NSBA
National Small Business Association®

The Honorable Mitch McConnell
Majority Leader
U.S. Senate
317 Russell Senate Office Building
Washington, DC 20510

The Honorable Paul Ryan
Speaker of the House
U.S. House of Representatives
1233 Longworth House Office Building
Washington, DC 20515

The Honorable Orrin Hatch
Chairman
U.S. Senate
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Kevin Brady
Chairman
U.S. House of Representatives
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Members of Congress:

Founded in 1937, the National Small Business Association (NSBA) is America's oldest, nonpartisan small-business advocacy organization with more than 65,000 members in every industry and every state across the country. The current U.S. Tax Code poses a significant disadvantage to America's small businesses, as it punishes work, investment, risk-taking and entrepreneurship. Comprehensive tax reform offers the prospect of sustained economic growth and could dramatically lower compliance costs. We commend your efforts to reform the tax system with the passage of the Tax Cuts and Jobs Act (H.R. 1), in order to reduce its complexity and compliance costs and to promote economic growth and prosperity.

For NSBA members, meaningful tax reform is a coherent set of reforms designed to promote economic growth, reduce complexity, and lessen administrative costs, increase parity and transparency and voluntary compliance in an equitable manner. Therefore, we have some specific and significant concerns that need to be addressed as lawmakers reach a compromise and move towards a final legislative package.

Key Issues for Small Business

Rate Parity: For NSBA, one of the main goals of fundamental tax reform is to make U.S. businesses—of all sizes—more competitive and to increase economic growth. This requires a reduction in tax rates on businesses and investment. Thus, most critical to small-business owners is lowering individual tax rates commensurate with corporate rate cuts. The Senate-passed bill reduces the top rate on C corporations to 20 percent. The bill reduces the top rate on S corporations to 38.5 percent, 18.5 points higher and 13.5 points above the promised rate in the Unified Framework for Fixing Our Broken Tax Code. The bill does include a deduction for pass-through businesses, if they have sufficient employees and payroll costs, of up to 23 percent, bringing the effective rate on qualifying pass-through businesses down to 29.6 percent, but still almost 10 points above the C corporation rate. NSBA is urging the tax-writers to find ways to greater close this gap.

While the bill's 23 percent deduction is a welcome attempt to lower rates on all pass-through businesses, the provision is both temporary and too low. The deduction's 50-percent payroll limitation would leave behind pass-through businesses that do not add direct payroll at a one-to-one ratio as they grow while blocking trust and estate income from the deduction would hurt multi-generation family businesses. The fraction of pass-through businesses that do get the full deduction would be subject to a 29.6 percent effective marginal rate, well short of the 25 percent rate forecast in the Framework and significantly higher than the 20 percent rate applied to C corporations.

Reducing the marginal tax rates applicable to small business income—with parity among organizations—is among the most important constructive steps that the tax-writers can take. NSBA members overwhelming believe that any serious tax reform proposal must also include further lowering the individual tax rate to support pass-through businesses. Allowing U.S. pass-through entities to compete with larger U.S. corporations is as important as allowing U.S. multinational corporations to compete on an equal basis with foreign multinationals.

Simplicity: Despite some efforts—and some successes—at simplifying the tax code, H.R. 1 is still more than 400 pages long; and for most taxpayers, the process for filing taxes will feel similar under this plan as it does today. In 2017, 40 percent of small-business owners reported they spend more than 80 hours per year dealing with federal taxes, and the majority spent more than 40 hours per year. Just imagine the collective business and job growth that could be done absent that burden. Furthermore, the majority of small businesses, 59 percent, say that federal taxes and credits or deductions have a significant to moderate impact on their business decisions while 67 percent say federal taxes have a significant to moderate impact on the day-to-day operation of their business.

In a few ways, H.R. 1 takes a couple of steps in the direction of simplification. The plan roughly doubles the standard deduction, leading fewer people to itemize their deductions—the complicated process in which taxpayers must determine which deductions they are eligible for and how much they can deduct. The plan also eliminates a long list of tax breaks, simplifying the itemization process. These two reforms would make it easier for many taxpayers to file their taxes—a real improvement over the current system. But the reach of these reforms would also be limited, especially since two-thirds of tax filers currently do not itemize their taxes. And since the plan retains almost all the major tax breaks, the actual itemization process will not be that much easier.

There are a few other notable areas where the plan simplifies taxes, including the elimination of the Alternative Minimum Tax (AMT), under which certain taxpayers have to effectively calculate their taxes under two systems. But relatively few Americans actually pay the AMT. On the business side of the code, the plan would allow businesses to write off the costs of their investments in the first year, replacing the complicated depreciation schedules that companies must currently use. But that change is temporary—it would expire after five years—forcing companies to revert to the previous system.

Overall, the proposal does very little to simplify the tax code, and actually make it more complex for the more than 83 percent of small businesses that organize their firms as pass-through entities. This means small-business owners will have to continue to dedicate more time and money into complying with a byzantine and bewildering tax code, further tilting the playing field in favor of large corporations that can afford armies of lawyers and accountants to search out every loophole and advantage. Truly simplifying the tax code means it will reduce compliance and administrative costs and make it possible for job creators to reinvest more of their own money in their businesses, by helping small businesses succeed in an increasingly competitive global market.

Permanency: As amended by the Finance Committee, the Senate bill would now sunset the pass-through deduction after the year 2025, resulting in significant tax hike on pass-through businesses. This tax increase would be relative to the new tax level in the Senate bill prior to 2026 and relative to current law. The former obviously is due to the loss of the 23 percent pass-through deduction beginning in 2026. The latter is due, with one exception, to all the Senate base broadening provisions are made permanent and would have the effect of permanently increasing the taxable income of pass-through businesses. These revenue raisers include the new cap on interest deductions, repeal of the Section 199 manufacturing deduction, repeal of the IC-DISC, and numerous other provisions affecting both C corporations and pass-through businesses.

As currently constructed, the Senate bill clearly favors towards C corporations by making all of the provisions affecting C corporations permanent, while only provisions benefiting individuals and pass-through businesses made temporary. NSBA supports making the pass-through business deduction permanent, just as the reduction in the C corporation rate to 20 percent is made permanent.

National Debt: The Joint Committee on Taxation (JCT) released a "dynamic" revenue score which estimated that the economic growth effects of tax reform would boost federal revenues by only $407.5 billion on a net basis between 2018 and 2027, bringing the bill's net impact on the federal deficit over the 10-year budget window to just over $1 trillion. As is, the bill would cause the national debt to increase from 77 percent of GDP this year to 96 percent or 98 percent of GDP by 2027, depending on whether dynamic effects are included, as compared to the 91 percent projected under current law.

With the possibility of more than $1 trillion being added to the national debt, this is simply not acceptable to members of NSBA, especially since the debt is already on an unsustainable course. The debt recently surpassed $20 trillion and is climbing steadily. Spending and revenue are already so out of balance that the debt is expected to grow by $10 trillion more over the next 10 years even before any tax cuts are included.

Tax reform is critically important in the effort to help grow the economy and help improve the fiscal situation, and there are still plenty of options available to make improvements on both fronts. We hope that the bill moves in that direction in negotiations between the conferees.

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. As Congress continues to debate what tax system should replace the current one, NSBA believes it is imperative that the U.S. moves towards a simpler, fairer tax system that does not attempt to only tweak one piece of the puzzle but instead is a permanent solution.

As lawmakers continue to refine the proposal, we encourage you to address these concerns expressed by the small-business community and modify the legislation to ensure that it spurs investment, jobs and economic growth by all forms of business. We look forward to working with you and the conferees to achieve these laudable goals.

Sincerely,

Todd McCracken
President & CEO

Cc: Conference Committee Members