



**AEO** *Association for  
Enterprise Opportunity*  
THE VOICE OF MICROBUSINESS

Statement for the Record

House Committee on Small Business

*Tax Reform: Ensuring that Main Street Isn't Left Behind*

April 15, 2015

Association for Enterprise Opportunity

The Association for Enterprise Opportunity (AEO) is submitting testimony in support of comprehensive tax reform and to recommend improvements to certain tax policies. AEO is the voice of microbusiness in the United States. For two decades, AEO and its more than 400 member organizations have helped millions of entrepreneurs contribute to economic growth while supporting themselves, their families and their communities.

AEO commends the Committee for convening a hearing on such a critical topic. While many small business advocates have shared their views on tax policy, AEO is adding the voice of microbusiness to this important discussion. There is consensus that our tax system should be simpler.<sup>1</sup> Citing numerous reports from the Internal Revenue Service (IRS) National Tax Payer Advocate and Small Business Administration (SBA) Office of Advocacy, it is clear that small businesses face a tax code that drains them of their two most valued resources: time and money. Notably, these burdens are not uniform across company size – big business has the resources to more easily comply with, and even shape, the tax code.

Much of this is due to a tax code that is outdated. The entrepreneurial landscape no longer aligns with our antiquated tax system, last reformed more than 25 years ago. Businesses now operate everywhere, including homes and shared office spaces, and the “independent workforce” is growing at an incredible pace: the number of Americans who “primarily work on their own” is up 14% (1.3 million people) since 2001.<sup>2</sup>

These 21<sup>st</sup> century entrepreneurs struggle to navigate the deductions and credits designed to spur business creation. Of the more than 20 tax provisions supporting small businesses, almost all require increased record keeping. This requires time and money that could be put to better use. It is also these entrepreneurs who hold the key to jumpstarting our economy. As noted in AEO’s *Power of One in Three* report, if 1 in 3 microbusinesses hired just one employee, America would be at full employment.<sup>3</sup>

The majority of these microbusinesses are structured as pass-through entities, allowing business owners to calculate and pay taxes on their individual taxes. According to the U.S. Census Bureau, for example, sole proprietorships make up a full third (33.6%) of all pass-through businesses that pay taxes at individual rates. For this reason, AEO urges that any reform to the corporate tax code be accompanied by a balanced reform to the individual code. Comprehensive tax reform is the only option to ensure that a vast majority of microbusinesses do not immediately face a significant and unfair disadvantage.

Any overhaul of the tax system should also be guided by the basic principles of simplicity and fairness. In AEO’s view, tax compliance – while necessary – should not be a barrier to entrepreneurship. Microbusinesses should expect a tax system that collects revenue in a consistent manner, offering certainty from year to year. The annual sprint to extend tax credits and deductions, or “extenders,” is a prime example of how the current system gives business

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<sup>1</sup> U.S. House of Representatives Committee on Small Business, *Memorandum on Tax Reform: Ensuring that Main Street Isn’t Left Behind* (2015), available at [http://smallbusiness.house.gov/uploadedfiles/4-15-2015\\_hearing\\_memo.pdf](http://smallbusiness.house.gov/uploadedfiles/4-15-2015_hearing_memo.pdf)

<sup>2</sup> Joel Kotkin, “Rise of the 1099 Economy,” *Forbes Magazine*, July 25, 2012.

<sup>3</sup> Association for Enterprise Opportunity, “Power of 1 in 3.” [http://www.aeoworks.org/pdf/one\\_in\\_three.pdf](http://www.aeoworks.org/pdf/one_in_three.pdf)

owners little certainty. Making tax expenditures that are proven to support small businesses permanent would eliminate annual confusion over credits and deductions.

Similarly, tax rates for businesses ought to be the same and tax liability should not depend on how a business is organized. American corporations only pay an effective tax rate of 12.6%, a far cry from the statutory 35%, while small businesses operating as S-Corps pay an effective tax rate of nearly 27%.<sup>4</sup> Conversely, tax deductions or credits should be applicable to any form of business (e.g. the self-employed cannot deduct health expenses, an option available to other businesses). Reforms should address these inequities. In our view, business is business.

In addition to ensuring that broader reforms take small businesses into consideration, AEO recommends the following policies that will benefit Main Street:

#### Expand Volunteer Income Tax Assistance Program to Assist Microbusiness

More than 1 in 4 (27%) of microbusinesses cited tax preparation as a problem for business.<sup>5</sup> This does not have to be the case. Already a program exists that could aid entrepreneurs. The Volunteer Income Tax Assistance (VITA) Program currently assists low- and moderate-income (LMI) individuals with support from IRS-certified volunteers. Congress and the IRS should expand the VITA Program's capacity to help microbusiness owners navigate the tax system.

First, the IRS Office of Stakeholder Partnerships, Education and Communication (SPEC) Office should improve the support that the program delivers to microbusiness owners. The program's capacity to serve microbusiness owners is limited by program rules that preclude VITA sites from preparing all but the simplest Schedule C forms. The Corporation for Enterprise Development (CFED) found that VITA sites are ready and willing to do more for microbusiness.<sup>6</sup> The IRS has the authority to lift the restrictions on Schedule C preparation at its discretion, without initiating the lengthy process of proposing a regulation for public comment.

The Entrepreneur Start-Up Growth Act (H.R. 3571), introduced in 2011 by Committee Member Judy Chu, proposed a pilot program to test the feasibility of expanding VITA support to self-employed tax filers. AEO hopes that similar legislation will be reintroduced in the 114<sup>th</sup> Congress. New provisions could consider authorizing VITA sites to implement pay-as-you-go fees for the most complex tax filings.

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<sup>4</sup> U.S. Government Accountability Office, "Corporate Income Tax: Effective Tax Rates Can Differ Significantly from the Statutory Rate." 2013. Available online at <http://www.gao.gov/assets/660/654957.pdf>

<sup>5</sup> Corporation for Enterprise Development, "Microbusinesses: America's Unsung Heroes." 2013. Available online at: [http://cfed.org/assets/pdfs/FactFile\\_May2013.pdf](http://cfed.org/assets/pdfs/FactFile_May2013.pdf)

<sup>6</sup> Corporation for Enterprise Development, "Innovations in Microbusiness." 2014. Available online at: [http://cfed.org/assets/pdfs/Innovations\\_in\\_Microbusiness.pdf](http://cfed.org/assets/pdfs/Innovations_in_Microbusiness.pdf)

## Aiding Underserved Communities through Proven Tax Policy

The Earned Income Tax Credit (EITC) is an important tax credit for low-income workers and allows entrepreneurs to reinvest their EITC back into their business. Research has shown that the EITC promotes work, reduces poverty, and benefits microbusinesses.<sup>7</sup>

The EITC can be strengthened to continue to aid underserved communities. Interestingly, the current structure of the EITC (withholding credit in U.S. Treasury) has increased savings among low- and moderate-income individuals – a lauded goal.

## Create and Expand Credits Needed by Microbusiness

AEO believes a New Entrepreneur Tax Credit would incentivize business creation. Studies have consistently found that underserved communities and individuals benefit from self-employment and new business ventures.<sup>8</sup> AEO encourages Congress to look further at small business tax provisions already in the tax code and how they could benefit new businesses during its time of greatest challenge.

Established microbusinesses should also be supported to save for their retirement. The SBA Office of Advocacy found that microbusinesses, especially those owned by minorities, are the least likely to have retirement savings. Currently, the Saver's Credit exists to address this issue. That credit, however, is nonrefundable, needlessly complex and is defined by sharp income eligibility cliffs. These shortcomings mean that only a very small percentage of low-income tax filers qualify for the credit, and an even smaller number actually claim the credit. By simplifying how microbusiness owners claim the credit and by making it refundable, Congress can improve the Saver's Credit's ability to aid saving for retirement.

The need for action on comprehensive tax policy is clear. In our view, addressing the corporate rate alone would be unfair for the microbusiness community at the very backbone of the American economy. Reforms should be enacted, based on the ideas of a simpler and fair tax code. Finally, should a tax overhaul not be viable this Congress, there are still small, but important, tax changes for policymakers to consider to strengthen the community AEO serves.

Thank you for consideration of these views and for this Committee's efforts to support microbusiness.

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<sup>7</sup> Center on Budget and Policy Priorities, "EITC and Child Tax Credits Promote Work, Reduce Poverty, and Support Children's Development." (2015). Available online at <http://www.cbpp.org/cms/?fa=view&id=3793>

<sup>8</sup> Brookings Institution, "Minority and Women Entrepreneurs: Building Capital, Networks, and Skills." (2015). Available online at [http://www.brookings.edu/~media/research/files/papers/2015/03/11-hamilton-project-expanding-jobs/minority\\_women\\_entrepreneurs\\_building\\_skills\\_barr\\_final.pdf](http://www.brookings.edu/~media/research/files/papers/2015/03/11-hamilton-project-expanding-jobs/minority_women_entrepreneurs_building_skills_barr_final.pdf)

## **About AEO**

The Association for Enterprise Opportunity (AEO) is the voice of microbusiness in the United States. For two decades, AEO and its more than 400 member organizations have helped millions of entrepreneurs contribute to economic growth while supporting themselves, their families and their communities. AEO members and partners include a broad range of organizations that provide capital and services to assist underserved entrepreneurs in starting, stabilizing and expanding their businesses. Together, we are working to change the way that capital and services flow to underserved entrepreneurs so that they can create jobs and opportunities for all.