

Testimony of Tom Mathison
Principal and Co-Founder

MATHISON | MATHISON ARCHITECTS

On behalf of the National Small Business Association



Senate Committee on Small Business and Entrepreneurship Hearing:

“Targeted Tax Reform: Solutions to Relieve the Tax Compliance Burden(s) for America’s
Small Businesses”

July 22, 2015

1156 15th Street, N.W., Suite 1100
Washington, DC 20005
202-293-8830
www.nsba.biz

Good morning. I would like to thank Chairman Vitter, Ranking Member Shaheen and the members of the Committee on Small Business and Entrepreneurship for inviting me to testify today on solutions to relieve the tax compliance burden for America's small businesses.

My name is Tom Mathison, and I am Principal and Co-Founder, along with my son, of Mathison | Mathison Architects, a full-service architectural and planning firm based in Grand Rapids, Michigan. We have projects throughout several states in housing, K-12 and higher education, commercial and institutional facilities. After a 30-year career as an architect in large-multi-disciplinary firms, I was joined by my son, who had practiced on the east coast for eight years, and we formed a new firm less than two years ago.

We are part of the 97 percent of architectural firms in the U.S. who have 49 or less employees in their small business. As co-founders of our firm, we have created and nurtured our practice from the ground-up. Starting in entrepreneurial fashion in late 2013 as a two-person venture, our staff has now grown to seven, and we have recently moved to larger quarters to accommodate our growth. In a state as hard-hit in the past recession as Michigan, and in a national sector as hard hit as design and construction, the improving economy is encouraging to start-ups like ours.

I am proud to be here representing not only my company, but also the National Small Business Association (NSBA)—the nation's first small-business advocacy organization. NSBA is a uniquely member-driven and staunchly nonpartisan organization—where I currently serve as a Board of Trustees Member and Tax Committee Chair.

Recently, there have been ambitious policy efforts in Congress to replace the current U.S. Tax Code. I welcome the eagerness of lawmakers to fix America's broken tax system, but I also recognize there are significant challenges with enacting comprehensive tax reform legislation in the near future. Therefore, in the interim, I commend this committee's efforts to reform the tax system in order to reduce its complexity and compliance costs and to promote economic growth and prosperity. Several of the provisions included in Chairman Vitter's measure—the *Small Business Tax Compliance Relief Act*—will provide simplification to the most complex provisions of the code and may help to significantly reduce the burden on individual taxpayers and small businesses.

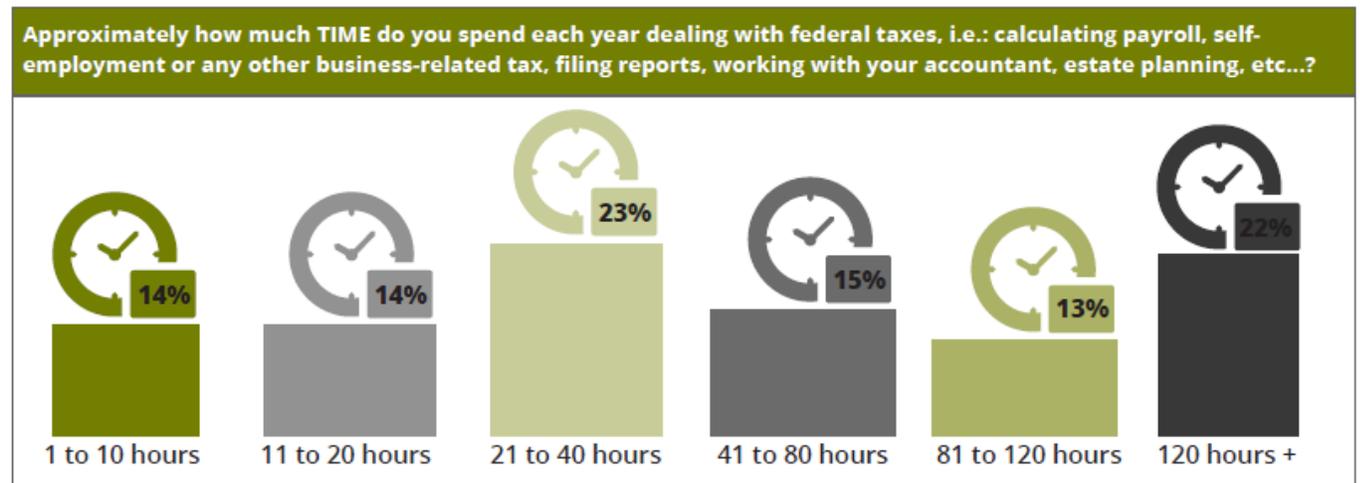
While there are many obvious problems with the current tax system, there are two paramount issues that must be addressed. The first major problem with the system is the generally high marginal rates of taxation on income. The other, perhaps more significant dilemma is the almost impossible task of compliance with all the rules and regulations. It is time that Congress acts to reexamine the tax code and simplify or repeal some of its most complex provisions.

Compliance Costs

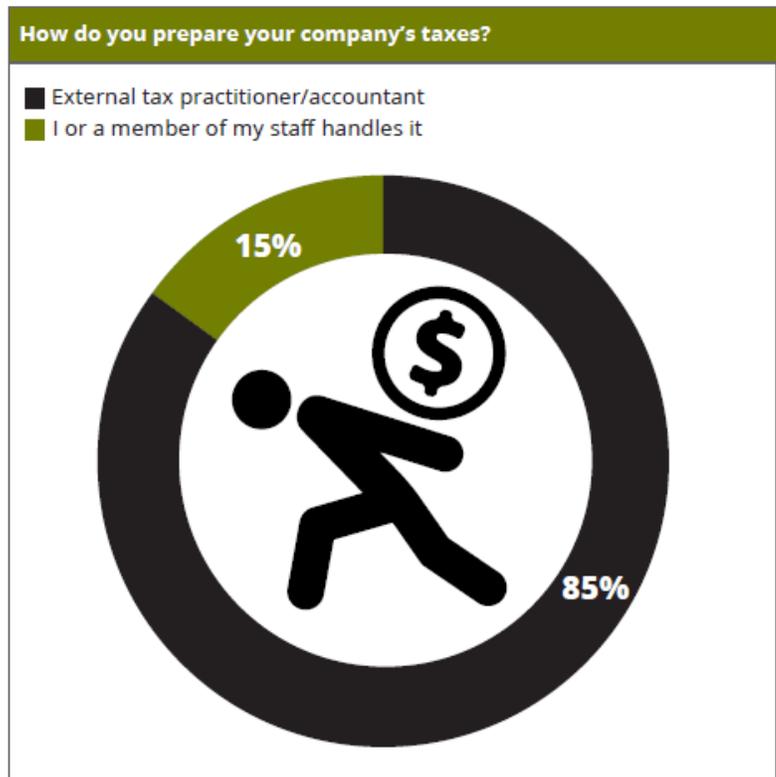
Although NSBA's members operate a wide variety of businesses, they all consistently rank reducing the tax burden among their top issues for Congress and the administration to address. The compliance burden on taxpayers, because of the complexity of our code, is truly staggering. While the actual tax liabilities for small firms is a huge issue, the sheer complexity of the tax code—along with the mountains of paperwork it necessitates—is actually a more significant problem for America's small businesses.

While I was part of larger corporations for most of my career, I had been accustomed to significant accounting, legal, and human resource personnel in-house. They provided the research and access to expertise that I now have to pay for through accounting, legal, and human resource consultants and advisors. For a start-up small business, the proportionate cost is significant, and the investment of time is even more consequential because it takes away from our productivity and growing the firm. Unlike larger corporations which have in-house accountants, benefits coordinators, attorneys, personnel administrators, etc. at their disposal, small businesses often are at a loss to keep up with, implement, afford, or even understand the overwhelming regulatory and paperwork demands of the federal government and tax code.

According to the [NSBA 2015 Small Business Taxation Survey](#), one-in-three small-business owners reported spending more than 80 hours per year dealing with federal taxes—that's two full work weeks spent just on federal taxes. Nearly 73 percent of small firms spend more than 40 hours per year on federal taxes alone. Just imagine the collective business and job growth that could be done absent that burden.



More than half of NSBA members have fewer than five employees—few, if any of whom is a tax specialist—leaving business owners—such as myself—with no other choice but to hire outside help to keep track of all their additional reporting and filing requirements. In fact, according to the [NSBA 2015 Small Business Taxation Survey](#), only 15 percent of small-business owners handle their taxes internally—meaning 85 percent are forced to pay an external accountant or practitioner—this data should send a strong message to the IRS and Congress that the tax code is far too complex.



Furthermore, when asked to rate the most significant challenge posed by the federal tax code to their business, the clear majority, 59 percent, picked administrative burdens—up from 53 percent last year—while 41 percent highlighted financial burdens as the most significant challenge to their business posed by federal taxes. The time it takes is not the only administrative burden either, more than half report they spend more than \$5,000 annually on the administration of federal taxes in the form of accountant fees, internal costs, legal fees and so on. This is before they even pay their actual taxes! In my company's case, the bill for preparing the company's taxes and my personal taxes as the owner of Mathison | Mathison Architects is thousands of dollars each year.

In addition to outside consultants, I personally spend significant time each week in the administration and filing of monthly and quarterly income and payroll reports, as well as trying to stay informed of changes to the tax code, changes to regulations, the status of expired tax extenders that may affect my business if they are extended or not, and so on. The aggregate cost of this represents thousands of dollars per employee and time away from doing more productive work to manage and grow my business.

According to a U.S. Small Business Administration (SBA), Office of Advocacy report entitled, "The Impact of Regulatory Costs on Small Firms," the compliance costs incurred by businesses are estimated to be about \$95 billion annually but may be as much as 50 percent higher. Individual and not-for-profit compliance costs are, of course, quite substantial as well.

In the case of small businesses these costs include the time of small-business owners and their accounting staff devoted to collecting necessary information and filling out Internal Revenue

Service (IRS) forms and the costs incurred hiring outside accountants and lawyers for advice about how to comply with the tax law. Small business compliance costs relative to income, revenues or per employee is disproportionately high. The SBA study quantifies this disproportionate impact, showing that the impact on small firms in terms of per employee costs is three times that of larger firms.

Tax Compliance Cost per Employee by Firm Size, According to SBA Office of Advocacy

| | All Firms | Firms with <20 Employees | Firms with 20-499 Employees | Firms with 500+ Employees |
|----------------------------------|-----------|--------------------------|-----------------------------|---------------------------|
| Tax Compliance Cost per Employee | \$800 | \$1,584 | \$760 | \$517 |

There will always be some compliance costs in any tax system. But today these costs are very high and if there is one thing the NSBA membership is almost universally agreed on, it is that the current compliance costs are too high and that the tax system needs to be simplified.

We should aim to raise the revenue needed by the federal government in the least costly way. The costs of the current system represent a huge waste of resources that could be better spent growing businesses, creating new products, conducting research and development, or purchasing productivity enhancing equipment.

These costs also represent a significant drag on the economic growth, on job creation and on the international competitiveness of U.S. businesses. Compliance costs must be recovered by businesses in the sales price of their goods or services. Otherwise, the businesses will fail. Reducing these costs is within our control and it should be a priority of Congress.

Fair Tax

Clearly, the current tax system is irretrievably broken and constitutes a major impediment to the economic health and international competitiveness of American businesses of all sizes, with widespread competitive disadvantages to small firms. To promote economic growth, job creation, capital formation, and international competitiveness, fundamental tax reform is required.

To that end, NSBA was the first small-business organization in the country to support the Fair Tax (*S. 155*)—a national 23 percent tax on the end point-of-sale for all goods that would replace all current individual and corporate tax schemes. It would dramatically reduce the tax bias against work, savings and investment, and would substantially reduce complexity and compliance costs. Additionally, the Fair Tax would make the U.S. an extremely attractive

location to manufacture goods and put U.S. produced products on even footing with foreign produced goods. Nearly the majority of small firms (49 percent) expressed support for the Fair Tax in [NSBA’s Small Business Taxation Survey](#).

Principles of Tax Reform

While we firmly believe the Fair Tax is the best path forward, NSBA understands the political landscape and need to move forward on broad reform, even if in a different iteration. As such, NSBA has developed nine principles as part of the NSBA Tax Reform Checklist to which any broad tax reform package ought to adhere. The nine principles are:

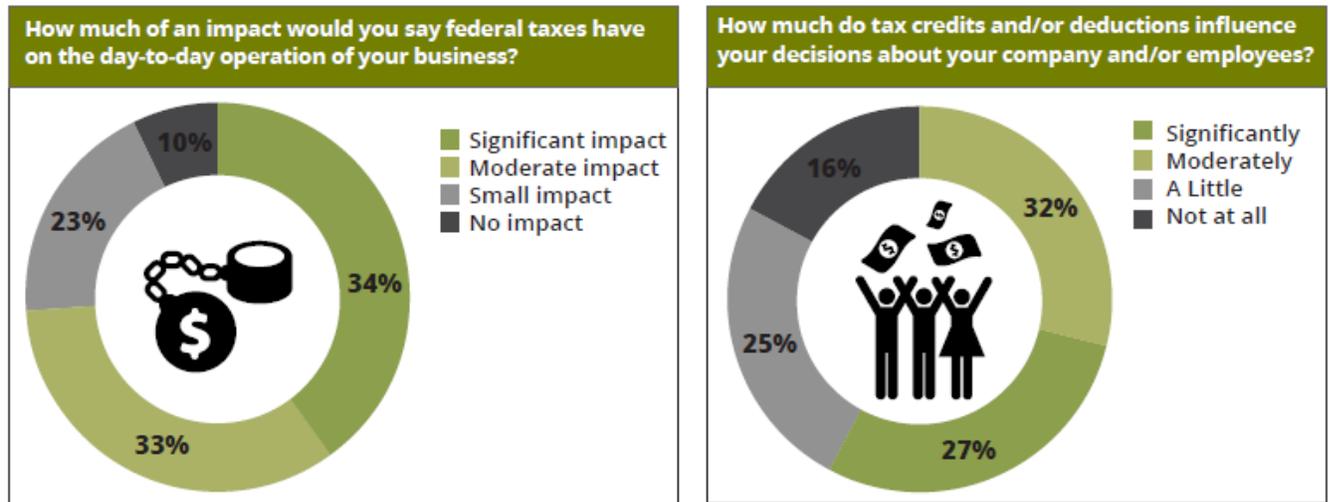
- ✓ Designed to tax only once
- ✓ Stable and predictable
- ✓ Visible to the taxpayer
- ✓ Simple in its administration and compliance
- ✓ Promote economic growth and fairness between large & small businesses
- ✓ Use commonly understood finance/accounting concepts
- ✓ Grounded in reality-based revenue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

This kind of broad reform is what small firms want: according to NSBA’s 2015 Small Business Taxation Survey, a large majority, 70 percent, expressed support broad reform of the tax system that reduces both corporate and individual tax rates, coupled with reducing both business and individual deductions.

| Please indicate your level of support for each of the following tax reform proposals | | | |
|---|--|---|--|
| |  SUPPORT |  DON'T SUPPORT |  NOT SURE |
| Reduce both corporate and individual tax rates, and reduce both business and individual deductions | 70% | 13% | 17% |
| A broad reform of the tax system in-line with the Fair Tax (elimination of all income and corporate tax rates as well as all deductions, and instead implement a 23 percent tax on the end point-of-sale for all goods) | 49% | 24% | 27% |
| Reduce the corporate tax rate and eliminate some business deductions | 46% | 22% | 31% |
| A European type value added tax | 7% | 56% | 37% |
| Moving the current U.S. tax system from a “worldwide” tax system, in which all income is taxed regardless of its origin, to a “territorial” system, in which all foreign-source income is exempted from tax | 19% | 48% | 33% |

All Tax Credits are Not Created Equal

According to NSBA's tax survey, the majority of small businesses, 67 percent, say that federal taxes have a significant to moderate impact on the day-to-day operation of their business and 59 percent say credits and deductions have a significant to moderate influence over their decisions about their company and employees.



The discussion of tax policy must not occur in a vacuum. NSBA is firmly committed to seeing the deficit reduced, and as such, we believe it is important to promote those tax credits that stand to offer the most benefit to the most people, both directly and indirectly.

While there are a number of tax deductions, credits and exclusions that are very beneficial to small-business growth and overall economic stimulation, some do little to promote economic growth. They may have other policy objectives and may or may not achieve those objectives, but they do not materially affect the incentives to work, to save or to invest. One in particular that, while good-intentioned, does not offer broad relief is the hiring tax credit whereby a firm would receive a credit for hiring a previously unemployed individual. Small firms are unlikely to hire a new person simply for that tax credit – those that are in a place to hire will likely do so regardless of a temporary, one-time credit, and they will look for the person best suited with the appropriate skills. Unfortunately, if that person isn't among the long-term unemployed, that will not likely be a factor in the employer's decision making process.

Adequate capital cost recovery allowances, preferably expensing, are critical to maintaining a reasonable cost of capital and to firms of all sizes being able to afford the capital investment necessary to compete in the international marketplace. It is hard to overstate this point. Capital formation is critical to maintaining long-term competitiveness and preserving relatively high U.S. wage rates. Unless U.S. firms invest in productivity-enhancing or innovative cutting-edge equipment that provides new capabilities, U.S. firms will only be able to compete by accepting

lower returns and by paying workers less. If, of course, they fall far enough behind their domestic and foreign competitors, the firms will simply fail.

Not only do these kind of investment-spurring tax credits and deductions help the qualifying firm, it helps promote economic growth by encouraging firms to make investments and purchase equipment from other firms. These tax provisions are the epitome of stimulatory.

Taxation of Pass-through Entities

Most small businesses are sole proprietorships, subchapter S corporations, or limited liability companies—such as Mathison | Mathison Architects. Most of the remainder are partnerships (either limited or general). There also are some business trusts. All of these businesses (83 percent, according to NSBA data) pay taxes on their business at the personal income level, or are so-called “pass-through” entities that are subject to individual tax rates – not corporate tax rates. For my firm, the pass-through tax implications are a major driver in our tax strategy, succession planning, and governance each year. It is no surprise then, that income taxes were ranked the most burdensome administratively, while payroll taxes were ranked the most burdensome financially, by small firms.

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 as, of course, are any dividends paid by the corporation to its shareholders. Thus, even for small C corporations, individual tax rates are key.

Broad reform of the entire tax code is necessary, not just for corporate entities. Many proposals have called for reducing the corporate tax rate while eliminating various business deductions and credits, which—if not examined more closely—sounds like a fine plan. However, many pass-through entities, small businesses, utilize these tax benefits that would be on the chopping block. So now I would be facing the same, high tax rate on my business income, but I could no longer take advantage of some important tax credits and/or deductions. The result is a tax increase on my firm while large corporations would be given a tax cut. 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.

I firmly believe that addressing just one piece of the puzzle—such as corporate tax reform—will only lead to even greater complexity and a massive tipping of the scales in favor of the nation’s largest companies at the expense of small businesses.

Imposing higher tax rates on small firms will stymie any growth from what is widely recognized as the source of much of the economic growth and dynamism in the U.S. economy: small business. For the overwhelming majority of small businesses, individual marginal tax rates are much more important than corporate marginal tax rates. 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. It is this kind of shortsightedness that has made the IRS a major foe of small firms and why so many of us support broad tax reform.

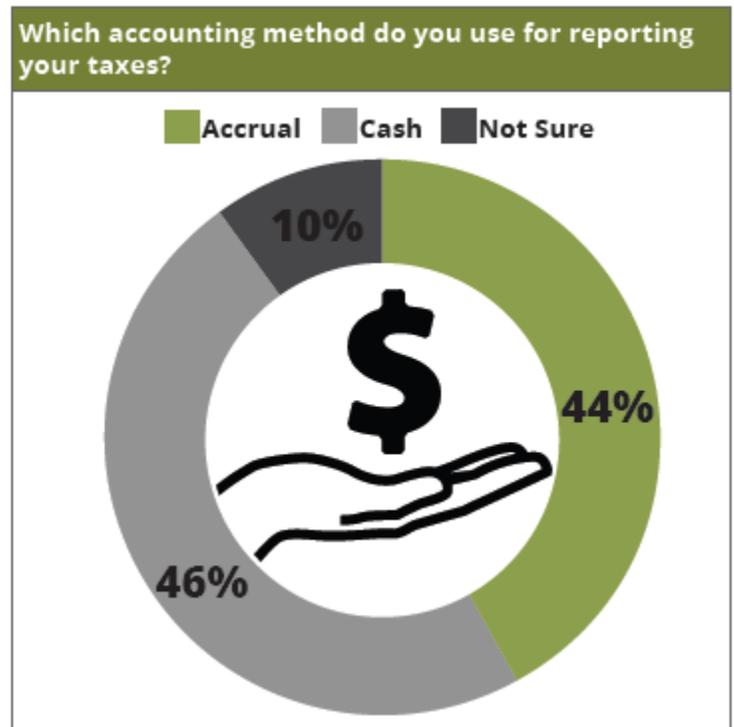
If Congress overhauls the tax system by dramatically broadening the base—cutting the breaks that litter the tax code—and lowering ALL rates, we would see real economic growth and raise revenues.

Small Business Tax Compliance Relief Act

The current tax code is comprised of more than 10,000 pages of laws and regulations that serve as a disadvantage to small businesses, and are egregiously complex and constantly in flux. Therefore, NSBA is pleased to support legislation introduced by Chairman Vitter that will provide relief from provision in the tax code that are frequently cited as overly restrictive and onerous for small businesses. The *Small Business Tax Compliance Relief Act* intends to help alleviate the administrative burden of tax compliance on small-business owners in a number of ways.

- a) Increasing the threshold for cash accounting to \$10 million

Providing flexibility and simplicity to small businesses in which method of accounting they use for tax purposes is important. Cash accounting—widely seen as a simpler, more straightforward method of accounting—is utilized by 46 percent of small businesses, according to the NSBA 2015 Taxation Survey and increasing the threshold to \$10 million will provide consistency in defining small business in the tax code. I use cash accounting in my small business because of its relative simplicity, and because it is a more honest reflection of the resources we have to sustain investments in equipment and personnel as we grow. I believe the proposal we are discussing here deserves support because it establishes simpler and more uniform rules and preserves the cash method of accounting for small firms.



- b) Increasing the de Minimis safe harbor threshold for small businesses from \$500 to \$2,500

The de Minimis safe harbor allows taxpayers without an applicable financial statement to deduct amounts paid for property if the amount does not exceed \$500 per invoice, or per item as substantiated by the invoice. NSBA supports raising the de Minimis capitalization to \$2,500 and applauds the measures efforts for including “reviewed” financial statements as “applicable financial statements” as this will certainly add to the number of small businesses able to use the limit.

- c) Self-employed Health Insurance Deductibility

Self-employed individuals (including partners and LLC members), unlike large corporations, cannot fully deduct the cost of their health insurance as a business expense. At issue is the 15.3 percent tax that self-employed individuals must pay on their employer-provided health insurance costs to which nobody else is subjected. The self-employment tax rate on net earnings is the sum of 12.4 percent for Social Security (old age, survivors, and disability insurance), and 2.9 percent for Medicare (hospital insurance).

The self-employed pay an average of \$12,680 per year for health insurance. Because they cannot deduct this as an ordinary business expense, the 15.3 percent payroll tax they alone pay on their premiums amounts to \$1,940 in extra taxes that only the self-employed pay. This is money that could be used to reinvest and grow the business, hire part-time help or cover the ever-increasing costs of health insurance. This additional 15.3 percent tax makes already disturbingly high-priced health care cost even more by adding thousands of dollars to the cost of an individual’s health care. As leaders in the fight for tax equity for the self-employed, NSBA is pleased to see this essential piece in your legislation.

Furthermore, according to the NSBA tax survey, small firms rated the full deductibility of health insurance costs the number one most important deduction or credit when it comes to stimulating small-business growth.

- d) Requiring the IRS to convene small-business review panels when making rules changes that would impact small businesses, as is customary with some agencies under the Regulatory Flexibility Act and the Small Business Regulatory Enhancement Flexibility Act

My fellow small-business owners have often described how the Internal Revenue Service (IRS) repeatedly ignores small businesses’ unique requirements and simply does not understand the impact that many of their rules have on the operation of a small business. By requiring the IRS to convene small-business review panels, we may begin to see better IRS rules which are easier to understand, implement and enforce, and which may draw a more positive reaction from smaller entities. By extending the Small Business Regulatory Enhancement Flexibility Act (SBREFA)

panel process to the IRS, the Chairman's legislation will help small businesses deal with one of the more troublesome and burdensome federal agencies, by requiring the IRS to fully consider the impact of their regulations on small businesses.

- e) Directing the IRS to produce a report that details the various statutory definitions that can be standardized and recommendations for how tax provisions can be "layman proof"

Small-business owners are smart people, but we often experience a hard time dealing with the complexity of ambiguous terms, intricate technical language and difficult sentences. The increased burden causes us to have trouble understanding the requirements. This forces us to spend more time trying to interpret the rules and ensure we are completing the forms accurately thus avoiding being fined by the agency for noncompliance.

The best thing for small businesses is simplicity: simplicity in instructions, in requirements, in consequences and an overall reduction in the amount of the paperwork and the time necessary to complete the forms. I am pleased to see the requirement for the IRS to produce a report that calls for simplification, streamlined definitions and plain-language.

Conclusion

NSBA strongly believes that the current tax system constitutes a major impediment to the economic health and international competitiveness of American businesses of all sizes, with widespread competitive disadvantages to small firms—biased against savings and investment, and impossibly complex. A tax system dedicated to investment, savings and small-business growth must be put in its place.

Complexity and inconsistency within the tax code pose a significant and increasing problem for small businesses. The ever-growing patchwork of credits, deductions, tax hikes and sunset dates is a roller coaster ride without the slightest indication of what's around the next corner. To promote economic growth, job creation, capital formation, and international competitiveness, fundamental tax reform is required. However, unless and until Congress agrees upon a replacement, we must fix tax problems with the current tax code by developing simplification measures that are fair and fiscally responsible.

This committee's leadership and input throughout the tax reform process will lead to a better legislative product with more understanding of how the tax code impacts all stakeholders. Specifically, Sen. Vitter's legislation brings small businesses a step closer to enabling us to invest in new equipment, hire more workers and dedicate more money to new entrepreneurial ideas and innovations, which in turn will help strengthen our economy. I commend you for working to bring this legislation to the Senate floor.

Again, I would like to thank Chairman Vitter and the members of the Committee on Small Business and Entrepreneurship for the opportunity to speak today.