TESTIMONY BEFORE THE UNITED STATES CONGRESS
ON BEHALF OF THE

NATIONAL FEDERATION OF INDEPENDENT BUSINESS

NFIB™

Statement for the Record of Kevin Kuhlman
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United States House of Representatives
Committee on Budget

Reigniting American Growth and Prosperity Series:
Incentivizing Economic Excellence Through Tax Policy

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Good afternoon, Chairman Arrington, Ranking Member Boyle, and members of the House Budget Committee. My name is Kevin Kuhlman; I am the Vice President of Federal Government Relations at the National Federation of Independent Business (NFIB).

NFIB is the nation's leading small business advocacy organization, advocating on behalf of nearly 300,000 small business owner members in Washington, D.C., and all 50 state capitals. NFIB's mission is to promote and protect the right of our members to own, operate, and grow their businesses.

Small businesses face economic challenges including stubbornly high inflation and pervasive workforce shortages.[1] Nearly half of small business owners cannot fill open positions. Small business optimism remains well below the nearly 50-year historical average. Small business owners' expectations of better business conditions six months from now remain near historic lows.

Additionally, small businesses face a very uncertain tax future that makes business planning extremely difficult. Beginning this year, certain business provisions of the Tax Cuts and Jobs Act (TCJA) of 2017 expire or wind down. In 2.5 years, the vast majority of the provisions that benefit individuals and small businesses will also expire. If Congress fails to act, there will be a detrimental and substantial tax increase on millions of small businesses. Further, proposals to increase taxes on businesses cloud optimism and further complicate business planning. Finally, the small business paperwork burden is increasing, which complicates tax compliance, while the IRS disproportionately expands enforcement efforts over compliance assistance and customer service improvements.

Small Business Benefits of Tax Cuts and Jobs Act of 2017

Small businesses received significant tax relief upon enactment of the Tax Cuts and Jobs Act of 2017. More than three-quarters of businesses are organized as pass-through businesses (S-Corporations, LLCs, Sole Proprietorships, and Partnerships). Business income is passed through to the business owners' individual income tax return (Form 1040), where individual income tax rates are applied. These businesses invest much of their post-tax dollars back into their businesses and employees.

[1] William C. Dunkelberg and Holly Wade, *NFIB Small Business Economic Trends*, NFIB Research Center, May 2023, https://strgnfibcom.blob.core.windows.net/nfibcom/SBET-May-2023.pdf.

For pass-through businesses, the 20% Small Business Deduction (also known as Section 199A), combined with the lower individual tax rates and broader income brackets, provided tax relief that was invested in small businesses and employees.[2,3] These provisions expire on December 31, 2025. Nearly half of small business owners (48%) reported the uncertainty of expiring tax provisions is impacting their current and future business plans.[4]

Fortunately, Congressman Lloyd Smucker (PA), a member of the Budget Committee, will re-introduce the *Main Street Tax Certainty Act* during the next Congressional work period. This legislation would make permanent the 20% Small Business Deduction, providing tax certainty for small business owners to grow their businesses. NFIB urges Members of Congress to support this legislation by joining as an original cosponsor.

The TCJA also contained provisions that encouraged business investment by allowing for the immediate deduction of equipment and capital expenses. These provisions include permanently extending Section 179 expensing and temporarily extending bonus depreciation and R&D expensing (Section 174).[5,6] Unfortunately, the latter two provisions expired last year. R&D expensing is a big deal when cashflow is tight, which is currently happening due to inflation and rising interest rates. The sooner that the positive small business and expensing provisions are extended, the better small businesses will be able to plan for the future. The proposed *Build It in America Act* (H.R. 3938) would extend these pro-growth provisions while the proposed *Small Business Jobs Act* (H.R. 3937) would expand Section 179 expensing.

Small Business Concerns with Fiscal Year 2024 Budget Request

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[2] *The Small Employer column shows 77.9% are organized as passthroughs (Sole Proprietors, Partnerships, and S-Corporations) and 22.3% are organized as C-Corporations and Other. Table 2, Legal Form of Organization (2019), Frequently Asked Questions About Small Business*, U.S. Small Business Office of Advocacy, March 2023, https://advocacy.sba.gov/wp-content/uploads/2023/03/Frequently-Asked-Questions-About-Small-Business-March-2023-508c.pdf.

[3] *"A quarter of small business owners who reported a tax saving raised spending on employee compensation (Q#14a6). The second most frequently reported increase in spending was on business investment and expansion (Q#14a5). Tax savings motivated 16% of small business owners to hire additional employees (Q#14a3) and another 20% to pay down debt obligations (Q#14a7)." The Tax Cuts and Jobs Act, One Year Later: Part II*, NFIB Research Center, September 2019, https://assets.nfib.com/nfibcom/TCJA-Part-2.pdf.

[4] *NFIB Tax Survey*, NFIB Research Center, 2021, https://assets.nfib.com/nfibcom/NFIB-Tax-Survey-Full-Report.pdf.

[5] *"Congress made a number of significant changes in the [bonus depreciation allowance] BDA in P.L. 115-97. Specifically, the act set the rate for the BDA at 100% for qualified property acquired and placed in service between September 28, 2017, and December 31, 2022. The rate then is scheduled to decrease to 80% for property placed in service in 2023, 60% for property placed in service in 2024, 40% for property placed in service in 2025, 20% for property placed in service in 2026, and 0% starting in 2027 and thereafter."* Gary Guenther, *The Section 179 and Bonus Depreciation Expensing Allowances: Current Law and Economic Effects*, Congressional Research Service, May 1, 2018, https://www.everycrsreport.com/reports/RL31852.html.

[6] *Beginning in tax year 2022, small businesses are now required to capitalize R&D costs and amortize them over a minimum of 5 years for domestic research and development.*

Further clouding business planning are proposed tax increases on small businesses. President Biden's Fiscal Year 2024 Budget Request would increase taxes on small businesses organized as corporations and pass-throughs. For the nearly one-quarter of small employers organized as corporations, the budget proposes increasing the corporate tax rate from 21% to 28%.[7] For the more than three-quarters of small employers that are pass-throughs, the budget proposes increasing the top marginal income tax rate, lowering the threshold that the top rate begins, creating a new 5% tax on business income above $400,000,[8] increasing capital gains tax rates above $1 million, and further limiting the ability to smooth out business losses. For businesses of all types, the President's budget limits like-kind exchanges and changes the tax treatment of stepped-up basis for family businesses and farms. While small businesses may not be impacted by these proposed tax changes every year, they will be impacted when they have profitable years, when they sell their businesses to fund their retirement, or when they pass along their businesses to the next generation.[9]

The President's Budget Request describes certain tax increases misleadingly as "closing loopholes." One example of this mischaracterization is the proposed expansion of the 3.8% "Net Investment Income Tax" (NIIT) to active business income and increase that tax rate to 5%.[10] This tax was originally created as part of the Affordable Care Act reconciliation bill as a tax on investment, or passive, income above $200,000.[11,12,13] It was a deliberate policy choice to exempt active business

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[7] *The Build Back Better Act that was considered by the Ways and Means Committee would have created a graduated corporate rate structure, as did the Senate amendment offered by Senators Sanders (I-VT) and Whitehouse (D-RI). The President's FY2024 Budget Proposal does not.*

[8] *The threshold for joint filers is $450,000. These thresholds are not indexed for inflation so it will absorb an increasing number of small businesses and a greater percentage of small business income every year*.

[9] *"The majority (52%) of small business owners plan to sell their business when they retire or move on from it. Additionally, about a third (33%) plan to pass it on to a family member when it's time to move on. Of the respondents who plan on passing their business on to family, half (49%) have talked to a tax professional already and 29% plan to but haven't yet. Many small business owners believe that if a capital gains tax were assessed on business inheritance, the next generation would have to take out a loan (38%) or sell part of the business (26%) to pay the tax. About a quarter (26%) believe the next generation would pay for the tax using savings or other income." NFIB 2021 Tax Survey*, NFIB Research Center, June 2021, https://assets.nfib.com/nfibcom/NFIB-Tax-Survey-Full-Report.pdf.

[10] *"The Budget closes the loophole that allows certain business owners to avoid paying Medicare taxes on these profits, and dedicates revenue raised by the Net Investment Income Tax (NIIT) to the Medicare HI Trust Fund, as originally intended. In addition, the Budget raises the Medicare tax rate on earned and unearned income and the NIIT rate from 3.8% to 5% for the wealthiest Americans." Budget of the U.S. Government, Fiscal Year 2024*, Office of Management and Budget, page 45, March 9, 2023, https://www.whitehouse.gov/wp-content/uploads/2023/03/budget_fy2024.pdf.

[11] *The NIIT was neither included in the House or Senate ACA proposals; it was added during reconciliation after the Cadillac tax (which has since been repealed) was delayed and Cadillac tax thresholds were increased*.

[12] *The threshold for joint filers is $250,000. These thresholds are also not indexed for inflation.*

[13] "*In summary, the NIIT arose as a last-minute revenue replacement to offset the revenue loss from Congress's delayed implementation of the 40% excise tax on high-cost, or Cadillac, health insurance plans. As a direct substitute for the Cadillac tax's general fund revenues, the receipts from the NIIT needed to flow into the Treasury's general fund instead of being dedicated to either of Medicare's trust funds. In other words, while helpful to supporting federal expenditures, including Medicare, the ACA did not directly link the NIIT to Medicare.*" Ausher M.B. Kofsky and Bryan P. Schmutz, *What a Long Strange Trip It's Been for the 3.8% Net Investment Income Tax*, May 15, 2019, https://digitalcommons.law.umaryland.edu/cgi/viewcontent.cgi?article=1057&context=endnotes.

income, which is not investment income, from the tax. As former Chairman of President Obama's Council of Economic Advisors Jason Furman described, it was not applied to active business income, "because it could be demonized as a tax on small businesses and doctors."[14]

A deliberate policy choice is not a "loophole." The proposed expansion of the tax would more than double the revenue collected, further demonstrating that the tax increase proposal is not "closing a loophole."[15,16] If it is ultimately enacted, this substantial tax increase would reduce the ability of passthrough business owners to invest in their businesses and employees, leaving them at a further disadvantage relative to corporations.

Over a few months, NFIB collected over 21,000 signatures from small business owners throughout the country opposing this "Small Business Surtax" and stating that "small business is not a tax loophole." Fortunately, none of these proposed tax increases were included in the recent debt limit increase.

Tax Complexity

Tax compliance is a challenge for small business owners.[17] More than 90% use a tax professional to prepare and submit their taxes. Among this group, "compliance" and "complexity" were the two dominant factors leading business owners to use a professional. Paperwork burdens are increasing, and enforcement efforts are ramping up. The Inflation Reduction Act of 2022 provided nearly $80 billion in new funding for the Internal Revenue Service (IRS), primarily focused on enforcement. Unfortunately, only 4% of that funding was designated for IRS customer service, which is in need of significant improvement. Small business owners are concerned about the implementation of increased enforcement efforts, the continued backlog of tax returns, and increased paperwork.

Currently, business owners are inundated with paperwork and current Form 1099 information reports. The forthcoming expansion of Form 1099-K reporting could further complicate tax preparation and require more reconciliation of paperwork. It

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[14] Jason Furman, Twitter, October 28, 2021, https://twitter.com/jasonfurman/status/1453756933689823241.

[15] *According to IRS Statistics of Income, the NIIT collected $32.1 billion in taxes in 2020*, https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-with-small-business-income-and-losses.

[16] *According to the FY2024 Treasury Greenbook, the proposed tax increase would collect an average of $65 billion per year over ten years – expansion of 3.8% NIIT to active business income (average $30.6 billion per year over ten years) and increase NIIT rate to 5% (average $34.4 billion per year over ten years)*, https://home.treasury.gov/system/files/131/General-Explanations-FY2024.pdf.

[17] *"Despite the high proportion of business owners enlisting the help of a tax professional, most respondents indicated a persistent administrative burden associated with preparing and paying their taxes. Specifically, as shown in Figure 5, more than 60% of respondents found the administrative burden of federal business income taxes and payroll taxes to be moderately or very burdensome." NFIB 2021 Tax Survey*, NFIB Research Center, June 2021, https://assets.nfib.com/nfibcom/NFIB-Tax-Survey-Full-Report.pdf.

has already been delayed once administratively as a result. The proposed *Small Business Jobs Act* (H.R. 3937) would provide paperwork relief from Form 1099 reporting requirements, rolling back the Form 1099-K expansion and revising upward the Form 1099-MISC threshold for the first time in decades. The genesis of this proposed change was testimony from NFIB member Alison Couch at a Ways and Means Field Committee hearing in Peachtree, Georgia, earlier this spring.

Small business owners must also file burdensome beneficial ownership reporting paperwork with Treasury beginning January 1, 2024. The statutory requirements for this new paperwork requirement are four pieces of personally identifiable information (full legal name, business or residential address, date of birth, and unique identifying number). Yet the draft application spans 6 pages and is 50 questions long, with many more pieces of information appearing to be required. The outreach and education efforts on both of these new reporting requirements have been lacking and businesses remain concerned by what these added burdens will have on their operations.

Small businesses continue to face economic headwinds. Congress can help mitigate economic challenges by extending beneficial small business tax provisions, reducing paperwork, and rejecting tax increases on small businesses. Tax certainty will help businesses plan for the future and increase small business confidence. I appreciate your time and attention to these concerns. Thank you for the opportunity to testify today on behalf of small businesses.