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On Behalf of
The National Small Business Association

House Small Business Committee Hearing
"Reforming the Tax Code to Assist Small Businesses"

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National Small Business Association®

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Chairman Manzullo, Ranking Member Velazquez, Members of the Committee. Thank you for inviting me to provide testimony on the important topic of the intersection of small businesses and the tax code.

My name is Marilyn Landis and I am the president of Basic Business Concepts, Inc., a multifaceted service firm providing financial consulting services to small businesses in Pennsylvania. Prior to starting my own business, I worked for three of the largest SBA lenders in the country—marketing, originating and underwriting SBA loans. In my career, I have worked in a variety of finance related fields including consumer loan and mortgage developments, delinquent loan collections and coordinating operations for a muli-bank merger.

Outside of the business world, I dedicate my time to serving on many non-profit boards overseeing social service and economic development. I am here today first as a concerned business owner and second as chair of the National Small Business Association's Legislative Action Committee. As you know, the NSBA is the nation's oldest non-partisan small business advocacy group representing more than 150,000 small business owners across the country. My role as chair of the Legislative Action Committee allows me to oversee the formation of all the NSBA's policy positions. Both personal experience and my role in the NSBA have allowed me to see small business owners wrestle with our complicated tax system. In fact, in the 108th Congress, two of my fellow NSBA members testified on difficulties small businesses face in the tax code.

Cost of the Code

Many excellent studies have been conducted that estimate the cost of complying with the U.S. Tax Code. It is important to remember that the "cost" these reports detail is not the money paid to the U.S. Treasury, but the opportunity cost of the time spent on studying the code, changing business practices, maintaining records and paying professionals to minimize taxes paid.

The Small Business Administration's Office of Advocacy continues to be an excellent source for such data. While I will leave the testimony of Chief Council for Advocacy Tom Sullivan to detail those studies, the results are always the same. Because of their size and available resources, small business owners pay a disproportionate amount of time and money complying with the Tax Code.

Compounding compliance costs are the costs faced by employers and employees at small firms who are prohibited from participating in tax advantaged benefits available to companies of a larger size. Being excluded from pension plans, pre-tax health savings and fringe benefit plans have a real economic impact on entrepreneurs.

Tax Equity

The issues facing small business owners in the Tax Code are so vast that we commissioned a study by the Prosperity Institute to root through the code and return the most egregious examples of inequities. Members of NSBA have testified before this and other committees on the findings of the study. We are very pleased to see some of our top recommendations included in Chairman Manzullo's recently introduced legislation, "The Small Business Tax Relief Act of 2005."

One recommendation from the NSBA Tax Equity Report that has been addressed by Chairman Manzullo and Representative Velazquez in past legislation—and National Taxpayer Advocate Olson in recent reports—is the repeal of the self-employment tax on health care. As the law stands now, self-employed individuals still pay for their health care with money that has been subject to the self-employment tax. All employed individuals pay the FICA tax on their wage income, of which 6.2 percent is allotted for Social Security and 1.45 percent goes to Medicare. Employers are required to match employee contributions with a 7.65 percent contribution of their own. Self-employed individuals are required to pay both sides of this tax resulting in a total 15.3 percent tax on income, commonly referred to as the "self-employment tax."

Contrary to rules for C Corporations, a provision of the Internal Revenue Code requires self-employed individuals to pay the additional 15.3 percent self-employment tax on the cost of their health care premiums. No other worker is required to pay FICA taxes on any portion of their employer-sponsored health benefits. With health care costs already sky-high, our members find it unbelievable that the federal government would slap an extra tax on those who have the hardest time securing coverage in the first place. NSBA is encouraged to see that Chairman Manzullo included this important issue in the Small Business Tax Relief Act.

Another issue from the Tax Equity report that was included in the chairman's legislation is parity for small business qualified pension plans. A recent CRS report, *Pension Sponsorship and Participation: Summary of Recent Trends* (RL30122), documented the relatively low percentage of small businesses offering pension plans compared to larger businesses. One reason for this disparity is the complexity and cost associated with offering the plans. Congress, in effect, has acknowledged that the regulatory environment surrounding popular pension plans is too onerous for small businesses by creating Savings Incentive Match Plans (SIMPLE).

Created in the 104^{th} Congress, SIMPLE plans allow small business owners and their employees access to tax benefits awarded to traditional qualified pension plans but with greatly reduced regulatory burden and cost. Unfortunately, this acknowledgement comes with a serious cost to participants. Current rules allow a traditional 401(k) participant to put away $14,000 in tax-advantaged dollars for retirement while a SIMPLE 401(k) participant may only save $10,000. It is stunning that Congress would penalize the small-business community's ability to save for retirement in the same legislation that acknowledges it is hard for them to do so. Fortunately, the Small Business Tax Relief Act of 2005 would fix this inequity.

The Small Business Tax Relief Act of 2005 includes many additional tax reforms for small business including extended Section 179 expensing and increased standard home-office deduction. NSBA looks forward to working with Chairman Manzullo and members of the committee to enact this important legislation.

Fundamental Tax Reform

While the changes in NSBA's Tax Equity Report and Chairman Manzullo's legislation would greatly improve the U.S. Tax Code, the system still continues to act as a brake on the economy.

At the 2005 Small Business Congress in February, NSBA members met to vote on the organization's priorities in the 109th Congress. When the votes were counted, the clear winner was fundamental tax reform. Specifically, NSBA members voted to endorse the Fair Tax.

The Fair Tax would replace the individual income tax, corporate income tax, capital gains taxes, estate taxes and payroll taxes with a 23 percent inclusive national sales tax on the purchase of all new goods and services. Under the Fair Tax, compliance costs will fall to less than $10 billion, creating enormous net savings that would eventually be incorporated in lower product prices for consumers. The tax will be collected at retail businesses, taking the tax burden out of the hands of the consumers.

Forty-five states already have a sales tax system, and the Fair Tax would simply add an additional line on the current sales tax reporting form. Businesses will collect the tax and send it to the state tax collecting authority. All businesses serving as collecting agents will receive a fee for collection, and the states also will receive a collection fee. While the Fair Tax should not be interpreted as a tax cut, the reduction in work required to administer the new tax will certainly be a relief for business owners and consumers alike.

It was a stroke of good luck that President Bush issued an executive order establishing an Advisory Panel on Federal Tax Reform a month before our membership chose fundamental tax reform as a top issue. While the panel's recommendations have been delayed, we expect that a form of the Fair Tax will be included as an option for reform.

Conclusion

As it stands now, the U.S. tax code is difficult to comply with and administer. The code also includes elements that act as a disincentive to entrepreneurship and business growth. A recent report from the IRS National Research Project (NRP) found there to be a $300 billion tax gap, much of it attributed to small business owners. I also understand that a similar study will be conducted focusing on businesses that are organized as S corporations. While there are undoubtedly tax cheats in any system, it is also true that in a complex system like the U.S. Tax Code many participants will be out of compliance unintentionally. We encourage the IRS to consider complexity when evaluating the final results from the NRP.

I once again thank the committee for the opportunity to share my thoughts on how the tax code might be reformed to assist small businesses. As a final thought, while it is ok to try and use the tax code to help small business owners, our ultimate goal should be to get it out of their way.