

# Deficit Reduction through Tax, Spending and Entitlement Reform

*Policymakers must pursue economically responsible and long-term sustainable deficit reduction*

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Reducing U.S. deficits and debt have a real benefit to small-business growth in the U.S. and is something America's small-business owners feel strongly about. The U.S. has always been a leader in entrepreneurship, however if we do not address our record-high national debt and annual budget deficits, our global competitiveness will be stymied.

To address these issues, NSBA supports a two-pronged approach to reduce annual budget deficits and lower the national debt: spending and entitlement reform and broad tax reform.

## ***Spending and Entitlement Reform***

Federal spending in 2010 amounted to approximately 24 percent of gross domestic product (GDP)—a level not seen since World War II—in part due to the economic downturn. Even with an economic recovery and the ensuing increase in tax revenues and decrease in spending on stimulative and safety net programs—without major changes—federal spending will continue to outpace revenues. If we continue to run high deficits, increased interest rates and constricted credit will negatively impact small businesses' ability to garner financing, the life-blood of every small firm.

The nation's long-term economic health cannot be assured unless the government gets control over its most costly entitlement programs. In light of many contributing factors: health care costs growing faster than the economy; the aging and increased life-expectancy of a Baby Boom generation reaching retirement eligibility; negative personal savings rates; and the fact that 55 percent of the elderly currently rely on Social Security for the majority of their income, Social Security and Medicare will be unsustainable in the long-run absent significant reforms.

Starting in 2015, Social Security expenses are expected to exceed cash revenues. The benefit structure and cost of the program must be addressed for any reform to succeed. Retirement savings and Social Security impact small-business owners and employers uniquely. Whether through the disproportionate cost and complexity of offering a 401K or other retirement plan to employees, or through the self-employment taxes (15.3 percent FICA payroll tax--12.4 percent for Social Security and 2.9 percent for Medicare) on the cost of health insurance that no other business owner or employee pays, small businesses face an unfair burden when it comes to these entitlement programs.

Small businesses have been open to enabling pre-funding of Social Security accounts and support allowing individuals to redirect a percentage of their payroll taxes to personal retirement accounts for investment in broad-based investment funds. Additionally, individuals ought to have the option to invest their funds into small businesses.

Another significant contributor to annual budget deficits is the Medicare program. Through much needed health care cost-containment reforms, Medicare can ensure its long-term viability, as well as provide innovative models of care and reimbursement that ensure quality, affordable health care. Tested cost containment initiatives can be used to inform commercial insurers, negotiate cheaper prescription drugs, establish greater transparency, spread health information technology, expedite a value-based purchasing system and new payment models, and eliminate waste, fraud and abuse.

Lawmakers finally appear to see that the fiscal problems facing the U.S. must be addressed. Although the recommendations forwarded by the President's National Commission on Fiscal Responsibility and Reform didn't garner the required number of votes for a formal recommendation, NSBA applauds their work as an important first step, and urges Congress to stay vigilant on reducing the U.S. deficit.

## ***Tax Reform***

One way to address the nation's deficit and debt crisis is to simplify the tax code, broaden the base, lower all individual and corporate tax rates, and make business taxes more globally competitive for U.S. business. These reforms will create a surge in economic growth. While there are many obvious problems with the current tax system, there are two paramount issues that must be addressed. The first major problem with the system is the generally high marginal rates of taxation on income. The other, perhaps more significant dilemma is the almost impossible task of compliance with all the rules and regulations.

The current tax code is comprised of more than 70,000 pages of laws and regulations that inevitably weaken the economy's strength by punishing work, investment, risk-taking and entrepreneurship. The tax code is unfair to small businesses, biased against savings and investment, and impossibly complex. Small businesses simply cannot cope with the ever-changing nature of the tax code. In addition, the current tax system impedes small-business growth by discouraging long-term investment, instituting a complex and resource draining estate tax, and by hindering job creation with an over-reliance on payroll taxes. A tax system dedicated to investment, savings and small-business growth must be put in its place.

Most small businesses are sole proprietorships, subchapter S corporations or limited liability companies. Most of the remainder are partnerships (either limited or general). There are also some business trusts. All of these businesses are pass-through entities that are subject to individual tax rates not the corporate tax rates. Some small businesses are C corporations that are subject to the corporate income tax, but these are a relatively small percentage and a large portion of these companies' net income before compensating the owners' is usually consumed by paying the owners' salary. This salary is also subject to the individual tax rates.

Thus, for the overwhelming majority of small businesses, individual marginal tax rates are much more important than corporate marginal tax rates. Broad reform of the entire tax code is necessary, not just for corporate entities. The overwhelming majority of small businesses are pass-through entities and therefore pay business taxes through their individual income tax. Allowing the smallest businesses to pay a much higher tax on their business income than a multinational, multi-billion corporations undercuts any semblance of fairness. Since small businesses disproportionately contribute to job creation, raising individual marginal tax rates can be expected to have a disproportionate negative impact on job creation.

If Congress overhauls the tax system by dramatically broadening the base—cutting the breaks that litter the tax code—and lowering rates, we would see real economic growth and raise revenues.

As both Congress and the American people debate what tax system should replace the current system, NSBA believes it is imperative that the U.S. moves toward a simpler, fairer tax system that incorporates the following principles:

- Designed to tax only once
- Stable and predictable
- Visible to the taxpayer
- Simple in its administration and compliance
- Promote economic growth and fairness between large & small businesses
- Use commonly understood finance/accounting concepts
- Grounded in reality-based revenue estimates
- Fair in its treatment of all citizens
- Transparent

[Click here](#) for NSBA's Tax Reform Checklist