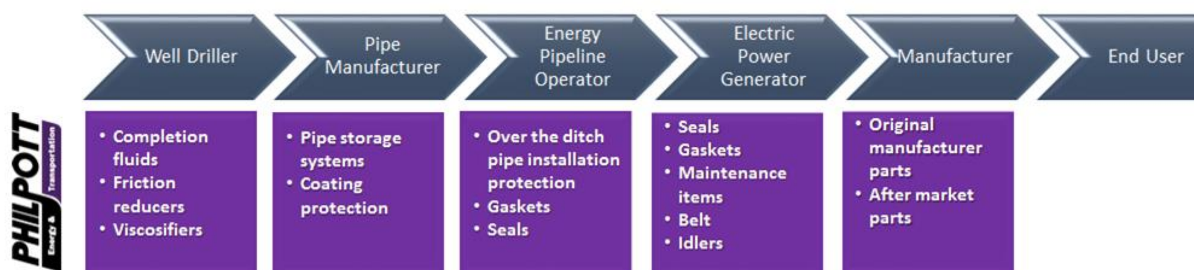
While we continue to operate our company-owned warehouse and fulfillment center in Brunswick, Ohio, our new Aurora, Ohio manufacturing facility has recently been commissioned and is in the process of making samples for customers' testing of the parts we are bringing back from China. Already, this has created six (6) new jobs and plans are for another 15 to 20 new manufacturing positions to be created over the next 3 to 5 years as our process of reshoring continues.

Tax Reform has already made significant contributions to Philpott and our employees. First, each employee received a $1,500 bonus in their last pay in December 2017, which our Board awarded as a direct result of Tax Reform. This amount was in addition to the performance-based cash bonuses that are normally paid by March 15th of the year following our fiscal year ending December 31st. In early 2018, our employees noticed and expressed their appreciation for the increase in their take home pay that Tax Reform created. Combined with their ownership in Philpott, keeping more of their salary and cash bonuses has provided added motivation to better serve our customers, thus helping our business grow.

Even more importantly, we have enjoyed significant growth in sales as a result of our customers' business expansions. Philpott does not sell directly to end users. Rather, we sell parts and subassemblies to manufacturers who may also be a tier or more away from the end user. As a result, we are seeing favorable impact from Tax Reform on all levels of the supply chains in which we participate. This includes revenue growth leading to job creation. Take for example the durable goods sector, which often uses steel as a component part. Philpott has seen growth in our sales of products to multiple levels of the durable goods supply chain as shown in the simple diagram below:



We also sell a food grade polymer to energy exploration and production companies that operate in the Utica and Marcellus Shale Basins. Through our subsidiary, *Philpott Energy & Transportation Company* sells a product that cleans a well after the hydraulic fracturing process, just before the well goes into service. This is the stage well drillers call the completion phase. During this process, Philpott field technicians deliver our patented product to the well driller using a proprietary, computer-controlled pumping unit. The completion phase usually requires Philpott product, equipment and personnel to be on the drill location 24-hours per day for three (3) to five (5) days. Therefore, often Philpott products are sold to customers in multiple tiers of the industrial energy for manufacturing operations supply chain as diagramed below.



As a small business, Tax Reform is creating growth drivers for Philpott in numerous ways. It gave us the courage to invest more than $5,000,000 in a new facility, equipment and upgraded manufacturing utilities infrastructure. This investment will, in turn, allow Philpott to reshore back to the USA manufacturing jobs that were sent to China a decade ago back. It will allow us to innovate new products to better serve our new and existing customers. All of this will drive growth in our business, new jobs and increased wages and cash bonuses for our employees. All of this will bolster our USA patriotism, which we call *Philpott Pride*!

Thank you Mr. Chairman, Ranking Member and Committee Members. I am happy to answer any questions the Committee may have and to assist the Committee in its work.

Chairman Buchanan. Thank you.

Mr. Horne, you are recognized.

STATEMENT OF JOHN HORNE, OWNER AND PRESIDENT, ANNA MARIA OYSTER BARS

Mr. Horne. Thank you, Chairman Buchanan and Ranking Member Doggett and members of the committee. I appreciate the invitation to be here today to share how the Tax Cuts and Jobs Act has affected my restaurant in Florida.

In advance of my testimony today, I was asked for a resume to introduce myself, but I haven't had a resume since my senior year of college at Clemson University, and I only had it then because it was part of my coursework.

I have never used a resume to get a job, because I started as a busboy in a seafood restaurant on Anna Maria Island while on summer break. I stayed with that small independent business for 10-1/2 years and helped the owner open five more restaurants.

Then I opened my own restaurant, a little 85-seat oyster bar on the Anna Maria city pier. Twenty-one years later, I have four restaurants in Manatee County, with 333 employees who earn $5 million annually. We serve between 700 and 1,000 meals at each of our restaurants every day of the year.

I know every industry thinks theirs is the best, the most important industry in the country, but ours actually is. One out of three Americans got their first job in the hospitality industry.

Our industry isn't just a first job; it is a career. Of our 300 hourly staff members, no one is paid minimum wage once they finish their training. Our hourly staff earn between 10 and 30 dollars an hour.

One-third are students working as bussers, hosts, food runners, et cetera. They earn between $10 and $12.50 an hour, not bad for a high school kid looking for date money. I assume the high school kids are still trying to get date money for their first jobs.

Almost 50 percent of our hourly staff earns 15 to 30 dollars per hour. Our annual FICA payments were over $552,000. Matched with the employees'

payments, that is over $1.1 million our small business contributed to social security.

Small businesses are big businesses. I know this committee often works with much larger numbers, but to a little guy like me, that is a huge number.

I paid my accountant just over $29,000 last year to file my taxes. Four restaurants, five pass-through S corps, two LLCs and my personal returns, the largest one there.

I have a BS in administrative management, but I do not remember learning how to read a return or how to understand the Tax Code. So to this end, I appreciate this committee's efforts to simplify the Tax Code.

What my CPA did explain to me, though, was the part of the new Tax Cuts and Jobs Act where I get a 20 percent business income deduction, starting this year. He showed me what my 2017 taxes would have been with a pass-through deduction. So I have already planned 2018.

What will I do with the 20 percent deduction that the new Tax Cuts and Jobs Act will provide? There are so many options. Some I have already taken. After the chat with my CPA, I bonused $60,000 to some of our staff. I purchased two new efficient LED signs at $20,000 each, to attract new customers.

Speaking of reinvesting in our business, which we all have to do to remain viable in our industry, we are looking forward to working with Congress on a critical technical correction on the depreciation timing of restaurants. Our facilities suffer excessive wear and tear due to the volume of guests and equipment upgrades necessary. We need the 15-year depreciation returned for these improvements, and bonus depreciation would be nice too.

I know you are all aware of this technical error and are working hard to make the correction. We need to get the depreciation back to 15 years as soon as possible so we can keep investing our dollars back into our business. Cash flow is very important in restaurants, as we operate on very, very small margins.

We are seasonal in Florida, but what I have noticed, many of us in our area have noticed, is that business is up. The seasonality is not near what it used to be. Our guest counts are up. People are eating out more. People have confidence in our economy. Many of the local restaurateurs are raving about

guest counts and business staying up year-round. Everyone is feeling the effects of a stimulated economy.

Monday, I spoke to my friend John Rice, who owns an appliance business near one of our restaurants. He told me his business was up 60 percent in the first quarter of this year. He had his first million-dollar month ever. I do believe that confidence in our economy is showing tremendously. John is selling durable goods in his store.

And an incoming tide raises all boats. Even here in D.C., my buddy Mike Finnerty, a 26-year veteran bartender at the Old Ebbitt Grill, told me in April that his sales and his take-home interest from tips are drastically increasing this year. Mike and I waited tables together in Anna Maria Island back in the eighties and have been buds ever since.

Like Finnerty, our staff at the Oyster Bars are feeling the same thing, as are people all over our region.

The most important thing that the new tax plan does is help small businesses stay in business, so I can continue employing 333 people earning livable wages and supporting our communities.

Thank you, Mr. Chairman.

Testimony before the House Ways & Means Tax Policy Subcommittee

John Horne, Owner and President, Anna Maria Oyster Bars

Wednesday, May 23rd, 2018

To testify today, I was asked for a resume and a CV to give to let you know who was testifying…I have neither…haven't had a resume since my Senior year of college at Clemson University…and only had it then because it was part of my course work getting my degree in Administrative Management…I never used a résumé to get a job because I started as a bus boy in a seafood restaurant on Anna Maria Island in Manatee County during summer break from college…I stayed with that small independent business and helped the owner open 5 more restaurants…I became a server, assistant to the assistant's assistant…general manager, Area Manager then opened my own restaurant…a little 85 seat oyster bar on the Anna Maria City Pier, 741 feet out in the mouth of Tampa Bay. 21 years later, I have 4 restaurants in Manatee County with 333 employees. 300 are hourly employees with an annual payroll of 2.5 million dollars in the past 12 months. 33 managers who earned $1.5 million in salary and bonus…we serve between 700 to 1000 guests at each location every day of the year…well, all but Christmas and Thanksgiving…that's a day people should be with their families.

I know every industry thinks theirs is the best, and the most important industry in the country, but ours actually is! One out of three Americans got their 1st job in the hospitality industry.

Wait…

Now many people believe that it is only an entry level job that most people are looking for when they start at a restaurant… as a host, or a dishwasher as a bus boy, like I did……but in Florida alone, the Hospitality Industry is the largest industry in the state and we collect and remit more sales taxes to Tallahassee than any other industry. Of my 300 hourly staff members, no one is paid minimum wage. Currently Florida is at one dollar higher than the federal minimum wage…we're at $8.25. My 300 range from: 113 between 10 and 12.50…most of these are the entry level jobs that are paid the minimum Tipped wage ($5.23) plus tip pool that ranges between 5.50 and 6.18 per hour…so they average between $10.73 and $11.41 per hour…not bad for a high school kid looking for date money. I guess high school kids are still working their 1st jobs for date money.

39 between 12.50 & $15

40 between 15 and $20 and

64 over $20…most of these are bartenders and servers earning 20-30 dollars per hour in tips. 47-48% of our hourly staff earn over 15 dollars per hour.

In the last 12 months, FICA payments at our 4 stores was $552,544…matched with the employees' payments, that's over 1.1 million dollars our small business contributed in FICA taxes. Small businesses are big businesses…I know you all are working with MUCH larger numbers, but to a little guy like me, these are huge numbers.

I met with my CPA after tax season this year when he brought me my returns…this is the part that kills me, I paid my accountant $ 29,050 and he brought me my info back and these returns…four restaurants, five "s" corps, 2 LLCs and my personal returns. As I said, I went to Clemson and have a degree in Administrative Management…but I don't remember them teaching me how to

read a statement or how to understand the tax code…however many pages there are…4,000 or 70,000.

What he did explain to me though was one of the parts of the new Tax Cut and Jobs Act where I get a 20% Business Income Deduction this year…so he showed me what my taxes were in '17 and if the new code were in effect what they would have been. So I've already planned 2018…Plugging my adjusted gross income for this year with the 20% deduction gives me an idea what we can expect this year.

How do I know my bottom line will remain the same? I don't, but we've been very consistent in our stores over the last 10 years as far as bottom lines go…we rarely raise prices on our menus and only to cover increased costs…we couldn't keep up if we tried to keep our percentage goals the same. I want dollars to the bottom line…not percentages. I have never deposited a percentage in the bank in my 35+ years in the restaurant business.

So what do I do with the 20% reduction that the new Tax Cuts and Jobs Act will provide? There are so many options…one I've already taken. Back in April after I met with my accountant, I bonused $60,000 to some of my staff. I purchased two new two-sided LED signs @ $20,000 each for two of my locations to attract new customers…I think I heard my accountant say we'd probably realize $100,000 in savings/benefits from new plan…sometimes I hear what I want to hear…not what they're saying…I may have to defer to my wife on my hearing!

Speaking of reinvesting in our businesses…which we all have to do to remain viable in our industry, we do need Congress to fix an alleged scrivener's error when the new code was passed, it reverted depreciation for restaurants back to 39 years…it was at 15 years due to the excessive wear and tear on restaurants due to the volume of guests and equipment upgrades

necessary…we need to get the depreciation back to 15 years so we can keep investing our dollars back into the businesses.

We're very seasonal in Florida…but what I've noticed and what many of us in our area have noticed, business is up, and the seasonality is not near the levels it used to be…our guest counts are up, people are eating out more lately. People have a confidence to come out more often lately. Many of my fellow restaurateurs in our local Restaurant Association are raving about guest counts increasing and staying up year-round…everyone's feeling the effects of a stimulated economy…even my buddy Mike Finnerty, a 29 year veteran bartender at Old Ebbitt Grill across the street from the Treasury Department told me on my last trip up here…Mike and I waited tables together on Anna Maria Island in the 80's and have been buds since…he sees his sales and his income from tips here in your neighborhood screaming up with the changes that have occurred in the last year. And like Finnerty, a bartender here in DC, my staff is feeling the same thing…and people all over our region in Florida…the most important thing the new tax plan does, is it helps small businesses STAY in business and continues employing 333 people livable wages and helps our communities.

If I had a resume, or a CV, you'd see the Oyster Bars have received many accolades and many recognitions for our work in the community…most recently receiving the Restaurant Neighbor award Nationally from the Education Foundation of the National Restaurant Association…a lot was for our efforts over the years in our community especially helping with education thru advisory boards, scholarships and many more efforts…but the program we piloted last year was outstanding…and successful…

Last summer my wife Amanda and I piloted a program locally with our school district. We brought in 75 rising 2nd and 3rd graders from three Title I

schools. We fed them breakfast, taught them some life skills, fork on the left, knife on the right, napkin in your lap, eye contact when you speak and shake hands when you meet people…one-on-one mentoring and reading with some of our regular guests who volunteered for the month of June. Our kids weren't ready to be invited to the royal wedding last weekend, but they did increase their reading skills by 1.25 months over the summer vs. the normal Summer Slide of minus 2.5 months for kids below the poverty level. They even got to take the books home with them every week and I'm pretty sure many started their own family libraries with these books. Our 75 kids read 1624 books last summer.

Why our emphasis on education and Grade Level Reading? Because from birth to 3rd grade, a child learns to read; from 3rd grade on, you read to learn.

Small businesses can get their staffs and their customers involved locally like no other business can…they're already in their communities and they know the needs of their communities and they have a vested interest to make their communities better!

Chairman Buchanan. Thank you.

Mr. Homan, you are recognized.

STATEMENT OF PHILIP HOMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, LORAM MAINTENANCE OF WAY, INC.

Mr. Homan. Chairman Buchanan, Ranking Member Doggett, and members of the committee, thank you for the opportunity to testify here today.

My name is Phil Homan, and I am the president and CEO of Loram Maintenance of Way, Inc. Loram is a privately owned company headquartered in Hamel, Minnesota, just outside of Minneapolis. Loram's mission is to deliver advanced equipment, innovative solutions, and unrivaled customer service in a safe and reliable manner to maintain and improve railway infrastructure.

The ability of our railway customers to continue investing in their infrastructure is essential to our future success. A highly efficient and safe railway system is a vital part of our Nation's economy, and Loram is proud to play a role in that.

Loram employs approximately 1,200 people, primarily working on railway lines across North America. We have manufacturing operations and corporate offices in Minnesota, Illinois, and Texas. With the exception of the Chinese market, all of our products are manufactured in the United States.

Although we are relatively small in size, we are unique, because there are a limited number of companies around the world who produce specialized railway equipment. Our global competition comes primarily from well-established European companies and state-owned enterprises in China.

Our success has always been affected by our ability to compete against organizations who are supported by regulatory regimes or tax systems that favor local industries. In the case of China, we were required to enter a technology transfer agreement and co-produce our equipment in China for that market.

The recently enacted tax reforms have somewhat leveled the playing field, and I am confident that we will be able to translate this into growth opportunities for our company, innovations for our customers, and prosperity for our employees.

More specifically, as a direct result of tax reform, Loram embarked on a strategy of reinvesting those savings in three key areas. First and foremost, our people. Secondly, our equipment and technology. And lastly, on enhancing our global competitiveness.

With regard to our people, Loram increased wages for our field staff by a dollar an hour, and we funded a $1,500 bonus to all nonexecutive employees. Loram is also developing and funding new training programs intended to improve our safety and enhance the technical skills of our employees.

With regard to our equipment and technology, Loram dedicated funding to new capital equipment and will increase spending on research and development, focused on new products.

With regard to global competitiveness, the tax rate reduction allowed us to adjust our international pricing practices. We are currently competing for several very significant international orders, and, if successful, we will increase U.S. production to fulfill those orders.

In addition, reducing the U.S. corporate tax rate and eliminating tax incurred when foreign earnings are repatriated will dramatically encourage new U.S. investment. This is not just a benefit for very large multinational corporations. Loram has Canadian shareholders and a Canadian subsidiary.

Prior to tax reform, we were encouraged to optimize our corporate tax structure for the benefit of lower Canadian corporate taxes. As a result of tax reform, our shareholders are now incentivized to reinvest more of those savings back here in the U.S.

Loram derives the lion's share of its businesses from U.S.-based Class I railroads. By their very nature, these customers are almost exclusively invested in the U.S. economy. We believe the tax reform legislation will have a significant positive impact on their business, and we are developing plans to keep pace with that growth.

While companies like Loram will continue to face a host of other challenges, the recently enacted tax reform will be a tremendous help to our business and our employees. I, for one, am excited to see how this historic and fundamental change in our corporate tax structure will impact the U.S. economy and American industry.

Thank you again for the opportunity to testify, and I look forward to your questions.

Testimony of Philip Homan

President and Chief Executive Officer, Loram Maintenance of Way, Inc.

Hearing before the Committee on Ways and Means Tax Policy Subcommittee

"How Tax Reform is Helping Small Businesses"

May 23, 2018

Chairman Buchanan, Ranking Member Doggett, and members of the Committee, thank you for this opportunity to testify on "How Tax Reform is Helping Small Businesses." My name is Phil Homan, and I am President and CEO of Loram Maintenance of Way, Inc.

Our Company

Loram is a privately owned company with headquarters in Hamel, Minnesota. In business for just over 60 years, Loram is recognized in the railroad industry for its innovative track inspection technologies, highly productive and reliable heavy maintenance equipment and a reputation for customer focused services. Our mission is to deliver advanced equipment, innovative solutions and unrivaled customer service in a safe and reliable manner to maintain and improve railway infrastructure. The ability of our railway customers to continue investing in their infrastructure is essential to our future success. A highly efficient and safe railway system is a vital part of our nation's economy and American industries global competitiveness. Loram is proud to play a role in that.

Loram employs approximately 1,200 people with the majority of those being heavy equipment operators and maintainers working on railway lines across North America. We have manufacturing operations and corporate offices in Minnesota, Illinois and Texas. Loram has over 100 pieces of equipment in our North American contracting fleet and we have sold over 60 machines into 11 countries in the past 10 years. We have subsidiaries in Canada, Mexico, the U.K., Australia and Brazil to support our international customer base.

With the exception of the Chinese market, which I will explain later, all our products and equipment are manufactured in the United States. Although we are relatively small in size, we are unique in that there are a limited number of companies globally that produce our kind of specialized railway equipment. We, therefore, compete on a global basis and are reliant on international activities to support future growth.

Our global competition comes primarily from well-established European companies with a much longer history in the railway industry and state owned enterprises supporting their own national rail systems in China. Our future growth prospects have always been effected by our ability to compete against these organizations who, in most cases, are well supported by government backed regulatory schemes that favor local industries and local factories as well as favorable treatment of goods and services exported to other countries. In the case of China, we were required to enter technology transfer agreements and co-produce our equipment in China for sales to that market.

Our ability to effectively compete on a global scale is significantly affected by these type of headwinds; however, when compounded with higher corporate tax rates than any of our competitors the systemic disadvantages become a daunting challenge. The recently enacted tax reforms have somewhat leveled the playing field and I am confident that we will be able to translate this into future growth opportunities for our company, innovations for our customers and prosperity for our employees.

Direct Effects of Tax Reform

More specifically, I wanted you to know that with the passing of the Tax Cuts and Jobs Act of 2017 Loram embarked on a strategy of reinvesting those savings in three key areas. First and foremost our people, secondly on equipment and technology and lastly on enhancing our global competitiveness.

Investment in people:

- Loram increased the permanent wage range for our field employees by $1 per hour which represents an increase of over seven percent.
- Loram funded a $1,500 bonus to all non-executive employees.

- Loram is developing and funding new training programs for employees intended to improve safety, enhance technical skills, accelerate product development innovations, and improve project management.

Investment in equipment and technology:

- Loram dedicated funding for new capital equipment that will increase productivity for our customers, improve safety for our employees and grow our services revenue.
- Loram will increase funding for research and development focused on new product development to enable future growth.

Investments in global competitiveness:

- The tax rate reduction allows us to adjust international pricing practices as well as our manufacturing and supply chain strategies. Lowering the cost of U.S. production for Loram as well as our entire supply chain will lower our costs and improve our competitiveness.
- Loram is currently competing for several significant international orders that, if successful, would result in new subsidiaries and we are now more competitive than ever as a result of this legislation. If successful, Loram will increase U.S. production to fulfill these orders.

Indirect Effects of Tax Reform

Reducing the U.S. corporate tax rate to 21% and eliminating U.S. tax incurred when future foreign earnings are repatriated will dramatically encourage new U.S. investment. This is not just a benefit for very large multinational corporations.

Loram Incentives for U.S. Investment:

- Loram has Canadian shareholders and a Canadian subsidiary. Prior to tax reform Loram was encouraged to optimize our corporate structure for the benefit of lower Canadian corporate taxes. As a result of tax reform our shareholders will now be incentivized to reinvest more of those profits and capital in the U.S. versus past practice of returning a portion of those profits back to Canada.
- Loram's future profits from our foreign subsidiaries will be repatriated tax-free and utilized for U.S. expansion, investment and acquisitions.

Considerations for Future Legislation

With respect to prospective tax reform impacts or issues, Loram has concerns regarding the potential sunset or transitional aspects for the 100% expensing of capital investments and the capitalization of Research and Development credit expenditures.

Capital Investments - 100% Expensing:

- Currently enacted reform sunsets this benefit after 5 years.
- Loram's business is extremely capital intensive and requires complex long range planning for two year equipment build cycles. Loram and its customers invest in assets with over 30 year life cycles so the uncertainty of future tax regimens has a negative effect on capital planning and investing. It is critical that we have certainty with respect to the 100% expensing and we strongly support making this corporate tax benefit permanent by removing the 5 year term.

Research and Development (R&D) credit – Capitalization:

- Currently enacted reform requires that qualified research expenditures be capitalized and amortized starting in 2022.
- Loram's technically advanced equipment requires heavy investment in engineering positions, research and experimentation to continually improve its product lines and capabilities to meet our customer's demands. The U.S. remains globally competitive by using the R&D credit as an incentive for companies like Loram to perform their research and development in the US creating high paying

jobs. However, the requirement to capitalize and amortize the qualified research expenditures will diminish the intended benefits of the current R&D credit. Loram strongly encourages that the Tax Policy Subcommittee consider eliminating the consequences U.S. corporations will suffer if capitalization is required beginning in 2022.

Conclusion

Loram derives the lion's share of its business from U.S. based Railroads. By their very nature, these customers are almost exclusively invested in the U.S. economy and stand to gain in a meaningful way from a growing U.S. economy. We believe the tax reform legislation will have a significant positive impact on their business and we are developing plans to keep pace with that growth.

The fifteen point reduction in our effective tax rate, the ability to repatriate foreign retained earnings at a lower tax rate and the ability to immediately expense capital builds has allowed Loram to make significant investments in our people, our equipment and technology and improve our competitiveness on the global stage. It will also encourage increased capital investment in U.S. assets and infrastructure.

While companies like Loram will continue to face a host of other challenges, the recently enacted tax reform has been, and will continue to be, a tremendous help to our business and employees. I for one am excited to see how this historic and fundamental change in our corporate tax structure will impact the U.S. economy and our global competitiveness.

Thank you again for this opportunity to testify, and I look forward to any questions you may have.

Chairman Buchanan. Thank you.

Mr. Arensmeyer, you may proceed.

STATEMENT OF JOHN ARENSMEYER, FOUNDER AND CHIEF EXECUTIVE OFFICER, SMALL BUSINESS MAJORITY

Mr. Arensmeyer. Chairman Buchanan, Ranking Member Doggett, members of the committee, thank you very much for inviting me to speak with you today.

I was a longtime small business owner prior to founding Small Business Majority 12 years ago. For 13 years, I was the founder and CEO of an award-winning interactive communications company, and earlier I was the chief operating officer of a pioneering multimedia business.

I founded Small Business Majority to serve as a leading advocate for America's 30 million entrepreneurs. We have a network of 58,000 small businesses across the country, with nine offices here and in seven States.

Despite the undeniable importance of small business to our Nation's economy, we are too often left behind during national policy debates and decisions. Our polling finds that 7 in 10 small business owners believe their business is harmed when big corporations use loopholes to avoid taxes, and 85 percent feel the Tax Code unfairly benefits large corporations and wealthy Americans.

The new tax law has done nothing to address this disparity. Indeed, the new law increases the deficit by $1.5 trillion without giving most entrepreneurs a significant tax break. It adds more complexity and confusion and fails to address loopholes that disadvantage small businesses.

First, the real winners of the new tax law are large corporations and wealthy individuals, not the 30 million Main Street small businesses. The law slashes corporate tax rates from 35 percent to 21 percent, even though only 5 percent of small businesses pay corporate taxes.

Additionally, the law's treatment of pass-through entities gives the bulk of the benefit to a small sliver of wealthy business owners, not to Main Street.

A new report from the Joint Committee on Taxation reveals a whopping 44 percent of the new pass-through deductions, $17.4 billion, will benefit

approximately 200,000 individuals making $1 million or more. In 2024, this will increase to $31.6 billion.

According to the JCT report, the majority of the 2018 tax-reduction benefit will go to the top 2.3 percent of pass-through firms; and by 2024, that percentage drops to 1 percent. By our calculations, a business owner earning $600,000 per year will save 26 times that of an owner with $75,000 in income, despite only earning eight times more.

Most small businesses are, indeed, very small enterprises that bring in a modest income. According to the Tax Policy Center, less than 2 percent -- 1.7 percent to be exact -- of all pass-through businesses with average profits of nearly three-quarters of a million dollars account for the majority of all pass-through income. These enterprises reaping most of the benefits of the pass-through deductions are most definitely not your typical Main Street small businesses.

Moreover, recent polling found the majority of small businesses say they do not plan on hiring new employees or giving raises as a result of the new tax law and believe that the law favors large corporations over small firms.

Second, the tax cuts are structured in a way that is temporary, convoluted, and confusing. Some quotes from our members:

Mike Brey, owner of a hobby-based retail store in Maryland: "We are all anxious for advice and clarification, having been told too many competing narratives."

Annie Wadsworth, second-generation owner of a bagel shop in upstate New York: "After doing quite a bit of research regarding the tax law, I am still confused as to what the changes mean for me and my employees."

David Arena, owner of a commercial real estate media business in Philadelphia: "They missed an opportunity to simplify taxes for small businesses. I don't actually think this will help us very much when all is said and done."

It is not surprising that the National Small Business Association found in a recent survey of its members that a mere 7 percent say they think filing taxes will become easier under the new law. A third are considering switching from a pass-through entity to a C corporation, and the majority say the temporary nature of the tax cuts is an issue for their business.

Third, the new tax law creates an even more unequal playing field for small businesses by allowing a few multinational corporations to funnel their profits to the lowest-taxation foreign jurisdictions, a provision small firms are unable to take advantage of. This primarily benefits 30 large corporations and, according to the CBO, corporations will shift $235 billion in profits annually offshore.

To make matters worse, this provision sits on top of yet another loophole in the law allowing large multinational corporations to repatriate their past profits at a deeply discounted rate.

And last but not least, the new Tax Code, with its large gap between top individual rates and top pass-through rates, only encourages wealthy individuals to game the system by simply declaring themselves pass-through business entities.

In short, America's hardworking entrepreneurs don't want special treatment. We simply want to compete on a level playing field. We had a once-in-a-generation chance to make our Tax Code work better for small businesses, and we blew it.

Thank you.

WRITTEN STATEMENT

BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS TAX POLICY SUBCOMMITTEE

HEARING ON

“TAX REFORM AND SMALL BUSINESSES: GROWING OUR ECONOMY AND CREATING JOBS”

May 23, 2018

John Arensmeyer, Founder & CEO

Small Business Majority

Chairman Buchanan, Ranking Member Doggett and fellow Members of the Committee,

Thank you for inviting me to speak with you today about the new tax law and its impact on America’s small businesses.

I was a long-time small business owner prior to founding Small Business Majority 12 years ago. For 13 years, I was the founder and CEO of ACI Interactive, an award-winning interactive communications company, and earlier I was the chief operating officer of a pioneering multimedia business. Following my many years of experience running small businesses, I founded Small Business Majority to create a national organization to serve as a leading advocate for America’s entrepreneurs.

Small Business Majority’s mission is to empower America’s entrepreneurs to build a thriving and inclusive economy. We actively engage small business owners and policymakers in support of public policy solutions, and deliver information and resources to entrepreneurs that promote small business growth and drive a strong, job-creating economy. Our extensive scientific opinion polling, focus groups and economic research help us educate and inform policymakers, the media and other stakeholders about key issues impacting small businesses and freelancers, including access to capital, taxes, healthcare, retirement and critical workforce issues.

Small Business Majority has a network of 58,000 small business owners across the country, with nine offices in Washington, D.C. and seven states. We work closely with our network and with more than 1,000 local business groups to create a strong small business voice in Washington and state capitals, and deliver critical education and resources to America’s job-creating entrepreneurs. Through our Entrepreneurship Program, we offer free education, tools and events to small business owners and aspiring entrepreneurs about access to responsible lending options, retirement, healthcare, wealth building tactics and more.

Through our daily interaction with small business owners and self-employed entrepreneurs we know that small businesses are not just the backbone of the American economy; we are its foundation. America’s 30 million small businesses represent 99% of all employer firms and account for half of

our nation's jobs and economic output, and their creativity spurs innovation in all sectors of the economy. According to the U.S. Small Business Administration, small businesses have created two out of three new private-sector jobs since the Great Recession.[1] Private-sector job creation at small- and medium-sized businesses has outpaced the rate of large-size companies for every month of 2017, per ADP's National Employment Report.[2]

Despite this undeniable importance to our economic success, small businesses are consistently left behind during national policy debates. Our nation's tax system has historically benefited the wealthiest Americans and large multinational corporations at the expense of small business owners. Small Business Majority's polling found 7 in 10 small business owners believe their business is harmed when big corporations use loopholes to avoid taxes, and 85% feel the tax code unfairly benefits large corporations over small businesses.[3]

The newly enacted Tax Cuts and Jobs Act has done nothing to address this disparity. Indeed, we believe the law will hurt small businesses and the economy because (1) it will increase the deficit by $1.5 trillion without giving most small business owners a significant tax break, (2) it adds more complexity and confusion and (3) fails to address corporate tax loopholes that give large businesses an unfair advantage. I will address these three issues in turn during my remarks.

The new law's tax breaks are skewed towards large corporations and a handful of wealthy pass-through entities, not Main Street small businesses

The real winners of the new tax law are large corporations and wealthy individuals, not Main Street small businesses. A priority of this legislation was to slash corporate tax rates from 35% to 21% even though only 5% of small businesses pay corporate taxes.[4] Adding $1.5 trillion to the deficit at a time of economic prosperity will do nothing to help small businesses, and it certainly doesn't level the playing field. It should be noted that our polling found 85% of small businesses want large corporations and wealthy Americans to pay their fair share of taxes.

Additionally, the law's treatment of pass-through entities gives the bulk of the benefit to the wealthiest business owners, rather than Main Street. New data from the Joint Committee on Taxation (JCT) reveals a whopping 44% of the new pass-through deduction ($17.4 billion) will benefit approximately 200,000 individuals making $1 million or more.[5] In 2024, this will increase to $31.6 billion.

According to the JCT report, the majority of the 2018 tax reduction benefit overall will go to the top 2.3% of pass-through firms, and by 2024 that percentage drops to one percent.[6] By our calculations, a business owner earning $600,000 per year (after standard and personal deductions) will save 26 times that of an owner with $75,000 in income, despite only earning eight times more.

According to the Small Business Administration, the median income for individuals self-employed at their own incorporated businesses was $50,347 in 2016.[7] This statistic is important to note because most small businesses are indeed very small enterprises that bring in a modest income. According to the Tax Policy Center, less than two percent (1.7%) of all pass-through businesses, with average

---

[1] Small Business Administration FAQs, June 2016, https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf
[2] ADP National Employment Report, January-August 2017, http://www.adpemploymentreport.com/
[3] Small Business Majority, "Small Business Owners Want Fair Tax System Over Tax Cuts," October 2017, http://smallbusinessmajority.org/our-research/taxes-budget-economy/small-business-owners-want-fair-tax-system-over-tax-cuts
[4] Brookings Institution, "Nine facts about pass-through businesses," May 2017, https://www.brookings.edu/research/9-facts-about-pass-through-businesses/
[5] Joint Committee on Taxation, "Tables Related to the Federal Tax System as in Effect 2017 through 2026," April 2018, https://www.jct.gov/publications.html?func=startdown&id=5091
[6] Ibid.
[7] Small Business Administration, 2018, https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf

profits of nearly three-quarters of a million dollars, account for the majority of all pass-through income. These enterprises reaping most of the benefits of the pass-through deduction are hardly your typical Main Street small business.[8]

In addition to not providing a real tax benefit, the law will in fact hurt small businesses by making health insurance more expensive and difficult to access. Not only did Congress fail to consider bipartisan legislation last year to bolster the marketplaces, the new tax law repealed the individual mandate, which is essential to ensuring robust participation and balanced risk pools. Small businesses consistently rank the cost of healthcare as one of their top concerns. By introducing more instability and uncertainty to the healthcare marketplaces, costs will increase for the millions of small business owners, solo entrepreneurs and small business employees who rely on the individual marketplaces for health coverage.

Tax cuts are too convoluted to benefit small businesses

The tax cuts are structured in a way that is convoluted and benefit those at the top far more than lower-income business owners, with the majority of benefits going to the wealthiest pass-through business entities. Small business owners who do see any benefit will not receive enough savings to grow or invest back in their businesses.

While corporations received large, permanent tax cuts across the board that will allow them to plan ahead for the future, the same cannot be said for most small businesses. Small business owners were given a temporary and complicated tax deduction that does nothing to streamline their taxes or help them invest back into their businesses. A recent report co-authored by Anne Zimmerman, a member of our national Small Business Council who owns a small public accounting firm in Ohio, found the 20% deduction on qualified business income is unlikely to generate enough savings for real small businesses to hire new employees, invest back into their businesses or make operational improvements.[9] Additionally, recent polling from Businesses for Responsible Tax Reform found a majority of small businesses say they do not plan on hiring new employees or giving raises as a result of the new tax law, and they say the law favors large corporations over small firms.[10]

In addition to the temporary nature of this tax cut, the complexity and confusion surrounding the new deduction means that any savings will go towards tax professionals to help entrepreneurs navigate their taxes or towards dealing with increased administrative burdens. We frequently hear from our members how confusing they find the changes. Mike Brey, owner of a hobby-based retail store in Maryland, says friends in the small business space are all anxious for advice and clarification about how the new tax law will impact their businesses. Mike says he feels small business owners have been told "so many competing narratives."

Other small business owners echo this feeling of confusion after looking online and finally turning to tax professionals for help. "After doing quite a bit of research regarding the tax law, I'm still confused as to what [the] new changes mean for me and my employees. I have yet to be able to find a single source with straightforward information," says Annie Wadsworth, second-generation owner of a bagel shop in upstate New York.

David Arena, owner of a commercial real estate media business in Philadelphia, told us, "I think they missed an opportunity to simplify taxes for small businesses and potentially reduce the administrative costs of filing taxes. In addition, I don't think they addressed tax issues that impact a

[8] Tax Policy Center, "Distribution of Business Income, by Statutory Marginal Tax Rate; Current Law, 2017," March 2017, https://www.taxpolicycenter.org/model-estimates/distribution-business-income-march-2017/distribution-business-income-statutory
[9] Businesses for Responsible Tax Reform, "The Tax Cuts and Jobs Act: Implications for Small Businesses," May 2018, https://docs.wixstatic.com/ugd/4a8609_5ae6299d49534af6b27acb872d044e30.pdf
[10] Businesses for Responsible Tax Reform, "Poll: Tax Law Won't Help Small Businesses Grow," March 2018, https://docs.wixstatic.com/ugd/4a8609_a801668b62ff4d9bacfe8b9fadacb995.pdf

small business's ability to hire new employees. I think there needs to be more focus on incentivizing small business to hire more employees with competitive wages and good benefits. As far as immediate benefits for me as an employer, I don't actually think this will help us very much when all is said and done."

Given these sentiments, it's not surprising that the National Small Business Association found in a recent survey of its members that a mere 7% say they think filing taxes will become easier under the new tax law, and 1 in 3 say they already spend more than 40 hours each year on federal taxes.[11] An additional 1 in 3 say businesses plan to, or are considering, switching from a pass-through entity to a C-Corporation as a result of the Tax Cuts and Jobs Act, with the majority saying the temporary nature of the small business tax cuts is an issue for their business.

Simply put, small business owners wanted a simplified and more streamlined tax system that would also help level the playing with large corporations, and they got the opposite.

The new tax law fails to address loopholes and exacerbates the risk that wealthy individuals will game the system

The enactment of a "territorial" corporate tax system in the new law creates an even more unequal playing field for small businesses because it allows a few multinational corporations to funnel their profits to the lowest-taxation foreign jurisdictions—a provision small firms are unable to take advantage of. Indeed, this loophole primarily benefits 30 large corporations at the expense of small businesses. According to the Congressional Budget Office, corporations will shift $235 billion in profits annually under the new tax law.[12] To make matters worse, this provision sits on top of yet another loophole in the law allowing large multinational corporations to repatriate their past profits at a steeply discounted rate.

And, last but not least, the new tax code, with its large gap between top individual rates and top pass-through rates, only encourages wealthy individuals to game the system by simply declaring themselves pass-through business entities. While the new law exempts certain industries from accessing the pass-through rate, there is no way to guard against abuse of the new deduction and ensure that it does not further exacerbate the benefits to hedge fund managers, lobbyists, lawyers and investment bankers—rather than Main Street small businesses.

Conclusion

Small business owners feel that our tax system primarily benefits wealthy corporate interests at their expense. The facts support this assessment. America's hard-working entrepreneurs don't want special treatment; they simply want to compete on a level playing field.

This is why we need a tax code that benefits America's entrepreneurs who are focused on growing their enterprises and making payroll at the end of each month. We had a once-in-a-generation chance to make our tax code work better for small businesses, and we blew it.

Thank you for the opportunity to comment on this important issue for America's small business community. I would be happy to answer any questions.

---

[11] National Small Business Association, 2018 Small Business Taxation Survey, http://nsba.biz/wp-content/uploads/2018/04/Tax-Survey-2018.pdf

[12] Congressional Budget Office, "The Budget and Economic Outlook: 2018-2028," https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53651-outlook.pdf

Chairman Buchanan. Thank you all for your excellent testimony. Now we will proceed to the question-and-answer session. I will defer my question to the end of the question period.

I now recognize Mr. Roskam, who will begin.

Mr. Roskam. Thank you, Chairman Buchanan.

And for all the witnesses, thank you for your testimony today.

I want to address something that Mr. Doggett mentioned in his opening statement, and that was a criticism of process. And I will just remind him that the Tax Policy Subcommittee had a hearing on small business, on tax reform, and we were able to incorporate that into the tax reform bill.

Now, that said, he has also created a plot trap, and here is the plot trap: Anybody who has benefited from the Tax Code is easy to dismiss, according to Mr. Doggett, as an exception.

Well, what happens if you hear exception after exception after exception after exception after exception? The exception then eats the rule and it becomes the rule.

So we had a hearing last week from people who came to testify, and they said that what they were seeing was an incredible benefit.

What you are describing, the four of you today are describing very significant benefits. You don't have the wealth -- I don't know your back stories -- you don't have the wealth of Donald Trump. And that is part of the subtext that Mr. Doggett was arguing, that those are the beneficiaries of this.

Certainly, that is not Mr. Gray's situation. That is not Mr. Horne's situation, certainly. And yet, you are here bearing testimony based on what you have seen. So Mr. Gray from the Show Me State says you are seeing economic optimism.

There is also an inherent criticism that we have got to deal with at the front end of this hearing that stock buybacks are inherently unhealthy for the economy. That is not true. The characterization, the adjective of shareholders that Mr. Doggett used was wealthy shareholders.

Well, I am sure there are some wealthy shareholders, but there are some shareholders who are not wealthy. There are some pension funds that need to grow, and they grow as a result of this.

So let's be clear about what we are discussing. Mr. Horne, you said that business confidence is up. Can you just emphasize again to us what the Tax Cuts and Jobs Act has meant to you? You gave us some specificity in terms of signage and other things.

But what is it that you are seeing, not in surveys, not in polls, not in organizations, not in all of that sort of stuff, but what are you seeing in real life when you are walking around in your shorts and your moccasins in sunny Florida? What are you seeing?

Mr. Horne. I mean, I do talk to our guests. That is the best part of my job, is I get to interact with my guests. There is a lot of paperwork, but the best part is walking and talking to guests.

I am seeing more of them. I am seeing them more often. So that tells me that they feel better. They are not staying home. They are not going to Publix and fixing dinner at home. They are going out. They feel comfortable going out.

So that tells me if they will come out -- I used to have a regular that was there every Tuesday. Now they are there every Tuesday and Thursday. They feel better about it. They are buying things again. You see new cars. You see them making different purchases.

We put money into our business. We put money into the LED boards to get people's attention. So we are spending more money and other people are as well.

Mr. Roskam. And as you spend more money, I mean, just to press the point a little bit, for LED signage, what, obviously, does that mean for the signage company?

Mr. Horne. Absolutely. I mean, they are selling more. Obviously, if people are enlarging or remodeling their homes, they are buying appliances from my buddy John Rice.

So people are spending money. It just permeates through our community, where people are selling their products, they are selling their signs, they are selling appliances. We are selling fish sandwiches.

Mr. Roskam. And, Mr. Baach, I am assuming that the 40 people that you described as the employee owners under an ESOP -- a lot of support for ESOPs on this committee, by the way -- that is not uber wealth, is it, Mr. Baach? Are those sort of work-a-day people that are employee owners and they have been the beneficiaries of the Tax Cuts and Jobs Act? Is that right?

Mr. Baach. They have, both in what we are putting into the ESOP as a result of our having cash available, as well as we do pay them well and give them bonuses when we succeed.

So as this business is growing, we are seeing more and more opportunities, and our employees are benefiting directly.

Mr. Roskam. You know, this time is evaporating on me. And I think as I was listening to Mr. Arensmeyer's testimony, the quotes that he was giving were from people who it was sort of prospective and confusion, like I am getting mixed narratives. Yeah, if you are being told that something is bad for you that is good for you, that is confusing. And I think what we are learning -- is this bill perfect? Of course not. Is it good? Yes, it is very good.

Mr. Gray, just in closing, what is it that you are seeing, from your perspective, from the people that you are interacting with around you?

Mr. Gray. The first thing is I compared the appointments during tax season and the 5 weeks after. In the 5 weeks after I saw small business coming in almost 2-1/2 times what they were in the prior year.

I see people giving pay raises. I know in my own office, we give raises in December. In the month of April, everybody in the office got an additional pay raise.

I have four full-time employees. I now have five. And I am seeing that throughout. And I am seeing small business, they are wanting to outsource the technical stuff, like that stack right there.

Mr. Roskam. Thank you, Mr. Gray.

I yield back.

Chairman Buchanan. I now recognize the distinguished ranking member, Mr. Doggett, for any questions that he might have.

Mr. Doggett. Well, thank you very much.

I suppose the main difference that Mr. Roskam and I have, since I was at the hearing that he referenced about small business in this subcommittee, is that I believe in having a hearing after we know what is in the bill and not one that just glorifies small business and its need for relief, that we need to deal with the specifics.

And, of course, there was no hearing after the bill was finally made public and no opportunity for small business or, for that matter, anyone else, and certainly no one in the Trump administration with the courage to come and sit where you gentlemen are and answer questions about the difference between the rhetoric and what was actually in the bill.

But I want to talk about one issue that there surely can be no dispute about, and that is complexity and added compliance cost.

All of us remember the postcard that was out here that was waved around during the markup, about how we were going to get great simplicity in the Tax Code for individuals so many of them would just be able to fill it out on a postcard.

Well, of course, that postcard got lost in the mail for individual tax holders and the complexity remained, but there is far more complexity for small businesses.

And the chart that I put up demonstrates some of the machinations that small businesses have to go through. They certainly won't be able to file on a postcard. There are multiple decisions that have to be made by small businesses.

If you are below the income threshold, then you still have to do a couple of calculations, but it is a relatively lesser burden on the taxpayer. If you are above the thresholds that are set out in the Republican bill for many taxpayers, there is a tremendous amount of complexity, some of which might be resolved with guidance, some may not be.

This is certainly, for small business and for all businesses and individuals, a full employment act for CPAs and tax lawyers.

From my understanding, the real complexity that is faced by taxpayers does relate to the phaseout ranges that are employed in specified service trades and

businesses. These taxpayers are in what I will call pass-through purgatory. They are taxpayers that are employed in a certain field that are disqualified from the deduction if they have incomes above a certain level, but are wholly eligible for the same work if they have incomes below a certain level.

If you just look at the chart and the various decisions that have to be made, you can see the challenges to qualify for this pass-through and the significant amount of resources that will be devoted to accountants to try to accomplish some of this.

I think that one of the concepts that was included for individuals was to increase the standard deduction. And that is an argument that has some disadvantages, but it also has some significant advantages.

It seems to me, Mr. Arensmeyer, that if the goal here was to really focus attention on small businesses across America, that it would have been much simpler to just have a small business deduction that would focus on small businesses rather than to shower so many of the benefits on people like The Trump Organization that seemed to be doing fairly well before this tax law was ever enacted.

Would you agree with that?

Mr. Arensmeyer. Absolutely, Congressman. There are many ways to deliver relief to small businesses.

Seventy-six percent of small businesses make less than $100,000 in net income. The average income for self-employed entrepreneurs is about $50,000.

So, there are some gentlemen up here who run very successful businesses, and more power to them, but the fact of the matter is there are 30 million small businesses in this country and the vast majority are not making that kind of money.

So if you want to give them a break, there are ways to do it. We proposed something last year. That is not the only way to do it. But certainly the way to do it is not to have cuts coming from the top so that the majority of benefits go to 2.3 percent of pass-through firms.

Mr. Doggett. You could cap in some way the pass-through benefits so that it was focused on doing more for those who are trying to become bigger businesses instead of those at the very top so that the benefits aren't skewed. That would be one way. And having a small business standard deduction would be another.

Mr. Arensmeyer. You could just have a cut. Say, the first $25,000 worth of income isn't taxed, and then you cap it for businesses making over, say, $200,000. I mean, there are multiple ways to do it. That is a bottom-up approach. That is where you are going to give direct benefit to most small businesses and not have it coming down from the top.

Mr. Doggett. Those are the kind of concepts that a real genuine hearing looking at this tax law last year might have provided us a better spot for small businesses than, as you said quite correctly, an opportunity, a once-in-a-lifetime opportunity that we blew.

Thank you very much.

Chairman Buchanan. Mr. Reichert, you are recognized.

Mr. Reichert. Thank you, Mr. Chairman.

Mr. Arensmeyer, how many businesses did you say were members of the Small Business Majority?

Mr. Arensmeyer. We have an aggregate of 58,000 businesses.

Mr. Reichert. Fifty-eight thousand. Are those businesses also members of the NFIB?

Mr. Arensmeyer. Some of them are. Yes, they are.

Mr. Reichert. I am confused by your directly 180-degree testimony from the four witnesses prior to your testimony. So you are not hearing any positive stories at all from the 58,000 businesses who are members of the Small Business Majority?

Mr. Arensmeyer. For the most part, we are not.

Mr. Reichert. Even though the NFIB has put out a statement saying small business optimism is near record highs, at levels only last seen in 2004. Small

business owners are turning this optimism into increased investments, hiring of employees, and higher wages for their employees.

So I just can't believe that some of those 58,000 members of your organization, being members of the NFIB, are not also part of the positive story that the NFIB is presenting to America as a result of the tax reform bill.

I know each of the four witnesses who own businesses here that testified prior to you, Mr. Arensmeyer, have already described employee benefits in your testimony, but I wonder if we can just go down the line real quick and just list those benefits off as a result of tax reform. What are some of the things that you are seeing for your workers?

And I know, Mr. Homan, you even mentioned that you are not giving raises or bonuses to the executive positions in your company, but to those people who are doing the everyday work. So, Mr. Homan, just list off quickly some of the benefits that you are seeing for your employees.

Mr. Homan. Yes, that is correct, Congressman.

Roughly half of our employees are field laborers. So they operate and maintain heavy equipment. They generally work 6 weeks on the road, housing in hotels. They are kind of basically salt-of-the-earth kind of folks who are out there. If you drive by people doing road construction all day, ours would be the same type of folks out there doing --

Mr. Reichert. Are they getting raises?

Mr. Homan. And every one of those folks got a $1,500 bonus, and every one of those folks got a dollar-an-hour raise. That went all through the whole organization.

Mr. Reichert. What does that do for your productivity, the employees' productivity in your company?

Mr. Homan. Yeah, I mean, it is a great question. It is really about employee morale and it is about how they feel about where they work and about their place. And I can't tell you how many emails I got or how many handshakes I got in the hallway, sort of thanking me, you know, for doing that. I basically said, well, you know, don't thank me.

Mr. Reichert. Stick with me, right?

Mr. Homan. Thank your local Congressman.

Mr. Reichert. Well, your employees too are probably more than likely to stay with your company since they are receiving bonuses and wages, right?

Mr. Homan. We would hope that.

Mr. Reichert. Yeah.

Mr. Horne. Yes, Congressman. We invest back into our plant, into our restaurants. We want our staff to be -- all of our staff -- 50 percent are tipped employees. So the main part of their income is from the guests.

Mr. Reichert. More customers, more --

Mr. Horne. More customers, more sales, more tips. It is very simple in the restaurant business.

So we want to make sure that the plant, the restaurant, and the atmosphere, is conducive to people coming in more often.

Mr. Reichert. Happier employees, happier customers.

Mr. Horne. Absolutely.

Mr. Reichert. Happier customers, more customers.

Mr. Horne. Correct. Our retention is phenomenal. We take care of our customers, we take care of our guests, and we take care of our staff so they will take care of the guests.

Mr. Reichert. And as was pointed out by Mr. Roskam, that is a spin-off to other businesses, too. The signage company that you mentioned in your testimony.

Mr. Horne. The carpet company. The roofing company. Absolutely.

Mr. Reichert. Mr. Baach.

Mr. Baach. We look at something similar, although we are putting money back into the company. And I mentioned the $5 million that we are making in investment. There is a direct correlation to employee satisfaction to customer satisfaction.

If we have more customers, it means that they are performing better. It means that we will pay them more. It is a function of their retirement as to what we pay them. There is a percentage then that is applied that allows us to put it into the retirement, which, by the way, somebody my age, that makes great sense.

But we also pay them in cash. Everybody got raises and everybody got that $1,500 bonus in December.

Mr. Reichert. And another great thing is that you are creating more jobs for more people to have that same opportunity.

Mr. Baach. We are.

Mr. Reichert. I yield back. My time is out.

I am sorry, Mr. Gray.

Chairman Buchanan. Ms. Sanchez, you are recognized.

Ms. Sanchez. Thank you, Mr. Chairman.

And thank you to our witnesses for joining us today.

I agree with Mr. Doggett that we should have had legislative hearings about how the actual tax cuts would impact important constituencies like small businesses, but here we are doing a little Monday morning quarterbacking instead.

The obvious question that I hear from my constituents about the new tax law is, "Congresswoman, exactly how is this going to affect me?" And unfortunately, all too often my answer to most is that they won't be seeing that much of a benefit.

This is more acute for small businesses across my district, because some minor temporary gains for the people I represent pale in comparison to the outrageous giveaways to extremely wealthy individuals and corporations.

One of the best parts of my job is when I am back in my district and I go on these small business walks, because through those walks not only do I find the greatest local restaurants and shops, but I get to have honest dialogue and conversations about what specific obstacles small businesses face.

And one theme that emerges over and over again through these business walks is this feeling like small businesses are being left out, feeling like the system is leaving them behind.

Small businesses in my district are not asking for a handout. They are asking for something very simple: a little bit of fairness.

Unfortunately, the bulk of what passed in H.R. 1 is in direct contrast to that goal. It didn't meaningfully bring small business owners back into the fold. Instead, it was a massive tax break for uber-wealthy corporations. And to add insult to injury, it is balanced on the back of the true small businesses that are in my district.

If there is one group that deserves a fairer tax rate, it is those small businesses and not huge multinational corporations that are finally bringing home money that they have been stashing offshore. And the bulk of the benefits certainly shouldn't have gone to hedge fund partners so that they can finance yet another yacht.

Squeezing the people in the middle, hardworking people and small business owners, has a longstanding impact throughout the community. I wanted a tax reform that would relieve pressure and let businesses buy that new machine, hire that next worker, or even put a little away for their own retirement.

Now, honestly, my biggest concern right now is: Now what will the Republicans do, now that some of them have suddenly woken up to realize that the tax bill that they voted for will add trillions of dollars to the deficit? How are we going to pay this $2.3 trillion tax bill price tag?

I am worried that it is going to come out of the retirement savings of hardworking Americans, and that is the last thing that middle-class families and small businesses need when they are trying to do right by their workers and just get ahead.

Republicans often focus on the competitiveness of our companies. And while I don't disagree that that should be a priority, equally as important should be the competitiveness of our communities. The success of small businesses and working families, the ability to successfully operate a local business, afford quality childcare, and drive on safe roads, that should be a focus as well.

The new tax law was sold as this silver bullet for increased economic growth that would result in an explosion of good-paying jobs, but in reality the law

provided modest temporary benefits for working people and local businesses, but didn't accomplish the meaningful reform that we had a chance to do.

I want to begin my questions with Mr. Arensmeyer.

I must say that your written testimony was spot on with what I have been hearing back home. And I know you discussed it a bit already, but with the little time that I have left, I would like you to expand a bit on your second and third points.

To me, these are really interrelated. The new tax law provisions are so convoluted that most small business owners will have to spend large sums of money to stay on the right side of the law, while sophisticated wealthy taxpayers will be able to continue to game the system.

What are you hearing from your members about how this is beginning to play out?

Mr. Arensmeyer. Well, Congresswoman, as I mentioned in my testimony, we are hearing that there is tremendous confusion.

I should point out there have been surveys done by groups across the political spectrum, from the NFIB, the NSBA, and Businesses for Responsible Tax Reform. All of them find there is tremendous confusion out there. So this is not a partisan response to this issue.

And you can see the chart that the ranking member put up there. This bill certainly did not do anything to improve on the tax law's confusion.

Ms. Sanchez. Thank you.

And, Mr. Chairman, I would ask unanimous consent to submit for the record a report and statement from Professor Caroline Bruckner of the Kogod School of Business at the American University. It details the unique needs of women business owners and how this tax bill did not take into account any of their special and unique needs when we were formulating this bill, nor when it was passed without hearings on the merits.

Chairman Buchanan. We will add it.

Pending Insert Submission

Chairman Buchanan. Mr. Renacci, you are recognized.

Ms. Sanchez. May I submit that, please? I am asking unanimous consent.

Chairman Buchanan. Yes.

Ms. Sanchez. Thank you. I yield back.

Chairman Buchanan. Mr. Renacci.

Mr. Renacci. Thank you, Mr. Chairman.

Mr. Renacci. Thank you, Mr. Chairman.

I want to thank my colleagues on the Ways and Means Committee for holding this hearing today.

As a businessman and a certified public accountant for 30 years, I understand the needs of small business. It is a story I lived. And I will continue to advocate for policies that will help small business owners achieve the American Dream.

You know, over the last 6 months, in Ohio, I must be living in a bubble, because I have heard countless stories about the benefits of tax reform that have been passed along to consumers, employees, and job seekers. At last week's hearing I tried to read off a list of companies exemplifying the benefits of tax reform. It was so long I ran out of time and couldn't get through everyone.

The Tax Cuts and Jobs Act is working for small business owners. I see it. I am a CPA. It is not as difficult as some want to say it is.

But, Mr. Arensmeyer, before I ask you, you quoted JCT as saying that 44 percent of the 199(a) deduction goes to millionaires. If we don't know how much tax they paid before tax reform then it is impossible -- it isn't impossible to evaluate whether this is disproportionate tax relief or whether it is commensurate with the taxes they pay.

So, let's look at the actual data from JCT to answer that question. As it actually turns out, the tax relief matches the share of the taxes that they pay. According to JCT, the 199(a) deduction will reduce income taxes paid by 38 percent for businesses earning under 75,000. In contrast, the 199(a) deduction will reduce

income taxes paid by just under 8 percent for businesses earning more than a million dollars.

I really appreciate, Mr. Baach, you traveling here and talking about your company. Philpott is employee owned. The $1,500 bonus is paid to all its employees, yourself excluded. The new job creation in combination with the repatriation of jobs from China. The positive supply chain implications. A sense of business optimism. And the capital expenditure implications.

I know that as I travel the State of Ohio I keep hearing positive things. According to the National Federation of Independent Business Owners, the number of small business owners that believe now is a good time to expand is at an all-time high.

Is your experience in the small business community, is it optimism like now in comparison to prior years? Is there much optimism?

Mr. Baach. Tremendous optimism. You said you read a list of successful companies. I hope you got to the P's so you mentioned Philpott, because we are one of them.

We deal on the supply side with very small companies. They express optimism. Our customers are really along the supply chain. We may hit it five times before, in the case of a durable goods sale, we end up selling to five different layers of the supply chain, all of which we have communication with and all of which are highly positive and have great expectations for what the future is going to bring.

Mr. Renacci. How do you see your company's capital investment changing due to tax reform, both now and looking ahead?

Mr. Baach. Well, we just invested $5 million. It had been probably 20 years combined we hadn't invested that much because things were going the other way. The company moved to China with manufacturing in 1990.

This 5 million is only the beginning. We have put brand new molding equipment in. Our employees walk out of the facility looking almost like I do now. They don't look like they came out of a coal mine. We have great jobs, great people, and we look forward to a great future.

Mr. Renacci. Thank you.

Other than Mr. Arensmeyer, who said there are negative effects, Mr. Gray, Mr. Horne, Mr. Homan, do you see any negative effects from tax reform, yes or no?

Mr. Gray. No.

Mr. Horne. Absolutely none.

Mr. Homan. No, other than, you know, I wouldn't necessarily disagree about some complexity -- I started my career as a CPA, and I am today happy to call myself a recovering CPA -- because I think there are opportunities in the future to clarify in some of your future technical corrections.

But in terms of the spirit of the law and the effect it is having on small businesses, I don't think there is anything I would change.

Mr. Renacci. Well, look, we don't want to put CPAs out of a job either. Those are actual jobs, too. So I appreciate that.

Again, I want to thank the chairman for allowing me to participate in this hearing, as well my colleagues for their continued work on this important issue. And I yield back the balance of my time.

Chairman Buchanan. Thank you.

Mr. Thompson, you are recognized.

Mr. Thompson. Thank you, Mr. Chairman.

Thanks to all the witnesses for being here.

And I just want to point out that there have been a couple folks that said that, you know, four of you think one way and only one thinks the other. Please know that the Republicans picked the witnesses. If it were the other way around, I am sure we could find four who agreed with us and one who agreed with you.

But thank you all for being here, and your stories were certainly impressive.

Mr. Arensmeyer, you spoke a lot in your testimony, written testimony, talked about the complexity of the pass-through deduction. And I have heard from a lot of folks in my district, small business owners, that say the same thing.

And there is one in particular that I thought was interesting. I want to quote one passage from it. And it is from an organization that represents a lot of small businesses.

And like you, Mr. Gray, I am a farmer also. And my district is made up of a lot of farmers, a lot of ranchers. I represent California's wine district. And small businesses, small wineries often times join together in order to do better business, as you can imagine, and one way they do that is to pool their resources or use a third-party storage facility before the wine is sent out.

And the passage from this letter is: Prior to the passage of Public Law 1597, the Republican tax bill, we were able to process excise tax payments for clients by claiming the small producers' tax credit on their behalf. This simplified tax reporting for members and ensured timely tax payments for the TTB. This process has been completely disrupted by this new legislation.

And I had, for instance, just the other day, I had a small vintner in my district said that: Since the Republican tax bill was passed, I am paying $10,000 a month more because of this provision.

And I want to ask unanimous consent to have this letter from the Sonoma County Vintners Co-op read into the record, Mr. Chairman.

Chairman Buchanan. That is fine.

Pending Insert Submission

Mr. Thompson. Thank you.

And I think that is illustrative of what a number of folks on our side have talked about, and that is doing a major tax bill, the most significant tax change in over 30 years, without a single hearing, without hearing from a single witness.

None of the four of you would do business that way. It is absolutely unacceptable. And all it has done is caused problem after problem, similar to the one from the Sonoma County Vintners association.

And what was supposed to be an expansion of the small producer credit for wine producers became one complicated mess. So now wineries have to dedicate compliance staff just to deal with the new complexity that this, quote/unquote, tax simplification bill has brought about.

Mr. Arensmeyer, you say in your testimony that the National Small Business Association found that a mere 7 percent of its members say they think filing taxes will become easier under the new tax law. Can you explain how this complexity makes it harder for small businesses to focus on business rather than on working through complicated taxes?

Mr. Arensmeyer. Yes, Congressman.

You know, the tax law is complicated as it is. And as I think we have heard, it was sold as a simplification measure. It is definitely not that. I mean, we are hearing nothing but confusion out there.

And, obviously, it goes without saying that the time that is spent dealing with paperwork and tax matters is time away from actually running the business and supporting customers and focusing on the product, et cetera. So that has not been something that has been fixed at all.

I did want to add one other thing. I mean, we have heard a lot about the success of businesses now. There is no question the economy is better. Now, it is much better for those at the top than at the bottom, but it is kind of better all around. And, clearly, we are hearing more small business confidence.

It is not because of the tax law. It is because of a growing economy over the last 8 years pulling out of the Great Recession. So I just wanted to make that point.

Mr. Thompson. And also do you have any of your small business owners telling you that they expect to file their taxes on a postcard?

Mr. Arensmeyer. That was generally what was talked about and --

Mr. Thompson. It was talked about from that side of this dais, but it is not a reality.

Mr. Arensmeyer. No, it is not a reality.

Mr. Thompson. And I also just want to point out two other things. One of the witnesses -- Mr. Gray, I believe it was you -- talked about healthcare. This tax bill took healthcare away from 13 million people, and the CBO said that everybody else is going to see a 10 percent increase in their premium because of this tax bill, not because of something else.

And then, lastly, I just want to point out that $2.3 trillion was added to our debt because of this tax bill. And I don't know where you grew up farming, but where I grew up farming, that is not a good thing.

I yield back the balance of my time.

Chairman Buchanan. Thank you.

Mr. Smith, you are recognized.

Mr. Smith. Thank you, Mr. Chairman.

It is clearly, by listening to the conversations on here, it is like we are from two different planets and we are looking at legislation two different ways.

I do want to ask some questions to Mr. Gray.

In your statement you were talking about the majority of Missourians and the people in our area will benefit greatly under the 20 percent deduction on the pass-throughs. And I wanted to look at some IRS data, because we have heard numbers from all different witnesses of like, it is so complicated, it is only helping the wealthy.

Let me read this IRS data, and I want to see if you would agree with commonsense Missouri logic that that is probably accurate in our State.

But it says: According to IRS data, 86 percent of married taxpayers are below the 315,000 income threshold in the new pass-through provision and so would get the 20 percent deduction without any limitation, making it very simple.

Is that what you see in Missouri?

Mr. Gray. Yes, that is what part of my testimony was.

Mr. Smith. It was. And so the IRS is saying you are right, Mr. Gray. So I am glad we are having some truth spoken about it being simple for at least 86 percent of joint taxpayers and pass-throughs.

Mr. Gray. Yeah. I think part of the problem is the communication and definitions. So, I see this exhibit here. I actually have one that I teach, and it is about half the size.

But when I talk about the 86 percent, what I look at, it is as simple as, let's say that I am married and I am a lazy husband. What happens is, my spouse is making $100,000 a year on a schedule C. It is the only thing on the return. We are going to do a tax return in about 30 seconds.

What is going to happen is, if we look at the bottom of the return, my adjusted gross income is 100,000. Standard deduction went to 24.

Mr. Smith. So how many people do you think doubling the standard deduction affected in Missouri?

Mr. Gray. A large part. We are going to have several people not itemizing anymore.

Mr. Smith. So that will be very simple to file your taxes, correct?

Mr. Gray. Right. And this QBI deduction, if I am below the threshold, making 100,000, subtract off the 24, QBI says I get either 20 percent of 100,000 or 20 percent of my taxable income. Well, 20 percent of 76,000 -- that is 100 minus 24 -- is 15.2.

If my wife gets me off the couch and I go to work for a W-2 for a new job then I make, together, jointly, 124,000. My itemized deduction is 24,000.

So what happens is my taxable income is 100,000. My QBI is 100,000. Guess what? I get my 20 percent. We have just now done a return.

Free file tax returns should be able to do a calculation like that. That is 86 percent of the people that is small business.

Mr. Smith. That sounds pretty simple.

There was a provision in the Tax Code that we added that would allow cash accounting for businesses under 25 million to try to help make it easier. Do you think that that would make it easier?

Mr. Gray. Yes, you did that in several areas. It went from 10 million to 25 million. And that is like any system. As we go on, it is a way of maybe indexing and making doing a tax return simpler.

Mr. Smith. Thank you, Mr. Gray.

So, simplifying the code with that provision, it was stated earlier that there are roughly 30 million small businesses in the United States. And if 86 percent, according to IRS data, are benefiting from the no restrictions, easy 20 percent deduction on their taxes, tax cut, that is 25.8 million small businesses. That is pretty substantial. That is not 7 percent. That is 86 percent of 30 million.

I also think that it is important to listen to some of these numbers. This is from the Joint Committee on Taxation: 77 percent of all the tax relief derived from the Tax Cut and Jobs Act goes solely to families and small businesses. Seventy-seven percent, from the Joint Committee on Tax. That is a nonpartisan group.

Just because you did not like the Tax Cut and Jobs Act and you wanted it to not pass doesn't mean it is not benefiting your constituents and benefiting the majority of Americans.

Thank you, Mr. Chairman.

Chairman Buchanan. Thank you.

Ms. DelBene, you are recognized.

Ms. DelBene. Thank you, Mr. Chairman.

And thanks to all of you for being with us this morning.

First, I would like to share a story we heard from ReShonda Young. She is the owner of Popcorn Heaven, which is a successful gourmet popcorn franchise with five locations, soon to be six.

ReShonda said, and I quote: "The Republican tax law is not what my business needs to create jobs and grow. I have talked with my accountant, and the nominal tax cut I might receive won't cause me to grow my business or hire more employees.

"In fact, this tax law makes me worried more than anything. I am worried about my employees' and customers' access to quality, affordable healthcare. In order to pay for the tax cuts to wealthy corporations, Republicans are sabotaging the ACA by repealing the individual mandate.

"Coupled with other efforts by the Trump administration, including the expansion of short-term and junk health plans, premiums are increasing by double-digit numbers while the quality of coverage is decreasing," end quote.

ReShonda told us that before Popcorn Heaven, she was running her dad's small business. She said, quote: "We had been searching for insurance for years and preexisting conditions were the biggest stumbling block. The failed system that was in place before the ACA made it unaffordable for us to provide health insurance for our employees. The policies we were shown also denied health benefits for several of our employees due to preexisting medical conditions," end quote.

ReShonda saw firsthand the impact that a broken healthcare system had on her employees. But, she said, quote: "After passage of the ACA, we were able to put a plan in place for our employees that did not exclude their pre-existing conditions. When I opened Popcorn Heaven in 2014, I was grateful to have an affordable health insurance option for my employees.

"To go back to where we started from doesn't make any sense. Our Members of Congress need to start making some smart decisions, and undermining access to lifesaving healthcare to give trillions of dollars in tax cuts to their wealthy donors is not one. It is putting us into a tailspin," end quote.

So, Mr. Arensmeyer, the Republican tax bill, as you know, repealed the individual mandate. So how will this impact current small business owners like ReShonda or those who are considering starting a small business?

Mr. Arensmeyer. Congresswoman, you are absolutely right, it repealed the individual mandate.

First of all, everyone forgets when talking about this, you know, everyone thinks it was great before the passage of the ACA. But actually, if you start looking at what has happened with the Affordable Care Act since its passage, there are tremendous benefits to small business.

Thirty-one percent of small business employees were without coverage prior to the ACA. That number has dropped to 19 percent. That is 4 million additional small business employees covered. The percentages are almost identical among self-employed entrepreneurs.

In addition, when it comes to costs, the only comparison we can do is in the small group market because the individual market was so different. The costs were increasing 10.4 percent average annually before the ACA. It has been 5.2 percent in the small group market since then.

So, we have seen tremendous benefits to getting a lot more independent entrepreneurs, small business owners, and small business employees covered. And the problem is, the individual mandate is a significant part of that and this law did remove that.

And now the problem is there is a risk of not having healthy, younger people in the system and there is going to be pressure on rates going up, not because of the Affordable Care Act but because of the removal of a key provision.

Ms. DelBene. And are you hearing that from a lot of your members?

Mr. Arensmeyer. Yes. In fact, healthcare ranks much higher than taxes on all the surveys we do in terms of importance to small business.

Ms. DelBene. So will the Republican tax law incentivize growth in hiring, or will it give small business owners anxiety about whether they can afford to grow and still provide competitive wages and benefits, like healthcare? And if they can't do that, will that hold them back from creating new jobs and expanding their businesses?

Mr. Arensmeyer. Well, there is no question that the law only benefits -- you know, as I have said in my testimony, the primary benefits are to much bigger pass-through entities and large corporations. It is a combination of the anxiety you talk about, but also the fact that the real benefits are fairly small.

There are definitely benefits to some small businesses, and there are definitely benefits to larger pass-through entities and other larger corporations, as you have heard here.

But the combination of the anxiety and the combination of the fact that if you are going to pass a 1.5 trillion or 2.3 trillion, as I have heard here, hit to the deficit, you want to have those benefits more evenly spread and particularly benefiting small businesses.

So we are not hearing that the tax law is creating any great interest in hiring or providing an investment to the vast majority of the 30 million small businesses out there.

Ms. DelBene. Thank you. I yield back.

Chairman Buchanan. Thank you.

Mr. Rice, you are recognized.

Mr. Rice. Thank you, Mr. Chairman.

The views and the opinions on the effect of the tax act are certainly startlingly divergent, where Ms. Pelosi, for example, called it Armageddon, has promised that if the Democrats retake the House that they will do away with the tax bill.

But then you look at the actual numbers, where unemployment rates are at 20-year lows, all-time lows for African American unemployment, business confidence is at decade highs, GDP growth is at over 3 percent, at levels that were never achieved during the entire Obama administration.

I just wonder what planet we are on here when we can't see how positive this bill has been for the economy.

Mr. Gray, you have a CPA practice, correct?

Mr. Gray. Yes.

Mr. Rice. How many clients do you have?

Mr. Gray. Well, it is like any stat. Are you talking about annual clients?

Mr. Rice. Just roughly, how many clients do you serve?

Mr. Gray. Around a thousand.

Mr. Rice. A thousand clients.

Have you done any projections for those clients? Because of the tax bill, they haven't paid taxes under the new bill yet. That will be for next April. Have you done projections for them, for any of your clients, to determine what the effect of the new tax bill will have on them?

Mr. Gray. What we tried to do this tax season, anytime we had a small business client coming in, when they set up the interview we looked at the features of the new law, and what we tried to do is go over what items would impact the return for the coming year.

There is not enough time to do plannings at that point in time, so what we would do, if they wanted to move forward, is that we would set up a planning session. So over the last few weeks, I have done several planners almost daily.

Mr. Rice. And what is your conclusion? Are their tax rates, are their tax bills going to go up or down?

Mr. Gray. Their tax bills are actually going to go down.

Mr. Rice. And would you characterize it as minimal or substantial reduction in their taxes?

Mr. Gray. Well, I think that if you are looking at a percentage, it is sizable to them, because 20 percent is 20 percent. When somebody says, "I only have to pay taxes on 80 percent of what I make," that makes a difference to them.

Mr. Rice. That makes a big difference to a small business, doesn't it?

Mr. Gray. Absolutely.

Mr. Rice. Mr. Gray, I would let you go on, but I just don't have enough time. I am sorry.

Mr. Baach, is it?

Mr. Baach. Yes, sir.

Mr. Rice. Okay. You said you made rubber components and you would offshore to China and you re-shored. I am sure you re-shored before the tax bill, so that really wasn't a factor, correct?

Mr. Baach. Well, it was to the extent that as we were putting our plan together we knew there was risk there. And by discussing with some of your peers what was going on, specifically Mr. Renacci --

Mr. Rice. So you were kind of counting on getting the tax bill done when you re-shored?

Mr. Baach. It was part of it.

Mr. Rice. All right. So both before and after reshoring, you compete with other folks, right? I think you said that you compete with folks from Europe and other places?

Mr. Baach. Primarily the big competition was out of Asia.

Mr. Rice. Okay. And so did you find that our Tax Code with a 35 percent bracket put you at a disadvantage to companies offshore?

Mr. Baach. Definitely.

Mr. Rice. So this Tax Code has made you more competitive in the world, right?

Mr. Baach. That is correct.

Mr. Rice. Which allows you more sales and more employees and so forth.

Mr. Baach. Yes.

Mr. Rice. Mr. Homan, you said you compete primarily with people who make specialty railroad products in Europe?

Mr. Homan. Uh-huh.

Mr. Rice. Those folks have significantly lower income tax rates than we do here, correct?

Mr. Homan. That is correct.

Mr. Rice. Did you find that paying a 35 percent corporate income tax here puts you at a disadvantage to those who are paying, say, a 20 percent corporate income tax in Europe?

Mr. Homan. It is a significant disadvantage when it comes to pricing our products on a global basis and competing in areas of the globe where neither one of us are domiciled. Obviously, that would give them a 15 percent advantage right off of the giddy-up before we get started. So, yes.

Mr. Rice. So have you found your competitiveness has improved as a result of this tax bill?

Mr. Homan. Yeah, Congressman. Unique to our industry, our sales cycle is years in the making. It takes us over a year to produce some of the equipment we do. So we are just at the beginning of starting to compete on a global basis under the new laws as they are written today.

So I do expect, as I have stated in my testimony, that this will make us more competitive and lead to future growth. I can't say, as I have seen it today, just because of the nature of our particular industry.

Mr. Rice. Thank you. I yield back.

Chairman Buchanan. Thank you.

Mr. Larson, you are recognized.

Mr. Larson. Thank you, Mr. Chairman.

And, Mr. Chairman, may I submit for the record, Ms. DelBene had an article from the Main Street Alliance, without objection?

Chairman Buchanan. You may.

Pending Insert Submission

Mr. Larson. Thank you, Mr. Chairman.

Mr. Chairman, I would also like to join in both thanking our panelists and congratulating them. It does seem that, for four of you, you have done extraordinarily well, and we are happy for you.

I don't know anybody, in fact, whenever they get a tax cut or mentions the fact that there is a tax cut that has ever been unhappy with that. It is just that our colleagues keep on saying to us they can't understand why we are perplexed on this side.

I guess they couldn't understand why Lee Zeldin, a Republican from New York said: "On balance, this bill remains a geographic redistribution of wealth, taking extra money from a place like New York, say, Connecticut, New Jersey, Massachusetts, California, and to pay for deeper tax cuts elsewhere. This bill chooses winners and losers in a way that could and should have been avoided."

That has been our contention from the outset. We want to see tax cuts for small businesses.

We just think that the way that we have gone about it -- having a hearing after the bill has been enacted and hearing its impact -- doesn't make an awful lot of sense to us. Because we feel that we could have very easily rectified a number of the problems, that a coming revolution is going to be caused in the blue States that are being double taxed to pay for some of these tax cuts that you, gentlemen, rightfully and have acknowledged, are doing well by.

We would like to see all 50 States flourish in this way and with a tax system that is fair to everyone. And I don't think there are any of you on the panel that would disagree with that. But that is not the way that this proposal came down.

And, listen, that is politics and sometimes it happens that way. It started a BAT tax. That wasn't acceptable or agreeable. That was pulled off the table.

Everybody went to the back room -- not even Members on this committee were in that back room -- where ultimately the tax decisions on what we are dealing with were decided. And then it came here to the committee and was rammed through.

Now we are dealing with the consequences. These consequences aren't Democrat or Republican. Mr. Zeldin is a Republican. Mr. King is a

Republican. It depends geographically where you are and whether or not, for example, you utilize SALT deductions how you are impacted in your given State.

And that is a travesty, because what happens is people are saying, again, there is a lack of confidence in the government that would have one segment of the society pay for another's tax relief. And with all of that, still most of the benefits going to the top 1 percent with the hope that somehow it will trickle down.

And, Mr. Arensmeyer, I know that the National Small Business Association stated its priorities were that we should have a tax reform that provided simplification, parity between small and large businesses, permanency and predictability in addressing the deficit. In your estimation, did this tax bill do that?

Mr. Arensmeyer. No, it did not, Congressman.

Mr. Larson. Now, it may have done it for some of you. But do you believe, Mr. Gray, that across the board that that is what this tax bill achieved?

Mr. Gray. It is kind of a leading question because you referred to SALT, which is the itemized deductions.

Mr. Larson. Well, yeah, it is leading because that is what the bill did.

Mr. Gray. Correct. But one of the backstops to that that has always been there, I mentioned in my testimony, is AMT. So the people in my area that have high income and the SALT is high, we do have a few people in our area that make above the threshold, et cetera, but they get hit by AMT tax.

Now, I know this Chamber was not responsible for that, but that is still there.

Mr. Larson. I hear you.

Mr. Baach, does it meet the four tests?

Mr. Baach. As far as I am concerned -- and I choose not to be confused by this -- we pay State tax in Ohio. The analysis that my tax planner, as well as the people with our company, it is a benefit to us.

Mr. Larson. Mr. Horne.

Mr. Horne. I am not an accountant. I know how to serve --

Mr. Larson. I understand.

Mr. Horne. But I do hire an accountant. And that is where I got the information about the 20 percent deduction. He called me.

Mr. Larson. And you are from Florida?

Mr. Horne. Florida, yes, sir. So, there is no State income tax.

Mr. Larson. And, Mr. Homan.

Mr. Homan. Yes. I am from Minnesota. We are not particularly known as a low tax State. But to my knowledge, the laws that are passed apply equally to all corporations no matter where they domicile.

As far as the effect from the personal tax side, which is what you are talking about, I guess I would defer to others.

Mr. Larson. Mr. Chairman, I thank you for the leniency of allowing them to answer the questions.

Thank you all. Thank the witnesses.

Chairman Buchanan. Thank you.

Mrs. Noem, you are recognized.

Mrs. Noem. Thank you, Mr. Chairman.

My colleague was just complaining about how damaging this bill and policy is when the aggregate tax cut in Connecticut, his home State, in 2019 will be 4.5 billion. In my home State of South Dakota, it is going to be 1 billion. So he is receiving four times the benefit than my State is.

Mr. Larson. Will the gentlelady yield?

Mrs. Noem. I will not yield.

Mr. Larson. I didn't think so.

Mrs. Noem. But I will clarify that we are a low tax State in South Dakota. We don't have a lot of people there. But everywhere I travel in the State people are telling me stories about the benefit of tax reform.

I am a lifelong farmer and rancher. I started and ran a hunting lodge for many years. We have an insurance agency. I managed my mother's restaurant for many years. Very hard business, Mr. Horne, one of my least favorites. But it was a lot of hard work, but a lot of fun, too.

But, listen, I want to thank all of the witnesses for being here today and telling your stories, both in your written testimony and what you have shared with us conveying why this Tax Cuts and Jobs Act was so important for you and your employees.

And as you have heard so far, our friends on the other side of the aisle are working hard to develop a false narrative on tax reform, a narrative that seems more focused on President Trump rather than on the policies that were in the bill. And I have to say, it is extremely difficult for our Democrat friends to keep up this charade, even faced with example after example of success that has resulted because of this policy.

I am extremely pleased that we have actual small businesses here, and I am happy that their testimony reflects the fact that this bill is working.

So, Mr. Gray, you said the tax law shows that America is investing in small business and that the economic attitude is positive.

Mr. Baach, you said the tax law is creating growth drivers for your business.

And, Mr. Homan, you said the tax law allowed your business to embark on a strategy of reinvesting your savings.

And, finally, Mr. Horne, your words were some of the most critical. You said the tax law helps small businesses stay in business.

South Dakota is home to over 80,000 small businesses across the State. Those are the kind of stories that I hear when I crisscross the State. And I spoke to number of folks in the agriculture industry in South Dakota who wanted to be with us here today, but it is planting time and they are all out in the field and have to get seed in the ground.

But it is not just agriculture that is benefiting from this tax bill. I hear stories from Aladin Industries in Elk Point, which provided bonuses of up to $1,000 per employee. They are spending between $1 million and $2 million on new equipment. And Ryder, located in Sioux Falls, South Dakota, and Rapid City, gave tax reform bonuses to their employees.

But like I said in our hearing last week, anecdotal stories are nothing unless they are backed up with data.

So, I know Mr. Reichert asked Mr. Arensmeyer about whether some of his member companies are also members of NFIB, and apparently a few of them are. And these companies are undoubtedly aware that some new data was just released from NFIB, and I think that that, as a group, that truly represents small businesses across the country.

I want to highlight the results of a survey that NFIB just released a couple weeks ago: 76 percent of small business owners believe the current business climate is heading in the right direction; 87 percent of small business owners think the Tax Cuts and Jobs Act will have a positive impact on the economy; 75 percent of small business owners think the Tax Cuts and Jobs Act will have a positive impact on their businesses; 51 percent expect that they will pay less in Federal income taxes next year; 47 percent of small business owners who expect to pay fewer taxes next year plan to use the savings to reinvest in their business. Many plan to invest in their employees through higher compensation.

And, Mr. Chairman, this is exactly why the Tax Cuts and Jobs Act is so important. It helps our small businesses stay in business. It puts us on the road to growth and reinvestment in our people and in our small businesses. And that is what I hear overwhelmingly across my State of South Dakota, and that is why it is so vital that we keep it up and not entertain false narratives like we have heard from our colleagues on the other side of the aisle today at this hearing.

I want to thank you, Mr. Chairman, for holding this hearing.

And I want to thank all of you for taking the time to travel here and share your stories. It is incredibly important.

With that, I yield back.

Chairman Buchanan. Thank you.

Mr. Schweikert, you are recognized.

Mr. Schweikert. Thank you, Mr. Chairman. And I am elated to be on this particular subcommittee. It is nice to know this subcommittee has the same sort of theater that all the others do and math is still secondary. But, hey, we will do our best here. And if that was sarcastic, that is what I was going for.

So actually, part of what I am after here is, okay, we will have the theater on the tax reform because the ideology, it turned out to be partisan. But for small business, you are key to our society's employment base. There are other factors out there other than just the taxes you pay. It is access to capital, access to labor, access to be able to get a permit to build the new restaurant, those things.

I am curious, because I have been bathing in the data of what we are seeing in the employment markets, and you would think there would be this sense of joy from all of us that we are seeing a lot of our brothers and sisters, who just came through a pretty rough decade, are long-term unemployed, a lot of our disaffected populations are moving into the labor market. That is wonderful. But if you are hiring, it also means your hiring has probably gotten much tougher.

Can you walk me through what are the headwinds? The three of you in the middle, who actually employ people in ongoing concerns. What are your headwinds? Is it access to capital? Is it labor? Is it barriers to entry? Permitting? Mr. Horne. Mr. Baach.

I mean, what do we need to do as policymakers, if many of us believe good things are happening in our society, what policy sets do we need to be pursuing to keep it going?

Mr. Horne. I think a lot of ours is labor. I mean, 333 employees for four restaurants, that is a lot of people. I mean, that is our biggest concentration, is the labor. So to provide the workforce to make sure that it is easy to hire, that it is easy to explain to them what benefits we have and everything that we offer to them is the easiest thing.

We are looking for a trained workforce. We work with advisory boards for the local trade schools to help in the culinary programs. Funding to the culinary programs and all the trade schools is important. Not everybody is going to college. We need workforce.

Mr. Schweikert. Mr. Baach.

Mr. Baach. Ours is definitely labor. There are many challenges. But right now we will train the people. We will bring them up to speed, show them how to do what we do.

Mr. Schweikert. Could you give me more definition on that, because a couple weeks ago we actually had an amazing experience where we had a gentleman who was hired out of prison and given the training. And the electrical contractor so needed labor they were willing to take a chance on populations that in a previous year would have been abandoned. What are you doing?

Mr. Baach. We have gone so far as to talk to the common police judge and to say that we have places to go for people rather than community service. It is just very, very difficult to find people that will want to work in a factory, albeit one that is not a sweatshop and we pay well. It is just not available.

Mr. Schweikert. Thank you for doing that.

Mr. Homan.

Mr. Homan. Like most businesses, our single greatest expense is on our employees and on our labor.

I would echo the comments that were previously stated about perhaps more emphasis on technical and trade schools. Those are the type of folks that we would have really good-paying jobs for if they were interested in joining us.

I don't see an access to capital as an impediment to our growth. There is plenty of free flow of capital in the markets. But access to labor is probably my number one concern today relative to things that would be affecting my growth. I have open positions today that I can't fill.

Mr. Schweikert. Someone who has been, a journeyman, someone who has been with you for several years, what salary range, what hourly range?

Mr. Homan. I would have 20-year-old kids with high school degrees who would have some form of mechanical aptitude making $80,000 a year, would be not uncommon.

Mr. Schweikert. Okay. Look, and I know it is only a snapshot and I know we are only, what, 170 days since the tax reform became law, and dear, Lord, I

hope the snapshot from GDPNow, the Atlanta Fed, is real, because whether you be on the right or the left, if we actually could have a couple quarters of 4 percent GDP, it will help us with a lot of our societal difficulties.

We have massive unfunded liabilities in particularly Medicare, and it is not about the tax reform. It is about demographics. But somehow theater outweighs math around here and that breaks my heart. But maybe we are starting to head in the right direction.

And with that, yield back.

Chairman Buchanan. Thank you.

The gentleman from Minnesota, Mr. Paulsen, you are recognized.

Mr. Paulsen. Thank you. Thank you, Mr. Chairman.

I want to thank all of our witnesses also for being here today and taking the time to testify.

One thing I want to correct is something that Mr. Arensmeyer had mentioned earlier about the international provisions. According to the Congressional Budget Office, the international reforms in the Tax Cuts and Jobs Act will actually reduce profit shifting by over $700 billion through 2028.

And the Joint Committee on Tax, the macroeconomic analysis specifically credits our international tax changes that we have made with increasing foreign direct investment here in the United States.

And I don't think, from the perspective of we have seen all these benefits in the first 170-some days, as my colleague had mentioned, it is only been 4-1/2 months, we have got all these encouraging results, but the international provisions, in particular, are where we will see long-lasting reinvestment decisions by companies to actually return to the United States, which is actually a good thing that we are having happen.

I certainly have the anecdotes in Minnesota. I have dozens of companies. And, Mr. Homan, you are here today to kind of share your perspective. I talk to small business folks, medium companies, and large companies actually in Minnesota, that are directly impacted by the new tax law in a positive manner.

And you get the larger economic indicators, right? We study this in the Joint Economic Committee and our committee here. Unemployment is down, jobless claims at a 50-year low, optimism high, wages up, investment in employees and operations capital equipment is up. And we have talked about that, and we have heard different perspectives from you and from members of the committee over the last couple of weeks in particular.

Let me just ask you this, Mr. Homan, because you mentioned in your testimony you have been reinvesting the savings from tax reform into your company, into your employees. You got capital equipment. You got research and development. It is going to result in future growth. And you have outlined that, in particular, as you save points from 35 percent down to 21 percent.

Can you also, as you just scratch the surface of this, but can you explain a little bit deeper maybe how those types of business investments are actually going to lead to stronger growth? And, in turn, what does stronger growth mean in terms of actual future job creation?

Mr. Homan. Thank you, Congressman.

Yeah, I mean, like any investor, if you are investing your own money, you are going to invest it looking for a return. So, what our investors would look for is an after-tax rate of return.

So that means investments in our business that may have been marginal in the past, may have been sort of on the fence where we are not quite sure if that is going to pay off or not, when we look at it under the lens of the new tax law, the after-tax rate of return would increase by a fair amount. And so, investments that were now marginal can become reality.

So, when we make those investments, typically in capital equipment or adding to our fleet, we employ lots of folks for the fabrications and the assemblies and the pieces and parts. So, any piece of equipment that we would build would resonate throughout our supply community of hundreds of companies that we buy from in our supply chain.

So, whether they are investing in our own fleet because of the 100 percent deductibility of capital equipment, which has made a significant impact, or whether it is equipment that we build for foreign export, it has the same effect on our entire supply chain and on the entire community that we procure from. So, I guess, it is exponential in terms of the benefit to us. It ripples throughout our entire supply chain.

Mr. Paulsen. So, it is exponential. I mean, it sounds like it is sort of like rocket fuel in some ways. So, your customers are doing well, your supply chain gets stronger and employs more people from the small business perspective, in terms of, I think, a lot of your suppliers, I would imagine.

But you also mentioned in your testimony you are currently competing for several significant international orders. What is sort of the timing do you expect on those types of international orders that are coming? It is only going to get better and stronger, I would assume, but is that near term or long term?

Mr. Homan. Yeah, these are parts of the world that are sort of less developed. So currently the Ministry of Rail in India, for an example, is building new dedicated freight lines. They have obviously got billions of people and congested infrastructure. And so little companies like us in Hamel, Minnesota, are partaking in that in various parts of the world.

So those sort of government-type contracts take months, if not years, to run to fruition. But the timing of this is great because we are in the bidding stage of those particular contracts.

So, we would work for mining companies around the world who own railroads. We work for state-owned enterprises or national rail systems around the world. And our technology is unique in that way. So, it is hugely beneficial for us to be able to build American and export that equipment if we can be more competitive on the global stage.

Mr. Paulsen. Thank you, Mr. Chairman. I yield back.

Chairman Buchanan. Mr. Doggett, you are recognized.

Mr. Doggett. Mr. Chairman, thanks for the way you have conducted this morning's hearing.

And thanks -- agree or disagree -- to each of our witnesses.

I would ask unanimous consent to place the following news reports in the record.

From Forbes: "Tax Geek Tuesday: Making Sense of the New '20 Percent Qualified Business Income Deduction.'"

From Reuters: "U.S. Republican Tax Law's Pass-Through Deduction Open To Gaming."

From Bloomberg: "No One's Sure Who Qualifies for This $415 Billion U.S. Tax Deduction."

From Forbes again: "The Republican Tax Plan's Break for Small Business Yields Huge Benefits...for Big Business."

From Business Insider: "A new report shows that one of the biggest breaks in Trump's tax law will go to the richest Americans."

From Vox: "Trump said this tax break was for small businesses. It is giving $17 billion to millionaires this year."

Another one: "Rich Americans Have Found Yet Another Tax Loophole."

And from Bloomberg: "Here is the Trump Tax Loophole Your Accountant Can Blow Wide Open."

I would ask unanimous consent on each of those, Mr. Chairman.

Chairman Buchanan. So added. Thank you.

EDITOR'S PICK | 308,976 views | Dec 26, 2017, 08:48am

Tax Geek Tuesday: Making Sense Of The New '20% Qualified Business Income Deduction'

Tony Nitti Contributor
Taxes

On December 22nd, President Trump signed into law the Tax Cuts and Jobs Act, finalizing a once-in-a-generation overhaul of the existing Code and leaving the once-burdensome tax law so simple, we'll all be preparing our returns on postcards come the spring of 2019.

HAHAHAHAHAHA

/wipes tear from cheek

Simple. That's rich. I'll make a deal with you: how about we spend some time diving into *just one* aspect of the bill -- the new deduction bestowed upon owners of sole proprietorships, S corporations, and partnerships -- and then you decide for yourself just how *simple* this all will be?

MIAMI, FL - DECEMBER 22: A copy of a IRS 1040 tax form is seen at an H&R Block office on the day President Donald Trump signed the Republican tax cut bill in Washington, DC on December 22, 2017 in Miami, Florida. (Photo by Joe Raedle/Getty Images)

For those of you who are familiar with the format of a "Tax Geek Tuesday," you know what to expect. For those of you who are new to this space, what we do here is beat the heck out of a narrow area of the tax law. In great, painstaking, long-form level of detail. The hope, of course, is that we can accomplish what Congress can't: making the law more manageable for those who need to apply it. Let's get to it.

Entity Choice Under Current Law

If you want to operate a business, there are four main choices for doing so:

YOU MAY ALSO LIKE

1. C corporation
2. Sole proprietorship

3. S corporation
4. Partnership

Owners of a "C corporation" are subject to double taxation. When income is earned by the corporation, it is first taxed at the business level, at a top tax rate of 35% under current law. Then, when the corporation distributes the income to the shareholder, the shareholder pays tax on the dividend, at a top rate of 23.8%. Thus, from a federal tax perspective, owners of a C corporation pay a combined total rate on the income earned by the business of 50.47% (35% + (65% * 23.8%)).

Of course, you don't *have* to operate as a C corporation. Instead, you can operate a business as a sole proprietorship. Or as an S corporation. Or as a partnership. And what do these three business types have in common? They all offer a *single level of taxation*: when income is earned at the business level, it is generally not taxed at that level; rather, the income of the business is ultimately taxed only once, at the individual level.

A sole proprietor simply reports his or her income directly on Schedule C. In the case of an S corporation or a partnership (the so-called "flow-through entities), the income of the business is allocated among the owners and then included on their individual returns. In either scenario, the business owner pays tax on their share of the income at ordinary rates, which rise to as high as 40.8% under current law (39.6% top rate plus a 1.2% phase out of itemized deductions for high earners).

So to summarize, under current law, the top effective tax rates paid by C corporations versus other business types are:

- C corporations: 50.47%
- Sole proprietors/shareholders in an S corporation/partners in a partnership: 40.8%

Entity Choice Under the New Law

Regardless of how the plan may have been sold to the public, the foundation of the recently-enacted Tax Cuts and Jobs Act was the reduction in the C

corporation tax rate from 35% to 21%. But Congress couldn't do this in isolation, because such a a one-sided dramatic decrease would cause the business playing field to tilt, with sole proprietors and owners of flow-through entities losing much of their advantage over their corporate competitors. To wit, the effective combined rate on corporate owners would become 39.8% (21% + (79%*23.8%), while the top rate on ordinary individual income -- the rate applied to the income of sole proprietors and owners of flow-through entities, whether distributed or not -- would become 37%. Thus, the advantage of a single level of taxation would shrink from 10% to just 2.8%.

While many politicians tend to treat S corporations and partnerships as replacement terms for "small business," the reality is quite the opposite -- many of the largest businesses in America are operated as flow-through entities. As a result, there was tremendous pressure on the tax reform process to provide a break to owners of flow-through businesses so they weren't left out in the cold with the corporate tax cuts.

After the House and Senate initially approached the non-corporate tax break from very different angles, the final law found some common ground, resulting in the creation of Section 199A, a new provision of the Code. On its surface, Section 199A will allow owners of sole proprietorships, S corporations and partnerships -- and yes, even stand-alone rental properties reported on Schedule E -- to take a deduction of 20% against their income from the business. The result of such a provision is to reduce the effective top rate on these types of business income from 40.8% under current law to 29.6% under the new law (a new 37% top rate * a 20% deduction= 29.6%).

Courtesy of this new deduction, sole proprietors and owners of flow-through businesses retain their competitive rate advantage over C corporations: it is 10% under current law, and will be 10% under the new law (39.8% versus 29.6%).

New Section 199A, however, is anything but simple, and the 20% deduction is far from guaranteed to business owners. Claiming the new deduction requires navigating a tangle of limitations, terms of art, thresholds, and phase-ins and

phase-outs, with one critical definition thrown in the mix that could potentially jeopardize the whole damn thing.

It's not every day that we get handed a brand spankin' new section of the Code to wrap our arms around. But over the coming months, tax advisors and business owners will be tasked with doing just that. To speed up that process, I figured we should tackle new Section 199A in a Tax Geek Tuesday, and approach this uncharted territory in the best way we know how in this space: with a little bit of Q&A.

But I'm warning you: this is going to get *looong*. So for ease of future reference , I will break the Q&A into sections so that you can key in on those areas of need. Let's jump in.

Overview of the QBI Deduction

Q: A 20% deduction. How hard can this be? First things first: Who gets to take it? Is it available to all taxpayers? Like, corporations, individuals, partnerships, etc...?

A: That's actually FOUR questions, which tells me that you really don't understand how a Q&A works. But I get the gist of what you're asking. Section 199A(a) makes clear that the deduction is available to all taxpayers <u>other than a corporation.</u> This would certainly seem to indicate that if an S corporation or partnership has an interest in a lower-tier flow-through entity, the upper-tier S corporation or partnership will have to determine its deduction first, before determining the amount of its income to pass through to its ultimate shareholders or partners. In fact, Section 199A(f)(4)(B) provides that regulations are coming to tell us how to determine the deduction in the case of tiered entities, so yes, it appears that this is in fact the case.

It's also worth nothing that at the last minute, Congress decided to allow the 20% deduction to trusts and estates that own an interest in a flow-through business. Rules under (now-repealed) Section 199 will be provided to determine how a trust or estate determines it's share of the "W-2 wages" and "adjusted basis" limitations we're going to discuss in detail below.

Q: Got it. Sounds like trusts, estates, individuals, and even S corporations and partnerships are eligible for the 20% deduction. So now can you just tell me how the 20% deduction works?

A: Sure, I'll do just that....over the next 9,000 words. We've got a number of terms to define, thresholds to establish, and computations to work through. But let's start with this concept: starting January 1, 2018, anyone who generates "qualified business income" will be entitled to take a deduction of 20% of that qualified business income on their tax return. That is, until the limitations set in.

Let's start by showing how the formula works, and then we'll break it all down, piece by piece.

The deduction is equal to the SUM OF:

1. The LESSER OF:
   - the "combined qualified business income" of the taxpayer, or
   - 20% of the excess of taxable income over the sum of any net capital gain
2. PLUS the LESSER OF:
   - 20% of qualified cooperative dividends, or
   - taxable income less net capital gain.

Next, let's simplify things a touch. We're going to focus our attention on the first half of the provision,and leave the "cooperative dividends" section for another day. That leaves us with this:

The deduction is equal to the SUM OF:

1. The LESSER OF:
   - the "combined qualified business income" of the taxpayer, or
   - 20% of the excess of taxable income over the sum of any net capital gain
2. ~~PLUS the LESSER OF:~~

- ~~20% of qualified cooperative dividends, or~~
- ~~taxable income less net capital gain.~~

Next, let's look the the formula for the first bullet: the determination of the "combined qualified business income" of the taxpayer, and then we'll start tearing this provision to pieces:

Combined qualified business income is *actually not income*, but rather a deduction. It is:

1. THE SUM OF:
    - The LESSER OF:
        - 20% of of the taxpayer's "qualified business income" or
        - THE GREATER OF:
            - 50% of the W-2 wages with respect to the business, or
            - 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property.
2. PLUS:
    - 20% of qualified REIT dividends
    - qualified publicly traded partnership income.

Q: I don't understand a single thing you just wrote. Please tell me this gets better.

A: Have some patience, man. We just got started. Let's knock out the easy part first, by starting with the second half of the equation. Starting January 1, 2018, you will be able to take a 20% deduction against your 1) REIT dividends, and 2) qualified publicly traded partnership income.

A "qualified REIT dividend" is any dividend from a real estate investment trust that isn't either:

- a capital gain dividend, or
- a qualified dividend.

"Qualified publicly traded partnership income" is the net amount of any qualified business income (defined below) from a PTP, plus any gain on the sale of a PTP interest that is included in your ordinary income.

Q: That's helpful and all, but I"m really not here to read about REITs and PTPs. I want to understand the *first half of the equation,* where we can deduct 20% of our income from sole proprietorships, S corporations and partnerships. Can we get to that now?

A: Why, yes. Yes we can. Let's focus on this part for the rest of our time together. You will be entitled to deduct, beginning in 2018, the LESSER OF:

- 20% of of the taxpayer's "qualified business income" or
- THE GREATER OF:
    - 50% of the W-2 wages with respect to the business, or
    - 25% of the W-2 wages with respect to the business plus 2.5% of the unadjusted basis of all qualified property.

Let's take it line-by-line, starting with the definition of "qualified business income."

Qualified Business Income

Q: Give it to me. What is "qualified business income?"

A: Will do, but first things first: if I'm going to have to type out "qualified business income" over and over again, I'm going to lose interest in writing this article in a hurry. So let's agree to use "QBI" for short, shall we?

QBI is actually pretty simple; it's defined in Section 199A(c) as the "ordinary" income -- less ordinary deductions -- you earn from a sole-proprietorship, S corporation, or partnership. QBI does not include, however, any wages you earn as an employee. This means that, yes, beginning in 2018, you could have two people doing the exact same job -- one as an independent contractor and one as an employee -- with the self-employment income of the former being considered

QBI (and thus eligible for a 20% deduction), while the wages earned by the latter would not be eligible for the 20% deduction.

Q: So why would anyone want to be an employee going forward? Why won't everyone just rearrange their relationship with their employer to become an independent contractor?

A: Good question. First, keep in mind, you can't just call yourself whatever you like. The IRS employs factors to determine who is an employee and who is an independent contractor, so it can ensure it's collecting payroll taxes from the truly responsible party. The primary factor is the "degree of control" the service recipient has over the service provider; in other words, if you're required to work 9-5 every day down at the cracker factory, well, you're an employee, regardless of what you might call yourself.

And don't forget, there are advantages to being an employee. For starters, your employer is on the hook for half of the payroll taxes; become an independent contractor, and you're paying the full 15.3% of Social Security and Medicare tax up to the Social Security wage base ($128,400 in 2018), and then the full 2.9% on income above that threshold.

In addition, employees are eligible for a host of fringe benefits that can be provided by an employer. Tax-free health insurance and employee game rooms can be tough to walk away from. Before you go rushing off to become an independent contractor to save some loot, you've got to take those things into consideration.

Q: Fair enough. So let's go back to someone who owns an interest in an S corporation or a partnership. Do you just add up all of the lines on the Schedule K-1 and call the result "QBI" eligible for the deduction?

A: Absolutely not. QBI does NOT include the following items of investment income:

- short-term capital gain or loss;
- long-term capital gain or loss;

- dividend income; or
- interest income.

If you are a shareholder or a partner in a flow-through business, it is important to note that QBI also doesn't include any wages or guaranteed payments received from the business. To illustrate, if you own 30% of an S corporation that pays you $40,000 of wages and allocates you $80,000 of income, your QBI from the S corporation is ONLY the $80,000 of income; the $40,000 of wages do not count. And as we'll talk about (much) later, if you're a shareholder in an S corporation who provides significant services and you *don't* pay yourself any wages, the IRS may *treat you* as if you took wages anyway, in which case this "reasonable compensation" will not be treated as QBI.

QBI also doesn't include any income that's not "effectively connected with the conduct of a U.S. trade or business," but that's a rabbit hole I"m not willing to go down in this article.

So in summary, when starting the process for determining the amount of the deduction, begin by adding up all of the items of income and deduction on a Schedule K-1 OTHER THAN the aforementioned bullet points. That's your QBI.

Q: QBI has "business" smack dab in the middle of it. Does that mean that to be eligible for the deduction, the activity has to rise to the level of a "business?" I know that is kind of a nebulous standard in the tax law, and I thought a lot of rental properties don't really count as a "business" for many purposes. Does that mean that if I own a single rental property in my individual capacity that I report on Schedule E, and that property produces income, I won't be entitled to a 20% deduction against the income?

A: You know...you're smarter than you look. Here's what we know: clearly, the 20% deduction is intended to apply to rental income, because a last-minute change was made to the limitation on the deduction (as discussed in detail below) specifically to accommodate rental owners.

But here's what we *don't* know:

Section 199A(c)(c) requires only that QBI be earned in a "qualified trade or business," and that language is a bit scary. Why? Because as crazy as it sounds, the term "trade or business" is not well defined by the tax law. In fact, there are a number of different interpretations of what constitutes a trade or business for different purposes of the Code. The highest standard, however, is that of a "Section 162" trade or business, and in order for an activity to achieve this standard, the business must be regular, continuous, and substantial.

Over 100 years of judicial precedent has not provided much insight into whether a rental activity rises to the level of a "Section 162 trade or business." The determination depends on many factors: How long is the lease? Is the lease gross or triple net? What type of property is being leased?

As you've probably guessed, this new statutory language is rife with peril. When Section 199A(d) requires that QBI be earned in a "trade or business," does it mean a "Section 162 trade or business?" And even if it doesn't, because it doesn't specifically say it DOESN'T require a Section 162 trade or business, will the courts interpret "trade or business" in Section 199A to *mean* a Section 162 trade or business?

And if that's the case, will some rental activities NOT rise to the level of a Section 162 trade or business --as is currently the case under the law -- precluding owners of the activities from claiming the 20% deduction?

I wish I could provide a more concrete conclusion, but this is the tax law we live in. For example, the net investment income tax rules of Section 1411 also refer regularly to the concept of a "trade or business," but those regulations: 1. make clear that they are referring to a Section 162 trade or business, and 2. take great pains to allow rental owners to not HAVE to try and navigate a century's worth of muddled case history in order to determine whether their rental activities rise to the level of a Section 162 trade or business.

Section 199A, however, is in its infancy. We don't have regulations. We only have a blanket reference to a "trade or business," which without further clarity, I would think HAS to be interpreted to mean a Section 162 trade or business. Which

means, yes, certain rental activities may not meet this definition -- for example, a triple-net lease where the owner has almost no regular involvement -- thereby denying the owner a 20% deduction.

Q: Man, am I ever sorry that I asked. How about we agree to check back in on that one when the IRS offers some explanation, OK? Good. So once I've got QBI, I just multiply by 20%, right? If my share of ordinary income from an S corporation or partnership or sole proprietorship is $400,000, I just take $400,000 * 20% and deduct the resulting $80,000 on my tax return, right?

A: Not quite. You computed the $80,000 correctly, but your work has just begun. This is when the limitations kick in.

W-2 Limitations

Q: Wait a second...what are these limitations you speak of?

A: There are several. Some are quantitative, others are business based. Let's start with the numerical limitations. You are only entitled to deduct 20% of QBI up to a limit. That limit is the GREATER OF:

- 50% of *your allocable share* of the "W-2 wages" paid by the business, or
- 25% of *your allocable share* of the "W-2 pages" paid by the business PLUS 2.5% of *your allocable share* of the "unadjusted basis" immediately after acquisition of all "qualified property."

Q: Those limitations contain a lot of italics and terms in quotations. That means this is a giant pain in the ass, isn't it? Why does it have to be this way?

A: That's *two* questions, so you're still not getting the gist of this Q&A thing, but here goes:

First, yes, these limitations are a pain in the ass.

Second, there is a good reason why those limitations exist -- they are intended to prevent abuse of the new system. Consider the following illustration:

I'm a partner at a BIG, PRESTIGIOUS ACCOUNTING FIRM. I am also, however, an employee; one who collects a wage. Now, let's just assume that my annual wage is $800,000 (it is not). With the new rules coming down and offering a 20% deduction against my income, what would prevent me from quitting my current gig, and then having my firm engage the services of "Tony Nitti, Inc." a brand new S corporation I've set up specifically to facilitate my tax shenanigans? Now, my firm pays that same $800,000 to my S corporation, and my S corporation simply allows that income to flow through to be as QBI. I, in turn, take a 20% deduction against that income, reducing my income to $640,000. See the problem?

My role at my firm hasn't changed. I provided accounting services before, I provide accounting services now. But before, I was receiving wages taxed at ordinary rates as high as 37%. Now, by converting to an S corporation and foregoing wages in favor of QBI, I am now paying an *effective rate* on that income of only 29.6% (37% * 80%). That's not fair, is it? Compensation for services should be taxed at the same rate, whether it's coming to me as a salary or flow-through income.

To prevent these abuses, Congress enacted the W-2 limitations. Because, in my example, Tony Nitti, Inc. does not pay any wages, in both scenarios my limitation would be a big fat ZERO, meaning I get no deduction. Like so:

My deduction is the LESSER OF:

1. 20% of $800,000, or $160,000, or
2. The GREATER OF:
    1. 50% of W-2 wages, or $0, or
    2. 25% of W-2 wages, or $0, plus 2.5% of the unadjusted basis of the LLC's assets, or $0, for a total of $0..

Q: That actually does make some sense. Now that you've explained *why* the limitations exist, maybe you could explain how they work, particularly all of those terms you put in italics an quotes. For example, why did you italicize *your allocable share* over and over again?

A: Because it has been my experience that you only learn through repetition, that's why. And here's the thing: I've already heard people make the mistake of suggesting that a shareholder's or partner's limitation is based on 50% or 25% of the TOTAL W-2 wages paid by the business. That would only be the case if you happen to be the sole owner of the business. If you're not, then you have to first determine your *allocable share* of the W-2 wages.

Q: This is going to require some clarification. First, what exactly are W-2 wages? Do things like management fees or payments to independent contractors count? And then, how does a shareholder or partner determine his or her share of the partnership's W-2 wages?

A: Let's take those one by one. First, W-2 wages are exactly that: wages paid to an employee, INCLUDING any elective deferrals into a Section 401(k)-type vehicle or other deferred compensation. W-2 wages do NOT INCLUDE, however, things like payments to an independent contractor or management fees, because new Section 199A(b)(4)(C) clearly states that an amount is not a W-2 wage for these purposes unless it shows up on a payroll tax return.

Next, how we do determine a shareholder or partner's allocable share of W-2 wages? For a shareholder in an S corporation, it's a piece of cake: Section 1366 and Section 1377 require that all items of an S corporation be allocated pro-rata, on a per-share/per-day basis.

Things get a bit more tricky for a partner in a partnership, however, because partnerships can -- subject to the substantial economic effect rules of Section 704(b) -- "specially allocate" different items of income, gain, loss and deduction among its partners at different percentages. Thus, without concrete guidance, it would be unclear how a partner in this type of partnership determines their share of the W-2 wages.

Luckily, Section 199A(f)(1) tells us that a partner's share of a partnership's W-2 wages is, quite logically, determined in the same manner as his share of the partnership's wage deduction. Thus, if you are own a 20% capital stake in a partnership, but under the terms of the agreement you are allocated 80% of any

depreciation but only 30% of Schedule K-1, Line 1 ordinary income, then because you are being allocated 30% of the partnership's wage deduction via your Line 1 allocation, you are stuck being allocated only 30% of the partnership's W-2 wage expense for the purposes of these limitations.

Here's an example:

A is a 30% owner of ABC, LLC. The LLC produced total ordinary income of $3,000,000. The LLC paid total W-2 wages of $1,000,000, and the total adjusted basis of property held by ABC, LLC is $100,000. A is allocated 30% of all items of the partnership.

A is entitled to a deduction equal to the LESSER OF:

	Total	**A's Allocable Share (30%)**	**20% Deduction**
QBI	$3,000,000	$900,000	**$180,000**

And the GREATER OF:

	Total	**A's Allocable Share (30%)**	**50% Limitation**
W-2 Wages	$1,000,000	$300,000	**$150,000**

or the TOTAL OF:

	Total	**A's Allocable Share (30%)**	**25% Limitation**	**2.5% Limitation**	**Total**
W-2 Wages	$1,000,000	$300,000	$75,000		$75,000
Unadjusted basis of property	$100,000	$30,000		$750	$750
Total					**$75,750**

Thus, A is entitled to a deduction of $150,000, the lesser of:

- $180,000, or
- the greater of:
    - $150,000 or
    - $75,750.

Q: I noticed that the second limitation is based not only on W-2 wages, but also the partner's or shareholder's allocable share of 2.5% of the "unadjusted basis" of "qualified property." Explain.

A: That's more of an order than a question, but here goes. Let's start with "qualified property:" this is defined in Section 199A(b)(6)(A) as any tangible property, subject to depreciation (meaning inventory doesn't count), which is held by the business at the end of the year and is used -- at ANY point in the year -- in the production of QBI. But there's a catch: if you're going to count the basis towards your limitation, the "depreciable period" of the period could not have ended prior to the last day of the year for which you are trying to take the deduction.

The depreciable period -- and I've seen a LOT of confusion about this -- starts on the date the property is placed in service and ends on the LATER OF:

- 10 years, or
- the last day of the last full year in the asset's "regular" (not ADS) depreciation period.

To illustrate, assume S Co. purchases a piece of machinery on November 18, 2014. The machinery is used in the business, and is depreciated over 5 years. Even though the depreciable life of the asset is only 5 years, the owners of S Co. will be able to take the unadjusted basis of $10,000 into consideration for purposes of this second limitation for ten full years, from 2014-2023, because the qualifying period runs for the LONGER of the useful life (5 years) OR 10 years.

Consider the same facts, only the asset is a non-residential rental building that is depreciated over 39 years. The shareholders of S Co. will be able to take their share of the building's basis into consideration from 2014-2052, the last full year of the asset's depreciation schedule.

Four quick notes:

1. The basis taken into consideration is "unadjusted basis," meaning it is NOT reduced by any depreciation deductions. In fact, Section 199A(b)(2)(B)(ii) requires that you take into consideration the basis of the property "immediately after acquisition."
2. Any asset that was fully depreciated prior to 2018, unless it was placed in service *after* 2008, will not count towards basis.
3. Just as with W-2 wages, a shareholder or partner may only take into consideration for purposes of applying the limitation 2.5% *his or her allocable share* of the basis of the property. So if the total basis of S corporation property is $1,000,000 and you are a 20% shareholder, your basis limitation is $1,000,000 * 20% * 2.5% = $5,000.
4. If you are a partner in a partnership, you must allocate your share of asset basis in the same manner in which you are allocated depreciation expense from the partnership. So go back to my earlier example where a partnership allocated W-2 wages, and the partner owned 20% of the capital of a partnership, was allocated 80% of depreciation, and only 30% of Schedule K-1, Line 1, ordinary income or loss. While that partner would be allocated 30% of the W-2 wages paid by the partnership, he or she would be allocated 80% of the unadjusted basis of the property, because that is the percentage of depreciation he is allocated.

Q: That's a lot to take in. I've gotta' ask: I understand that the point of the "50% of W-2 wages" limitation was to prevent abuses where people forego salary for tax-favored flow-through income, but what's the point of this second limitation, the one that allows for the 20% deduction up to 25% of your share of W-2 wages PLUS 2.5% of your share of the unadjusted basis of the property?

A: That second limitation, my friend, is a prime example of how the sausage really gets made on Capitol Hill. Follow along:

Under the House bill, owners of S corporations and partnerships would have gotten a top 25% tax rate on their income. Unfortunately, the only way to get the 25% rate on ALL income was to be a "passive owner." Who are passive owners? Those that either:

1. Own rental real estate, or
2. Own non-rental businesses, and don't show up at work enough to "materially participate."

Thus, under the House bill, rental income would have been taxed at a top rate of 25%.

The Senate bill, however, took a different tack in trying to bestow a benefit on flow-through business owners. Rather than incentivize people to work *less* with the promise of a 25% tax rate, the Senate offered the deduction we're dealing with now, without differentiating between "passive" and "nonpassive" business owners. But in the initial Senate bill, the deduction would have simply been capped at 50% of each owner's share of the W-2 wages of the business; this "share of property basis" rule didn't exist.

And here's the problem with that: most large rental activities don't pay W-2 wages; instead, they tend to pay management fees to a management company. As a result, if the law hadn't been massaged, owners of large rental empires would have gotten no 20% deduction, meaning they would be paying 37% on their rental income as opposed to 25% under the House bill. And that wasn't going to fly.

So at the 11th hour, the conference committee added in this SECOND limitation, allowing for a 20% deduction up to the GREATER of:

1. 50% of W-2 wages, or
2. 25% of W-2 wages PLUS 2.5% of unadjusted basis of property.

This made ~~President Trump~~ ~~Senator Corker~~ rental owners very happy, because they were suddenly eligible for a deduction they otherwise wouldn't' have gotten. To illustrate:

A owns a 50% interest in a commercial rental properties through an LLC. A's share of the rental income of the LLC is $1,500,000. The LLC pays no W-2 wages, rather, it pays a management fee to an S corporation A controls. The management company pays W-2 wages, but also breaks even, passing out no net income to A. A's share of the total unadjusted basis of the commercial rental property is $10,000,000.

Until mere days before the final legislation was agreed upon, A would not have been entitled to a 20% deduction against his $1.500,000 of QBI, because he ran up against the 50% of W-2 wages limitation ($0). After the 11th hour change, however, A is now entitled to a deduction - assuming the rental activities rise to the level of a Section 162 business, as discussed above -- equal to the LESSER OF:

1. *20% of QBI of $1,500,000 ($300,000) or*
2. *2.5% of the unadjusted asset basis of $10,000,000 ($250,000).*

As a result, A grabs a $250,000 deduction that was very nearly nil.

Q: Couldn't all this be avoided if someone was permitted to elect to group all of their businesses or rental activities together? For example, say someone owns 20 rental properties through 20 different LLCs -- with none of them paying W-2 wages -- but also owns a property management company that pays SIGNIFICANT W-2 wages. Why can't they just elect to group the 20 rentals with the management company, pulling in the W-2 wages for purposes of the limitation?

A: It's an interesting point, but as of right now, it certainly appears that the 20% deduction will be required to be computed with respect to each separate business owned by the individual. For starters, Section 199A(b)(1)(A) requires that the deduction be computed for "each" qualified trade or business. And then there's the fact that the provision works in terms of "businesses," rather than "activities,"

so it appears that Section 199A would not be able to leverage off of the existing elective grouping regime of Section 469 that applies to "activities." So for now, at least, I think we can count on computing the deduction for each separate business.

Q: Understood. So the bill is good for big landlords, but what about the little guy? What if I earn $150,000 from my small business LLC, but the business pays, for example, only $10,000 of wages and has no significant property? Am I limited to taking only a $5,000 deduction, equal to the LESSER OF:

1. QBI of $150,000 * 20%, or $30,000, or
2. 50% of W-2 wages of $10,000, or $5,000

A: At first blush, that's exactly what would happen. But the new law isn't *just* about trying to help the Monte Burns of the world; it offers something to your average Joe Sixpack as well, in the form of an exception to the W-2 limit.

Exception to W-2 Wage Limitations

Q: Hey, I'm an average Joe Sixpack! Kindly explain how this exception would work.

A: Here goes: Section 199A(b)(3)(A) provides that if your TAXABLE INCOME for the year -- not adjusted gross income, not QBI, but TAXABLE INCOME -- is less than the "threshold amount" for the year, then you can simply ignore the two W-2-based limitations. The "threshold amounts" for 2018 are $315,000 if you are married, and $157,500 for all other taxpayers. These amounts will be indexed for inflation starting in 2019. And quite obviously, you determine taxable income WITHOUT factoring in any potential 20% deduction that we're discussing here.

Q: Interesting. I'm married; so if I my taxable income is less than $315,000 -- and it is -- I get to just take a deduction of 20% of QBI and call it a day?

A: That's it? Let's look at an example:

A has QBI of $200,000 from an S corporation that paid a total of $30,000 of W-2 wages and that has no qualified property. A's spouse has $50,000 of W-2 income, and A and B have interest income of $20,000. Thus, total taxable income is $270,000.

Normally, A's deduction would be limited to $15,000, the LESSER OF:

1. 20% of QBI of $200,000, or $40,000, or
2. The GREATER OF:
    1. 50% of W-2 wages of $30,000, or $15,000, or
    2. 25% of $30,000 plus 2.5% of $0, or $7,500.

While normally, A's deduction would be limited to $15,000, because A's taxable income is $270,000 -- which the last time I checked, is less than $315,000 -- the two limitations are disregarded, and A simply takes a deduction equal to 20% of QBI, or $40,000.

Phase-In of W-2 Limitations

Q: That's great news. But you know where I'm heading with this, don't you? Next year I expect my S corporation to make more money, pushing me over $315,000 in taxable income. Now what? Do I have to deal with the W-2 limitations again?

A: That, my friend, depends on *how much* you go over that $315,000 limit. This is where some math will be required.

Section 199A(b)(3)(B) provides that once your taxable income exceeds the threshold ($315,000 if married filing jointly; $157,500 for everyone else), you have to start factoring in the W-2 limitations, but *not all at once*. Rather, the W-2 limitations will be "phased in" over the next $100,000 of taxable income (if you're married filing jointly, or $50,000 for everyone else).

It's a multi-step process, but if you break it down piece by piece, it makes sense. Let's look at an example:

A and B are married. A earns $300,000 from an S corporation. A's share of the W-2 wages paid by the S corporation is $40,000. A's share of the unadjusted basis of qualified property held by the S corporation is $0. B earns wages from her job, so that taxable income for A and B in 2018 is $375,000.

How do we compute A's deduction?

Step 1: We start by asking the following question: what would A's deduction have been if his taxable income was less than $315,000? This is simple: at that level of income, the W-2 limits wouldn't apply, and A would take a deduction of 20% of QBI of $300,000 or $60,000.

Step 2: If A were given a $60,000 deduction because taxable income was less than $315,000, how big of a break would the law have been giving A compared to a situation where the W-2 limits applied in full? Stated another way, how does A's $60,000 deduction compare to what it WOULD have been if the W-2 limits did apply? If they applied, A's $60,000 deduction would have been limited to the GREATER OF:

- 50% of $40,000 or $20,000, or
- 25% of $40,000 plus 2.5% of $0, or $10,000.

So if the W-2 limitations HAD applied, A would have been entitled to a deduction of only $20,000. This means that if taxable income had been $315,000 or less, the new law would have given A a break in the form of $40,000 of additional deduction ($60,000 - $20,000). This is known as the "excess amount" in Section 199A(b)(3)(A)(ii), but I just want you to think of it as the "get out of jail free" card the new law gives you when your taxable income is below the thresholds.

Once your taxable income is *above* the threshold, however, you start to lose the benefit of that "get out of jail free" card, bit-by-bit, over the next $100,000 of taxable income ($50,000 if you're not married filing jointly). But by how much?

Step 3: Look at it this way: A gets a TOTAL RANGE of $100,000 of taxable income -- from $315,000 to $415,000 -- before his $40,000 "get out of jail free" card is totally eliminated. So it makes sense that the $40,000 benefit should be

reduced based on *how far you are into that $100,000 range*. It works like so: you start by determining by how much your taxable income exceeds your threshold:

Taxable income:	$375,000
Less: threshold:	($315,000)
Excess taxable income:	**$60,000**

A has gone $60,000 of the way through a $100,000 phase in range. Next, we put it into percentage terms. Here is how much of his "get out of jail free" card of $40,000 A should no longer be entitled to;

Excess taxable income:	$60,000
Divided by: Total phase-in range	$100,000
Percentage of benefit A should lose:	**60%**

Step 4: A started with a benefit of $40,000: a $60,000 deduction when a $20,000 W-2 limit would have otherwise applied. Now that A has burned through 60% of that phase-in range, he should lose 60% of that $40,000 benefit, or $24,000. Thus, as a final step, we reduce A's $60,000 deduction by the amount of the "get out of jail free" card that he has lost because his income is too high:

20% of QBI deduction:	$60,000
Reduction in $40,000 benefit because income is over $315,000:	($24,000)
Final deduction	**$36,000**

Thus, A is entitled to a deduction of only $36,000.

To prove the system works, look what happens if taxable income was $415,000, but everything else remained the same:

Step 1: Tentative deduction would still be $60,000

Step 2: Excess amount -- think, "get out of jail free" card -- would still be $40,000 ($60,000 - $20,000)

Step 3: Excess taxable income amount would now be $100,000 ($415,000 - $315,000) and thus the amount by which A has burned through the phase-in range would be 100% ($100,000/$100,000).

Step 4: As a result, A must reduce his $40,000 "get out of jail free" card by 100%, or $40,000. This leaves him with a deduction of $20,000 ($60,000 - $40,000 reduction).

Because A is left with a deduction of $20,000, the system works. Remember, $20,000 is the amount A would have been entitled to deduct if the W-2 limit had applied in full, which it should once taxable income hits $415,000. My work is done here.

Q: That *is* pretty neat, but we're not done yet. Now that I understand these W-2 limits, I'm still a bit confused. What would prevent Mr. Big FANCYPANTS LAWYER from quitting his job as an employee, and having his $700,000 salary be paid into an S corporation he sets up. The S corporation can then pay him $200,000 in W-2 wages, and let the remaining $500,000 flow-through as income eligible for the 20% deduction. He wouldn't run into a W-2 limit problem, because 20% of $500,000 ($100,000) is not greater than 50% of W-2 wages ($100,000). Hasn't this lawyer just converted $500,000 of W-2 income into $400,000 of QBI?

A: That's an exceedingly long question, but at least it shows that you're following along. Yes, at this point in the game, it looks like the lawyer can do that, but you have to understand something: NOT ALL BUSINESSES ARE ELIGIBLE FOR THE 20% DEDUCTION.

Treatment of "Specified Service Trades or Businesses"

Q: Wait...certain *businesses* can't take the deduction? Which ones?

A: This, my friend, is likely to become one of the more prevalent --and impactful -- questions in all of the tax law over the coming years. It starts like so: Section 199A(d)(1) makes clear that there are two "trades or businesses" that are not eligible for the 20% of QBI deduction:

1. Anyone who is in the business of being an employee (yes, being an employee is considered being in a business), and
2. Any *"specified service trade or business."*

Then, Section 199A(d)(2)(A) defines a "specified trade or business" in reference to Section 1202(e)(3)(A), which includes the following:

> "any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees."

Q: OK, I recognize most of those businesses. But now I must ask: why? What's the point of handpicking these businesses and saying, "NO DEDUCTION FOR YOU."

A: While the businesses selected may seem arbitrary at first blush, they actually makes sense. In each business, the people who make up the business -- whether they be lawyers or accountants or doctors -- only offer clients or customers one thing: services. They don't sell goods. They don't build stuff. They simply provide services.

And when viewed through that lens, it makes sense to eliminate these businesses from qualification for the 20% deduction. After all, when someone provides services, the payment they receive in return should be taxed as wages, or at least at the same rates as wages (i.e., ordinary income). So if you have an entire *business* that does nothing but provide services, it should follow that all of

the income generated by the business should be taxed the same way wages would be taxed -- as ordinary income.

Go back to the previous example about the lawyer. Lawyers provide services; that's it; that's all. So if you allow a lawyer to form an LLC to collect what was once wages, and then get a 20% deduction against that income, you have allowed a service provider to convert what would have been wages taxed at a top rate of 37% into tax-favored QBI taxed at an effective rate of 29.6%. And that ain't right.

Looking at it from the opposite direction, if you own an S corporation or partnership that *isn't* engaged in a "specified service trade or business" -- like a fast-food restaurant -- then it follows that some of the income generated by the business isn't necessarily attributable to the *skill and services* of the employees and owners. Some of the revenue, rather, is generated from the highly efficient deep fryer. The alluring ambiance. The primal pleasure of consuming nearly a pound of fried beef in one sitting. So Congress can justify giving a special deduction -- and therefore a lower effective tax rate -- to these types of businesses because the argument can be made that some of the income allocated to the owners is not a return on the efforts of those owners and their employees, but rather on the capital the owners invested in the business to buy the equipment that in turn created part of the revenue.

Q: You know...that *does* kind of make sense. So the owners of the following businesses get no deduction: accounting, law, health, archit...

A: Stop right there. Section 199A modifies the definition of "specified service businesses" found in Section 1202 in a couple of important ways:

- It removes architects and engineers from the businesses barred from taking the 20% deduction. Why? These types of businesses were eligible, in limited circumstances, for a Section 199 "manufacturer's deduction" before that provision was eliminated as part of the new law. This is because, unlike accountants and lawyers, architects and engineers are an integral part of actually, you know...*building something*. As an accountant, I create

nothing, unless you could a 10,000 word missive on just *one provision* of the new tax law "something."

- The definition of disqualified businesses for purposes of Section 199A ignores Sections 1202(e)(3)(B), which adds additional types of businesses to those in Section 1202(e)(3)(A) as the types of businesses barred from using Section 1202 (which we'll get into in a moment). Those types of businesses listed in (e)(3)(B), which are disqualified under Section 1202 but NOT under Section 199A, include:
  - banking,
  - insurance,
  - financing,
  - leasing,
  - investing,
  - farming,
  - any business giving rise to depletion,
  - any business of operating a hotel, motel, (Holiday Iiiin), or restaurant.
- So at this point, those bulleted businesses ARE eligible for the 20% of QBI deduction. But then Section 199A(d)(2)(B) adds MORE businesses that don't qualify for the 20% deduction, namely, the business of investing and investing management, trading, or dealing in securities, partnership interests, or commodities. So now those businesses are back OUT of the Section 199A deduction.

Q: So if I'm following you correctly, whether a business is a "specified service business" is going to be critical under the new law; after all, if you are a specified service business, you get no deduction. If you're not, 20% off the top, right?

A: Yes, it's going to be VERY important. And here's the problem: despite the fact that Section 1202 was enacted in 1993, we have almost no available guidance from regulations, administrative rulings, or judicial precedent to help us determine what is and isn't a "service business" for purposes of Section 1202. Here's why:

Section 1202 gives the holder of "qualified small business stock" an exclusion from gain upon the sale of such stock that has been held for longer than five years. Part of the requirements for qualifying as QSB stock is that the corporation can't be engaged in one of the service businesses described above in Sections 1202(e)(3)(A) and (e)(3)(B).

Thus, one would think that with a 24-year history, the "service business" requirement of Section 1202 would be well-worn territory. But the reality is, taxpayers didn't care about or use Section 1202 until 2010. Why? For all QSB stock issued up to 2010, the exclusion from gain was only 50%, with the other 50% of gain taxed at 28%. This meant that sellers of QSB stock paid tax on the gain at an effective rate of 14%, and since most taxpayers pay tax on long-term capital gains at 15%, prior versions of Section 1202 only conferred a 1% benefit on taxpayers. Hence, the provision wasn't used a whole heck of a lot.

Starting with stock issued in September of 2010, however, the exclusion of gain from QSB stock held more than 5 years increased to 100%. While this change makes the exclusion significantly more valuable, its relatively recent addition to the Code means that the new, improved version of Section 1202 didn't start to reap dividends to shareholders until September 2015. This, in turn, means that we're *just about* at the point where Section 1202 arguments should start showing up in the Tax Court. As a result, we may start seeing some debate about what constitutes a service business for purposes of Section 1202(e)(3)(A) -- and now, Section 199A -- and quite frankly, we're going to need it.

The definitional debate has already gone crazy on the interwebs. For example: what do we do about an insurance business? Section 1202(e)(3)(B) included "insurance" among its disqualified businesses, but then Section 199A chose to link its definition of disqualified businesses only to Section 1202(e)(3)(A). Does this mean that insurance businesses are good to go under Section 199A?

Maybe, but wait...what type of "insurance" business is Section 1202 referring to? The business of *selling* insurance, or the business of actually *creating* insurance package? I honestly have no idea, and I doubt many others do either. But we're going to have to find out.

Q: That does sound like a bit of a problem. But for now, we should just assume that lawyers, doctors, accountants, etc... are out and can't get the deduction?

A: You should know better than that. Nothing is that simple. Listen up: even if you're in one of those prohibited "specified service businesses," you can claim the 20% deduction, *provided your taxable income is less than $315,000 (if you're married filing jointly, $157,500 for all other taxpayers)*.

Q: Those are the same thresholds as the ones we used for the W-2 limitations, right? So does that mean the phase-in rule is the same, where the ability to take the deduction for owners of "specified service businesses" is eliminated over a span of $100,000 of taxable income for married taxpayers?

A: You got it. But before we get into the phase-in rule for service businesses, let's just look at a couple of simple examples:

Example 1: A is partner in a law firm. A is married, and has taxable income of $800,000. A's share of the income of the law firm is $700,000, his share of the W-2 wages of the law firm is $100,000, and his share of the unadjusted basis of the assets of the business is $20,000. A is entitled to no deduction, because a law firm is a specified service business and A's taxable income exceeds $415,000, meaning he is completely phased-out of any possible deduction.

Example 2: Same as in Example 1, except A's taxable income is $300,000, his share of the income of the law firm LLC is $200,000, his share of the W-2 wages is $60,000, and his share of the assets of the LLC is $40,000. Even though A is a lawyer, he may take the deduction because his taxable income is below $315,000, the start of the phase-in threshold. As a result, A can take a deduction of 20% of $200,000, or $40,000.

Q: But wait...in Example 2, 50% of A's share of the W-2 wages of the law firm is only $30,000. Shouldn't his $40,000 deduction be limited to $30,000 under the first W-2 limitation?

A: Great catch, but as is usually the case, you're wrong. Remember, when taxable income is less than $315,000, *the W-2 limitations don't apply*. As a result, A is

entitled to the full $40,000 deduction.

Phase-Out of Deduction for Specified Service Businesses

Q: I follow those examples, but I'm almost afraid to ask: what happens to a lawyer, doctor, accountant, etc...if taxable income starts to exceed $315,000 for a married couple?

A: Yeah, I wish we could skip that whole thing, but this is where the magic happens. Just like with the W-2 limitation, the "get out of jail free" card Congress gives owners of specified service businesses -- the ability to take the 20% deduction -- starts to disappear once taxable income exceeds $315,000 for married taxpayers ($157,500 for everyone else), and is completely gone by the time taxable income hits $415,000 ($207,500).

To illustrate, assume the following example. It should seem familiar, as it was the same fact pattern we used before for a non-specified service business.

A and B are married. A earns $300,000 from an S corporation. A's share of the W-2 wages paid by the S corporation is $40,000. A's share of the unadjusted basis of qualified property held by the S corporation is $0. B earns wages from her job, so that taxable income for A and B in 2018 is $375,000. This time, A is a lawyer, so his $300,000 of income from his S corporation is from a disqualified "specified service business."

Step 1: We start by determining what A's deduction would have been if his taxable income had been less than $315,000. This is determined by taking the LESSER OF:

1. 20% of QBI of $300,000, or $60,000, or
2. the GREATER OF:
    - 50% of W-2 wages of $40,000, or $20,000, or
    - 25% of $W-2 wages of $40,000 + 2.5% of basis of property of $0, or $10,000.

But wait...don't forget that if taxable income is less than $315,000, not only does A get to take the deduction despite being a lawyer, in addition, the W-2 limits don't apply at that level of income. Thus, while A would generally be entitled to a deduction of only $20,000 in this case, had taxable income been $315,000 or less, he would have gotten the full $60,000.

Because taxable income is greater than $315,000, however, we must now determine how much of that $60,000 deduction A has to give up.

Step 2: We begin by figuring out, once again, how much of his $100,000 "phase-in" threshold A has exceeded, although now it's probably more accurately described as a "phase-out" threshold. The math looks the same as before:

Taxable income:	$375,000
Less: threshold:	($315,000)
Excess taxable income:	**$60,000**

A has gone $60,000 of the way through a $100,000 phase-in range. Putting this into percentage terms, here is how much of the benefit A should lose:

Excess taxable income:	$60,000
Divided by: Total phase-in range	$100,000
Percentage:	**60%**

Step 3: Thus, A should lose 60% of his benefit. Section 199A(d)(3)(B) accomplishes this by requiring A to compute his "applicable percentage," which is simply 100% - the percentage from Step 2:

Starting Percentage	100%
Less: percentage from Step 2:	(60%)

Applicable percentage	**40%**

Now that we've determined the applicable percentage, A is only entitled to take into consideration, in computing his deduction, the applicable percentage of his allocable share of QBI, W-2 wages, and basis of assets. Like so:

	Allocable Share	**Applicable % (40%)**
QBI	$300,000	$120,000
W-2 Wages	$40,000	$16,000
Basis of Assets	$0	$0

Next, we determine A's deduction under the general rules using these new numbers:

Step 4: A's deduction is equal to the LESSER OF:

1. 20% of QBI of $120,000, or $24,000,
2. or the GREATER OF:
    - 50% of W-2 wages of $16,000, or $8,000, or
    - 25% of W-2 wages of $16,000 , or $4,000, plus 2.5% of basis, or $0, for a total of $4,000.

Thus, A's tentative deduction is $8,000. BUT DON'T FORGET...the W-2 limit doesn't apply if taxable income is less than $315,000, and is phased in as income goes from $315,000 to $415,000. So believe it or not, we now have to jump through those hoops as well. On to Step 5, which starts by figuring out the "get out of jail free" card the new law would have given A if the W-2 limit didn't apply at all:

Step 5: The "get out of jail free" card is the excess of the deduction allowed to A in the absence of a W-2 limit over what the deduction would be if the limit applied in full force. Thus, it is $16,000 ($24,000-$8,000).

Next, we have to reduce that excess benefit based on how much A's taxable income exceeds $315,000.

Step 6: A gets a TOTAL RANGE of $100,000 of taxable income -- from $315,000 to $415,000 -- before his $16,000 "get out of jail free" card is totally eliminated. So it makes sense that the $16,000 benefit should be reduced based on *how far A is into that $100,000 range*.

Taxable income:	$375,000
Less: threshold:	($315,000)
Excess taxable income:	**$60,000**

A has gone $60,000 of the way through a $100,000 phase-in range. Putting this into percentage terms, here is how much of his "get out of jail free" card of $16,000 A should no longer be entitled to;

Excess taxable income:	$60,000
Divided by: Total phase-in range	$100,000
Percentage of benefit A should lose:	**60%**

Step 7: A started with a benefit of $16,000: a $24,000 deduction when a $8,000 W-2 limit would have otherwise applied. Now that A has burned through 60% of that phase-in range, he should lose 60% of that $16,000 benefit, or $9,600. Thus, as a final step, we reduce A's $24,000 deduction by the amount of the "get out of jail free" card that he has lost because his income is too high:

20% of QBI deduction:	$24,000
Reduction in $24,000 benefit because income is over $315,000:	($9,600)
Final deduction	**$14,400**

A's final deduction is $14,400. Once again, we know the system works, because if A's taxable income had been $415,000 or greater, his "applicable percentage" in Steps 2 and 3 would have been $0.

Taxable income:	$415,000
Less: threshold:	($315,000)
Excess taxable income:	**$100,000**

Then, the percentages:

Excess taxable income:	$100,000
Divided by: Total phase-in range	$100,000
Percentage:	**100%**

Starting Percentage	100%
Less: percentage from Step 2:	(100%)
Applicable percentage	**0%**

Finally, we take his applicable percentage of QBI and wages:

	Allocable Share	**Applicable % (40%)**
QBI	$300,000	$0
W-2 Wages	$40,000	$0
Basis of Assets	$0	$0

Since QBI and W-2 wages are reduced to zero, A gets no deduction, which he shouldn't once taxable income exceeds $415,000.

Q: Let's put this all together: You said the W-2 limits are in place so that people can't convert wages into tax-favored QBI. Then, you said that certain service businesses can't use the deduction at all. But then you said that the W-2 limits don't apply AND service businesses can use the deduction when taxable income is less than $315,000 for married taxpayers ($157,500) for all others. So what is stopping an accountant who gets $300,000 in wages from setting up an S corporation as you mentioned, having the $300,000 paid to the S corporation, paying NO wages out of the S corporation, and converting $300,000 of wage income into $240,000 of QBI?

A: First of all, congratulations on your applied knowledge. Impressive. But this is where the inconsistencies of the current law take hold. Theoretically, you *could* form an S corporation to do exactly what you just proposed, but there's one issue: S corporations are required to pay wages to any shareholder who is also an officer and provides "significant services" to the corporation. This "reasonable compensation" standard has been around for decades, because Revenue Ruling 59-221 provides that S corporation flow-through income is NOT subject to self-employment tax. As a result, ever since 1959, S corporation shareholders have had tremendous motivation to forego compensation in exchange for distributions in order to save on payroll taxes. The IRS, of course, wants to collect its share of payroll taxes, so it will frequently attack S corporation shareholders who withdraw no wages but take substantial distributions, forcing them to reclassify a portion of distributions to salary and pay the corresponding payroll taxes.

And as you may have noticed, way up above, we said that QBI does NOT include "reasonable compensation" paid to the shareholder. This means that even if an accountant DID set up an S corporation to take $300,000 of what were once wages and pass them through as QBI, even though according to Section 199A this would fly, the IRS could come in and say that some or all of the $300,000 is reasonable compensation, which is NOT treated as QBI. So, for example, if the IRS

reclassified $120,000 of the S corporation's income as reasonable compensation, only $180,000 of the S corporation's income would be eligible for the QBI treatment.

The same risk, however, does not exist with partnerships, because: 1. partnerships cannot pay wages to partners, only guaranteed payments, and 2. There is generally no "reasonable compensation" standard for partnerships, because partnership income is usually subject to self-employment tax. Therefore, a partner has nothing to gain by foregoing guaranteed payments in exchange for an increased share of flow-through income, because there would be no payroll tax savings.

Thus, it follows, an accountant or attorney COULD set up an LLC, rather than an S corporation, and convert up to $315,000 of wages into QBI. Of course, over time, the IRS could seek to establish the same type of reasonable compensation standard for partnerships that currently exists for S corporations, minimizing or closing this potential loophole.

Q: So if I'm following you, setting up an LLC could be a loophole. Until it's not. Got it. Anything else I should know?

A: A few things, yes. Let's take a look.

Ancillary Issues

Q: We figured out how to compute the 20% deduction. But where do we actually take it?

A: This is an interesting one: the deduction will NOT be on Page 1 -- as a deduction in computing adjusted gross income -- nor will it be an "itemized deduction" deducted on Schedule A and only available to those who itemize. Rather, it looks like the deduction will take its place on the top of Page 2 as a deduction available to all taxpayers, similar to the standard deduction or personal exemptions.

Q: Does it reduce a taxpayer's self employment income?

A: I don't see how it could, since, as discussed immediately above, it will show up as a deduction on Page 2 of the Form 1040.

Q: What about the individual alternative minimum tax? Can you take the 20% of QBI deduction against AMT taxable income?

A: Based on my reading, you certainly can. Section 199A(f)(2) provdes that when computing alternative minimum taxable income, you determine qualified business income" without taking into consideration any AMT adjustments or preferences as provided in Sections 55 -59. To me, this simply means that QBI is the same for AMT as it is for regular tax, and thus, the 20% deduction is computed the same way. And since the determination of alternative minimum taxable income starts with taxable income, and the amended Code provides no specific add-back to AMTI for the 20% deduction, I say we're good to go.

Q: Let's say my sole proprietorship, S corporation, or partnership generates a *loss*. There would obviously be no 20% deduction -- since there's no income -- but what happens to that loss in the next year if there *is* QBI in the following year?

A: It appears that when you have a loss in Year 1 from a QBI-type activity, *even if that loss is used in computing taxable income in Year 1* -- when you get to Year 2, that QBI loss "carries over" and reduces Year 2 QBI *solely for purposes of computing the 20% of QBI deduction*. To illustrate:

A owns 50% of an S corporation. In 2018, the S corporation allocates a $100,000 loss to A. Because A materially participates in the S corporation, he is able to use the $100,000 loss in full to offset his wife's $200,000 of wages.

*In 2019, the S corporation allocates $200,000 of income to A. While A would generally start the process of determining his Section 199A deduction by taking 20% of $200,000, Section 199A(b)(6) provides that in determining A's QBI deduction for 2019, the $200,000 of income must be reduced by the $100,000 of loss from 2018. Thus, while A will still include the full $200,000 of S corporation income in his taxable income in 2019, his deduction will be limited to $20,000 (20% * $100,000) rather than $40,000 (20% * $200,000).*

Q: What if I have a Section 199A deduction in a year I have a net operating loss? Does the deduction add to my NOL?

A: Nope. Section 172(d) has been amended to provide that a net operating loss does NOT include the Section 199A deduction.

Q: That *is* interesting. Any other weird rules/limitations I should know about?

A: Yes. Let's come full circle to where we started and remember that it's not just enough to determine the deduction subject to the rules described above. Once you've navigated the specified service business rules, the W-2 and adjusted basis limitations, and the phase-ins and phase-outs, you have to remember that there is also an overall limitation based on taxable income.

About 10,000 words, ago, we laid out the first rule of Section 199A. Under Section 199A(1)(a), once you've determined the 20% deduction, you've got to deal with an overall limitation, where the deduction is equal to the LESSER OF:

- the combined "qualified business income" of the taxpayer, or
- 20% of the excess of taxable income minus the sum of any net capital gain

Remember, the combined qualified business income is the 20% deduction we determined above, PLUS qualified REIT dividends PLUS income from a publicly traded partnership. But we can ignore those latter two items for our purposes; I'd prefer to look at the second element of the limitation, where the deduction is limited to 20% of the excess of taxable income over net capital gain. When will this limitation matter? Consider the following example:

A has $100,000 of QBI. In addition, A has $200,000 of long-term capital gains, $20,000 of wages, and $50,000 of itemized deductions, for taxable income of $270,000. A's deduction is limited to the lesser of:

- 20% of QBI of $100,000, or $20,000, or
- 20% of ($270,000-$200,000), or $14,000.

Thus, A's deduction is limited to $14,000. Why? Because while A has taxable income of $270,000 -- including $100,000 of QBI -- $200,000 of that taxable

income will be taxed at favorable long-term capital gains rates. Thus, there is only $70,000 to be taxed at ordinary rates, meaning the 20% deduction should be limited to $70,000 of income; after all, you don't want to give a 20% deduction against income that's already taxed at a top rate of 23.8%!

Q: You've outdone yourself today. But since all of this law is brand new, there's really no way for me to check your math. How do I know you're right?

A: That's kind of the point. With no regulations, no form instructions, and most unfortunate of all, no one who helped craft the bill or vote on the thing who actually *understands what it says,* it may be a while before clarify is forthcoming. So for now, I"m all ya' got.

I am a Tax Partner in WithumSmith+Brown's National Tax Service Group. I am a CPA licensed in Colorado and New Jersey, and hold a Masters in Taxation from the University of Denver. My specialty is corporate and partnership taxation, with an emphasis on complex mergers and acq... MORE

Follow along on Twitter, @nittiaj.

Click on allow to subscribe to notifications

Stay updated with the latest happenings on our site

Powered by iZooto Allow Later

US Republican tax law's pass-through deduction open to gaming: Experts

By: Reuters | Published: April 25, 2018 4:41 AM

Tax professionals and business groups have said the law is unclear.

Click on allow to subscribe to notifications
Stay updated with the latest happenings on our site
Powered by
Allow Later

The Republican ta[...]nded to help small businesses, was "il[...]ny, experts told the US Senate Finance Committee on Tuesday at a hearing on the law's early impacts.

The tax overhaul, which sailed through the Republican-controlled US Congress in December without Democratic support, created a new 20 percent deduction for income that owners of so-called pass-through businesses report on their individual tax returns.

Republicans said the deduction would provide tax relief for the type of smaller, family-run businesses that would not benefit from the reduction in the top corporate rate to 21 percent from 35 percent. In a move to further limit its use by high-income workers, they exempted those in "services" professions such as law and accounting from qualifying.

But tax professionals and business groups have said the law is unclear. They have asked the Internal Revenue Service to issue guidance on which types of business income are eligible for the pass-through deduction.
Douglas Holtz-Eakin, an economist who heads the American Action Forum, a conservative think tank, told senators on Tuesday that even once the IRS weighs in later this year, the pass-through provision drew "haphazard lines in the sand" that "are the exact kind of lines that tax lawyers and experts will attempt to try to game."

Democrats have complained that the tax code rewrite favors businesses and the wealthy, and that working-class taxpayers will see little benefit. The pass-through provision is just one reason why Republicans should work with them to rewrite portions of the hastily passed law, Democratic senators said on Tuesday.

A new analysis from the nonpartisan Joint Committee on Taxation released ahead of the hearing was used by Democrats to bolster their argument.

The JCT estimated that in 2018, more than half of the pass-through benefit will go to taxpayers making $500,000 or more, with $17.8 billion going to those reporting more than $1 million in income, and another $3.6 million going to taxpayers earning $500,000 to $1 million.

Click on allow to subscribe to notifications
Stay updated with the latest happenings on our site
Powered by iZooto
Allow
Later

and another $5.3 r [...] the JCT said.

David Kamin, a Ne[...]ittee the pass-through deduction was "ill thought through" and "one of the worst provisions that's been added to the tax code in the last several decades."

But David Cranston, president of Cranston Material Handling Equipment Corp in McKees Rocks, Pennsylvania, estimated the pass-through deduction will save him up to $10,000 annually. He said it has allowed him to expand into a new product line.

It "put me in a better financial position to self-fund this new product," Cranston told the committee.

Get live Stock Prices from BSE and NSE and latest NAV, portfolio of Mutual Funds, calculate your tax by Income Tax Calculator, know market's Top Gainers, Top Losers & Best Equity Funds. Like us on Facebook and follow us on Twitter.

Black Friday Sale | Up to 65% Off Select Product Sitewide | Appliances Connection
Appliances Connection | Sponsored

25 Hysterical Construction Mistakes, #3 Is Hilarious
Compose Simple | Sponsored

Actress Saira Banu, wife of Dilip Kumar, seeks PM Modi's help; Know whyActress Saira Banu, wife of Dilip Kumar, seeks PM Modi's help; Know why
In December, 2017, Banu had claimed that the builder was threatening and harassing her and her husband, Dilip Kumar, over a piece of land in Pali Hill, Bandra (West).
FinancialExpress

Old Mahindra Marshal used as roof for a house in Ladakh leaves Anand Mahindra

Politics

No One's Sure Who Qualifies for This $415 Billion U.S. Tax Deduction

By Ben Steverman
March 12, 2018, 4:00 AM EDT

- IRS guidance on pass-through break could miss June deadline
- Veterinarians, massage therapists among those in cross hairs

A woman walks out of the Internal Revenue Service (IRS) headquarters building in Washington. *Photographer: Andrew Harrer/Bloomberg*

Congressional Republicans created a juicy new tax break for business owners when they rewrote the U.S. tax code late last year. Three months later, hundreds of thousands of U.S. employers still don't know if they qualify.

The Internal Revenue Service has said it will provide guidance detailing exactly who's allowed to take the so-called pass-through deduction. With billions of dollars at stake, business groups are lobbying for the agency to open the doors to the deduction as widely as possible.

Some high-earning proprietors -- such as construction contractors, massage therapists, executive headhunters and restaurateurs -- could be excluded if the IRS writes the rules too narrowly. The agency plans on issuing guidelines by June. But that deadline has been questioned by a former top Treasury official given the vagueness of the legislation and complexity of the task.

The 20 percent deduction is aimed at pass-through businesses, whose income is reported on their owners' personal tax returns. Congress tried to bar wealthy owners of service businesses from getting the break -- leaving out many doctors, lawyers and hedge fund managers unless they can find a loophole.

By trying to exclude those service businesses, though, Congress ended up asking the IRS to settle some rather absurd philosophical and semantic conundrums. What, for example, is an entertainer? Are humans the only species who get "health care," or do animals count too? How do you tell a broker from a salesperson, or an interior designer from an interior architect?

"We want to make sure that real businesses that are generating real economic activity get to take advantage of the deduction," said Chris Smith, executive director of Parity for Main Street Employers, a new group formed to lobby the IRS and Congress on behalf of pass-through businesses. "You should be able to organize your business for business reasons, and not have to restructure because of quirks in the tax code."

Here's the Trump Tax Loophole Your Accountant Can Blow Open

The challenge ahead for the IRS, which has been struggling with limited resources and faces a possible restructuring by Congress, is monumental. The agency must write coherent rules, and then be ready to make judgments on every business in the U.S. And the IRS can be challenged by taxpayers and second-guessed by courts, a process that could take years to play out.

A spokesman for the IRS didn't respond to a request for comment.

A lax interpretation of the pass-through rules would please businesses, but also could blow a hole in the U.S. Treasury. The nonpartisan Joint Committee on Taxation estimates that the pass-through deduction, which expires at the end of 2025, would cost about $415 billion over the coming decade. The tax break could be even more expensive if IRS regulations can't keep gamesmanship to a minimum.

Tax professionals are pleading with the IRS for details as soon as possible. The American Institute of CPAs asked for "immediate guidance" on the pass-through provision in a Feb. 21 letter

to the IRS. "Taxpayers and practitioners need clarity" to comply with their tax obligations and "make informed decisions regarding cash-flow, entity structure, and other tax planning issues," the AICPA said.

This much is clear: If you're a pass-through business owner who earns less than $157,500, or $315,000 for a married couple, you get full access to the deduction no matter what you do.

Above those thresholds, the deduction fades for certain "service" industries specified in the law including health, law, consulting, athletics, financial and brokerage services. (The break is completely eliminated for service business owners earning more than $207,500 if they're single, or $415,000 if they're married.)

Tattoo Artists

Each term raises questions. Veterinarians, for example, can't know for sure whether their work qualifies as "health care" in the tax code. Even if it does, vets do lots of things that probably don't fall in that service category, from boarding pets to selling drugs and dog food.

The American Veterinary Medical Association "is working with the IRS and Congress to explore all options to improve tax provisions impacting veterinary medicine," said Kent McClure, the AVMA's chief government relations officer.

"Consulting" and "brokerage" are two catch-all terms that could ensnare many unsuspecting businesses. The function of a consultant is to give advice: So how does the IRS legally distinguish a management consultant, who advises a CEO on restructuring, from a tattoo artist who tells you what might look good on your shoulder?

"What does it mean to be a broker? It could be very narrow or it could be big," said Troy Lewis, a CPA and professor at Brigham Young University who chairs an AICPA task force on the topic. "There are a lot of people who are in the information business, who get paid to put two people together."

Reputation or Skill

Just as puzzling to tax advisers is another phrase in the law. Any firms where the "principal asset" is the "reputation or skill of one or more employees or owners" are also excluded by the law as service businesses.

This makes many businesses nervous. Contractors, for example, can live and die based on their reputations.

For "a lot of the big names in construction, it's their name that is the company," said Matt Turkstra of the Associated General Contractors of America, which represents more than 27,000 firms in the construction business. The law's wording on reputation and skill is "broad enough that it could be concerning if it was taken out of the context," he said.

What does the law mean, Lewis asks, for businesses that advertise their skill or reputation? If you brag you're the "best baker in the tri-city area," will the IRS use those claims against you? Will restaurants owned by celebrity chefs get taxed differently from other restaurants?

'One Big Problem'

Tax professionals are poring over old IRS regulations and rulings looking for clues. Lobbyists aren't consultants, according to a 1988 IRS memo. Another obscure regulation tries to distinguish brokers, consultants and salespeople based on how they get paid.

The final version of the bill took "engineers and architects" off the list of service professionals. Professions like interior decorators and designers could be caught up in disputes over whether they're more like architects or consultants.

"You can see how fine the line is," said Megan Lisa Jones, a tax attorney at Clark & Trevithick in Los Angeles. "The IRS can decide one thing and the court can decide another." Individual IRS examiners could end up disagreeing with each other, she said.

Even some defenders of the tax overhaul find fault with the pass-through provision.

University of Michigan law professor Reuven Avi-Yonah said in a recent paper he supports most of the tax law's provisions such as the doubling of the standard deduction, reduced corporate tax rate and international changes.

But he cited the pass-through deduction as the "one big problem" that creates "an unworkable, unadministrable mess."

Terms of Service

EDITOR'S PICK | 11,799 views | Apr 24, 2018, 08:40am

The Republican Tax Plan's Break For Small Business Yields Huge Benefits... For Big Business

Tony Nitti Contributor
Taxes

Activists hold signs during a Tax March D.C. event on the U.S. Capitol East Lawn April 17, 2018 in Washington, DC. Activists gathered on Capitol Hill to urge for "a fair economy that works for all Americans," to "demand" Congress repeal the Tax Cuts and Jobs Act, and 'demand' President Donald Trump to release his tax returns. (Photo by Alex Wong/Getty Images)

As part of the recently-enacted Tax Cuts and Jobs Act (TCJA), a new provision of the Internal Revenue Code was born: Section 199A, which provides a deduction to owners of sole proprietorships, partnerships and S corporations equal to 20% of the income earned by the business. Republican leaders who designed the TCJA

hailed the provision as a field leveler; after all, the foundation of the tax bill was a reduction in the tax rate of so-called "C corporations" from 35% to 21%. And, the logic went, if owners of C corporations were going to enjoy that type of windfall, then something needed to be done for the Mom-and-Pop store down on Main Street as well.

Because, you see, in all likelihood, that sweet couple down at Al's Hardware doesn't run their business as a C corporation. Instead, Al's is either a sole proprietorship, partnership, or S corporation. Why? Because if you operate a business as a C corporation, your business income is taxed twice: once at the corporate level when it is earned (now at the new, lower 21% rate), and again at the individual level when the corporation distributes the income to you as a dividend. That stings.

To the contrary, if you operate your business as a sole proprietorship, partnership, or S corporation (so-called "pass through businesses"), you only pay tax on the income of the business *once;* at the individual level at individual rates. And since Mom and Pop generally don't want to pay tax twice, most small businesses avoid operating as a C corporation and opt instead to be taxed as a pass through business.

As a result, these small businesses care not a whit about a reduction in the corporate rate, because the owners of most small businesses only pay tax at individual rates. So to keep them from being left out in the cold by tax reform, Republican leaders gave birth to Section 199A, or what is often referred to as the "pass through deduction."

On the surface, Section 199A is simple: it allows owners of a pass through business to claim a deduction equal to 20% of the income earned by the business. Dig a little deeper, however, and you'll find that there are many limitations, thresholds, caveats and provisos lurking within the new law, making the real world application of Section 199A anything but clear. Don't believe me? You can read all about it here.

YOU MAY ALSO LIKE

The uncertainty surrounding Section 199A, however, has done nothing to prevent GOP leaders from loudly proclaiming it to represent a tremendous victory for small businesses, a claim that has only grown louder with midterm elections drawing near.

But is it true? Is Section 199A a big boost for small businesses? Earlier today, the Joint Committee of Taxation -- the Congressional scorekeeper for all things taxes -- published a table showing who ultimately benefits the most from Section 199A, and here's a spoiler: it ain't Mom and Pop at the hardware store.

To best understand the JCT data, lets start slow: here are the number of returns the JCT predicts will be filed in 2018 claiming a Section 199A deduction, by income level:

Income Level	Returns Filed in 2018
$10,000 to $20,000	500,000
$20,000 to $30,000	700,000
$30,000 to $40,000	800,000
$40,000 to $50,000	900,000
$50,000 to $75,000	2,500,000
$75,000 to $100,000	2,500,000
$100,000 to $200,000	6,200,000
$200,000 to $500,000	3,000,000
$500,000 to $1,000,000	200,000
> $1,000,000	200,000

The pronounced bell curve reflected above is no surprise. At low levels of income, it is unlikely a taxpayer would own a business. As income rises above $50,000, the popularity of pass through businesses begins to increase, reaching a peak of 6.2 million returns reporting a Section 199A benefit filed by those earning between $100,000 and $200,000.

Above that income levels, the number of returns claiming a Section 199A deduction dissipates. Again, that is not unexpected. This occurs largely for two reasons:

1. Naturally, as the income levels of the business owners increase, so does the relative size of the business. And when businesses get very large, they tend to be established not as pass through businesses, but rather as C corporations. Why? For starters, S corporations are limited to 100 shareholders and generally, all shareholders must be U.S individuals. With no institutional or foreign investors permitted, S corporations are not an ideal option for large businesses that often have complex and ever-evolving financing needs. And while a partnership has no such limitations on the number or nature of owners, quite simply, many large businesses gravitate towards operating as a C corporation so they can become publicly traded or participate in tax-free mergers and acquisitions. Thus, it is no surprise that by the time the income of a business owner exceeds $1,000,000, only 200,000 returns are being filed claiming a Section 199A deduction.
2. Based on the preceding point, you are typically only going to see very profitable businesses operated as a S corporation or partnership when they are 1) closely held, and 2) need little in the way of capital investment. This would generally include your accounting firms, law firms, and doctor groups, and here's the catch: under Section 199A, owners of these types of service businesses are generally barred from claiming the Section 199A deduction. As a result, while the table above may give the appearance that only 200,000 returns are being filed by people earning more than $1,000,000 showing income from an S corporation or a partnership, that is not the case; rather, the total is likely much higher, it's just that many of those individuals will be ineligible to claim a Section 199A deduction.

At this point, the GOP's tax plan seems to have accomplished its intended goal, with the overwhelming preponderance of tax returns claiming a Section 199A deduction belonging to those earning between $50,000 and $250,000. HOORAY FOR SMALL BUSINESS!!!

There's just one small problem. In order for it to be revelaed, let's layer on to the above table how much tax benefit each income group will actually *receive* via new Section 199A:

Income	**Returns Filed in 2018**	**Section 199A Benefit**
$10,000 to $20,000	500,000	$100,000,000
$20,000 to $30,000	700,000	$200,000,000
$30,000 to $40,000	800,000	$200,000,000
$40,000 to $50,000	900,000	$300,000,000
$50,000 to $75,000	2,500,000	$1,000,000,000
$75,000 to $100,000	2,500,000	$1,200,000,000
$100,000 to $200,000	6,200,000	$6,300,000,000
$200,000 to $500,000	3,000,000	$9,400,000,000
$500,000 to $1,000,000	200,000	$3,600,000,000
> $1,000,000	200,000	$17,800,000,000

Well, that's odd. Despite the fact that those earning between $100,000 and $200,000 will file SIX MILLION more tax returns claiming a Section 199A deduction than those earning more than $1,000,000, those in the high-earning group will enjoy a total tax benefit from the new deduction that is ELEVEN BILLION DOLLARS greater than their middle-class compatriots.

What happened? How could Section 199A be sold as a cut for small businesses when over 44% of the total benefit of the provision goes into the pockets of those earning more than $1 million annually?

It really comes down to a combination of two factors:

First, the JCT table doesn't reflect the total tax *deduction* under Section 199A for each income group, but rather the tax *benefit*. The deduction is generally 20% of income earned by the business; the ultimate benefit, however, is dependent on your marginal tax rate.

To wit: assume you're married and earn $100,000 in income, all of it from a sole proprietorship. Your marginal tax rate at that level of income is 22% in 2018; thus, if Section 199A grants you a deduction of $20,000, that deduction is worth $4,400 ($20,000 * 22%) to you.

Assume instead that you earn $1,000,000 of taxable income, all of it from your interest in an S corporation. Your marginal tax rate at that level of income is 37% under the new law, and so the $200,000 Section 199A deduction is worth $74,000 ($200,000 * 37%) to you.

So as you can see, that's a 1:1 return comparison, with each return reflecting a 20% deduction under Section 199A, but the reduction in tax to the individual earning $1,000,000 is over 15 times larger than that of the taxpayer earning $100,000.

"Fine," you might say, "but in order for the richest taxpayers to have a much larger benefit that the owners of small businesses, there still needs to be a lot of owners of big businesses claiming a Section 199A deduction. And I thought you said most big businesses were C corporations?" A fair point, and one that leads us to our next discussion.

Certain businesses can be both wildly profitable *and* set up as a pass through business. First and foremost, for tax reasons, real estate is almost never placed in a C corporation. As a result, nearly every rental property in America is owned in a pass through business, and as you're probably well aware, rich people tend to own a *lot* of real estate.

To illustrate, imagine someone who owns an empire of commercial buildings, generating $10,000,000 in rental income annually. In 2017, that income was taxed

at a top rate of 39.6%, generating a tax bill of $3,960,000. Fast forward to 2018, however, and the combination of a lower top rate under the TCJA and the new 20% deduction conspire to yield a tremendous reduction in tax: now, that same $10,000,000 of rental income gives rise to a tax bill of $2,9600,000, a $1,000,000 reduction compared to the previous year. Now you understand why owners of highly profitable real estate are smitten with the new tax bill.

But it's not just real estate moguls who are walking away with that $17.8 BILLION in tax savings courtesy of Section 199A. When things line up perfectly, some of the largest businesses in the country are able to operate as a pass through business. For example, many closely-held professional sports franchises are established as S corporations or partnerships. And while it is not clear exactly whether they file as a C or an S corporation, we know that Koch Industries, Inc. -- with its $115 billion in annual revenue -- is privately held, and thus may very well be operated as an S corporation. The same is true for Cargill, whose annual revenue actually exceeds that of the Koch brothers, making it the largest privately-held company in America. That's over $250 billion in annual revenue that may be eligible for a Section 199A deduction.

This is the faulty logic of the GOP's tax plan. The TCJA gives a 20% deduction to pass-through business, predicated on the belief that "pass through business" is synonymous with "small business." But the facts simply don't bear that out: as recently as 2015, $1.2 trillion in income was reported on Schedules E and C from pass through businesses. Of that amount, $550 billion -- or nearly half the total pass through income -- was reported by taxpayers earning more than $1 million in income. If only the GOP could have known this information *before* they designed Section 199A...oh wait, they most certainly did, because this information is published annually by...you guessed it...the JCT.

Section 199A is poorly constructed for a number of reasons, but from a big picture perspective, the notion that it was created as a boon to small business has long been challenged by tax wonks, and the JCT's report only confirmed such suspicions. Had the GOP been serious about providing a benefit to Main Street rather than Wall Street, it could have easily capped or phased out the benefits of

Section 199A above certain income levels. But it chose not to, and now it must face the unflattering news that its handout to small businesses is dwarfed by the gift given to some of the wealthiest taxpayers in the country.

So while Ma and Pa down at the hardware store may find an extra $4,000 in their pockets courtesy of the new "small business" tax break, the likes of Ma and Pa Trump, Koch and Cargill will walk away with nearly $20 billion.

I am a Tax Partner in WithumSmith+Brown's National Tax Service Group. I am a CPA licensed in Colorado and New Jersey, and hold a Masters in Taxation from the University of Denver. My specialty is corporate and partnership taxation, with an emphasis on complex mergers and acq... **MORE**

Follow along on Twitter, @nittiaj.

BRIEFING (HTTPS://WWW.BUSINESSINSIDER.COM.AU

A new report shows that one of the biggest breaks in Trump's tax law will go to the richest Americans

BOB BRYAN

APR 25, 2018, 1:50 AM

(https://static.businessinsider.com/image/5a

BENEFITS- BENEFITS- BENEFITS- BENEFITS- IN THIS
2018- 2018- 2018-4) 2018- ARTICLE
4&T=A+NEW+REPORT+SHOWS+THAT+ONE+OF+THE+BIGGEST+BREAKS
BUSINESS
INSIDER

Drew Angerer/Getty Images

- A new report from the congressional Joint Committee on Taxation analysed benefits from different parts of the new GOP tax law.

- **The JCT found the new deduction for pass-through businesses would heavily benefit the wealthiest Americans.**
- **Americans making over $US1 million a year, who make up 0.3% of all tax filers, will receive 44.3% of the total benefit from the pass-through deduction.**

A new report from the Joint Committee on Taxation found that a provision from the Republican tax law designed to help small businesses would mostly benefit Americans in the top 1% of earners.

The report, released Monday, broke down various aspects of the GOP tax law, including the new deduction for pass-through businesses, or companies in which the owner takes the profits as income and pays taxes on those profits as part of his or her individual tax return.

In the new law, many pass-through businesses will be able to deduct the first 20% of qualified pass-through income from their individual filings. That would theoretically bring down the top marginal tax rate for pass-through owners from to 29.6% from 37%.

AUSTRALIA: HTTPS://WWW.B TRUMP-TAX-LAW-PASS-THROUGH-DEDUCTION-BENEFITS-2018-4&SUBJECT=A NEW REPORT SHOWS THAT ONE OF THE BIGGEST BREAKS IN TRUMP'S TAX LAW WILL GO TO THE RICHEST AMERICANS)

A significant amount of the pass-through deduction's benefits will go to those filers making more than $US1 million a year. According to the JCT report, 44.2% of its benefits would go to about 200,000 millionaire filers in 2018. The report projected that share would increase to 52.4% by 2024.

In short, that means about one-third of the 0.3% of Americans making $US1 million and over will receive a benefit of $US17.8 billion.

The JCT report showed:

- Filers making over $US1 million a year will account for 12.7% of US income and pay 36% of all individual income taxes in 2018.
- 53% of the deduction's benefits in 2018 will go to roughly 400,000 filers making above $US500,000. In tax year 2015, the latest year the Internal Revenue Service has data (https://www.irs.gov/pub/irs-soi/soi-a-ints-id1801.pdf), a filer had to make $US480,930 a year to qualify for the top 1% of earners.
- 7.9 million of the roughly 133 million tax filers making $US100,000 or less will

> receive $US3 billion, or 7.5%, of the total benefit from the pass-through deduction in 2018.

Republicans have argued that pass-through-business owners will take tax savings and reinvest in their companies, saying it will lead to job growth and possibly a macroeconomic boost.

NOW WATCH: Briefing videos

Business Insider Emails & Alerts

Site highlights each day to your inbox.

Email Address

Email Join

Follow Business Insider Australia on Facebook (https://www.facebook.com/BusinessInside Twitter (https://twitter.com/BIAUS), LinkedIn (https://www.linkedin.com/company/busin insider-au), and Instagram (https://www.instagram.com/businessinsid

TAGGED IN

Trump said this tax break was for small businesses. It's giving $17 billion to millionaires this year.

Those making $1 million or more will save more than $30 billion on the "pass-through" tax deduction by 2024.

By Emily Stewart | Apr 24, 2018, 2:20pm EDT

President Donald Trump holds up a copy of legislation he signed before before signing the tax reform bill into law in the Oval Office December 22, 2017, in Washington, DC. | Chip Somodevilla/Getty Images

If many average Americans aren't noticing or **loving** the **tax cut bill** yet, it might be understandable — it **benefits the wealthy** by design. And a **congressional report** released this week shows that one specific new deduction for so-called "**pass-through**" companies is heavily benefiting the rich.

The Joint Committee on Taxation on Monday released a **report** outlining some of the initial effects of the **tax law** passed in December. (**NBC News** was first to report on it.) The committee estimates that the owners of pass-through entities — companies organized as sole proprietorships, partnerships, LLCs, or S corporations that don't pay corporate income taxes — will save $40.2 billion in 2018 thanks to the tax bill.

Of that total, $17.4 billion will go to individuals and households making more than $1 million per year. (Revenue estimators are based on tax returns, so a married couple filing jointly is one taxpayer, and a married couple filing separately are two.)

By 2024, the committee estimates pass-throughs will save $60.3 billion on taxes via the new law. More than half of the benefit — $31.6 billion — will go to individuals and households earning more than $1 million.

How the new tax law benefits wealthy business owners

Pass-through companies have their income "passed through" to their owners to be taxed under the individual income tax rate instead of the corporate rate. The **vast majority** of US businesses are pass-throughs, including those owned by President Donald Trump — his Trump Organization is structured as a collection of pass-through entities.

Under the previous tax law, such companies could be taxed as much as 39.6 percent, the individual rate for the highest earners.

Under the new tax regime, pass-throughs get to deduct **up to 20 percent** from their income before they're taxed. Aaron Krupkin and Howard Gleckman, analysts at the Tax Policy Center think tank, called the deduction "**extremely generous**" for those who qualify it, noting the law as it's written is complicated to navigate. (**So much for simplifying the tax code**.)

The Joint Committee on Taxation's Monday analysis showed just how generous the pass-through change is. Those making $1 million or more will reap $17.8 billion of the total $40.2 billion benefits of the law in 2018, or about 44.3 percent, and those making over $500,000 will get $3.6 billion. In other words, people making over $500,000 will get more than half of the entire benefit this year.

And by 2024, it will be even more skewed. Pass-through tax breaks will total $60.3 billion, with those making $1 million getting $31.6 billion and those making $500,000 getting $5.3 billion in tax benefits.

Table 3.–Distribution of Tax Benefit for Pass-Through Deduction Under Section 199A

Income Category [1]	2018		2024	
	Returns (Millions)	$ Billions	Returns (Millions)	$ Billions
Less than $10,000	[2]	[3]	[2]	[3]
$10,000 to $20,000	0.5	-$0.1	0.6	-$0.1
$20,000 to $30,000	0.7	-$0.2	0.7	-$0.2
$30,000 to $40,000	0.8	-$0.2	0.8	-$0.3
$40,000 to $50,000	0.9	-$0.3	1.0	-$0.4
$50,000 to $75,000	2.5	-$1.0	2.6	-$1.3
$75,000 to $100,000	2.5	-$1.2	2.6	-$1.5
$100,000 to $200,000	6.2	-$6.3	6.5	-$8.0
$200,000 to $500,000	3.0	-$9.4	3.2	-$11.6
$500,000 to $1,000,000	0.2	-$3.6	0.3	-$5.3
$1,000,000 and over	0.2	-$17.8	0.2	-$31.6
Total, All Taxpayers	**17.4**	**-$40.2**	**18.4**	**-$60.3**

Joint Committee on Taxation

"Congress advertised the pass-through deduction as relief for 'small-business,' but in reality, it mainly benefits the one percent, as JCT's table demonstrates," said Steve Rosenthal, a senior fellow at the Tax Policy Center.

The GOP put in guardrails meant to curb some of the benefits for the pass-through deduction. The law restricts the ability of providers of "specified services" — for example, doctors, lawyers, and athletes — to claim the pass-through deduction if they make more than $157,500 a year, or double that for married couples. It also limits the deduction with a **complicated formula** based on the wages a business pays to employees.

"Those were intended to focus the benefits more on small business, but apparently it didn't really disturb the fact that pass-throughs are overwhelmingly held by high earners," Rosenthal said.

In December, Ari Glogower, an assistant professor of law at Ohio State University, outlined at **Vox** the multiple ways rich people can game the new Republican tax bill, and much of it focused — surprise — on pass-throughs. And he noted at the time the guardrails on the pass-through deductions are not hard to skirt:

> With a bit of creativity, professionals on the list can still access the pass-through deduction. Sure, a lawyer at a law firm is out of luck, because she provides legal services to customers, but she might leave the firm and provide those same services in-house, say, at a real-estate firm. Now she's no longer

> in a "specified service" — she's in the real-estate business. Voilà: She may qualify for the pass-through deduction.

The tax bill is great for corporations and rich people

The Republican tax bill cut the corporate tax rate to 21 percent from 35 percent and disproportionately benefits corporations and **the wealthy**. The Tax Policy Center last year estimated nearly 83 percent of the tax bill's benefit goes to the **richest 1 percent** of Americans.

Which explains why the tax bill isn't quite as popular as **Republicans had hoped** and is a complicated sell to 2018 midterm voters.

A recent **Gallup poll** found that 52 percent of Americans still disapprove of the tax bill, while 39 percent approve. That's sort of a step up from December — when 56 percent said they disapproved of the bill, 29 percent said they approved, and more were undecided — but it's still not great.

A February **Politico/Morning Consult poll** found that most voters say they haven't seen any change in their paychecks, which isn't to say that there have been no changes but rather that they're just not that noticeable.

Remember when House Speaker Paul Ryan **tweeted about that school worker** who was getting an extra $1.50 in her check? Square that with the pass-through millionaires.

Politics

Rich Americans Have Found Yet Another Tax Loophole

By Lynnley Browning
March 6, 2018, 4:00 AM EST

- Top earners may form co-ops to avoid pass-through income limit
- Cooperatives are 'weird little corner' of code, lawyer says

Highly paid professionals including investment managers, doctors and lawyers are eyeing a loophole in what's supposed to be a mom-and-pop benefit of the new tax law as a way to supersize their savings.

The loophole lies in the law's 20 percent deduction for owners of small businesses run as partnerships, limited liability companies and the like. These so-called pass-through entities underpin the U.S. economy, ranging from small-town builders to law practices, but also private-equity and hedge fund firms.

The law features a guardrail intended to keep service professionals such as hedge fund managers or cardiologists from using the break once their income hits a certain level. But top earners can exploit a gap that lets the benefit go to anyone who runs profits through an obscure entity known as a cooperative.

"You can make gobs of money and still get the deduction," said Erin Fraser, a tax and wealth-planning lawyer at Hanson Bridgett LLP in San Francisco, who has gotten calls in recent weeks from lawyers, consultants and a wealth management firm about the advantages of the cooperative model.

Signed by President Donald Trump in December, the law marked the biggest change to the tax code in a generation. Yet the rush by congressional Republicans to finish the bill may have inadvertently created a way for highly paid professionals to exploit a special break that the GOP has advertised as benefiting mom-and-pop operations.

Read more about the tax loophole your accountant can blow open

The cooperatives benefit applies to a business model more often associated with farmers, groups that distribute electricity to rural residents and progressive collectives than with elite doctors' offices.

A cooperative is a worker-owned, worker-run enterprise whose members earn salaries and share profits paid out as so-called patronage dividends. Members then pay ordinary rates on them. The dividends are deductible to the cooperative, which pays the corporate rate on anything retained for reinvestment in the business. Employees who aren't members typically receive regular wages.

"It's a weird little corner" of the tax code, Fraser said.

Bigger Savings

For cooperatives, the 20 percent deduction applies to a much larger bucket of income than it does for pass-through entities -- resulting in bigger savings that can potentially wipe out a tax bill.

The pass-through deduction, which expires after 2025, is part of the broader package signed by Trump that cuts individual tax rates, nearly doubles the standard deduction and lowers the corporate rate to 21 percent. The break costs more than $414 billion over a decade -- almost a third of the $1.5 trillion law.

Pass-throughs -- which include S corporations and sole proprietorships -- don't pay taxes themselves. Instead, they pass profits to their owners, who then pay taxes at individual rates. The new law lowers the top individual rate to 37 percent from 39.6 percent. With the new 20 percent deduction, pass-through owners taxed at the top rate can now get their rates as low as 29.6 percent.

Critics say this creates an incentive for top earners to recast themselves as independent contractors and funnel wages taxed at ordinary rates through a pass-through entity.

Gross Income

Now, tax advisers are exploring another move: to recast a pass-through as a cooperative, because the new law lets cooperatives apply the deduction to their gross income. By contrast, pass-throughs can only apply the break to net taxable income, which is gross income minus expenses and the like.

The new law sets income limits on the deduction for high earners in health, law and service professions such as financial services, consulting and performing arts. But those limits apply only to pass-throughs -- not cooperatives.

The law starts phasing out the pass-through deduction once the net income of an owner in one of those professional fields hits $157,500, or $315,000 for joint filers. Once their income hits $207,500 -- $415,000 for joint filers -- the deduction disappears altogether.

Pass-through owners who aren't in those fields but who earn above those initial limits -- think of a booming contractor in Greenwich, Connecticut -- can continue to use the deduction if they pay certain levels of wages or invest in real estate. Engineering and architectural firms were hit by the phase-out in early bill drafts but later exempted.

Here's an example of how it could work. A group of plastic surgeons making millions of dollars a year could set themselves up as a cooperative and pay themselves via dividends on their gross income, saving far more than if they continued to operate as an S corporation.

'Lucrative Avenue'

"Unless Congress takes action to fix it, the new deduction for cooperative dividends could become a lucrative avenue of tax avoidance for people across the country," said economist Scott Greenberg, a senior analyst at the conservative Tax Foundation.

The strategy could also be used by hedge funds.

"There's got to be a way for an investment professional to do it," said Gregory Wilson, a tax lawyer in solo practice and an authority on cooperatives.

One possibility is to form a cooperative consisting of several companies, and keep the investment capital in one of those companies but the profits in the cooperative, he said.

"You could probably do this with most businesses," Wilson said. "I'm talking to a very profitable law firm interested in doing this."

Adopting cooperative status could be as simple as changing your bylaws to reflect the three pillars of being a cooperative: control of capital by the owners, who are also called members; giving each owner one vote; and distributing profits to owners.

‘Crazy-Easy to Do’

While the maneuver sounds complicated, “it’s crazy-easy to do,” Fraser said, especially for groups of high-earning doctors, accountants, consultants and lawyers.

Lawmakers have vowed to fix one related quirk in the legislation. That one, known as the “grain glitch,” lets farmers who sell their crops to cooperatives deduct 20 percent of their gross sales. It encourages farmers to bypass corporate buyers like Archer-Daniels-Midland Co. and can erase a farmer’s tax bill. Farmers who sell to a corporate buyer can deduct only 20 percent of their net income and still wind up with a tax bill.

But lawmakers have been silent about the benefit for cooperatives in industries outside farming. And it’s unclear whether the loophole for well-paid professionals could be fixed through a technical correction or instead would require new legislation.

Tax planners caution they’re keeping an eye on what Congress does while also looking for ways to use the cooperative to their clients’ benefit.

“Even if this is only around for a year or two, if you roll the dice, you may save a lot of money,” Wilson said.

In this article

ADM
ARCHER-DANIELS
41.23 USD ▼ -1.17 -2.76%

Terms of Service
Trademarks Privacy Policy
©2018 Bloomberg L.P. All Rights Reserved
Careers Made in NYC Advertise Ad Choices Contact Us Help

Business

Here’s the Trump Tax Loophole Your Accountant Can Blow Wide Open

By Ben Steverman and Patrick Clark

February 5, 2018, 4:00 AM EST
Updated on February 5, 2018, 3:44 PM EST

- New tax law allows 20% deduction for pass-through businesses
- Tax pros are devising creative ways to avoid deduction limits

If exploiting a tax loophole is as much an art as a science, then the tax planning profession is poised for a creative renaissance.

The inspiration is the tax law signed by President Donald Trump in December. The patrons are affluent Americans who can afford advice from the nation’s more ingenious accountants, tax lawyers and financial advisers.

And the new medium they’re experimenting with? A 20 percent deduction for so-called pass-through businesses, whose income is taxed on firm-owners’ personal returns.

Follow the Trump Administration's Every Move

It's early days, and the Internal Revenue Service has yet to issue guidance on how to interpret the hastily passed law. That hasn't stopped tax pros from circulating proposals and riffing on each other's ideas, as the industry seeks to coalesce around strategies that will save their clients money while standing up to scrutiny by the IRS and judges. Some pass-through owners may be instructed to group together their diverse businesses to minimize their tax bills, while others may be told to split pieces off.

"I'm sure folks will try to push the edge of the envelope," said Mark Nash, a tax partner at PricewaterhouseCoopers LLP. "They always do."

Trump and Congressional Republicans have said middle-class Americans and small businesses will be the biggest beneficiaries under the $1.5 trillion tax cut. But the strategies under consideration to take advantage of the 20 percent pass-through deduction show how top earners could ultimately reap the biggest gains.

'Principal Asset'

All taxpayers who earn less than $157,500, or $315,000 for a married couple, can now deduct 20 percent of the income they receive via pass-through businesses from their overall taxable income. If taxpayers earn above those amounts and aren't service professionals, they must meet tests to take the full deduction -- the size of their deduction depends on how much they pay in employee wages or how much they've invested in capital like real estate.

For "service professionals," the break fully phases out if they earn more than $207,500 if they're single, or $415,000 if they're married.

There's ambiguity with the rules, though. For example: What's a service business? The tax code already specifies an official list that includes health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services and brokerage services. But that language is "broad and vague and the IRS has never provided guidance as to what those terms mean," Nash said.

Plus, that section of the new legislation ends with a puzzling coda. Also excluded are "any trade or business" where the "principal asset" is the "reputation or skill" of its employees or owners. Few are really sure what this means.

"If I put 10 professionals in a room, I'm going to have 10 different ideas of what's going to be excluded," said Edward Reitmeyer, a tax partner at accounting firm Marcum LLP.

That kind of confusion creates opportunities to work around the service definitions or to re-cast businesses in ways that arguably fall outside the excluded categories.

Office Real Estate

One strategy being discussed is to combine diverse businesses into a single entity. Let's say you're an accountant who also invests in real estate, managing hotels and other properties. Depending on how the IRS writes the regulations, it might make sense to put everything in one company, according to Richard Kollauf, director of business advisory at BMO Private Bank.

Instead of appearing to the IRS to be an accountant -- a service-based profession that wouldn't qualify for the pass-through break over the income limit -- you look more like a real estate magnate, who would qualify because of large capital investments.

Or, if your business makes the majority of its money through your service profession, the opposite strategy could work. By breaking different businesses apart, service business owners could have at least some of their income qualify for the pass-through deduction. A medical practice might do a fair amount of debt collection or other back-office support. Those divisions could be spun off into a separate "management company," which could qualify for the break.

Taking it a step further -- service professionals may also consider buying new real estate and adding it to their business portfolios. That's an option under consideration by Nicholas Sher, a

certified public accountant, with offices in midtown Manhattan. Sher said he’s thinking about buying an office condo through a new entity -- which would then lease it back to his firm, Sher & Associates. He could then try to take the 20 percent deduction through the condo entity.

“If I had the right location I would do it in a second,” Sher said.

Business owners who do that may be tempted to drive a hard bargain with themselves -- to maximize the money that qualifies for the deduction. But keep in mind: The IRS has rules about transactions with yourself, and you may have to use market prices.

Employee Leasing

“Tax lawyers are very good at dreaming up these things,” said Indiana University Bloomington Professor Bradley Heim, an economist who studies tax policy.

A service business could also spin off an employee-leasing entity, to get around the professional service restrictions, according to Kenneth Brier, a partner at tax-planning firm Brier & Ganz based outside Boston. Employee-leasing entities tend to charge mark-up prices as a way to make a profit.

For instance, instead of paying its attorneys $200,000 a year, a law firm could pay its leasing spinoff a marked-up price of $250,000 per employee -- shifting profits from the law firm to the leasing entity. While the lawyers in the new spin-off unit would be doing legal work just like before, Brier said he believes their new employer could qualify for the deduction as an employee-leasing company.

IRS Resources

At least theoretically. Not all these strategies will work. IRS regulations could shut down some loopholes, forcing tax planners to improvise new, riskier tactics to get around the rules. The most aggressive techniques might require a legal fight with the IRS. (But don’t worry: Creative tax strategies won’t send you to prison unless you’re actually lying to the IRS.)

The agency might have trouble keeping up. Adjusting for inflation, the Taxpayer Advocate Service estimates the IRS budget has been cut by 20 percent since 2010.

The estimated cost of the pass-through deduction is $415 billion over the coming decade, according to the nonpartisan Joint Committee on Taxation. The tax break could be even more expensive if IRS regulations can't keep gamesmanship to a minimum.

"You have to be careful. There are people out there who come up with hare-brained ideas," said Eric Hananel, a CPA and principal at UHY Advisors. "Tax considerations are important but you can't let a tax consideration drive a business decision."

Not all tax planning strategies are controversial. A married doctor making $500,000 might drop her taxable income below the threshold by maximizing contributions to retirement plans and a health savings account (HSA), and strategically giving money to charities, perhaps through a donor-advised fund.

Some law firms and other pass-through entities may wind up converting to so-called C corporations, which now enjoy tax rates of 21 percent, instead of 35 percent. (There's a potential drawback: Corporate profits get taxed a second time when they're received by individuals, usually as dividends.)

Expect lots of creativity from America's tax experts this year. After all, most of them have a strong incentive to bend the rules. As well-paid service professionals, they're personally excluded from the new law's biggest benefits. "That's an issue near and dear to every lawyer and accountant's heart," said Jack Wilk, managing partner of the law firm Wilk Auslander.

(Updates with cost estimate for pass-through deduction in third paragraph under 'IRS Resources' subhed. An earlier version of a title in the 13th paragraph was corrected by the company.)

In this article

10182Z
PRICEWATERHOUSECOOPERS LLP
Private Company

1159268D
BMO PRIVATE BANK
Private Company

Terms of Service
Trademarks Privacy Policy
©2018 Bloomberg L.P. All Rights Reserved
Careers Made in NYC Advertise Ad Choices Contact Us Help

Chairman Buchanan. Let me just thank our witnesses for being here today.

I do want to, before I jump into the tax thing, I do want to mention one point. We have talked about debt in the next 10 years, 2.3 ideally in added debt. We have had $10 trillion in added debt in the last 10. Nobody brought that up much. We have had 1 percent growth in the last 10, the slowest growth in 50 years. So, to keep doing what we were doing was going to clearly put us into bankruptcy.

So I want to mention, everybody has got a different background that they bring to this. But I was in business for 30 years. Blue collar family. Started a small business, my wife and I, in 1976, a small printing company. We built that company up over a lot of years.

But I can just tell you, I am also a cyclist, and it makes a big difference if you have the wind at your face or the wind at your back. There is a mindset now in Florida and a lot of other places that Washington is with us now in terms of reducing some of the regulations, not all of them, but also in terms of tax reform.

But when you talk about corporations, one thing. My thing that I am so passionate about is small businesses. If you look at them, they are going to have a substantial reduction, up to 25 percent when you add it all up.

But just as important, or more important for a lot of small businesses, full expensing, new and used equipment. Instead of writing it off over 5 or 7 years, that is going to make a huge difference.

So, I just see the mindset you are going to be able to keep more of what you earn so you can redeploy that, whether it is buying equipment, expanding your businesses.

And then two things just looking it at anecdotally. I mean, when the economy is growing right now 3, 3.5 percent, we had 1.5 percent. And I can tell you in our area, I can't tell you how many job sites and other things they can't find workers. So we are almost at full employment, at least in Florida.

So those are two gigantic -- it is almost overheated, the economy in Florida. People are very bullish down there.

So, let me ask again, as we talk about lowering rates and full expensing, what does that mean to your business today and going forward?

And someone mentioned something about the spirit of the tax cuts and the psychology, to some extent, of the tax cuts, what that means to your businesses.

Mr. Horne, could you lead off?

Mr. Horne. Well, as I said in my testimony, it is important for our cash flow. If we can recoup that immediately, it is important for us to be able to put the money back in. It helps us tremendously.

And the bonuses I gave, I doubt they stayed in their banks long. They were back in the economy pretty quickly. I mean, people were glad to have some extra money in their pockets. So I know that it is putting back into the economy that way as well.

Chairman Buchanan. Again, anecdotally, I hear it from almost everybody. That is why it is so different than what has been said here. At least in Florida, I can't talk about all the other States, but people are very bullish.

Mr. Gray, what about the psychology of where we are at with tax cuts and the reality of that as well?

Mr. Gray. I see a huge increase. I live in a little town. I live south of Salem, Missouri, and I also have a practice in Rolla. And if you just drive through the towns, you will see more construction. I have clients in construction that cannot get qualified, skilled employees in my office, with bonuses, with retaining employees. I also saw an uptick of matching under the retirement account even in our own firm.

So, it is a whole attitude. My employees are picking up new business. It is an attitude. And the more you show that attitude to your employees, in my case to my clients, the more they are engaged and the more that that money circulates in a small local community.

Chairman Buchanan. And the other thing, what I found, when we go through these heated economies -- and that is what I think we are going to be getting into -- where you have fewer workers to pick from, if you need those workers, you are going to have to pay more.

So, I think you are going to see rising inflation or however you want to look at it, wages, for a lot of our employees. That is just the truth. If you run a law

firm, you need a paralegal and there are not many of them out there, you are either going to step up and pay another 10,000 or you are going to do without.

Mr. Baach.

Mr. Baach. I think the great word and the one that really matters is "attitude." And as much as things have to be fact based, and in the end that is what the foundation is, when people are seeing positive things, it reflects on their attitude. Attitude is infectious. It is creating growth. I see positive at every level that we touch, both on the supply and customer side, and it is going to be great here for a while.

Chairman Buchanan. Yeah.

Mr. Homan, anything you want to add?

Mr. Homan. Yeah, in terms of reading the tea leaves I generally refer to my customers, because that is where I would get my indicator.

And if I could put in a shameless plug for them, the railway industry, unlike the roads in this country, self-fund all of their own infrastructure. And by their nature, they are capital intensive.

So for this bill, to allow my customers to make those significant investments in their capital with a greater degree of confidence, which is what I am seeing, that confidence then transfers to me. I can get a little bullish about my business plans. And, therefore, that confidence then translates into the folks that I buy from.

So, I would agree with your assertion that the economy is almost in an overheated situation.

Chairman Buchanan. Okay. And let me just say, we just completely, unfortunately, disagree in terms of it is not having much of an impact on small businesses. I would ask you to come to Florida, talk to a lot of people that are there, small, medium-sized businesses. They are very bullish, and it is making a big difference in our area.

Our problem is, we don't have enough people in terms of jobs. That is the reality that I hear every day. I chaired the Florida chamber and a local chamber, and I can tell you, I talk with them occasionally on different things, they are very bullish about it.

I would like to thank all of our witnesses for appearing before us today. Please be advised that members will have 2 weeks to submit written questions to be answered later in writing. Those questions and your answers will be made part of the formal hearing record.

And with that, this subcommittee stands adjourned.

[Whereupon, at 11:56 a.m., the subcommittee was adjourned.]

PUBLIC SUBMISSIONS FOR THE RECORD

WRITTEN STATEMENT FOR THE RECORD FOR
THE HOUSE WAYS & MEANS TAX POLICY SUBCOMMITTEE

HEARING ON

'TAX REFORM AND SMALL BUSINESS: GROWING OUR ECONOMY AND CREATING JOBS'

May 23, 2018

Businesses for Responsible Tax Reform

This House Ways and Means Tax Policy Subcommittee has been optimistically titled 'Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs.' Optimistic because the evidence is stacking up that this tax law does little to help our Main Street small businesses and despite assurances from proponents that the new tax law would simplify tax code, many small business owners are struggling[i] to understand what exactly The Tax Cuts and Jobs Act means to them.

In recent weeks, our CPA members say they have seen a spike in concerned and confused clients coming through my doors seeking advice about the new tax law—an unusual sight so soon after Tax Day, when the last thing most people want to do is talk more about their taxes. But they are right to ask questions and get prepared because the new law is complicated, confusing and likely to be costly for small business owners.

Under the new tax law, small businesses face increased complexity, steep competition from large companies with the means to take advantage of low tax rates created by the territorial tax system, and a 20 percent deduction on pass-through business income that does not apply equally to all, according to the Businesses for Responsible Tax Reform study "The Tax Cuts and Jobs Act: Implications for Small Business[ii]."

Here are the realities illuminated by the report:

- The 20 percent deduction on qualified business income for pass-through entities applies differently to different types of small businesses. Small businesses that are primarily providers of a "specialized service" are subject to greater limitations on

the deduction. The formula for figuring out how it impacts an individual's business is complex and the results are likely unique to each individual's situation.

- The new territorial system of taxation adds complexity for small businesses operating internationally. On average, the international taxation of business income gives corporations a larger tax break and, as a result, puts small pass-through businesses at a competitive disadvantage.
- The new tax law may not translate into significant savings for small businesses, many of which will require the outside expertise and incur the additional cost of accountants and tax lawyers in order to navigate and satisfy their tax obligations.

What these changes mean is that small businesses will likely require the services of costly tax experts to handle the complexity. Under the rate structure of a CPA member—which is typical of the industry—they could easily spend up to $2,000 on an accountant to figure out the new pass-through deduction and file their taxes.

The average small business owner earns $50,000 a year, according to the Small Business Administration[iii]. By our calculations the new 20 percent deduction could save that person $1,500—easily wiped out by the fees charged by tax professionals with the expertise to navigate the new tax code. Also out the window is the idea that the deduction could generate enough money for a business to hire additional full-time employees or offer current employees raises. Businesses for Responsible Tax Reform public opinion polling[iv] shows that small business owners were skeptical that the tax law would allow them to make meaningful investments in their companies even before talking to their accountants (69% of small business owners said they would not hire as a result of the new law and 59% said they would not give raises).

On the other hand, large corporations and wealthy businesses will be able to turn to attorneys and pricey tax specialists to search out every loophole and tax advantage. And they will find them.

Some experts expect the 20 percent deduction will be an important factor in how businesses organize themselves to take advantage of the tax code. They expect an increase in businesses creating an LLC branch in order to maximize their eligibility for business deductions. Because LLCs are eligible for the deduction, businesses that do not qualify will find the LLC structure extremely attractive.

Economists also predict many businesses will use other strategies, such as "cracking and packing"[v] to split and restructure their businesses in order to qualify and maximize their deduction eligibility. "Cracking" a business entails breaking apart revenue from a service partnership in order to reclassify it into a category that qualifies for the deduction. The second strategy is to pack businesses that qualify for the deduction into a service partnership in order to transform the business into an entity that is not considered a specialized service trade or business.

Douglas Holtz-Eakin, an economist who heads the American Action Forum, recently told the Senate Finance Committee that the pass-through provision drew "haphazard lines in the sand" that "are the exact kind of lines that tax lawyers and experts will attempt to try to game."[vi]

Pursuing these types of strategies is usually done with the help of a tax professional—at a cost. Main Street small businesses often can't afford such luxuries and, as a result, they will be a competitive disadvantage to those large businesses that can search out the best tax rates and structure their businesses to take advantage of them.

When it comes to the new tax code, the bottom line for small business owners is they need get ready now—and be prepared to pay for it.

---

[i] National Association for the Self-Employed Survey, April 2018: https://www.nase.org/about-us/media-relations/PressReleases/2018/04/24/national-small-business-tax-survey-reveals-most-don-t-understand-new-law-and-feel-inadequately-prepared/

[ii] 'The Tax Cut and Jobs Act: Implications for Small Business' May, 2018: https://docs.wixstatic.com/ugd/4a8609_5ae6299d49534af6b27acb872d044e30.pdf

[iii] SBA United States Small Business Profile 2017: https://www.sba.gov/sites/default/files/advocacy/All_States.pdf

[iv] Businesses for Responsible Tax Reform poll, March 2018: https://docs.wixstatic.com/ugd/4a8609_a801668b62ff4d9bacfe8b9fadacb995.pdf

[v] Wall Street Journal article, 'Crack and Pack: How Companies are Mastering the New Tax Code,' April 3, 2018: https://www.wsj.com/articles/crack-and-pack-how-companies-are-mastering-the-new-tax-code-1522768287

[vi] Reuters article, ' U.S. Republicans tax law's pass-through deduction open to gaming – experts,' April 24, 2018: https://www.reuters.com/article/usa-tax-congress/u-s-republican-tax-laws-pass-through-deduction-open-to-gaming-experts-idUSKBN1HV2XW

Democrats Abroad
P.O. Box 15130
Washington, D.C. 20003
DemocratsAbroad.org

May 23, 2018

Representative Kevin Brady, Chairman
Representative Richard Neal, Ranking Member
House Ways and Means Committee
waysandmeans.submissions@mail.house.gov

Dear Chairman Brady, Ranking Member Neal and all Members of the Committee,

Re: House Ways & Means Committee Hearing Series on Tax Reform and Small Business: Growing our Economy and Creating Jobs – Wednesday May 23, 2018

Democrats Abroad thanks you for holding this important hearing on how tax reform is helping small businesses grow their operations and invest in local communities. We respectfully request that you accept this report for inclusion in the hearing record.

As you will know from our submission to the first hearing in this series (see Appendix I), Americans living abroad who own businesses in the countries where they live are coming to terms with the catastrophic impact the 2017 Tax Cuts and Jobs Act (P.L. 115-97) will have on their companies and their personal financial security. We reiterate our view that this is a highly unfortunate, unintended consequence of tax law changes meant to grow the U.S. economy and create jobs. We do not believe Congress meant for these two new taxes - the Repatriation Tax and the GILTI Tax regime - to harm American business owners abroad. However, we and the other organizations representing Americans living abroad, worry that Congress has not fully understood that businesses will be destroyed, companies will be closed and Americans abroad will lose livelihoods they have worked hard to build unless Congress acts urgently to exempt them from a law that was never intended to impact them in the first place.

In the time since our submission to the first hearing was published we have received more messages from Americans whose businesses cannot withstand the financial pressure of being taxed both in the jurisdiction where they are incorporated and in the U.S.[1] The accounts profiled herein further demonstrate that the new tax law poses an existential threat to their companies. It is destroying not only their livelihood but also their life savings. The taxpayers impacted are hard-working, law-abiding citizens who are shocked that, with no warning, Congress has turned their world upside down. They are proud and loyal Americans who are devastated by the choice of either keeping their business or renouncing their U.S. citizenship.

---

[1] No deductions or offsets exist for taxes already paid, so the owners of these businesses are paying tax twice on the same dollar of profit. And, of course, in the case of the retroactive Repatriation Tax, there is no revenue event correlated to the tax imposition.

From a Pennsylvania voter living in Canada

I am a film film producer, with a small but successful company in Canada. We have been producing television commercials and internet based films for more than 30 years. My wife and I have worked very hard to secure a secure retirement within our own means. Both the transition tax and GILTI will not only take that away, but will also shut down our business as there will no longer be ANY reason to continue our business, as we will be complying to 2 different government taxation rules and we will only be able to secure negligible profits.

From a Wisconsin voter living in Germany

The existance (SIC) of my business is threatened by the change to existing law and regulation... Our margins are just too small to survive. Businesses like mine also buy and sell from American companies, so when we are gone, American companies will suffer as well.

From a California voter living in Sweden

I am the owner of a small software development business that has never done any business in the U.S., yet still reports to the U.S. IRS and will continue to do so as long as deemed that the cost is within reason. [And then] my options are simply to shut it down or expatriate [renounce citizenship].

From a California voter living in Canada

The Retained Earnings targeted by Repatriation Tax are in fact my retirement savings—the funds I expected to depend on in the absence of a defined benefit retirement plan. I have followed the run of the mill path for small business guys incorporated in Canada to prepare for retirement—as supported by Canadian tax law and heretofore fully acceptable under US tax law for ex-pats. Now suddenly my retirement is under threat because mega-tech companies with hundreds of lawyers and accountants have been dodging billions in taxes. Really? Savaging my retirement is going to turn that around?

From a California voter living in France

My business is small in terms of employees (i.e., me) and annual sales volume (i.e., less $45K). Nevertheless, it has been my livelihood since June 2004. I have patiently filled out as best I can the Form 5471 every year since then, like I have filled out the Form 1040 every year since 1977. When the Paperwork Reduction Act Notice for Form 5741 was last published in 2014, the total time required by the taxpayer to fill it out was indicated to be twenty-one 8-hour working days! Being a small American taxpayer living abroad is a very time-consuming and stressfully condition. That condition is only getting worse. It has now come to a point that renunciation of my US citizenship is a viable alternative in spite of the exorbitant State Department fee of $2,350. I never imaged as a native-born American who served his country for six years in the US Army and who spent 30 years on US soil that I would one day ever contemplate such a possibility.

Democrats Abroad believes strongly that a remedy is needed to exempt American small business owners living abroad from this crushing new tax liability - one that Congress never intended.

Transaction Tax Remedy

We believe Americans overseas with interests in foreign corporations should be exempt from the Repatriation Tax and from the GILTI Tax regime for any given year so long as:

(1) they meet the conditions required for exemption under IRC Section 911, and

(2) they are individual U.S. Shareholders.

This solution both achieves the U.S. Congress's goal of capturing corporate tax it has been long-denied, and recognizes that the profits of businesses owned by Americans living abroad were never meant to be repatriated to the U.S. because they are needed to sustain the underlying business entities and the American expatriate families who rely upon them.

We strongly urge Congress to correct this unintended tax burden that harms Americans and the small businesses they have worked hard to build. American business owners abroad should be exempted from these transition taxes so they can remain positioned to manage and grow their businesses, take care of their families and build financial security in retirement.

We thank you for considering our views. We recommend that future hearings on tax reform include a witness that can speak directly to the concerns and predicaments of the community of Americans living outside the U.S. If you have any questions regarding this letter or would like to discuss these matters further, please do not hesitate to contact either me or Democrats Abroad's Carmelan Polce who can be reached at Carmelan@democratsabroad.org.

Sincerely,
Julia Bryan
International Chair
Democrats Abroad
chair@democratsabroad.org

Democrats Abroad is the branch of the U.S. Democratic Party for Americans living outside the U.S. Democrats Abroad has members in over 190 countries and official country committees in 53 nations on six continents. Democrats Abroad's main activity is helping overseas Americans register to vote in U.S. elections. We host our own voter assistance website - www.votefromabroad.org - to aid Americans in that process. We often cooperate with U.S. Embassies and Consulates in our countries to encourage voter participation on a non-partisan basis. You can find out more information about us at www.democratsabroad.org.

APPENDIX I

DEMOCRATS ABROAD SUBMISSION TO THE HOUSE OF REPRESENTATIVES WAYS & MEANS COMMITTEE

HEARING SERIES ON TAX REFORM: GROWING OUR ECONOMY AND CREATING JOBS

WEDNESDAY MAY 16, 2018

Note. In order to ensure this submission complies with the ten page limit, Appendix I and II of this submission have been omitted. The submission can be found and downloaded in its entirety at: www.democrastabroad.org/taxation

Democrats Abroad
P.O. Box 15130
Washington, D.C. 20003
DemocratsAbroad.org

May 16, 2018

Representative Kevin Brady, Chairman
Representative Richard Neal, Ranking Member
House Ways and Means Committee
waysandmeans.submissions@mail.house.gov

Dear Chairman Brady, Ranking Member Neal, and all Members of the Committee,

Re: House Ways & Means Committee Hearing Series on Tax Reform: Growing our Economy and Creating Jobs – Wednesday May 16, 2018

Democrats Abroad thanks you for holding this important hearing on tax reform and we respectfully request that you accept this report for inclusion in the hearing record.

The 2017 Tax Cuts and Jobs Act (P.L. 115-97) had a horrific surprise for Americans living abroad who own businesses in the countries where they live: two new taxes that pose an existential threat to their businesses. We appreciate that this is a highly unfortunate unintended consequence of provisions expected to grow the U.S. economy and create jobs. We do not believe Congress meant for these new taxes to do the harm they are currently doing. However, we join other organizations representing Americans living abroad in our serious concern that the 115th Congress will fail to pass a bill that includes corrections to this flaw in the Act. We hope this report adequately profiles the terror this cohort of up to 1 million Americans[2] is feeling and the need for Congress to act on their behalf, and urgently enact a remedy to save their companies from closure.

In 2017, the U.S. Congress included Territorial Taxation for Corporations (TTC) in the group of reforms built into the Tax Cuts and Jobs Act (TCJA). Chairmen Brady and Hatch both stated that TTC was implemented in order to help level the international tax playing field for U.S. multinational corporations. However, Congress also included in the TCJA two new "transition tax" provisions to capture tax on corporate profits held offshore. These new "transition taxes" are among our primary concerns because they materially threaten the viability of businesses owned by Americans living abroad.

The TCJA "Transition Taxes"

<u>15.5% Repatriation Tax</u> - imposed on undistributed (and therefore untaxed by the U.S.) business profits from 1986 through 2017. Overseas resident American business owners declare those undistributed business profits on their 2017 personal tax filing. *This is a retroactive*

[2] In 2014 research published by Democrats Abroad approximately 20% of respondents identified themselves as "Self-employed/Business Owner." Given the Department of State estimates that 6.5 million voting age Americans live abroad, we estimate that perhaps a million American citizens are impacted by the "transition taxes" in the Tax Cuts and Jobs Act.

imposition of tax that is unrelated to the realization of revenue that might be used to pay the tax.

GILTI Tax regime – starting in 2018, mandatory declaration of undistributed business profits on the personal tax filings of business owners abroad, *taxed at the highest personal marginal tax rate and without access to two critical offsets afforded corporate owners of businesses abroad: 1) a 50% deduction and 2) credits for taxes already paid on the profits to the business's jurisdiction of incorporation.* Further, as with the Repatriation Tax, *the GILTI tax is imposed on profits where there may be no realization of revenue to use to pay the tax.*

Clearly, TTC was enacted to strengthen U.S. multinational corporations. We believe TTC's "transition tax" provisions were never meant to beleaguer ordinary, hard-working Americans living and owning companies abroad. **In truth, the Repatriation Tax and the GILTI Tax regime are having an enormously harmful financial impact on the estimated 1 million non-resident Americans who own businesses abroad.**

Transaction Tax impacts on non-resident Americans who own businesses abroad

Americans living abroad owning and operating businesses are an exceedingly diverse group; they are architects, yoga studio owners, retailers, recruiters, beekeepers, IT professionals, film and television producers, music distributors, advertising agency owners, financial service providers and more.[3] When asked in early 2018 about the impact of the TCJA "transition taxes" on their enterprises, expat American owners of businesses in their countries of residence provided the following comments:

> My family and I own a small private property development company based in the UK and operating since 2001. The profits of this company are fully taxed in the UK and **none of the proceeds have been repatriated to the US as they are used for the continuing financing of the business.**
> *Massachusetts voter living in the UK*

> I am a widow, mother of 2 children (ages 16 and 22). My husband was a Canadian glass artist he did not have a pension. I am and have been a self employed graphic designer for many years. I have no pension. **My corporation is just me. It holds my savings which are now being taken away by this tax.**
> *Wisconsin voter living in Canada*

> I operate my company with just myself and my spouse and make minimal profit ($20,000 PA at the most after all UK taxes have been paid) and most recently a loss, none the less I file my US taxes at a cost of $1000 each time and **now I find I might be hit with an extra US tax making my company potentially nonviable.**
> *American living in the UK*

[3] See Appendix 1 – Sampling of businesses run by Americans abroad.

I run a technology company from Hong Kong with offices in three territories (China, HK and Taiwan). We have 10 employees and are an exceedingly small company who struggle every day to meet bills and grow our company. **But we have big dreams and want to succeed. Don't snuff out small business owners like myself.** We are the past, present and future of American business both at home and abroad.
New Jersey voter living in Hong Kong

As an architect, I established my small office of 6 employees as a Professional Corporation. This means that the US government is attempting to take a percentage of my savings, which will be needed to weather downturns in the market, which greatly affects my ability to retain employees and keep my business open. I have no home office in the US, nor is there any way for me to benefit from the large corporation tax breaks. **This is simply the US siphoning away the funds I need to keep my business up and running.**
Massachusetts voter living in Canada

I have been in Canada for several decades, except for 1997-2001 when my wife and I lived and worked in the U.S. For the past 11 years I have been doing IT consulting for the Canadian government, which required having a corporation. I have built up savings within the corporation which are meant for my retirement, and it operates solely within Canada, i.e. not a branch operation of any U.S. company. It was a shock to learn from my accountant that **I am facing a tax of about $12,000 on my retained earnings, as a result of the subject legislation.**
North Carolina voter living in Canada

My family business is a simple IT training and consulting corporation that employs me and my husband only. We file and pay taxes in Australia and the US as required. **This new tax can ruin us**, and if we were simply living in the US, would not apply to us. **This is unfair.**
California voter living in Australia

I have a little landscaping business with 5 employees. I am very proud of the work we do, but keeping on top of all of the paperwork is a struggle for me. I am happy to pay my fair share of taxes, but **this law is not fair**.
California voter living in Canada

My business is a one person marketing consulting corporation in which I maintain a simple portfolio to save for my retirement. This is a travesty.
Vermont voter living in Canada

I am a VERY small business owner, running a private counselling practice out of my home. I am very worried that the new laws will be punitive. I already have to pay a tax accountant more than $600 CDN each year for preparing my US tax returns yearly. My fear is that the increased complexity will not only raise the amount I need to pay them, but will result in my needing to pay taxes twice on the same money.

Massachusetts voter living in Canada

My business, REDACTED, is a values based business with a focus on sustainability. We make the best REDACTED in Vancouver, BC and strive to be the best employer in our industry. The livelihood of my family and the 100 staff that REDACTED employs is in danger from this policy mistake.
Washington state voter living in Canada

I am a small business person with a trading company and some small service businesses. I declare my businesses and income and pay the taxes due both locally and to the US Treasury. Although I have lived overseas for over 40 years, **I am proud to be an American and to support the government with my tax dollars. But this latest abomination of a regime is putting an unbearable burden on me and countless other Americans for little tangible benefit.** We're the small worthless fish being swooped up by a giant drift net meant to catch the larger valuable prey, and we're being left to suffocate and die for lack of interest. Please help us.
Wisconsin voter living in Taiwan

I am a practicing physician. I am shareholder in our small incorporated family owned medical business. **This Canadian only corporation serves only local people, and the income from this stays in Canada and is effectively our only pension.** The Repatriation/GILT is unfair taxation! We have diligently and without fail filed our US Tax returns all the years that we have been required to do so in addition the Treasury Department forms at excess cost to us.
California voter living in Canada

I run a one-person incorporated consulting business. I have worked part-time for the past nine years, with the specific purpose of putting money aside to send my two daughters to college in the US. Any additional penalizing taxes paid out of my corporation will be a direct hit to the tuition funds I have worked hard to save, and result in a higher need for federal financial aid.
Illinois voter living in Canada

I am the owner of a small software development business that has never done any business in the U.S., yet still reports to the U.S. IRS, and will continue to do so as long as deemed that the cost is within reason. **My options are simply to shut it down or expatriate.**
California voter living in Sweden

All of these comments, and several more not listed here, demonstrate that many Americans business owners living abroad fear that this additional tax burden will *force them to close their businesses*[4]. In addition to the new transition tax burden American business owners abroad will

[4] Appendix 2 contains comments from Americans living abroad who had planned to start businesses in their countries of residence but who may cancel those plans because of the "transition taxes".

bear, they are also being subjected to even greater tax filing/compliance costs. The new rules for calculating the "transition taxes" are exceedingly technical and organizing accurate filings is proving very time-consuming and complex. U.S. expat tax professionals hired to prepare these filings are passing on to American business owners abroad the additional cost of their time and labor, enlarging the financial burden the new TCJA taxes places on the taxpayer.

Further, while U.S. corporations establish subsidiary businesses abroad in order to expand the operations and profitability of their U.S.-based parent company, U.S. citizens abroad establish businesses in their countries of residence in order to build a life and future abroad.

These are *desperate cries* from your constituents for help.

> I set up my business only in June last year (2017) as a stop-gap to enable me to earn consulting fees during a period of unemployment following involuntary redundancy. I am earning a fraction of what I earned when employed (about 75% less), yet I am now faced with the cost of employing a tax preparer to deal with the complexity of earning my small income through a UK limited company that I own rather than through a UK company owned by someone else. **On 2017 income of about US$15,000, I expect a bill from a tax preparer in excess of US$2,000, more than 10% of my total income, only to comply with the filing burden placed on me as UK business owner who happens to possess a US passport. I can't even estimate what the cost will be if any US taxes are owed.**
>
> I have lived outside the United States for nearly 25 years and have filed my tax returns and FinCen and FATCA forms without the assistance of a tax preparer for the last 15 years**. Now, at a time when I am on significantly reduced income, I am being penalised for being a US citizen earning money the wrong way.**
>
> *Virginia voter living in the UK*

> As a simple freelance consultant to the life sciences industry, I only established a British limited company on the request of my corporate clients to ensure compliance with local employment regulations and law. I have no employees and no teams of accountants and finance advisors. Between the transition tax and the small fortune I will spend on tax accountants, **my financial position will suffer detrimental damage** – not only will I suffer a significant income loss, the reduced income will severely impact my likelihood of being able to re-mortgage my home and potentially force me and my wife to sell our home at a loss. I have been fully compliant with US tax and reporting laws for the 10 years of living overseas – **this law however has the potential to financially destroy millions of Americans like myself in a matter of months.**
>
> I beg you, PLEASE PLEASE PLEASE PLEASE PLEASE PLEASE remove innocent overseas US business owners from this broad net of unintended taxation. I believe it was not intended to financially destroy people like me, but it is has the potential to do exactly that.
>
> *Arizona voter living in the UK*

We believe strongly that a remedy is needed to exempt these taxpayers from a potentially crushing new tax liability - one that Congress never intended.

Transaction Tax Remedy

We believe Americans overseas with interests in foreign corporations should be exempt from the Repatriation Tax and from the GILTI Tax regime for any given year so long as:

(1) they meet the conditions required for exemption under IRC Section 911, and

(2) they are individual U.S. Shareholders.

This solution both achieves the U.S. Congress's goal of capturing corporate tax it has been long-denied, and recognizes that the profits of businesses owned by Americans living abroad were never meant to be repatriated to the U.S. because they are needed to sustain the underlying business entities and the American expatriate families who rely upon them.

We strongly urge Congress to correct this unintended tax burden which harms Americans and their opportunities for personal savings and economic growth. American business owners abroad should be exempted from these transition taxes so they can remain positioned to manage and grow their businesses and take care of their families.

We thank you for considering our views. If you have any questions regarding this letter or would like to discuss the matter further, please do not hesitate to contact either me or Democrats Abroad's Carmelan Polce who can be reached at Carmelan@democratsabroad.org.

Sincerely,
Julia Bryan
International Chair
Democrats Abroad
chair@democratsabroad.org

Democrats Abroad is the branch of the U.S. Democratic Party for Americans living outside the U.S. Democrats Abroad has members in over 190 countries and official country committees in 53 nations on six continents. Democrats Abroad's main activity is helping overseas Americans register to vote in U.S. elections. We host our own voter assistance website, www.votefromabroad.org, to aid Americans in that process. We often cooperate with U.S. Embassies and Consulates in our countries to encourage voter participation on a non-partisan basis. You can find out more information about us at www.democratsabroad.org.

STATEMENT FOR THE RECORD

United States House of Representatives
Committee on Ways and Means
Tax Policy Subcommittee

Hearing on Tax Reform and Small Businesses:
Growing our Economy and Creating Jobs

May 23, 2018

Bond Dealers of America
1909 K St NW, Suite 510
Washington, DC 20006

Introduction

The Bond Dealers of America (BDA) appreciates the opportunity to offer its views regarding the critical issue of tax reform and small business. BDA commends the Committee for recognizing a basic truth—the dynamism of the American economy is ultimately dependent on small businesses, which are our leading source of innovation, entrepreneurial energy, and, above all, jobs.

As the only Washington, DC–based trade association representing the interests of "main-street" investment firms and banks active predominately in the U.S. fixed income markets, BDA has a unique perspective on how best to ensure that the capital required to put our small businesses to work is readily available. In particular, our members provide essential assistance to state and local governments and private entities to raise the capital used to pay small businesses—and their employees and suppliers—for their goods and services.

BDA applauds the Committee and Congress for passing last year's sweeping tax reform legislation, the *Tax Cuts and Jobs Act,* which will greatly benefit small businesses by reducing their tax burden, simplifying compliance, and boosting economic growth, and through that greater growth, will expand opportunities for small businesses.

Nonetheless, more work is needed. Tax reform was a major legislative achievement. However, it is also an ongoing task. Now that tax reform has been enacted, policymakers must exercise vigorous oversight to ensure that the changes to the Internal Revenue Code implement sound tax policy, to assess the actual revenue impact of the enacted provisions, and to identify further changes to the tax code that should be enacted. Congress also must remain mindful of provisions of current law that help small businesses to thrive, and be vigilant in protecting those provisions from being made less effective or even eliminated altogether.

In our comments, BDA would like to focus on three tax policy goals that Congress must pursue if it is to ensure capital is readily available for priority projects that engage, make purchases from, or facilitate operation of small businesses:

- Continue the tax-exemption for interest paid on bonds issued by state and local governmental entities.

- Restore the ability of state and local governments to save taxpayer dollars and generate additional funds for infrastructure and other key initiatives by restoring tax-exempt Advanced Refundings (ARs).

- Expand the use of tax-exempt Private Activity Bonds (PABs).

Retain tax exemption for interest paid on state and local government bonds

Since the enactment of the federal income tax in 1913, interest paid on bonds issued by state and local governments has been excluded from taxation. Over the century since, the wisdom of that approach has been repeatedly affirmed.

In principle, the federal government has no business taxing the legitimate governmental functions of state and local government, including the servicing of debt incurred for vital government projects and services.

In practice, the tax exemption for interest paid by state and local governments has reduced their borrowing costs by hundreds of billions of dollars. Further, the proceeds of the tax-exempt bonds, together with concomitant interest savings, have been used to create much of the existing stock of roads, bridges, schools, hospitals, and other key physical and institutional assets that are essential to the operation of our economy and society—assets that largely were built, supplied, or served by small businesses. Had the interest on state and local government bonds been taxable, the cost of those assets would have been vastly higher. In turn, those higher capital costs necessarily would have resulted in higher state and local tax burdens and dramatically fewer infrastructure projects.

Indeed, even consideration of proposals to limit the tax exclusion for interest paid on state and local government bonds has proven extremely disruptive to capital

markets, the projects they finance, and the jobs they create. Past proposals released or discussed in the last two Congresses have sent tremors through the municipal markets and have increased interest rates on tax-exempt bonds. The perceived risk to the tax exemption led some investors to seek higher yields on municipal bonds and to pull much-needed capital and liquidity out of the municipal markets. In turn, if government issuers must pay higher borrowing costs, governments must reduce or abandon infrastructure projects they can no longer afford.

BDA commends the Committee and Congress for recognizing that tax reform did *not* require changes to the tax treatment of interest paid on state and local bonds (with the exception of advance refundings). However, BDA also is mindful that such exemption is a regular target of proposals to raise federal tax revenue. BDA urges the Committee and Congress to be wary of such proposals, and reject any initiatives to ignore the lessons of the past century and tax interest paid on state and local debt.

Restore Advance Refundings

BDA is deeply concerned that the *Tax Cuts and Jobs Act* repealed tax-exempt advance refunding bonds upon enactment of the legislation. The repeal of this provision is working against the stated goal of the tax reform legislation—that is, to energize the economy and lower the tax burden of middle-class Americans. Moreover, that major change deprives state and local governments of an essential tool that has been widely used to help finance America's infrastructure and generate capital that is spent with small businesses.

State and local governments routinely refinance their outstanding debt obligations, just as corporations and homeowners do. The advance refunding technique allows state and local government issuers to refinance, and thus benefit from lower interest rates, when the outstanding bonds are not currently callable. It is important to note that, under previous law, tax-exempt bonds could be issued to advance refund an outstanding issuance only once, a significant restriction on these transactions.

According to recent Government Finance Officers Association data, between 2012 and 2017, there were over 9,000 advance refunding issuances nationwide, saving taxpayers over $14 billion in the five-year period. We note that this represents the "present value" measurement of the savings—actual savings were substantially greater.

Advance refundings are of particular benefit to small issuers. For example, in Montgomery County, TX, six advance refundings for bonds used to finance Conroe primary and secondary education needs resulted in savings of over $20 million dollars. In North Barrington, IL, the city was planning to advance refund a $6,200,000 issuance that would save the village $310,000. This is currently on hold

due to the repeal of the cost saving tool. In Eden Prairie, MN a $250,000 issuance of general purpose bonds was advance refunded.

Critical public policy considerations strongly support restoration of advanced refundings. Moreover, BDA believes that ARs may be reinstated without an unacceptable tax revenue impact—in particular, the BDA believes that data unavailable at the time tax reform was enacted will demonstrate that the projected federal savings from the repeal of advance refundings in the tax bill will be lower than the Joint Committee on Taxation estimate of $17 billion, largely due to the rush of issuers into the market in the latter part of 2017 and slowly rising interest rates.

Representative Hultgren, Representative Ruppersberger, and others recently introduced H.R. 5003, a bipartisan bill to reinstate tax-exempt advance refunding bonds. As explained by the bill's sponsors, "the legislation would restore advance refundings so that states and local governments can take advantage of favorable interest rates and more efficiently manage their financial obligations." H.R. 5003 has been referred to the Committee on Ways and Means. BDA strongly urges the Committee to report the bill favorably at the earliest opportunity, and for Congress to pass the legislation so that it may be signed into law.

The loss of advance refundings will severely impact the financing of core public services and infrastructure in states and localities that must deal with rapid growth and inadequate or aging infrastructure.

For example, in Texas, more than 50 issuers including cities, schools hospitals, and water and public transportation boards in the five largest counties in Texas (Bexar, Dallas, Harris, Tarrant, and Travis) will lose the ability to advance refund an estimated $6.6 billion dollars in bonds over the next two years. The repeal of this vital financing tool translates into a loss of millions of dollars that could have been reinvested back into these communities or used to reduce the burden on local taxpayers. Similarly, the Port of Galveston, which was planning to advance refund an $11.3 million issuance in bonds that would produce a cost savings of $450,000, will not be able to do so.

Though the negative consequences of the repeal of advance refundings already are clear, the extent of that impact will not be fully evident for some time. Due to the low interest rates at the end of 2017 and the pending repeal of the ability to advance refund bonds, many state and local governments refinanced their bonds prior to year-end. As a result, there will be a relatively short period during 2018 before state and local governments feel the real impact of this change in law. However, as time passes and interest rates continue to rise, repeal of advance refundings is certain to have significant, long-lasting impacts on state and local governments.

In the long term, state and local governments will be greatly disadvantaged by the loss of the ability to issue tax-exempt AR bonds. Most importantly, they will have lost the most efficient mechanism to take advantage of low interest rates to

refinance higher rate debt in advance of when such debt can be called. The inability to lock in lower interest rates when they are available will, simply stated, result in increased costs to these governmental entities and increased tax burdens on their residents. Moreover, at a time of relatively low, but steadily increasing, interest, state and local governments have lost an important means of restructuring their outstanding debt to respond to short or long-term fiscal issues (which can include both paying off their debt more quickly or restructuring debt to deal with short term financial difficulties).

There are no alternatives to advance refundings that are as effective in terms of cost or risk. State and local governments are, wisely, hesitant to use interest rate swaps. Similarly, other alternatives are more costly than ARs and will not be able to provide an effective replacement for advance refunding bonds.

Expand the use of Private Activity Bonds

Bonds issued by state and local governments may be classified as either governmental bonds or Private Activity Bonds. Governmental bonds are bonds that are primarily used to finance governmental functions or which are repaid with governmental funds. PABs are bonds in which the state or local government provide financing to nongovernmental persons (e.g., private businesses or individuals) or for public projects that have significant nongovernmental involvement. The exclusion from income for state and local bonds does not apply to private activity bonds unless the bonds are issued for certain permitted purposes and other Internal Revenue Code requirements are met.

One requirement for most PABs is the "volume cap" limitation. If, during a given year, an issuing authority issues more qualified private activity bonds than its allocable volume cap, the tax-exempt status of those excess bonds is jeopardized. For calendar year 2018, the amounts used under Internal Revenue Code section 146(d) to calculate the state ceiling for the volume cap for private activity bonds is the greater of (1) $105 multiplied by the State population, or (2) $311,375,000. However, not all private activity bonds are subject to the volume cap limitation. For example, bonds used to finance airports, public education facilities, docks, wharves, and certain other government-owned facilities are not subject to the cap.

Private activity bonds are used for a qualified purpose if 95 percent or more of the net bond proceeds are to be used for one or more defined qualified purposes. The qualified purposes are described in Sections 142 through 145 and 1394 of the Internal Revenue Code. For purposes of the 95 percent requirement, issuance costs financed with bond proceeds are generally treated as not being used for a qualified purpose.

The U.S. has compelling, unmet infrastructure needs, but state and local governments do not have the fiscal means to address those needs without substantial private sector engagement. Tax-exempt PABs facilitate greater private

sector involvement in infrastructure projects and programs that, in turn, provide important public benefits that should be preserved and enhanced. Expanding the use of current infrastructure financing tools like PABs, rather than creating new financing methods (and resulting bureaucracies) such as a federal infrastructure bank, would help state and local governments partner with private entities in general—and small businesses in particular—to meet pressing infrastructure and other needs.

The *Tax Cuts and Jobs Act* recognized the benefit of PABs and, thus, did not adopt proposals to further limit, or even ban, their use. BDA urges the Committee and Congress to act on those acknowledged benefits of PABs and provide state and local governments additional flexibility to utilize PABs efficiently and effectively, and at low cost for the taxpayer.

Towards that end, BDA strongly supports expanding of the types of infrastructure facilities that are eligible to use tax-exempt PABs, lifting the PAB volume caps, and eliminating other restrictions on the use of PABs, such as the governmental ownership requirement for certain eligible facilities that apply under current law.

Significantly, each of those policy objectives are emphatically endorsed by the Trump Administration's "Legislative Outline for Rebuilding Infrastructure in America". The White House expressly calls for multiple steps to "Create Flexibility and Broaden Eligibility to Facilitate use of Private Activity Bonds", which it states, correctly, "would allow for greater Federal leverage and therefore more efficient infrastructure improvements." BDA very much concurs with the Administration's recommendations.

Conclusion

For over 100 years, municipal bonds have served as the primary financing mechanism for public infrastructure. Nearly three-quarters of the nation's core infrastructure is built for state and local governments, which engage small businesses to do much of the work. Imposing an unprecedented federal tax on state and local bonds, including advance refundings, will make these critical investments more expensive, and thus more infrequent or modest in scale. The Internal Revenue Code should affirm the benefits of tax-exempt bonds for state and local governments, and not unnecessarily impede their use.

STATEMENT ON BEHALF OF

THE COUNCIL OF INSURANCE AGENTS AND BROKERS (CIAB)[1],
THE INDEPENDENT INSURANCE AGENTS & BROKERS OF AMERICA (IIABA)[2],
AND THE NATIONAL ASSOCIATION OF INSURANCE AND FINANCIAL ADVISORS (NAIFA)[3]

BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING ON TAX REFORM AND SMALL BUSINESSES: GROWING OUR ECONOMY AND CREATING JOBS

SUBMITTED MAY 31, 2018

INTRODUCTION

On behalf of CIAB, IIABA, and NAIFA ("Insurance Producer Associations" or "Associations") we submit the following statement for the record regarding the above referenced hearing that occurred on May 23. Together all three Associations represent tens of thousands of pass-through businesses that are licensed by state insurance regulators to sell and service insurance products. These insurance businesses employ people in every congressional district in the country.

As the committee knows, Section 199A of the Internal Revenue Code (IRC) is a new section of the IRC that creates a 20% deduction on "qualified business income" (QBI) for owners and shareholders of pass-through businesses. The Associations are currently seeking clarity on the application of this deduction with the Department of Treasury and the Internal Revenue Service (IRS).

As outlined further below, the Insurance Producer Associations understand that it was the intent of Congress to exclude the business of insurance, including insurance producers, from the definition of "specified service trade or business" contained in Section 199A. The Associations are submitting this statement for the record because confusion over the proper application of this definition is already creating problems for our members as they file quarterly estimated tax payments. Consequently, we urge

---

[1] CIAB represents the most successful employee benefits and property/casualty agencies and firms in the U.S. Our member firms annually place more than $300 billion in commercial insurance business in the United States and abroad, and they employ upward of 350,000 people worldwide. The products sold by Council members provide vital security and benefits to countless employees and businesses across the country.

[2] IIABA is the nation's oldest and largest trade association of independent insurance agents and brokers, representing a nationwide network of approximately a quarter of a million agents, brokers, and employees. IIABA represents independent insurance agents and brokers in all 50 states that offer customers a choice of policies from a variety of insurance companies across all lines of insurance—property, casualty, life, health, employee benefit plans and retirement products.

[3] Founded in 1890, NAIFA is the oldest, largest and most prestigious association representing the interests of insurance professionals from every Congressional district in the United States. NAIFA's mission – to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members – is the reason NAIFA has consistently and resoundingly stood up for agents and called upon members to grow their knowledge while following the highest ethical standards in the industry.

Congress if necessary to clarify that congressional intent at time of passage of the "Tax Cuts and Jobs Act" was that the business of insurance, including insurance producers, be excluded from the definition of "specified service trade or business," and therefore able to fully utilize the 20% deduction.

THE BUSINESS OF INSURANCE, INCLUDING INSURANCE PRODUCERS, IS PROPERLY EXCLUDED FROM THE DEFINITION OF "SPECIFIED SERVICE TRADE OR BUSINESS" IN SECTION 199A OF THE IRC AND ANY IMPLEMENTING GUIDANCE OR REGULATIONS SHOULD APPROPRIATELY RECOGNIZE THIS.

Section 199A can be summarized as follows:

- All pass-through business owners/shareholders can receive the full 20% deduction when their annual taxable income does not exceed $315,000 (joint) / $157,500 (single).
- For owners/shareholders at higher income levels the deduction cannot exceed 50% of applicable employee wages paid, or 25% of applicable wages plus 2.5% of capital assets (e.g. tangible property purchased for the business), whichever is greater
- Finally, the deduction is phased out for owners/shareholders of a "specified service trade or business" between $315,000 (joint)/$157,500 (single) and $415,000 (joint)/$207,500 (single). In other words, an owner/shareholder of a "specified services business" with annual taxable income above $415,000 (joint) an $207,500 (single) cannot utilize the deduction.

The new law adopts an amended definition of what is not considered a "qualified trade or business" for purposes of exclusions for gains from business stock contained in Section 1202(e)(3) of the tax code to create a definition for a "specified service trade or business" that would be excluded from using the 20% deduction in certain cases.

The new § 199A generally defines a non-qualified "specified service trade or business" as those described in IRC § 1202(e)(3)**(<u>A</u>):**

> *any trade or business involving the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.*

The new tax law, however, modifies the above definition in three respects. Namely, it:

- Excludes "engineering" and "architecture;"
- Refers to the reputation or skill of "employees or owners," instead of just "employees:" and
- Adds investing and investment management as specified service businesses.

Tellingly, when Congress altered the definition in 1202(e)(3)(A), **<u>Congress did not add insurance businesses to the list of non-qualified service businesses</u>**. Indeed, adding investing/investment management businesses was necessary because IRC § 1202(e)(3)(B) includes a list of businesses distinct from (e)(3)(A) (i.e., a list of businesses not captured in the non-qualified services definition based on subsection (A) alone). Those businesses in 1202(e)(3)(B) include:

> any banking, ***<u>insurance</u>***, financing, leasing, ***<u>investing</u>***, or similar business.

Ultimately, Congress could have included within the definition of "specified service trade or business" all of § 1202(e)(3), or (e)(3)(A) and (B)—but it did not. Instead, it selectively expanded the definition of service businesses in (A) to include investing businesses, and did not include insurance businesses, banking businesses, leasing businesses, etc. Thus, the Insurance Producer Associations understand that while

Congress intended that any insurance business should not be treated as a "specified service trade or business."

Moreover, our member firms are "insurance businesses" and are regulated as such.[4] Our members operate as the day-to-day sales force for the insurance industry. Insurance producers are licensed as insurance businesses by state insurance regulators. Every state requires individuals to obtain an insurance license to sell and service insurance products. Additionally, many states require them to be appointed as agents with authority to sell on behalf of insurers and deliver binding insurance contracts. They also have special examination, appointment, compensation and disclosure requirements (and restrictions) under state insurance laws and regulations by virtue of their role as insurance businesses.

Finally, it is well settled law at the federal level (in statute and judicial decisions) that the sale and servicing of insurance is considered part of the "business of insurance." Multiple federal statutes, including the Gramm Leach Bliley Act of 1999 and the Dodd Frank Wall Street Reform and Consumer Protection Act of 2010, include the sale and servicing of insurance as part of the "business of insurance."

CONCLUSION

The Insurance Producer Trade Associations appreciate your leadership on tax reform and are committed to continuing to work with Congress on these important issues. However, our member firms are not the type of businesses that Congress intended to exclude from receiving the full benefits of Section 199A. Our members provide protection products that are essential to the economy, individual businesses and American families, employ millions of people across the U.S., and occupy numerous retail locations in every state. Excluding our member firms from receiving the full benefits of § 199A would be contrary to Congress' broad public policy goals of growing the economy and creating jobs, and—as with any policy development that increases the cost of doing business—would ultimately be detrimental to consumers of vital insurance products. With the "Tax Cuts and Jobs Act," Congress enacted, and the President signed the broadest changes to the American tax code since the 1980s. The intent of this endeavor was to provide businesses and hardworking individuals across the country with much-needed tax relief. Interpreting the pass-through provisions in the new tax law in a narrow and exclusionary manner would only undermine these objectives and stunt economic benefits associated with tax reform.

[4] The McCarran Ferguson Act, 15 U.S.C. §§ 1011-1015, leaves regulation of the "business of insurance" to the States, unless preempted by a federal law that "specifically relates to the business of insurance." See generally, Barnett Bank of Marion Cnty. v. Nelson, 517 U.S. 25 (1996) (finding federal law permitting certain banks to act as insurance agents and sell and solicit insurance products "specifically related to the business of insurance").

WRITTEN STATEMENT
SUBMITTED BY THE AMERICAN FEDERATION OF MUSICIANS
TO THE HOUSE COMMITTEE ON WAYS AND MEANS

HEARING ON "TAX REFORM AND SMALL BUSINESSES: GROWING OUR ECONOMY AND CREATING JOBS"
June 6, 2018

This statement is submitted in accordance to a request for stakeholder comments and is in compliance with Committee submission guidelines regarding the impact of HR 1, the Tax Cuts and Jobs Act of 2017 (TCJA) signed into law by President Donald Trump on December 22, 2017.

The American Federation of Musicians of the United States and Canada (AFM) is an international labor union that has been in existence since 1896. We represent more than 80,000 professional musicians and we serve the interests of all professional musicians seeking congressional relief in the United States and in Canada on a multitude of legislative issues from tax relief to immigration, copyright and music licensing, arts appropriations, and regulatory matters.

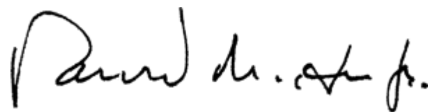
Our members comprise this nation's most well-known featured and non-featured artists performing every style of music. Renowned artists such as Willie Nelson, Itzhak Perlman, Bruce Springsteen members of all major symphony, opera and ballet orchestras such as the Dallas Symphony Orchestra, the New York Philharmonic, the Metropolitan Opera Orchestra, and the Kennedy Center Opera Orchestra as well as Hollywood and New York film orchestra musicians, and a broad range of musicians and artists in every committee members' district have for decades relied upon a financial model that includes tax deductions as a means to live and create great music for audiences the world over. The livelihoods of all professional musicians are affected by the negative implications of HR 1.

TCJA is the most fundamental and substantive change to US tax law in 30 years. For professional musicians, particularly those who earn their living as employees and are subject to W-2 reporting and withholdings, the new tax law has created undue hardship for those who rely on specific tax deductions to recognize legitimate expenses that are essential to the performance of music but that are not reimbursed by employers.

Recent tax code changes affect not only professional musicians but also university and conservatory musicians who aspire to professional careers in music. As a result, it is difficult for them to meet or exceed the new standard deduction of $12,000.00 to $24,000.00 annually. The increase in tax liability makes it more difficult to survive as a professional musician and perform at the level our audiences and employers expect and deserve.

We note that the change in applying Miscellaneous Itemized Deductions beginning in the 2018 tax year eliminates deductions for necessary items such as the purchase of an instrument, sheet music, supplies or equipment, required concert clothing, mileage, job search/audition expenses, research expenses for music professors, or home office teaching and practice studios. Additionally, musicians can no longer deduct tax preparation fees, memberships to professional organizations, or union dues. All of these items are necessary for the growth and development of employment opportunities and for maintaining employment of professional musicians. Unless these and similar deductions are restored by congress, the careers of musicians in the United States are now in jeopardy and will be demonstrably and detrimentally affected.

As the International President of the largest organization in the world representing those who record and perform live music, and teach millions of students across our nation, we seek your help in crafting an amendment to the code that will restore fairness in taxation for professional musicians and enable them to continue to bring joy to the world.



Raymond M. Hair, Jr.
International President
American Federation of Musicians
of the United States and Canada
1501 Broadway, Suite 600
New York, NY 10036

U.S. House of Representatives Committee on Ways and Means Tax Policy Subcommittee
"Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs"
Wednesday, May 23, 2018

Statement of Deborah Field
Owner, *Paperjam Press PDX*
4730 NE Fremont Street
Portland, OR 97213
(503) 238-5777

Deborah Field is the co-owner of Paperjam Press PDX, a boutique printing and design company located in Portland, Oregon employing four people. She serves on the Executive Committee of the Main Street Alliance of Oregon, a statewide network of small business owners.

The GOP tax plan doesn't help me or many other small businesses. I used to be a corporate tax accountant, so I am very comfortable with numbers. I calculated my tax based on the new changes, and I end up paying $700 more than last year.

I wanted to see what this would mean for some of my fellow businesses, so I went out and talked to them. They didn't even pause, they all laughed and said this isn't for us -- this tax plan is a giveaway to the biggest corporations who aren't paying their fair share in taxes already.

Too many big corporations take advantage of all America has to offer, but then refuse to pay their fair share in taxes. Corporate loopholes are already so large that some multinational corporations pay less in taxes than I do. There is something deeply wrong with that.

If Republicans really wanted to help small businesses, they would stop giving us phony tax cuts and look to the banks that are not loaning to small businesses. They would invest in policies and programs that expand access to credit and capital for small businesses. That would really help small businesses like mine grow-- trillion dollar tax breaks large corporations will not.

For questions, please contact Sapna Mehta, Legislative and Policy Director, at sapna@mainstreetalliance.org, or (440)-823-7336.

U.S. House of Representatives Committee on Ways and Means Tax Policy Subcommittee
"Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs"
Wednesday, May 23, 2018

Statement of Davis Senseman
Founder, **Davis Law Office**
400 South 4th Street, Suite 401-200
Minneapolis MN 55415
(612) 293-9308

Davis Senseman is the founder of Davis Law Office in Minneapolis, MN, a full-service law firm for small and medium sized businesses. Davis Law Office employs five people and has a roster of over 800 Minnesota-based small business clients. Davis is a member of Main Street Alliance of Minnesota, a statewide network of small business owners.

The new tax law is so confusing that tax accountants and lawyers are the only ones who are going to grow their business and hire more employees as a result of it. Even then, there's so much uncertainty in the law that it's really hard to find an accountant who can give you a simple yes or no answer about whether you should restructure your small business into an S-corp or an LLC.

Our law firm sits in a very privileged position when it comes to this tax law because we are attorneys who advise small businesses. We decided to restructure our business, and we had to spend a great deal of money to figure out the details with our accountant. That means that, in the first year at least, what we will save in taxes will be pretty much outweighed by what we spent to figure it out, and again, we are in such a unique position. I would double what we spent for any other small businesses because they will need to talk to their attorneys as well.

I have been talking about the uncertainty of this tax bill a lot with my clients who are small business owners. The median income for a self-employed individual with an incorporated business in Minnesota was about $48,241 in 2015. For the vast majority of small businesses, that means that it does not make financial sense to spend thousands of dollars on accountants, attorneys, and other fees in order to restructure their business. In my experience, these business owners are more concerned about the dire need for investment in infrastructure, schools, and our healthcare system than they are about potential nominal decreases in their tax rates anyways.

Uncertainty is never your friend when running a business, and there are so many things about this bill that are uncertain. We simply don't know how much of it is going to be interpreted. Just wait until next April, when people are trying to guess what they should be doing.

For questions, please contact Sapna Mehta, Legislative and Policy Director, at sapna@mainstreetalliance.org, or (440)-823-7336.

U.S. House of Representatives Committee on Ways and Means Tax Policy Subcommittee
"Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs"
Wednesday, May 23, 2018

Statement of Maurice Rahming
Owner, *O'Neill Construction Group*
4444 S.E. 27th Avenue
Portland, OR 97202
(503) 493-6045

Maurice Rahming is the co-owner of O'Neill Construction Group, a general contracting company located in Portland, Oregon, employing over 50 individuals. He serves on the Executive Committee of the Main Street Alliance of Oregon, a statewide network of small business owners.

At O'Neill Construction Group, we strive to create quality, living wage careers in construction for all our employees, especially people of color who have been traditionally shut out of careers in construction. We've been a fixture in our community for over 20 years and have grown from two employees to over 50.

A large part of our business comes from public contracts. The recent tax changes reduce the SALT deductions, putting pressure on public budgets. Public budgets which are already stretched thin. Not only does this mean fewer public construction projects, and less business for my company, but it means we won't be able to repair our roads and bridges or modernize our schools. In Oregon, and all across the country, we have crumbling infrastructure like the Marquam Bridge. We need more public investment to repair the bridge, not less.

If that's not bad enough, the rollbacks to the SALT deduction also make owning a home more expensive. This will lead to fewer new home purchases and renovation projects, depressing the housing market and hurting small contractors like us, and our crews of electricians, carpenters, painters, and masons.

If we took the trillions of dollars in tax breaks multinational corporations are receiving and instead invested that money into infrastructure projects, we could repair the Marquam Bridge and make many more needed infrastructure upgrades.

For questions, please contact Sapna Mehta, Legislative and Policy Director, at sapna@mainstreetalliance.org, or (440)-823-7336.

U.S. House of Representatives Committee on Ways and Means Tax Policy Subcommittee
"Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs"
Wednesday, May 23, 2018

Statement of Mike Draper
Owner, RAYGUN
505 East Grand Ave
Des Moines, IA 50309
(515) 288-1323

Republicans say they support small businesses, the economic backbone and job creators of communities across the country and in Iowa, often citing "The American Dream." And they continue to say that their tax plan is benefitting small businesses. But the truth of the matter is, this tax plan threatens my ability to access healthcare and provide health coverage to my employees. And that is worth much more in absolute terms than the marginal tax cuts I might receive.

When Republicans jammed their tax plan through Congress late last year, they included a repeal of the ACA individual mandate to help pay for the windfall in tax cuts to wealthy corporations. This increased the number of uninsured and caused hefty premium increases - which are projected to spike even more in 2019 and 2020.

President Trump's 'nobody knew how complicated healthcare was' comment made me want to raise my hand and say, 'oh, I actually knew how complicated healthcare was.' I've gone through every phase of healthcare, from uninsured, insurance through my wife, an individual policy that I paid for, and now through RAYGUN on our group insurance.

The group insurance that we now have is one part of the ACA that allowed small businesses to buy into larger groups and still have options within those groups. There is a lot of focus on the larger issues - preexisting conditions and the individual mandate, but there are also a lot of small parts of the ACA that every day small businesses like mine actually use.

As Republicans continue to sabotage the ACA, through the proposed expansion of short-term and junk plans, I am extremely concerned that the double digit premium increases will threaten my ability to provide healthcare to my employees. In Iowa, estimated premium increases in 2019 due to these acts of sabotage average nearly $1,500. Small business owners like me are being saddled with higher healthcare premiums and looming cuts to other essential services in order to fund tax cuts to wealthy corporations.

I know and like David Young personally, but strongly disagree with his decision to support tax cuts for the wealthy. It will take years to unwind.

Mike Draper is the owner of RAYGUN, a custom t-shirt design company. RAYGUN headquartered in Des Moines, IA with stores in Des Moines, Cedar Rapids, Iowa City and Kansas City. He is a leader at with the Main Street Alliance, a national small business network.

For questions, please contact Sapna Mehta, Legislative and Policy Director, at sapna@mainstreetalliance.org, or (440)-823-7336.

U.S. House of Representatives Committee on Ways and Means Tax Policy Subcommittee
"Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs"
Wednesday, May 23, 2018

Statement of ReShonda Young
Owner, Popcorn Heaven
P.O. Box 1965
Waterloo, IA 50704
(319) 504-2323

The Republican tax law is not what my business needs to create jobs and grow. I've talked with my accountant, and the nominal tax cut I might receive won't cause me to grow my business or hire more employees.

In fact, this tax law makes me worried more than anything. I'm worried about my employees and customers access to quality, affordable healthcare. In order to pay for the tax cuts to wealthy corporations, Republicans are sabotaging the ACA by repealing the individual mandate. Coupled with other efforts by the Trump Administration, including the proposed expansion of short-term and junk health plans, premiums are increasing by double digit numbers, while the quality of coverage is decreasing.

I started fighting for the ACA in 2009, when I was actually running my dad's small businesses. We had been searching for insurance for years, and preexisting conditions were the biggest stumbling block. The failed system that was in place made it unaffordable for us to provide health insurance for our employees. The policies we were shown also denied health benefits for several of our employees due to pre-existing medical conditions.

Knowing that most of our employees had no health insurance in place, and had no way of paying for it on their own, was a huge concern for us. We knew that an illness or an accident could put our employees in a situation where they had to choose between getting the medical care that they need, and paying their rent/mortgage, putting food on the table or keeping the heating on during cold Iowa winters. Those aren't choices anyone should have to make.

After passage of the ACA, we were able to put a plan place for our employees that did not exclude their pre-existing conditions. When I opened Popcorn Heaven in 2014, I was grateful to have an affordable health insurance option for my employees.

To go back to where we started from doesn't make any sense. Our Members of Congress, and especially Representative Rod Blum, need to start making some smart decisions, and undermining access to lifesaving healthcare to give trillions of dollars in tax cuts to their wealthy donors is NOT one. It is putting us into a tailspin.

ReShonda Young is the owner of a gourmet popcorn franchise called Popcorn Heaven. Popcorn Heaven is headquartered in Waterloo, IA with locations in Des Moines, IA; Kansas City, MO; Peoria, IL; Charlotte, NC and soon in Waldorf, MD. She serves on the Executive Committee of the Main Street Alliance, a national small business network.

For questions, please contact Sapna Mehta, Legislative and Policy Director, at sapna@mainstreetalliance.org, or (440)-823-7336.

TESTIMONY BEFORE THE UNITED STATES CONGRESS ON BEHALF OF

Statement for the Record

Before the

Committee on Ways and Means
Subcommittee on Tax Policy
United States House of Representatives

Hearing on Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs

May 23, 2018

NFIB
1201 F Street, NW Suite 200
Washington, DC 20004

Chairman Buchanan and Ranking Member Doggett,

On behalf of NFIB, thank you for the opportunity to submit this statement for the record for the Ways and Means Tax Policy Subcommittee hearing entitled, "Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs."

As NFIB represents roughly 300,000 small and independent businesses across the country, we appreciate the Ways and Means Committee's continued attention to how tax policy, specifically the *Tax Cuts and Jobs Act*, impacts small businesses.

For years, small businesses have counted tax issues among five of their top ten problems, according to NFIB's *Small Business Problems and Priorities* survey.[1] The *Tax Cuts and Jobs Act* presented the biggest tax overhaul in more than three decades, and it dramatically improved the landscape for many small businesses.

The centerpiece of those changes is the new Section 199A, or the pass-through deduction – important because more than 90 percent of small businesses are organized as pass-throughs (S corporations, LLCs, sole proprietorships, or partnerships), not as corporations. Under the law, a pass-through business owner – regardless of the type of business they own – can now claim a full 20 percent deduction on their share of the business's income up to $315,000 for those filing jointly.

That's a huge relief for small business owners. The much-needed savings provides more capital to invest in growing, hiring, and producing. And because many small business owners whose taxable income exceeds this threshold will also be able to claim the deduction, the overwhelming majority of small businesses in America are eligible for this benefit.

Since enactment of the tax law, the tangible effect has been remarkable and historic. According to NFIB's monthly *Small Business Economic Trends* survey,[2] small and independent business owners are notably confident about the economy. They are reporting that sales are strong, profits are good, and employee compensation is increasing. Small business owners are reporting record profit trends with April's small business optimism index reaching its highest point in the survey's 45-year history. They're making new capital outlays and increasing inventories. And many are setting into motion plans to expand.

Coupled with increased thresholds for the alternative minimum tax and estate tax, a doubling of the standard deduction, and a significant increase in the expensing limits, the benefits to small and independent business owners are substantial.

To put these reforms in context, consider David Cranston. He owns a small material handling equipment business outside of Pittsburgh with seven full-time and two part-

---

[1] Holly Wade, Small Business Problems and Priorities, NFIB Research Foundation, 17, (August, 2016), available online at https://www.nfib.com/assets/NFIB-Problems-and-Priorities-2016.pdf (last visited June 6, 2018).

[2] William C. Dunkelberg and Holly Wade, NFIB Small Business Economic Trends, NFIB Research Foundation, 2, (April, 2018) available online at https://www.nfib.com/assets/SBET-April-2018.pdf (last visited June 6, 2018).

time employees. In testimony before the Senate Finance Committee[3] in late April, he detailed just how important the tax law and, specifically, the pass-through deduction are to his business.

Cranston noted, “I now qualify for a 20 percent deduction on my pass-through income. In real terms, this means I will be able to keep $5,000 to $10,000 a year in my company. This is a big deal to a small business owner like me.”

These savings will allow Cranston to expand into a new product line. Cranston’s business is purchasing new equipment, investing in training, and building a new website to self-fund this new product line.

On May 17, 2018, NFIB released a survey titled *Small Business Introduction to the Tax Cuts and Jobs Act (Part 1)* to provide a baseline reading on small business owners’ initial responses to the *Tax Cuts and Jobs Act*.[4] The survey, the executive summary of which is attached as an addendum to this statement for the record, found small business owners are bullish about business and the impact of the new tax law:

- The vast majority (76 percent) of small business owners believe the current business climate is heading in a positive direction.
- Three-fourths of small business owners believe the tax law will positively impact their business.
- Eighty-seven percent think the new tax law will have a positive impact on the general economy.

The majority of respondents anticipate a lower tax bill next year and plan to allocate the extra money across a number of business activities. Among these small business owners:

- Forty-four percent plan to increase employee compensation.
- More than one-quarter (27 percent) plan to use the extra savings to add employees.[5]

Certain specific benefits stand out for small business owners:

- Overwhelmingly, 84 percent of small business owners view the creation of Section 199A as important.
- Eighty-five percent consider the reduction of individual rates as important.

---

[3] Senate Finance Committee hearing, “Early Impressions of the New Tax Law” (April 24, 2018), testimony available online at https://www.finance.senate.gov/hearings/early-impressions-of-the-new-tax-law (last visited June 6, 2018).

[4] Small Business Introduction to the Tax Cuts and Jobs Act: Part 1, NFIB Research Center, (May, 2018), available online at https://www.nfib.com/assets/TCJA-Survey.pdf (last visited June 6, 2018).

[5] *Id.*

- Two-thirds regard the changes to the estate tax as important.
- Seventy-six percent of small business owners view the doubling of the standard deduction as important.[6]

Due to these increased measures of confidence and plans for future investment and expansion, NFIB encourages the Ways and Means Committee to provide certainty to small and independent businesses by removing the December 31, 2025 sunset date for the individual and small business provisions of the *Tax Cuts and Jobs Act*.

As small businesses make up more than 99 percent of all U.S. businesses, they account for nearly half of the nation's private sector jobs and almost half of its GDP. When small businesses signal plans to grow, hire and boost pay, it is good news for the entire economy.

[6] *Id.*

Small Business Introduction to the Tax Cuts and Jobs Act: Part 1

May 2018

Executive Summary

- Over three-quarters (76 percent) of small business owners believe the current business climate is heading in a positive direction (Q#4).
- The vast majority (87 percent) percent of small business owners think the new tax law will have a positive impact on the general economy. Just 4 percent believe it will have a negative impact and 9 percent think it will have no significant impact (Q#14).
- Three-fourths (75 percent) of small business owners believe the tax law will positively impact their business, 22 percent anticipate it will have no impact, and 3 percent a negative impact (Q#12).
- While small business owners are enthusiastic about the law generally, many of the details are still unfamiliar to them. Almost one-in-four (24 percent) percent of small business owners are not at all familiar with the new tax law (Q#7).
- Half of small business owners with some familiarity about the law obtained their most useful information from their tax preparer or advisor, another 28 percent from the general news media (Q#8).
- Over half (51 percent) of small business owners expect to pay less in federal income taxes next year, 7 percent expect to pay more, and 37 percent about the same (Q#15).
- Almost half (47 percent) of small business owners who expect to pay less in taxes next year plan to increase business investments with their tax saving (Q#15a5) and 44 percent plan to increase employee compensation (Q#15a6). Another 40 percent of small business owners plan to pay down debt obligations (Q#15a7), 32 percent plan to retain the funds freed up as higher earnings available to support business growth (Q#15a4), and 27 percent plan to hire an additional employee (Q#15a3).
- Over half (55 percent) say that the creation of Section 199A, allowing for up to a 20 percent small business income tax deduction, is “very important” with another 29 percent “somewhat important” (Q#20B).
- Forty-five percent of small business owners say that changes to the personal income tax brackets and rates are “very important” to them and their business, 40 percent say “somewhat important” (Q#20A).

May 23, 2018

The Honorable Vern Buchanan	The Honorable Lloyd Doggett
Chairman	Ranking Member
Subcommittee on Tax Policy	Subcommittee on Tax Policy
Committee on Ways and Means	Committee on Ways and Means
U.S. House of Representatives	U.S. House of Representatives
Washington, D.C. 20515	Washington, D.C. 20515

Dear Chairman Buchanan and Ranking Member Doggett:

Thank you for holding a hearing on tax reform and small business. I am president and CEO of Noble Gas Solutions in Albany, New York, a gas distribution and welding supply company founded in 1940. We employ a team of thirty three full-time and three part-time employees and specialize in delivering industrial grade and pure grade gases to the industrial, specialty, and medical industries across upstate New York's Tech Valley region, southern Vermont, and western Massachusetts.

Thanks to the passage of the Tax Cuts and Jobs Act of 2017, I am able to reinvest savings that I will realize this year to raise wages for my employees. Additionally, I am planning on hiring new staff, a luxury I could not afford for the past several years.

I started with the company as a salesman in the summer of 1976 and purchased what was then-called AWESCO in 1986. During the recent recession, Noble Gas Solutions experienced revenue decline of 15% and the business in upstate New York remained flat for eight years. Last year, the economy in our area finally rebounded and our sales came up 10%.

There really is no way to effectively describe the elation as a small business owner when revenues finally started to increase and when leadership change in Washington, DC sent a message to me that small business is important. The effort to provide regulatory relief from the tsunami of red tape emanating from our nation's capital and passage of tax reform are signs that political leaders care about me along with millions of other proud small business owners who are the fabric of free enterprise in the United States.

In addition to my involvement in Albany, I am a member of the Small Business Council of the U.S. Chamber of Commerce, a strong proponent of tax reform.[1] The U.S. Chamber of Commerce is the world's largest business federation. It represents the interests of over three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. Ninety-six percent of Chamber member companies have fewer than 100 employees and 75 percent have fewer than 10. The Small Business Council that I serve on works to ensure the views of small business are considered as part of the Chamber's policy-making process.

---

[1] *See generally*, www.uschamber.com/tax-reform.

My situation at Noble Gas Solutions mirrors numerous examples from businesses throughout the United States and from the businesses presenting testimony today before your Subcommittee. Lower rates from the Tax Cuts and Jobs Act of 2017 are allowing Main Street businesses to reinvest savings to raise wages, buy equipment, expand operations, enhance employee benefits, and other things that are improving communities and America's economic competitiveness.

The 62 million people employed at small firms represent about half of the nation's private sector workforce. And, since 1995 small businesses are responsible for creating two-thirds of the net new jobs in the country. The power of small business to create growth, spur innovation, hire workers, and improve communities throughout the United States is undisputed. However, the old tax code stifled small businesses' ability to expand.

I applaud your Subcommittee for highlighting the importance of tax reform for small business, and I thank you for considering our views in this letter. Please do not hesitate to contact me at (518) 465-5229, extension 1519 for any additional information about the views expressed here.

Sincerely,

J. David Mahoney
President/CEO

The Honorable Vern Buchanan
U.S. Congressman, Sixteenth District of Florida
Chairman, House Ways and Means Tax Policy Subcommittee
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Buchanan,

I write to you on behalf of the Policy and Taxation Group, which is an organization comprised of family-held businesses from throughout the country that are dedicated to reform of the estate tax. We appreciate the Subcommittee's work on tax reform and, in particular, are supportive of your ongoing efforts to ensure that tax reform is achieving its goal: namely, growing the economy and adding jobs. We also strongly agree with Chairman Brady when he said: "We are not in the first inning of the ball game… we're at the first batter of the first inning of the ball game. And already the results are so encouraging." That said, in order to ensure that tax reform is a "grand slam," we believe that there are several additional actions that tax-writers should take – actions we want to highlight as part of the Tax Policy Subcommittee's May 23, 2018, hearing titled "Tax Reform and Small Businesses: Growing Our Economy and Creating Jobs."

As we have and will continue to do, we want to express our sincere appreciation for doubling of the estate tax exemption as part of tax reform. We believe this is a critical policy change that should be made permanent and not allowed to revert back to tax year 2017 levels at the end of 2025. While we believe that eliminating the estate tax is ultimately the best approach, permanently doubling the exemption would be a step in the right direction. Nevertheless, we believe that more than just a doubling of the exemption is needed.

For example, based on the 2016 Internal Revenue Service estate tax tables, 88-percent of those who filed an estate tax return fall within the current exemption; however, of those who actually *paid* the tax, 66-percent *remain* subject to the tax – despite the increased exemption. This means that many of the family-held businesses that employ millions of Americans will be at risk when their estate tax bills come due – as will the jobs that they provide. Attached to this letter is a PowerPoint (along with a one-page summary) with jobs and other economic data on 180 of the largest family-owned businesses in the United States to underscore the important role that these businesses play as job creators throughout the country that help our economy grow.

If the Subcommittee is genuinely concerned about economic growth and job creation, you must take bold action to protect family-held businesses. One legislative option that will help *all* family-held businesses subject to the estate tax: reduce the rate – which is arbitrarily the highest rate in the tax Code – to the capital gains tax rate, while maintaining step-up in basis.

In addition to a reduction in the estate tax rate, there are various other policy changes that could be implemented to protect family-held businesses from the unfair and disastrous consequences of the estate tax. As the Subcommittee continues to examine such policies in a post-tax reform world, we stand ready to serve as a resource to you, your fellow Subcommittee members, and staff and are happy to provide additional information or answer any questions that you may have.

PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Thank you for your consideration of these important tax policies and your continued efforts to improve our nation's tax Code.

Sincerely,

Pat Soldano

Pat Soldano
Founder, Policy and Taxation Group

PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Family Businesses in U.S.

U.S. Family Business Figures		
180 total businesses 155 private 25 publicly traded	**3,002,560** domestic jobs	**$1.7 trillion** combined revenue

By the Numbers

- In the US, family firms generate 64% of GDP & account for 65% of domestic employment[1]
- 78% of new job creation stems from family owned firms[1]
- 35% of Fortune 500 companies are family-owned or controlled[1]
- Family firms have higher employee retention rates than non-family firms[2]
- 60% of family firms have women in top management positions[3]
- 24% of family firms are led by a female CEO or President[3]

Sources: Conway Center for Family Business Fact References (accessed 1/28/18)

Overview

- Data is based on the most recent available statistics from multiple sources (SEC 10k filings, company data, and other public data).
- "Family-owned business" defined as a public or private enterprise that is majority owned and managed by the founding family
  - Family holds at least 50% of the ownership
  - Family is active in top management
- "U.S. Employment" refers to number of domestic jobs
- The 180 firms in this study generate $1.7 trillion annually, which is worth almost 50% of the total federal budget for 2018

PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Company	Family	U.S. Employment	Annual Revenue
A. G. Spanos Companies	Spanos	900	$1.13 billion (2007)
Advance Publications	Newhouse	12,000	$2.4 billion (2016)
Alex Lee Inc.	George	10,000	$2 billion (2017)
Allegis Group, Inc	Davis	15,000	$11 billion (2016)
Alticor Global Holdings	Van Andel, DeVos	13,000	$9.2 billion (2010)
Amerco*	Shoen	26,400	$3.4 billion (2017)
American Century Companies	Stowers	1,300	$878 million (2015)
American Financial Group*	Lindner	6,750	$1.57 billion (2017)
American Greetings	Weiss	27,500	$1.8 billion
Asplundh Tree Expert Company	Asplundh	34,000	$3.9 billion (2016)
Bashas'	Basha	14,300	$2.05 billion (2005)
Bechtel	Bechtel	29,000	$32.9 billion (2017)
Berwind	Berwind	6,000	$2.835 billion (2007)
Brookshire Grocery	Brookshire	13,795	$2.5 billion (2016)
Brown-Forman*	Brown	2,300	$3.08 billion (2016)
C & S Wholesale Grocers	Cohen	13,200	$30 billion (2016)
Cargill	Cargill, MacMillan	13,000	$120.4 billion (2016)
Carlson	Carlson	20,000	$4.4 billion (2016)
Chick-Fil-A	Cathy	40,924	$8 billion (2016)
Cintas*	Farmer	35,000	$4.9 billion (2016)
Comcast*	Roberts	159,000	$80.4 billion
Cox	Cox, Kennedy	55,000	$20 billion (2016)
Culver Franchising System, Inc.	Culver	7,000	$1.45 billion
Cumberland Gulf Group	Haseotes	7,200	$16.5 billion (2016)
Dart Container	Dart	15,000	$1.25 billion (2004)

Company	Family	U.S. Employment	Annual Revenue
Day & Zimmermann	Yoh	21,000	$2.42 billion (2016)
Delaware North	Jacobs	35,000	$2.6 billion (2013)
Dell*	Dell	55,000	$54.9 billion (2016)
Demoulas Super Markets	Demoulas	25,000	$4 billion (2014)
Dillard's*	Dillard	21,600	$6.754 billion (2016)
E&J Gallo	Gallo	6,500	$4.7 billion (2016)
84 Lumber	Hardy	5,000	$2.5 billion (2015)
Enterprise Holdings	Taylor	91,000	$19.4 billion (2016)
Enterprise Products Partnership	Duncan	6,800	$47.9 billion (2014)
Estee Lauder Companies*	Lauder	20,000	$11.824 billion (2017)
Fidelity Investment	Johnson	20,000	$15.9 billion (2016)
Follett	Follett	8,000	$3.38 billion (2017)
Ford*	Ford	85,000	$151.8 billion (2016)
Gap Inc.*	Fisher	87,150	$15.15 billion (2016)
Gilbane Building Company	Gilbane	2,000	$26 billion (2014)
Golub Corporation	Golub	24,000	$3.4 billion (2013)
Gordon Food Service	Van Westenbrugge/Gordon	13,000	$12.6 billion (2016)
Goya Foods	Unanue	3,500	$1.4 billion (2017)
Hallmark Cards	Hall	16,000	$4 billion (2016)
Hasbro*	Hassenfeld	5,000	$5.01 billion (2016)
Haworth	Haworth	4,500	$1.8 billion(2014)
HE Butt Grocery	Butt	69,000	$23 billion (2016)
Hearst Communications Inc.	Hearst	20,000	$10.8 billion (2016)
Herschend Family Entertainment	Herschend	10,000	$175 million
Hovnanian Enterprises Inc.*	Hovnanian	2,006	$2.06 billion (2014)

PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Company	Family	U.S. Employment	Annual Revenue
Hunt Consolidated, Inc.*	Hunt	4,500	$2.7 billion
Hyatt*	Pritzker	35,309	$4.4 billion (2016)
In N Out	Torres, Snyder	16,000	$575 million (2015)
Ingram Entertainment Holdings Inc.	Ingram	540	$616 million (2010)
Ingram Industries	Ingram	5,000	$2.12 billion (2014)
JM Family Enterprises	Moran	4,200	$14.9 billion (2017)
J.R. Simplot Company	Simplot	8,000	$6 billion (2017)
Kelly Services*	Kelly/Adderley	8,100	$5.5 billion (2015)
Koch Industries	Koch	60,000	$100 billion (2015)
Kohler	Kohler	28,000	$3 billion (2017)
Leprino Foods	Leprino	4,000	$3 billion (2016)
Levi Strauss & Co	Strauss	4,000	$4.5 billion (2016)
L.L. Bean	Bean	5,100	$1.6 billion (2016)
Loew's Corporation*	Tisch	18,000	$15.05 billion (2013)
Love's Travel Stops & Country Stores Inc.	Love	15,000	$14.2 billion (2016)
Maritz	Maritz	4,300	$1.2 billion (2014)
Mars Inc.	Mars	24,000	$33 billion (2016)
Mary K	Kay/Ash	5,000	$3.5 billion (2016)
McKee Foods	McKee	6,300	$1.3 billion (2014)
Meijer	Meijer	77,000	$16.1 billion (2016)
Meredith Corporation*	Meredith	3,600	$1.6 billion (2016)
M/I Homes*	Schottenstein	785	$1.38 billion
P. C. Richard & Son	Richard	3,000	$1.5 billion (2012)
Penske Corp	Penske	5,000	$26 billion
Perdue	Perdue	19,000	$6.5 billion (2016)

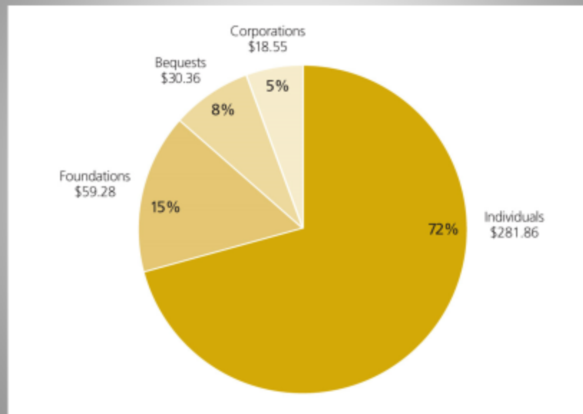
Company	Family	U.S. Employment	Annual Revenue
Phillips 66*	Phillips	10,000	$84.28 billion (2016)
Pilot Flying J	Haslam	20,000	$22.9 billion (2016)
Publix	Jenkins	180,000	$33.1 billion (2016)
Purdue Pharma	Sackler	1,700	$14 billion (2015)
Raley's Supermarkets	Teel	12,000	$3.2 billion (2016)
Retail Ventures, Inc.*	Schottenstein	18,000	$2.91 billion (2006)
Reyes Holdings LLC	Reyes	24,000	$25 billion (2016)
Rich Products	Rich	11,000	$3.6 billion (2016)
Rooney Holdings	Rooney	1,975	$1.1 billion (2005)
S.C. Johnson & Son	Johnson	12,000	$11.75 billion (2013)
Schnuck Markets Inc	Schnuck	15,000	$2.6 billion (2011)
Sheetz, Inc.	Sheetz	14,500	$8.4 billion (2017)
Sierra Pacific Industries	Emmerson	5,000	$1.01 billion (2007)
The Duchossois Group	Duchossois	3,000	$1.41 billion
The Long & Foster Companies	Long, Foster	11,000	$56.8 billion (2015)
The McClatchy Company*	McClatchy	5,600	$977 million (2016)
Tishman	Tishman	1,051	$3.56 billion (2007)
Tyson*	Tyson	108,000	$39.6 billion (2016)
W. L. Gore & Associates	Gore	9,500	$3.2 billion (2016)
Walsh Group	Walsh	6,500	$5.05 billion (2016)
Watkins Associated Industries	Watkins	10,000	$1.22 billion (2004)
Wawa Inc.	Wood	30,000	$9.68 billion (2014)
Wegmans Food Markets, Inc.	Wegman	58,000	$7 billion (2013)
Weis Markets Inc.*	Weis	19,000	$2.88 billion (2015)
White Castle	Ingram	12,000	$12 million (2013)

Giving USA 2017

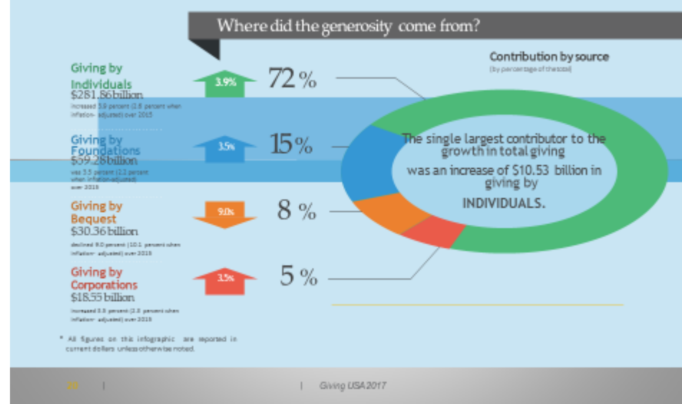
Data and Summary of Charitable Giving in America by Source

Total 2016 contributions: $390.05 billion

(in billions of dollars)



In 2016, **INDIVIDUAL DONORS** drove the rise in philanthropic giving



PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Charitable Giving in 2016

- Individuals comprised **72%** of giving, that is a total of **$281.86 billion**
  - 3.9% increase from 2015
- Corporations comprised **5%** of giving, that is a total of **$18.55 billion**
  - 3.5% increase from 2015

Giving USA Highlights

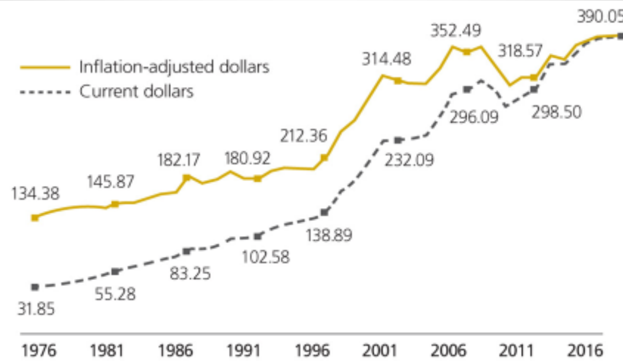
- Individuals continue to be the **primary source** of philanthropy in the US
  - Increasingly from "high-net-worth households (at least $1million in assets, excludes value of home)
- Personal disposable income is key factor
  - American individuals account for nearly **three-fourths** of all donations annually
- Common misconception: corporations & foundations comprise bulk of charitable giving

GIVING USA 2016

- IRS Statistics of Income (SOI) data indicates from 2003 to 2013 itemized contributions grew **40%** for households w*ith income of $100,000 or more, with the greatest increase of **104%** in households with incomes of $10 million or more*.
- Charitable deductions for households earning less than $100,000 decreased 34% in the same time period.

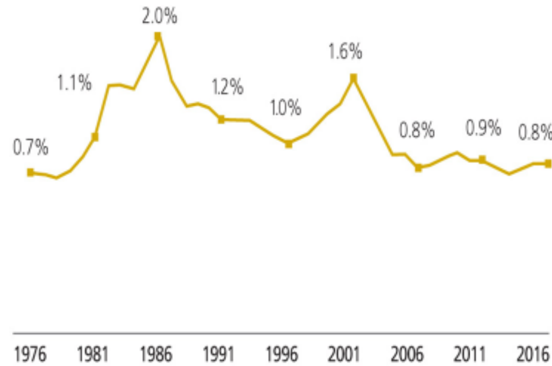
PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Trends in Total Giving 1976-2016



Source: *Giving USA 2017*, 47

Corporate Giving as a Percentage of Corporate Pre-tax Profits 1976-2016



Source: *Giving USA 2017*, 51 (graph in current dollars)

Appendix

* Denotes publicly traded firm

Italics denote estimated employment based on SEC 10k filings, company data, & other public data.

Giving USA 2017 research conducted by Indiana University Lily Family School of Philanthropy

Study conducted by

Heather Huffman, MPP
PhD Candidate, Economics & Public Policy
Claremont Graduate University

PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

Family Enterprise USA

Enterprising families. Working together.

Family Businesses in the United States

From a sample of 180 Family Businesses in the US

- **3,001,060 of US jobs**
- **$1.7 trillion of combined revenue**

Giving by families; 2017

- IRS Statistics of income (SOI) indicates that from 2003-2013, itemized contributions grew **40% for households with income of $100,000 or more, with the greatest increase of 104% in households with incomes of $10 million or more**
- Charitable deductions for households earning less $100,000 decreased 34% in the same

TOTAL	FAMILY OWNED FIRMS ACCOUNT FOR:
78%	New job creation
72%	Individuals comprised of giving v. 5% of Corporations
65%	Domestic employment
64%	GDP in the United States
60%	Women in top management positions
35%	Fortune 500 companies

FEUSA; Research of 180 Privately owned businesses March 2018; (2) 2017 Giving USA

PO Box 17693 | Anaheim Hills, CA 92817
(714) 357-3140 | pmsoldano@policyandtaxationgroup.com

AMERICAN FEDERATION OF GOVERNMENT EMPLOYEES, AFL-CIO

Joseph P. Flynn
National Secretary-Treasurer

J. David Cox, Sr.
National President

Augusta Y. Thomas
NVP for Women & Fair Practices

378317

April 23, 2018

Honorable John B. Larson
Ranking Member, Social Security Subcommittee
Committee on Ways and Means
U.S. House of Representatives
1501 Longworth House Office Building
Washington, DC 20515

Dear Ranking Member Larson:

We are writing to express our support for the legislation you have authored to strengthen and improve Social Security, the *Social Security 2100 Act* (H.R. 1902), and introduced in the Senate by Senators Richard Blumenthal and Chris Van Hollen as S. 2671. The American Federation of Government Employees (AFGE) is the largest federal employee union, representing 700,000 workers in the federal government and the government of the District of Columbia, including more than 48,000 Social Security Administration employees across the United States.

Social Security is the foundation of economic security for millions of retirees, widows and widowers, severely ill or injured workers, and children. Since its inception, Social Security employees have worked on the front lines to make sure Americans get the benefits they have earned, on time and in full. We know that Social Security reaches almost every family at some point in their lives, and we see daily its value to Americans.

That is why it is critical for our nation to continue to ensure that Social Security meets the needs of the American public and can do so for generations to come. At a time when too many Americans are facing retirement insecurity as a result of the decline in traditional pensions and low wages that leave little or no money for retirement savings, Social Security plays an ever more essential role in helping people retire with dignity and preventing poverty in old age.

The *Social Security 2100 Act* provides four vital improvements to strengthen Social Security:

- It provides an across-the-board benefit increase for both current and future beneficiaries. For a typical retiree, this would mean $300 more in their pocket each year for medicine, food, and other necessities.
- It strengthens the Social Security cost-of-living adjustment (COLA), so that it better-reflects the higher costs seniors face for health care and other expenses.

80 F Street, N.W., Washington D.C. 20001 • 202.737.8700 • Fax 202.639.6490 • www.afge.org

- It provides tax relief for middle-income seniors, raising income thresholds to protect more seniors from paying taxes on their benefits.
- It helps people who have worked hard and played by the rules for their whole lives, by improving the minimum benefit to prevent retirees from falling into poverty.

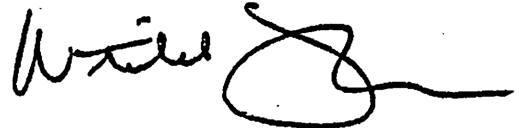
The legislation guarantees solvency through the planning period: Social Security's independent actuary has certified that it protects the Trust Fund beyond the traditional 75-year evaluation period and into the next century. No longer will program detractors be able to scare Americans into believing that Social Security is going bankrupt. Confidence in the future of the program will be restored.

The legislation asks the wealthy to pay their fair share, by paying FICA taxes on all of their salary like everyone else. And it institutes a small, gradual increase in workers' and employers' contributions to the Social Security Trust Fund, phased in over 24 years. This is the first increase since 1983 in the premiums workers pay for Social Security's unmatched insurance protections, and is well worth it.

Again, AFGE is pleased to support and endorse the *Social Security 2100 Act*. We thank you for championing this bold effort and leading the fight to expand and strengthen Social Security.

Sincerely,

J. David Cox, Sr.
National President, AFGE



Witold Skwierczynski
President, National Council of SSA
Field Operations Locals, AFGE

Tax Alliance
for ECONOMIC MOBILITY

June 6, 2018

The Honorable Kevin Brady
Chairman
House Committee on Ways and Means
1102 Longworth House Office Building Washington, DC 20515

The Honorable Richard Neal
Ranking Member
House Ways and Means Committee
1139E Longworth House Office Building
Washington, DC 20515

The Honorable Vern Buchanan
Chairman, Tax Policy Subcommittee
House Committee on Ways and Means
1102 Longworth House Office Building Washington, DC 20515

The Honorable Lloyd Doggett
Ranking Member, Tax Policy Subcommittee
House Ways and Means Committee
1139 Longworth House Office Building
Washington, DC 20515

Dear Chairman Brady, Chairman Buchanan, Ranking Member Neal and Ranking Member Doggett:

Thank you for the opportunity to submit a statement for the record on how tax reform is impacting the U.S. economy, job creation and wages for Americans.

As a coalition comprised of over 40 diverse members, including racial justice advocates, child advocates, asset-building advocates, tax reform experts and researchers, the Tax Alliance for Economic Mobility[*] works to identify near- and long-term policy priorities to create economic opportunities for lower-income households through the U.S. tax code. We believe in a tax code that works for everyone—lifting low-income families out of poverty rather than taxing them further into it, and being accessible, simple and transparent so that it benefits middle and working-class families, as well as families with low-incomes, as much as it does for those at the top. In other words, we believe that the tax code should be fair.

Unfortunately, the Tax Cuts and Jobs Act of 2017 (TCJA, PL 115-97) falls short of the tenets the Tax Alliance believes, and will not help everyday American families build financial stability. Congress had the opportunity to preserve and expand on policies that help working-class families get ahead instead of falling further behind, yet the Tax Cuts and Jobs Act further exacerbates our already upside-down tax code. Even more unfortunate, the Tax Cuts and Jobs Act would also make the growing racial wealth gap facing the nation worse as its benefits would disproportionately accrue to wealthy, mostly white households leaving low-wealth communities of color further behind.[1]

While some workers have experienced modest gains from the tax legislation since it was enacted into law, the massive tax breaks provided to big businesses and the ultra-wealthy have dwarfed that limited progress. According to the bipartisan Tax Policy Center, next year the top one percent of households are set to receive an average tax cut of more than $50,000. For those in the top 0.1 percent, their share of the benefits from the TCJA will amount to an average tax cut of nearly $200,000. Meanwhile, the bottom 60 percent of households—middle and working-class, as well as families with low-incomes—would see their tax cuts total just over $400, on average.[2] Even more troubling, by 2025, the bottom 60 percent of households would continue to receive the same average tax benefit as they would in 2019, while households in the top one percent would see their tax cuts increase by at least $10,000.[3]

The Tax Cuts and Jobs Act is also alarmingly dismissive of the added risks to the economy from the increased deficit due to the law's $1.5 trillion price tag. The steep decrease in revenue from the TCJA, mostly due to tax

[*] **The comments outlined in this document were developed by the Steering Committee for the Tax Alliance for Economic Mobility, and may not reflect the views of individual members of the Tax Alliance.**

breaks for the wealthy and corporations, is particularly irresponsible considering the growing cost of supporting our aging population through Medicare and Social Security.[4] Because these programs enjoy broad public support, other critical benefits that low- and moderate-income households receive are beginning to come under attack. Recently proposed cuts to the Supplemental Nutrition Assistance Program (SNAP), included in the House Farm Bill, are only one such example of current and possible future justifications of cuts to critical programs that support health, housing and food assistance to offset the TCJA.[5]

At the same time, the suggestion that the Tax Cuts and Jobs Act would result in corporations investing in their workforce and increasing wages has not come to fruition. In fact, according to a Reuters/Ipsos poll conducted earlier this year, just two percent of workers say they've received a bonus, raises or other benefits because of the TCJA.[6] Meanwhile, corporate stock buybacks are happening at a record pace[7] and numerous statements and surveys demonstrate that U.S. executives[8] and corporations[9] are not rapidly moving to make large domestic capital investments because of the law's benefits.

The tax reform debate undertaken by Congress last year should have been about reforming tax expenditures to ensure they help those who need it most; about preserving and expanding on what works; and about closing gaps in critical credits—such as the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC)—to improve their reach and effectiveness. Regrettably, the Tax Cuts and Jobs Act locked out millions of workers from accessing the full benefits of the expanded CTC,[10] stripped the CTC from nearly a million children without a social security number,[11] threatened the stability of the private insurance market by repealing the individual mandate and made no improvements to the EITC.[12]

Workers and their families want a Congress that is on their side when it comes to tax reform—not a Congress that changes the rules to benefit the wealthy and the biggest corporations. Recent polling shows how few Americans see any benefit from the TCJA, with more than half reporting they see no change in their paychecks.[13] As more than 60% of Americans already think that corporations and the wealthy do not pay their fair share of taxes,[14] we urge the Full Committee and Tax Policy Subcommittee to avoid the approach to tax reform that they took with the TCJA. Instead, the Committees should consider reforms that truly benefit working families, including:

1) Building on the opportunity-boosting successes of the EITC and CTC by strengthening these tax credits and making their benefits more inclusive and widely accessible, particularly for low-income workers, workers without children and ITIN (Individual Taxpayer Identification Number) filers[15]
2) Making higher education tax expenditures work for everyone, especially low-income families and students[16]
3) Leveraging the tax code to encourage savings and investment for retirement among working families[17]
4) Reducing subsidies for mortgage debt and larger homes, and use those savings to help working families save for a downpayment and increase tax benefits for renters, rather than providing tax cuts for the wealthy[18]

As the Full Committee and Tax Policy Subcommittee continues to explore "how tax reform is growing the U.S. economy, creating jobs here at home, and increasing paychecks for hard-working Americans," we would welcome the opportunity to provide additional input on how to improve the American tax system to create a more equitable tax code that will expand opportunity for everyone, across the country.

Thank you considering our views.

Signed,

Prosperity Now

Center for Law and Social Policy (CLASP)

Tax Alliance for ECONOMIC MOBILITY

First Focus Campaign for Children

National Association for Latino Community Asset Builders

Thomas Shapiro, PhD
Institute on Assets and Social Policy
The Heller School for Social Policy and Management
Brandeis University

Laura Sullivan, PhD
Institute on Assets and Social Policy
The Heller School for Social Policy and Management
Brandeis University

UnidosUS

….

---

[1] According to a recent analysis by Prosperity Now, while non-Hispanic Whites account for about 62% of the nation's population, they make up about 80% of the richest one percent and .01%. African Americans and Latinos, who account for more than 30% of the population, make up just 3.2% and 4.7% of those in the top one percent. At the same time, Black and Latino households are over-represented among the poorest fifth of Americans. See *The Tax Cuts and Jobs Act Leaves Everyone Behind—Except for Those at The Top* for more information.
[2] TPC Staff, *Distributional Analysis of the Conference Agreement for the Tax Cuts and Jobs Act* (Washington, DC: Tax Policy Center, 2017), 3-4.
[3] Ibid.
[4] Center on Budget and Policy Priorities Staff, *New Tax Law Shrinks Revenue When More Revenue Is Needed* (Washington, DC: Center on Budget and Policy Priorities, 2018).
[5] Ed Bolen, Lexin Cai, Stacy Dean, Brynne Keith-Jennings, Catlin Nchako, Dorothy Rosenbaum, and Elizabeth Wolkomir, *House Agriculture Committee's Farm Bill Would Increase Food Insecurity and Hardship* (Washington, DC: Center on Budget and Policy Priorities, 2018).
[6] Amanda Becker, Chris Kahn, "Few U.S. adults report bonuses, raises from Republican tax law," *Reuters*, January 29, 2018, https://www.reuters.com/article/us-usa-tax-poll/few-u-s-adults-report-bonuses-raises-from-republican-tax-law-idUSKBN1FI16Q.
[7] Patti Domm, "Companies buying back stock at record pace since Trump tax bill may aid market's comeback," *CNBC*, February 15, 2018, https://www.cnbc.com/2018/02/15/companies-buying-back-stock-at-record-pace-since-trump-tax-bill-may-aid-markets-comeback.html.
[8] Steve LeVine, "Forget about broad-based pay hikes, executives say," *Axios*, May 27, 2018, https://www.axios.com/broad-based-pay-rises-retraining-automation-executives-3e68d31c-51bc-4bde-a362-7ce12b039e7c.html.
[9] "Nation's CEOs Are Disappointed in Trump but Hopeful: Yale CEO Summit Survey," *Yale School of Management*, December 18, 2017, https://som.yale.edu/news/2017/12/nation-s-ceos-are-disappointed-in-trump-but-hopeful-yale-ceo-summit-survey.
[10] Center on Budget and Policy Priorities Staff, *New Tax Law Tilted Toward Wealthy and Corporations* (Washington, DC: Center on Budget and Policy Priorities, 2018).
[11] Jacob Leibenluft, *Tax Bill Ends Child Tax Credit for About 1 Million Children* (Washington, DC: Center on Budget and Policy Priorities, 2017).
[12] Center on Budget and Policy Priorities Staff, *New Tax Law Tilted Toward Wealthy and Corporations* (Washington, DC: Center on Budget and Policy Priorities, 2018).
[13] "CNBC All-America Economic Survey: CNBC's Steve Liesman: Trump's Approval Ratings Dip Amid Opposition to Tariffs and Little Change from Tax Cuts," *CNBC*, March 27, 2018, https://www.cnbc.com/2018/03/27/cnbc-all-america-economic-survey-cnbcs-steve-liesman-trumps-approval-rating-dips-amid-opposition-to-tariffs-and-little-change-from-tax-cuts.html.
[14] Frank Newport, "Majority Say Wealthy Americans, Corporations Taxed Too Little," Gallup, April 18, 2017, news.gallup.com/poll/208685/majority-say-wealthy-americans-corporations-taxed-little.aspx
[15] For specific policy recommendations, please see the Tax Alliance for Economic Mobility's Policy Principles: Tax Credits for Low-Income Workers.
[16] For specific policy recommendations, please see the Tax Alliance for Economic Mobility's Policy Principles: Higher Education and College Savings Tax Expenditures.

[17] For specific policy recommendations, please see the Tax Alliance for Economic Mobility's Policy Principles: Retirement Savings Tax Expenditures.
[18] For specific policy recommendations, please see the Tax Alliance for Economic Mobility's Policy Principles: Housing and Homeownership Tax Expenditures.

STATEMENT BEFORE THE U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON WAYS AND MEANS TAX POLICY SUBCOMMITTEE HEARING ON TAX REFORM AND SMALL BUSINESSES: GROWING OUR ECONOMY AND CREATING JOBS
May 23, 2018

Chairman Buchanan, Ranking Member Doggett, and Members of the Subcommittee, the National Association of Professional Insurance Agents (PIA)[1] appreciates the subcommittee holding this hearing and thanks Chairman Buchanan for his leadership on tax issues. PIA also appreciates the subcommittee providing this opportunity for PIA to submit this testimony for the record to address the gaps contained in the tax reform legislation passed at the end of 2017, particularly as they pertain to some small businesses. Specifically, we request that you work with the administration to issue clarifying language related to H.R. 1.

When Congress began its work on tax reform, PIA was encouraged by the historic opportunity to provide tax relief for small business owners and overhaul the complicated tax structure for all taxpayers. About half of all PIA member agencies own independent insurance businesses organized as sole proprietorships, partnerships, LLCs, or Subchapter S ("pass-through") corporations. Under the law as it existed before the passage of H.R. 1, such small businesses did not pay corporate income tax. However, their business income "passed through" their small companies and appeared directly on their owners' individual tax returns, where it was taxed as normal income.

While the new law (new Internal Revenue Code Section 199A) provides provisions that will result in savings for some pass-through entities, the benefit is limited by an income threshold and a categorical exclusion that may prevent some PIA members with pass-throughs from benefitting from the new deduction. The 20 percent deduction is not allowed for service trades or businesses with income over a certain threshold ($207,500 for individuals or $415,000 for joint filers).

For those filing individually whose pass-through income is between $157,500 and $207,500, and for those filing jointly whose pass-through income is between $315,000 and $415,000, where the

[1] Founded in 1931, PIA is a national trade association that represents independent insurance agencies and their employees who sell and service all kinds of insurance but specialize in coverage of automobiles, homes, and businesses. PIA represents independent insurance agents in all 50 states, Puerto Rico, and the District of Columbia. They operate cutting-edge agencies and treat their customers like neighbors, providing personal support and service. PIA members are *Local Agents Serving Main Street America*℠.

deduction is subject to a gradual phase-out, the language describing the excluded trades and businesses is ambiguous. The law leaves unclear whether income earned by independent insurance agents is considered "qualified business income." It excludes "brokerage services" but is unclear as to whether insurance agents and brokers will be viewed as engaging in "brokerage services." Finally, it excludes any trade or business in which the "principal asset" of the business is the "reputation or skill" of the business owners or employees. Because of these provisions, the law could be interpreted as disallowing insurance agents from taking the new pass-through deduction based on any or all these caveats.

The list of "qualified trade or business[es]" is taken from 26 U.S. Code § 1202(e)(3)(A), except for engineering and architecture businesses, which are permitted to benefit from the deduction in Section 199A. This is significant because the very next sentence of that existing law, 26 U.S. Code § 1202(e)(3)(B), specifically lists insurance businesses. Ostensibly, if Congress meant for insurance-related businesses not to benefit from the deduction, it could have included a reference to the very next sentence in existing law. As it stands, whether insurance agencies are excluded may remain unknown until the Internal Revenue Service (IRS) issues regulations or guidance pertaining to the new law.

PIA respectfully asks that, as the authors of H.R. 1, you work with your colleagues in the Senate, the IRS, and the administration to ensure that owners of independent insurance agencies can benefit from the maximum deduction or include clarifying language in any technical bill. Independent agents play a critical role in the insurance marketplace across lines of business and around the country, providing individuals and businesses with expert advice on often complex issues. They are small business owners providing advice to their local communities. Including insurance agencies in a group with wealthy global law firms is unfair and will hurt small business owners. Guidance from the IRS should clarify that insurance agency owners who file as S corps are able to use the 20 percent deduction, which will allow for business growth. Otherwise, they may need to consider reorganizing as C corporations, a burdensome and costly process.

The tax reform bill was touted as a move toward tax relief for small businesses, but its effect will be substantially curtailed if the pass-through provision is not clarified to include small businesses like insurance agencies. In addition, as Congress works with the White House and the IRS to address the shortcomings of the tax reform law, it is essential that the needs and interests of small business owners be at the forefront of lawmakers' minds. PIA looks forward to continuing our engagement with Congress on this important issue in the months ahead and thanks the subcommittee for holding this hearing today.

WRITTEN STATEMENT
SUBMITTED BY THE AFL-CIO
TO THE HOUSE COMMITTEE ON WAYS AND MEANS

HEARING ON "TAX REFORM AND SMALL BUSINESSES: GROWING OUR ECONOMY AND CREATING JOBS"
May 23, 2018

On May 23, 2018, the Ways and Means Committee held a hearing on the effect of Tax Cuts and Jobs Act (TCJA) on small business, the economy, and job creation and invited submissions of written testimony from the public.

We submit this written testimony on behalf of the AFL-CIO, a voluntary democratic federation of 55 national and international labor unions representing 12.5 million working men and women.

We believe the TCJA will not help small business, grow our economy, or create jobs, but will instead have the opposite effects.

The TCJA will have harmful effects on small businesses, the economy, and jobs because (1) it creates a tax incentive for large corporations to locate production offshore; (2) it increases health care premiums for owners and employees of small businesses and other individuals in the non-group health insurance market; (3) it significantly reduces federal tax revenues, which will be used as an argument for budget cuts that harm working people and weaken the foundations for long-term economic growth and shared prosperity; and (4) its poorly designed pass-through provisions add more complexity and confusion to the tax code, while benefiting millionaires rather than Mom and Pop small businesses.

The TCJA fails to live up to the claims made by its supporters. Rather than fueling a boom in business investment or wage increases for working people, the TCJA's corporate income tax cuts have led primarily to stock buybacks that boost stock prices and CEO pay.

Finally, the TCJA represents a missed opportunity for much-needed tax reform that (1) eliminates the tax incentive for outsourcing jobs; (2) staunches the loss of U.S. corporate tax revenue through the shifting of domestic profits offshore; and (3) generates the tax revenue we need for public investment to create and support good jobs and full employment.

OFFSHORING

The TCJA adopts a "territorial" corporate tax system that largely exempts the offshore profits of U.S. multinationals from U.S. taxation, thereby encouraging the outsourcing of production to lower-tax foreign jurisdictions.

According to the Center for Budget and Policy Priorities (CBPP), "This system risks creating a large, permanent incentive for U.S. multinationals to shift overseas not just profits on paper but actual investment as well. This could lead to a reduction in capital investment in the United States and thereby wind up reducing U.S. workers' wages."

In addition, according to the CBPP, "the provisions [that the TCJA] offers to stem abuse are likely to be largely ineffective and potentially create other perverse incentives." Specifically, two provisions designed to reduce the incentive for corporations to shift high-return assets (such as intellectual property) to low-tax countries may increase the incentive to locate tangible assets offshore, according to the Congressional Budget Office (CBO). "The GILTI (tax on global intangible low-tax income) and FDII (deduction for foreign-derived intangible income) provisions affect corporations' decisions about where to locate tangible assets. By locating more tangible assets abroad, a corporation is able to reduce the amount of foreign income that is categorized as GILTI. Similarly, by locating fewer tangible assets in the United States, a corporation can increase the amount of U.S. income that can be deducted as FDII. Together, these provisions may increase corporations' incentive to locate tangible assets abroad."

According to the Institute on Taxation and Economic Policy (ITEP), the overall effect of the permanent international provisions of the TCJA, which actually lose revenue, "is that companies' offshore earnings will at most be taxed at half the rate on domestic earnings, with many companies paying nothing in U.S. taxes on these earnings."

While supporters of the TCJA claim it reverses incentives for outsourcing, these claims have not been borne out in the case of Harley-Davidson. In September 2017, House Speaker Paul Ryan (R-WI) visited a Harley Davidson plant in Wisconsin to highlight the benefits of the GOP tax bill. Yet the TCJA tax windfall to Harley-Davidson—a profitable company with $800 million to $1 billion in pre-tax profits—appears to have provided the capital to fund a plan to outsource U.S. jobs. Following passage of the TCJA, the company announced the layoff of 800 workers at a plant in Kansas City, the opening of a new factory in Thailand, and a plan to buy back 15 million shares currently valued at $700 million.

Harley-Davidson says the new plant in Thailand is unrelated and that it is not outsourcing jobs, but Richard Pence, a machinist at the Kansas City plant, says, "Part of my job is being moved to York [Pennsylvania], but the other part is going to Bangkok."

Greg Tate, a representative of United Steelworkers District 11, which represents about 30 percent of the workers at the Kansas City plant, blames the TCJA: "They have the capital now to move Kansas City, to shut it down. All of that money really came from the tax cut plan, so it kind of had the opposite effect of what it was supposed to do."

HEALTH CARE PREMIUMS

The TCJA will increase health insurance of premiums for millions of Americans by repealing the individual insurance mandate of the Affordable Care Act (ACA). Small businesses consistently rank the cost of health care as one of their top concerns, yet repeal of the individual mandate will increase costs for small business owners and employees who rely on the individual marketplaces for health insurance coverage.

According to the CBO, ending the ACA individual mandate will result in 3 million more people being uninsured by next year and a 10 percent increase in health insurance premiums in the non-group market, where insurance is purchased individually.

Without the individual mandate, some healthier enrollees may decide to go without insurance and wait until they get sick to enroll. This will leave the remaining pool of enrollees in the marketplaces less healthy on average, driving up average premiums.

On May 23, 2018, Blue Cross Blue Shield Vice President Kris Hatlmeyer said he expects "substantial" premium increases for 2019 in the individual marketplaces, due in part due to repeal of the individual mandate. Haltmeyer estimated that average premium increases nationwide will be in the "low teens," but there will be major variation across areas, ranging from the low single digits to up to 70 or 80 percent. He said the premium increases are "related to the loss of the mandate and then underlying medical costs. Those two things have the most impact on the rate increases."

REVENUE LOSS AND BUDGET CUTS

According to the CBO, the TCJA will cost $1.9 trillion by 2028—significantly more than originally estimated. If the past is any guide, this revenue loss (and the resulting increase in the federal deficit) will be used as an argument for cutting programs that benefit working people and reducing public investment that supports good jobs and a strong economy over the long term.

Right on cue, some Republicans have already started calling for cuts to Medicare, Medicaid, and Social Security to make up for the lost tax revenue. Moreover, President Trump has proposed a budget that cuts Medicaid and health care subsidies by $763 billion, with annual cuts reaching $128 billion by 2028.

There is a double standard here. When it comes to programs that benefit working people and investments that create or support good jobs, Republicans want us to believe that America is broke. But when it comes to wasting trillions of dollars on tax giveaways to Wall Street, big corporations, and the wealthiest people in our country, it seems that money is no object.

COMPLEX PASS THROUGH RULES BENEFITING MILLIONAIRES

The TCJA provides many owners of pass-through businesses—partnerships, S corporations, and sole partnerships—a temporary tax deduction of 20 percent on qualified business income.

These pass-through provisions, which cost $265 billion, have been advertised as a tax cut for Mom and Pop small businesses. However, they are extremely regressive. According to an analysis by the Center for Budget and Policy Priorities (CBPP) of estimates provided by the Joint Committee on Taxation (JCT), "Some 61 percent of the benefit from the 2017 tax law's 20 percent deduction for pass-through income will flow to the top 1 percent of households in 2024, compared to just 4 percent for the bottom two-thirds." The main beneficiaries of these provisions are not Mom and Pop small businesses.

The TCJA's pass-through provisions make the tax code even more complex and more confusing—two complaints frequently voiced by small businesses. A leading tax expert concludes that the new rules "achieved a rare and unenviable trifecta, by making the tax system less efficient, less fair, and more complicated. It lacked any coherent (or even clearly articulated) underlying principle, was shoddily executed, and ought to be promptly repealed."

Furthermore, the gap between the new top individual rate (37 percent) and new top pass-through rate (29.6 percent) may encourage wealthy individuals, who can afford high-priced accountants and lawyers, to game the system by declaring themselves pass-through businesses.

Finally, according to the CBO, "the deduction gives owners of pass-through businesses an incentive to underreport their reasonable compensation—a tactic that has been used successfully to avoid self-employment taxes in the past and that is not available to wage earners. In addition, the deduction's different treatment of different industries could further affect economic decisions."

BUSINESS INVESTMENT, JOB GROWTH, AND WAGE GROWTH

While it is still too early to determine the ultimate effects of the TCJA, evidence that the new law has resulted in more business investment, job creation, and wage growth is extraordinarily weak.

As Senator Marco Rubio said recently, "There is still a lot of thinking on the right that if big corporations are happy, they're going to take the money they're saving and reinvest it in American workers. In fact, they bought back shares. A few gave out bonuses. There's no evidence whatsoever that the money's been massively poured back into the American worker."

Indeed, there is no clear evidence to date of a significant increase in business investment due to enactment of the TCJA. According to the Economic Policy Institute (EPI), nonresidential investment growth in the first quarter of 2018 was slightly faster than in the last quarter of 2017, but slower than rates of growth in 2011 and 2014.

With regard to the long-term effect of the TCJA, the only permanent tax cut in the new law is its reduction of the corporate income tax rate. As EPI explained in its testimony submitted to the Committee last week, the "evidence based on past experience with corporate rate cuts—either in the United States, in international peer countries, or in individual U.S. states—argues strongly that capital investment and pay for most American workers will not noticeably increase due to the TCJA."

President Trump and Congressional Republicans promised that workers would see their pay increase by at least $4,000 a year due to the corporate tax cuts in the TCJA. However, there is no evidence that wage growth has materially picked up since the TCJA took effect. In May 2018, nominal wages were only 2.7% higher than a year earlier. The slow pace of wage growth has actually puzzled economists, given the low unemployment rate.

Corporations seem to be dedicating the bulk of their tax windfall to dividends and stock buybacks, which only make the rich richer. U.S. companies completed a record $178 billion in

stock buybacks in the first three months of 2018, and a record $200 billion in May 2018. According to UBS, corporations are likely to spend more than $2.5 trillion this year on share buybacks, dividends, and mergers and acquisitions activity.

While it is sometimes claimed that stock buybacks lead to job-creating investments, this is not the case. Stock buybacks boost stock prices and CEO pay in the short term, but over the long term they are a missed opportunity to reinvest in the company. Dividends and stock buybacks now exceed corporate earnings, which amounts to eating your seed corn.

A MISSED OPPORTUNITY

The TCJA represents a missed opportunity for real tax reform that eliminates the tax incentive for corporations to shift jobs and profits offshore, which gives big corporations an unfair advantage over small business. In February 2018, Rep. Doggett (D-TX) and Sen. Whitehouse (D-RI) introduced the No Tax Breaks for Outsourcing Act, which would eliminate the TCJA's incentives for outsourcing by, among other things, equalizing tax rates on domestic and offshore profits.

The TCJA also represents a missed opportunity to raise more corporate tax revenue by ending the shifting of domestic profits to offshore tax jurisdictions. According to the CBO, the shift to a territorial tax system "is anticipated to encourage some further profit shifting, because corporations that shift profits from the United States to lower-tax countries can now repatriate them without paying taxes. That increase in profit-shifting will reduce the amount of income subject to U.S. taxes."

Also according to the CBO, about 80 percent of corporate profit shifting will remain in place under the TCJA, as U.S. corporations will continue to shift $235 billion in profits annually. According to Brooklyn Law School professor Rebecca Kysar, profit shifting will be reduced even less than estimated by the CBO, and the policy choice of applying the new minimum tax (GILTI) on a global rather than per-country basis will encourage profit shifting.

The TCJA also represents a missed opportunity to raise corporate revenue through the taxation of accumulated offshore earnings. Prior to enactment of the TCJA, U.S. corporations had accumulated an estimated $2.6 trillion in profits "offshore," on which they owed an estimated $750 billion in taxes. Instead of making corporations pay taxes on these accumulated profits at the full 35 percent rate that applied when these profits were earned, the TCJA allows corporations to pay a discounted rate of either 8 or 15.5 percent. This "deemed repatriation" tax, estimated to raise $340 billion, represents a windfall of over $400 billion for a handful of corporations and rewards aggressive tax avoidance strategies using offshore tax havens.

The TCJA also represents a missed opportunity to use the revenues generated from deemed repatriation to fund a massive increase in infrastructure investment, which many Democratic and Republican members of Congress had previously supported. Instead, the TCJA uses these one-time-only revenues to pay for wasteful tax giveaways.

CBO projects the positive economic effect of deemed repatriation will be "small." "Even though the term 'repatriation' suggests that the undistributed funds will return to the United States from abroad, they are often already invested in dollar-denominated fixed income securities issued by U.S. borrowers. The funds are outside the United States only in the sense of being owned by a foreign subsidiary of a U.S. corporation. In fact, MNCs have held a substantial fraction of their undistributed funds as long-term Treasury securities, CBO estimates. Finally, over the past decade, MNCs have paid large amounts of cash to their shareholders through share repurchases even as they have kept earnings undistributed, so it is unlikely that the foreign earnings represent pent-up dividends or investments waiting to happen."

Finally, the TCJA represents a missed opportunity to raise sufficient revenues to increase public investment on a scale necessary to lay the foundations for full employment and good jobs over the long term. The reality is that the United States does not collect enough tax revenue. Revenues at the federal, state, and county level—as a share of the economy—are lower in the United States than in any other developed OECD country. The United States is also 23rd among OECD countries in total social spending as a share of the economy, and total non-defense discretionary spending is at its lowest level since the Eisenhower administration. The failure to raise sufficient tax revenue and make sufficient public investment is threatening the economic future of the United States, and the TCJA makes this problem worse.

CONCLUSION

Supporters of the TCJA have often touted its benefits to small business and the economy, but in fact the new law will have a harmful impact on both small business and economic performance. The TCJA wastes trillions of dollars on wasteful tax giveaways to millionaires, big corporations, and Wall Street that threaten our economic future.

Tax Cuts and Jobs Act: A Missed Opportunity for Latino-Owned Businesses and Latino Workers

Submitted to

U.S. House Committee on Ways & Means,
Tax Policy Subcommittee

Submitted by

UnidosUS

June 6, 2018

Introduction

UnidosUS, formerly the National Council of La Raza, is the largest national Hispanic civil rights and advocacy organization in the United States. For 50 years, we have worked to advance opportunities for middle and working-class Latino families to achieve economic stability and to build wealth. In this capacity, UnidosUS and its Affiliate network of over 260 community-based organizations in 41 states, the District of Columbia, and Puerto Rico, work to provide education, healthcare, housing, workforce development, free tax preparation, and other services to millions of Latinos in the U.S. each year.

For more than two decades, UnidosUS has been actively engaged in anti-poverty work by advocating for a fair and equitable federal income tax system, preserving and expanding the Earned Income Tax Credit (EITC) and Child Tax Credit (CTC) and fighting for all individuals who pay their fair share of taxes to have access to crucial tax credits they have earned and for which they are eligible.

The primary purpose of the income tax system is to raise revenue to pay for public goods and services. Over time the tax code has been used to influence behavior and, while the individual income tax system is progressive and relatively fair, the wealth incentives in the tax code are completely skewed to the top. That said, the tax system can be reshaped to advance equity in many socioeconomic areas from housing to education. To achieve this, federal tax policy must address inequities within the system that treat wealthy taxpayers better than middle-class and lower income taxpayers. For example, the Latino community has the highest labor participation rate in the country (66%), but they are concentrated in low-wage jobs with few benefits. Many are struggling to make ends meet and face persistent barriers to building wealth. In 2016, 19.4% of Latinos lived in poverty compared to a national rate of 12.7%[i] and in that same year the average Latino family had just $2 for every $10 the average White family held in wealth.[ii]

We believe there is an opportunity to restructure the tax code's wealth-building subsidies around homeownership, higher education, and retirement so that they benefit more middle-class and working families, as well as communities of color. To do this, Congress must prioritize tax reforms that truly benefit working families, including incentives for homeownership, retirement security, and saving for higher education, rather than providing tax cuts for the wealthy.

Unfortunately, Republican leadership in Congress and the Trump Administration missed an opportunity to fuel economic mobility for working people. Instead, Congress passed and President Trump signed, the Tax Cuts and Jobs Act (TCJA) which is already giving massive financial windfalls to the wealthiest Americans and largest corporations but has done little to nothing for middle-class and working families. For example, the TCJA left millions of workers without the full benefits of the expanded CTC,[iii] denied the CTC to nearly a million children without a social security number,[iv] repealed the individual mandate and made no improvements to the EITC.[v] The massive tax cuts in the law will add $1.5 trillion—at a minimum—to the national deficit, which has led some Members of Congress to call for steeper cuts to federal programs that help working families make ends meet.

This written statement focuses on how the TCJA affects Latino families, Latino-owned businesses, and implications for spending on important federal support programs.

Benefit for Latinos Dwarfed by Corporate Windfall

Latinos, a young, aspiring, and hardworking segment of the federal tax base, make up 17% of the current U.S. population, and by 2050 will account for one-third of the U.S. workforce, making the community an integral component of the nation's economy. According to the Selig Center for Economic Growth, Hispanics in the US controlled $1.3 trillion in buying power in 2015, an amount larger than the GDP of Australia. Furthermore, in 2015 Hispanic households contributed almost $215 billion to U.S. tax revenues, including almost $76 billion in state and local tax payments.[vi] Of this, foreign-born Hispanics contributed $96.9 billion in tax revenues. That includes almost $36 billion in state and local taxes and more than $61 billion in taxes to the federal government.[vii] Latino contributions will continue to strengthen the national economy for decades to come, and we could see greater economic security for our workers if the economic and tax playing fields are leveled.

But, instead of helping hard-working Latinos, the TCJA provides a massive tax cut for the richest Americans and largest corporations while providing little relief for working families.

- Nationally, in 2019 the TJCA gives an average tax cut of $55,190 to the richest 1% of Americans while 89% of Latinos will see an average tax cut of only a $316.[viii]
  - In Arizona, the disparity is similar: the richest 1% will receive an average of $54,250 compared to $331 for 89% of Latinos.[ix]
  - In Florida, the gap is much worse, with the richest 1% receiving an average tax cut of $98,480 while 84% of Latinos will see an average reduction of only $260.[x]

It is clear from these examples how heavily skewed the benefits of the TCJA are toward the wealthiest Americans.

Recent UnidosUS polling substantiates those statistics as few Latino families report seeing benefits from the new tax law. Only one-in-five Latino voters said their taxes have been reduced because of the law and only one-in-four reported seeing an increase in their take-home pay. In addition, the TCJA is misaligned with the priorities of Latino voters: six-in-ten said big corporations and the wealthy paying their fair share of taxes should be a high priority for Congress.

No Tax Relief for Latino-Owned Businesses

Much of the TCJA's $1.5 trillion price tag comes from a reduction in the corporate tax rate, which dropped to 21% from 35%. However, many small businesses are not corporations, and changes in the tax law that affect small businesses only provide meager—and temporary—relief. Nationally, there are 4.37 million Latino-owned businesses that generate $700 billion in revenue.[xi] They are growing two to three times faster than the national average, standing to create millions of private sector jobs.[xii] Between 2012 and 2017, the number of Latino-owned businesses increased nearly 32% compared to a 13.8% growth rate overall.[xiii]

Yet, the TCJA heavily benefits large corporations, private equity firms, hedge funds, and real estate developers instead of helping many small business owners.[xiv] The majority of the changes to the tax code that impact businesses will not help Latino-owned companies because 90% of Latino-owned businesses (more than four million) are not corporations disqualifying them from the reduction in the corporate tax rate.[xv] Furthermore, benefits from changes to the tax code that affect "pass-through" businesses favor the wealthy. The Joint Committee on Taxation estimates that in 2018 taxpayers earning more than $500,000 will get a total tax benefit of $21.4 billion, more than half of

the overall benefit from the change to the pass-through deduction.[xvi] Businesses for Responsible Tax Reform found that changes made by the TCJA will not generate enough savings for small businesses to hire new employees or make substantial investments and to understand the complexities of the TCJA will require many small businesses to hire outside experts, increasing their tax compliance costs.[xvii]

Not only are the benefits for Latino-owned businesses far too small, but any provisions that would benefit them—including changes to the individual tax code—will expire after 2025. This means that by 2027, the TCJA will be even more lopsided with almost half (2.1 million) of Latino businesses facing a tax increase due to the expiration of most of TCJA's provisions.[xviii] At that point, more than 3.2 million Latino businesses (three in four) will lose an average of $300 in after-tax income.

American Families Continue to Pay for Tax Cuts

Before passage of the TCJA, UnidosUS warned that tax proposals increasing the national deficit would lead to the Trump Administration and Republican leadership in Congress calling for draconian cuts to federal benefit programs that help millions of Americans.[xix] Prior to the bill becoming law, the Congressional Budget Office estimated that in FY2019 the federal deficit would be $689 billion.[xx] After passage of the TCJA, CBO revised their estimate to $980 billion, a 42% increase.[xxi] The taxpayers of tomorrow will pay dearly for the TCJA's massive tax giveaway to the wealthy. Unfortunately, the American people have already seen this scenario begin to play out in the Trump Administration's fiscal year 2019 budget[xxii] and most recently in the House reauthorization of the Farm Bill.[xxiii] The administration and some Congressional Republicans have also made broad-based attempts to institute severe work requirements for families to access federal benefit programs, while doing nothing to help reduce poverty or improve job quality or access.[xxiv]

The projected growth in the deficit resulting from the massive tax cuts given to the wealthiest Americans and largest corporations is already being used to justify devastating reductions to programs, including Medicaid, SNAP, housing assistance, and in education, that help Latino families make ends meet. Eighteen million Latinos rely on Medicaid,[xxv] including more than one-in-four (27%) Latinas. [xxvi] Nearly 740,000 Latino households rely on rental assistance and 10 million Latinos rely on SNAP for food.[xxvii] Reduced funding for these programs threaten the wellbeing of millions of Latino families and children. Federal programs[xxviii] lifted approximately 6.3 million Latinos out of poverty in 2015, including three million Latino children and 351,000 Latino seniors. These proposed cuts, and a renewed focus on work requirements, show a deep misunderstanding of the reality working families face when hard-earned wages are not enough to put food on the table, stay healthy and afford a safe place to live.

Conclusion

Instead of taking an opportunity to reform the tax code so that it does more for working families, Congress prioritized the wealthiest Americans and largest corporations, leaving families and small businesses with little to no benefit. By primarily benefitting people who already hold the most wealth and doing nothing to help lower income families financially stabilize and create wealth, the TCJA will only exacerbate an already wide racial and ethnic wealth gap.[xxix] The process by which this bill was created and passed, provides further evidence that a comprehensive restructuring of the tax code by Congress must be done in a deliberative and transparent way, be bipartisan, and ought to include a broad range of perspectives and voices, much like the 1986 tax reform effort. Sustainable, systemic reforms are built on public and Congressional consensus. The TCJA did not embody that spirit,

significantly lacks the perspectives of diverse stakeholders and does not reflect broadly shared values of voters about government tax and spending policies.

Moving forward, we urge Congress to consider reforms that truly benefit working families, including those that directly address core barriers to economic security and wealth-building:

1) Strengthening the EITC and CTC and expanding access to more taxpayers including workers without children and ITIN (Individual Taxpayer Identification Number) filers;[xxx]
2) Making higher education tax expenditures work for everyone, especially low-income families and students;[xxxi]
3) Leveraging the tax code to encourage retirement savings and investments among working families; and
4) Ensuring that tax subsidies for homeownership are more progressive, include ways to assist working families in saving for a down payment and increase tax benefits for renters.

We welcome the opportunity to provide additional input on how to approach future tax reform initiatives in a way that establishes a modernized system capable of supporting America's future workers, entrepreneurs and taxpayers and bolsters a more inclusive economy.

---

[i] Jessica Semega, Kayla Fontenot, and Melissa Kollar, Income and Poverty in the United States, (Washington, DC: 2017), https://www.census.gov/library/publications/2017/demo/p60-259.html (accessed June 2018).
[ii] Urban Institute, "Features: Nine Charts about Wealth Inequality in America," updated October 5, 2017, http://apps.urban.org/features/wealth-inequality-charts/ (accessed June 2018).
[iii] Center on Budget and Policy Priorities Staff, New Tax Law Tilted Toward Wealthy and Corporations, (Washington, DC: Center on Budget and Policy Priorities, 2018).
[iv] Jacob Leibenluft, Tax Bill Ends Child Tax Credit for About 1 Million Children, (Washington, DC: Center on Budget and Policy Priorities, 2017).
[v] Center on Budget and Policy Priorities Staff, New Tax Law Tilted Toward Wealthy and Corporations, (Washington, DC: Center on Budget and Policy Priorities, 2018).
[vi] New American Economy and UnidosUS, Power of the Purse: How Hispanics Contribute to the U.S. Economy, (Washington, DC: 2017), http://publications.unidosus.org/bitstream/handle/123456789/1818/powerofthepurse.pdf?sequence=1&isAllowed=y (accessed June 2018).
[vii] Ibid
[viii] UnidosUS, "Tax Cuts and Jobs Act: United States," (Washington, DC: UnidosUS, 2018), http://publications.unidosus.org/bitstream/handle/123456789/1843/tcja_national.pdf?sequence=1&isAllowed=y (accessed May 2018).
[ix] UnidosUS, "Tax Cuts and Jobs Act: Arizona," (Washington, DC: UnidosUS, 2018), http://publications.unidosus.org/bitstream/handle/123456789/1845/TCJA%20AZ.pdf?sequence=1&isAllowed=y (accessed May 2018).
[x] UnidosUS, "Tax Cuts and Jobs Act: Florida," (Washington, DC: UnidosUS, 2018), http://publications.unidosus.org/bitstream/handle/123456789/1845/TCJA%20FL.pdf?sequence=2&isAllowed=y (accessed May 2018).
[xi] Geoscape and U.S. Hispanic Chamber of Commerce, Hispanic Businesses and Entrepreneurs Drive Growth in the New Economy, (Miami, FL: Geoscape and USHCC, 2017), https://ushcc.com/2017-geoscape-report/ (accessed May 2018).
[xii] Douglas Rivers, et al., State of Latino Entrepreneurship, 2016, (Stanford, CA: Stanford Graduate School of Business, 2016), https://www.gsb.stanford.edu/faculty-research/publications/state-latino-entrepreneurship-2016 (accessed May 2018).

[xiii] Ibid.
[xiv] Steven Rosenthal, “The 25-Percent Rate for Pass-Through Businesses Helps Rich Investors, Not ‘Small’ Businesses,” November 8, 2017, Tax Policy Center, https://www.taxpolicycenter.org/taxvox/25-percent-rate-pass-through-businesses-helps-rich-investors-not-small-businesses (accessed May 2018).
[xv] UnidosUS, “Tax Cuts and Jobs Act: Impact on Latino-Owned Businesses,” (Washington, DC: UnidosUS, 2018), http://publications.unidosus.org/bitstream/handle/123456789/1844/tcja_smallbusinesses.pdf?sequence=1&isAllowed=y (accessed May 2018).
[xvi] Joint Committee on Taxation, Tables Related to the Federal Tax System as in Effect 2017 Through 2026, report prepared by the Joint Committee on Taxation for the Senate Committee on Finance, 115th Congress., 2nd sess., 2018, https://www.jct.gov/publications.html?func=startdown&id=5091 (accessed June 2018).
[xvii] Elizabeth Glass, The Tax Cuts and Jobs Act: Implications for Small Businesses, (Washington, DC: Businesses for Responsible Tax Reform, 2018), https://docs.wixstatic.com/ugd/4a8609_5ae6299d49534af6b27acb872d044e30.pdf (accessed May 2018).
[xviii] Ibid.
[xix] Eric Rodriguez for UnidosUS, Leveling the Playing Field: The Effect of the Tax Code on Inequity, 115th Cong., 2nd sess., 2018, https://waysandmeans.house.gov/wp-content/uploads/2017/07/20170719TP-Testimony-Rodriguez.pdf (accessed May 2018).
[xx] Congressional Budget Office, An Update to the Budget and Economic Outlook: 2017 to 2027, (Washington, DC: Congress of the United States, 2017), https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/52801-june2017outlook.pdf (accessed June 2018).
[xxi] Congressional Budget Office, The Budget and Economic Outlook: 2018 to 2028, (Washington, DC: Congress of the United States, 2018), https://www.cbo.gov/system/files/115th-congress-2017-2018/reports/53651-outlook.pdf (accessed June 2018).
[xxii] Amelia Collins, “The Trump budget is not what the American people want or need,” (Washington, DC: UnidosUS, 2018), http://blog.unidosus.org/2018/02/12/trump-budget-2019/ (accessed May 2018).
[xxiii] UnidosUS, “House GOP SNAP proposal threatens Latino health and economic well-being,” (Washington, DC: UnidosUS, 2018), http://blog.unidosus.org/2018/04/17/farm-bill-snap/ (accessed May 2018).
[xxiv] UnidosUS, “Work Requirements Will Hurt Latino Families Most,” (Washington, DC: UnidosUS, 2018), http://publications.unidosus.org/handle/123456789/1851 (accessed May 2018).
[xxv] “Distribution of the Nonelderly with Medicaid by Race/Ethnicity,” Kaiser Family Foundation, https://www.kff.org/medicaid/state-indicator/distribution-by-raceethnicity-4/?dataView=1¤tTimeframe=0&sortModel=%7B%22colId%22:%22Location%22,%22sort%22:%22asc%22%7D (accessed May 2018).
[xxvi] Adam Sonfield, “Why Protecting Medicaid Means Protecting Sexual and Reproductive Health,” (Washington, DC: Guttmacher Institute, 2017), https://www.guttmacher.org/gpr/2017/03/why-protecting-medicaid-means-protecting-sexual-and-reproductive-health (accessed May 2018).
[xxvii] UnidosUS, “Federal Programs Lift Millions of Latinos Out of Poverty,” (Washington, DC: UnidosUS: 2017), http://publications.unidosus.org/bitstream/handle/123456789/1748/Fact_sheet_Anti-poverty_UnidosUS2.pdf?sequence=5&isAllowed=y (accessed May 2018) and UnidosUS, “House GOP SNAP proposal threatens Latino health and economic well-being” (accessed May 2018).
[xxviii] The model includes the following federal programs: EITC, CTC, SNAP, HUD, SSI, TANF, LIHEAP, and WIC.
[xxix] Derrick Hamilton and Michael Linden, Hidden Rules of Race are Embedded in the New Tax Law, (New York, NY: Roosevelt Institute, 2018), http://rooseveltinstitute.org/hidden-rules-new-tax-law/ (accessed May 2018).
[xxx] UnidosUS, *Latino Priorities, American Values: A Latino Policy Agenda for the 115th Congress*, (Washington, DC: UnidosUS: 2017), http://publications.unidosus.org/handle/123456789/1729 (accessed June 2018).
[xxxi] UnidosUS, “The Federal Tax Code: Higher Education Tax Benefits and Latinos,” (Washington, DC: UnidosUS, 2018), http://publications.unidosus.org/bitstream/handle/123456789/1795/AOTC.Higher%20Ed%20Tax%20Benefits_FINAL.pdf?sequence=1&isAllowed=y (accessed June 2018).

Comments for the Record
United States House of Representatives
Committee on Ways and Means
Tax Policy Subcommittee
Tax Reform and Small Business:
Growing Our Economy and Creating Jobs
Wednesday, May 23, 2018, 10:00 A.M.
By Michael G. Bindner
Center for Fiscal Equity

Chairmen Brady and Buchannan Ranking Members Neal and Doggett, thank you for the opportunity to comment on the new tax law.

The Brookings-Urban Tax Policy Center looked at the distribution of benefits of the new tax law. It found that they mostly went to the highest income taxpayers. The small businesses most likely to benefit are on Wall Street, not Main Street. This will have little impact on services in the lower Manhattan area, since these cuts are unlikely to affect consumption on meals and entertainment in the area, which is also priced at the high end. It may impact real estate and personal services spending in the Greater New York area, but again, these areas are not particularly suffering.

The plurality of small businesses are not high income. Indeed, they are actually 1099 employees whose income tax rates are far below the special rates for Pass Through businesses. Real tax reform would have given the clients of these individuals an incentive to hire them full-time with benefits. I suspect that the new law did the reverse.

We are on record predicting that enactment of the Fiscal and Job Cuts Act (not a typo) will restrict wages and cause other labor cost savings so that executives can cash in on the lower tax rates by earning higher bonuses. This means more cost cutting and 1099 employment, which is not as good for the employee as full-time statutory employment.

Small businesses will gain more from increased federal spending in the Two-Year Omnibus appropriation. They will spend money from government spending and spur the economy. None of that have come from tax cuts.

The two-year Omnibus will eat up most of the effect of the tax cut on the economy, which will now have a negative relationship between deficits (net of net interest, which controls for matching injection to the financial markets from federal borrowing) and economic growth, meaning deficits are good. The closest available curve showing that model are the Bush years, so given the current deficit size, the predicted growth rate in about a year (it takes time to obligate money and pay bills) should be around 3.3% or higher.

We remind the Committee that in the future we face a crisis, not in entitlements, but in net interest on the debt, both from increased rates and growing principal. This growth will only feasible until either China or the European Union develop tradeable debt instruments backed by income taxation, which is the secret to the ability of the United States to be the world's bond issuer. While it is good to run a deficit to balance out tax cuts for the wealthy, both are a sugar high for the economy. At some point we need incentives to pay down the debt.

The national debt is possible because of progressive income taxation. The liability for repayment, therefore, is a function of that tax. The Gross Debt (we have to pay back trust funds too) is $19 Trillion. Income Tax revenue is roughly $1.8 Trillion per year. That means that for every dollar you pay in taxes, you owe $10.55 in debt (although this will increase). People who pay nothing owe nothing. People who pay tens of thousands of dollars a year owe hundreds of thousands.

The answer is not making the poor pay more or giving them less benefits, either only slows the economy. Rich people must pay more and do it faster. My child is becoming a social worker, although she was going to be an artist. Don't look to her to pay off the debt. Your children and grandchildren and those of your donors are the ones on the hook unless their parents step up and pay more. How's that for incentive?

Those small businesses from Wall Street, et al who are in high income tax brackets will be the ones paying back the debt in the future. It would have been better to simply not have raised their taxes.

Thank you for the opportunity to address the committee. We are, of course, available for direct testimony or to answer questions by members and staff.

Contact Sheet

Michael Bindner
Center for Fiscal Equity
14448 Parkvale Road, #6
Rockville, MD 20853
240-810-9268
fiscalequitycenter@yahoo.com

Committee on Ways and Means and Tax Policy Subcommittee
Tax Reform and Small Business: Growing Our Economy and Creating Jobs
Wednesday, May 23, 2018, 10:00 A.M.

All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears:

This testimony is not submitted on behalf of any client, person or organization other than the Center itself, which is so far unfunded by any donations.

May 20, 2018

Dear Chairman Brady, Subcommittee Chairman Buchanan and Members of the Committee:

The Tax Cuts and Jobs Act has left my husband and me in an untenable situation.

I am a Canadian with US citizenship, left the United States as a child and have lived in Canada since 1968. My husband was born in Canada and is a US citizen through his American father. We operate a small Canadian film company and for years have been diligently saving for our retirement within the company. US tax reform threatens those savings and the future of our company through the “Repatriation Tax” and GILTI aimed to encourage large US corporations to move their foreign subsidiaries back to the United States.

Our company is not a foreign subsidiary and cannot be “repatriated” back to the US. Our company has no presence in the United States, but we do hire service providers in the US who in turn create US jobs. Our ability to directly and indirectly bring jobs to Americans in the US will cease should our Canadian business be forced to fold because of excessive US tax burdens we believe were not meant for us.

This punitive tax is imposed on us solely because we are US citizens, even though we don’t live in the US and cannot benefit as large US companies can from “repatriating” their subsidiaries there. We can’t even open a bank account in the US because we don’t reside there!

For years, my husband and I have been filing US taxes and reporting our Canadian corporation to the US government on an annual basis. The understanding was that our corporation would not be subject to US tax, let alone be taxed retroactively and punitively for something that never has or should be applied to us. I have always had a deep appreciation of my US citizenship, but this attempt by the US government to confiscate a major source of income for my old age through a “gotcha” manoeuvre would turn the most patriotic American into a fierce adversary! I am apparently worth more to the United States as a taxpayer than a citizen when tax laws leave Americans in impossible situations that threaten our families and futures. That hurts. Is this how you create jobs through small businesses, by

bankrupting American small business owners in other countries resulting in job losses in the United States?

If the Repatriation Tax and GILTI were not intended to apply to Americans living as residents in countries around the globe, then please fix it before irreparable harm is done to your unofficial ambassadors abroad.

There is a simple balanced solution to solve this problem: an American living abroad should be exempt from the Repatriation and GILTI Tax regimes for any given year so long as: (1) the American meets the conditions set forth under IRC Section 911, and (2) that person is an individual U.S. Shareholder.

I strongly request that the Congress act to correct this most painful problem. I thank you for considering my statement.