Testimony of

Andrew B. Lyon
PricewaterhouseCoopers LLP*

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Tax Reform and Small Business

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***** Principal, PricewaterhouseCoopers LLP. Employment is shown for identification purposes only. The views expressed do not necessarily represent those of PricewaterhouseCoopers or its principals and partners.

I. Introduction

I thank the Committee for the opportunity to testify this morning on the appropriate design of the tax system as it applies to business, with particular attention to the application of the tax system to small business both in the context of the current economic slowdown and, forward looking, to promote long-term economic growth.

While the design of temporary tax stimulus to the economy may differ from the structure of a permanent tax system, I believe the long-run growth of the U.S. economy and small businesses is best promoted by providing for a simple, transparent business tax system with the lowest possible rates.

Private business drives the $14 trillion U.S. economy, providing in 2007 approximately 115 million jobs and $1.5 trillion in investment to raise future living standards. Small business plays a vital role within the private economy. In 2005, businesses with less than 500 employees represented 99.7 percent of all firms, and accounted for half of all private employment and 45 percent of all private payrolls.[1] Internal Revenue Service data based on receipt size (rather than employment) show that businesses, including sole proprietorships, with less than $50 million in receipts accounted for 99.9 percent of all businesses, 31 percent of total receipts, and 37 percent of business payrolls in 2003.[2] While showing a substantial role of small businesses in the economy, these data also show that the relatively small number of large businesses also provide a leading role in economic activity in the United States; firms earning $50 million or more in annual receipts represent just 0.1 percent of all businesses yet generate 69 percent of total receipts and 63 percent of business payrolls.

Given the important role of both small and large businesses to the economy, there is a general consensus among most economists that special tax assistance based on size of business is unwarranted in the absence of market failures. Recent papers reaching this conclusion include those by former Congressional Budget Office Director Douglas Holtz-Eakin, University of Michigan Business School and Economics Professor Joel Slemrod, and former Clinton Administration Deputy Assistant Secretary of Treasury Eric Toder.[3] The basic rationale expressed in these papers is that in the absence of taxation the market economy would lead to a distribution of small and large firms in the economy that generates the most economic output. In the presence of taxes, the tax system should therefore aim for equal treatment of small and large firms, so as to maximize economic output for a given level of business taxation.

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[1] U.S. Small Business Administration, Office of Advocacy, "Employer Firms, Establishments, Employment, and Annual Payroll Small Firm Size Classes, 2005," http://www.sba.gov/advo/research/data.html

[2] Kelly Luttrell, Patrice Treubert, and Michael Parisi, "Integrated Business Data, 2003," Statistics of Income, Internal Revenue Service, http://www.irs.gov/taxstats/bustaxstats/article/0,,id=152029,00.html

[3] See, Douglas Holtz-Eakin, "Should Small Businesses Be Tax-Favored?" *National Tax Journal*, Vol. XLVII, No. 3, September 1995, pp. 387-395; Joel Slemrod, "Small Business and the Tax System," in *The Crisis in Tax Administration* (eds., Henry J. Aaron and Joel Slemrod), Brookings Institution, 2004, pp. 69-123; and Eric Toder, "Does the Federal Income Tax Favor Small Business?" in National Tax Association, *Proceedings of the 100th Annual Conference, 2007* (available at http://www.urban.org/publications/411606.html)

This "level playing field" argument is persuasive to most economists. Firms operating under a tax system providing a level playing field can best replicate the competitive outcome that would occur in an economy without taxes.

One complicating factor, noted by Slemrod (2004), is that the very presence of a tax system may impose an inordinate compliance burden on small business relative to large business. While to some this may justify the use of special incentives to offset these compliance burdens, a best practice would be to design the tax system to impose the lowest possible compliance burdens, everything else equal. Special tax incentives intended to offset compliance burdens can themselves complicate the tax system; further, compliance costs of claiming these tax incentives may offset a significant amount of their benefit, especially for small businesses. In addition, if overall business tax collections are held fixed, special incentives ultimately may be paid for by higher tax rates that have additional distorting consequences on the operations of businesses.

II. Legal Forms of Business Operations

Small businesses operate in a wide range of legal forms -- including sole proprietorships, partnerships, S corporations, and C corporations -- and operate in a wide range of economic sectors. **Table 1** presents aggregate IRS data on businesses classified by size of business receipts for C-corporations, S-corporations, partnerships, and non-farm sole proprietorships for tax year 2003.[4] Sole proprietorships, S-corporations, and partnerships are pass-through entities subject to a single level of tax on the business owner. C-corporations are taxable at the entity level and the equity return is taxable to shareholders as dividends or capital gains.[5]

The overwhelming number of businesses in these data were operated as sole proprietorships: 19.7 million sole proprietorships, constituting 72 percent of the 27.5 million total businesses in 2003. Next most prevalent were S-corporations (3.3 million businesses, or 12 percent of total businesses) and partnerships (2.4 million, or 9 percent of total businesses). The least prevalent form of business was C-corporations (2.1 million businesses, or 7 percent of total businesses).

Larger businesses are more likely to operate as C-corporations than smaller businesses. Among the largest corporations (those with business receipts of $50 million or greater), C-corporations were the most prevalent (constituting 52 percent of all businesses with business receipts of $50 million or greater), followed by S-corporations (30 percent of all businesses with business receipts of $50 million or greater), partnerships (17 percent of all businesses with business receipts of $50 million or greater), and sole proprietorships (less than 1 percent of all businesses with business receipts of $50 million or greater).

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[4] Additional IRS integrated business data are available at http://www.irs.gov/taxstats/bustaxstats/article/0,,id=152029,00.html

[5] Currently dividends and long-term capital gains are taxed at a maximum rate of 15 percent for individuals as a result of temporary provisions enacted in 2003. The dividends tax rate is scheduled to increase to a maximum rate of 39.6 percent and the maximum long-term capital gains tax rate is scheduled to increase to 20 percent beginning in 2011.

Table 1.--Number of Businesses, Total Receipts, Net Income (less Deficit), and Salaries and Wages, by Form of Business and Business Receipt Size, Tax Year 2003

[All figures are estimates based on samples--money amounts are in thousands of dollars]

Form of business, item	Total	under $25,000	$25,000 under $100,000	$100,000 under $250,000	$250,000 under $500,000	$500,000 under $1,000,000	$1,000,000 under $2,500,000	$2,500,000 under $5,000,000	$5,000,000 under $10,000,000	$10,000,000 under $50,000,000	$50,000,000 or more
All businesses											
Number of businesses	27,486,691	15,872,235	5,521,119	2,578,962	1,331,692	932,914	686,257	263,211	143,693	124,568	32,040
Total receipts	24,461,950,768	171,850,677	283,643,212	399,675,771	466,753,866	650,698,469	1,064,907,945	918,729,000	995,285,415	2,583,604,931	16,926,801,481
Salaries and wages	2,389,996,593	13,835,571	12,420,821	40,735,142	65,026,979	102,127,201	151,872,220	123,510,264	120,362,165	264,299,581	1,495,806,649
Net income (less deficit)	1,353,802,117	-23,427,608	75,630,471	79,225,921	55,733,253	51,703,038	54,086,095	41,991,902	47,086,139	133,379,079	838,393,827
C corporations											
Number of businesses	2,059,631	450,597	307,399	328,012	268,188	247,385	229,634	103,484	57,788	50,628	16,516
Total receipts	16,457,008,327	31,386,821	20,967,927	58,311,445	100,910,587	180,167,017	373,712,629	370,007,131	410,398,180	1,060,140,824	13,851,005,765
Salaries and wages	1,599,662,967	5,911,201	2,153,003	7,678,722	14,770,133	28,087,167	54,797,775	46,855,558	50,980,009	114,828,385	1,273,601,013
Net income (less deficit)	608,414,019	-14,450,726	-3,092,854	-3,055,026	-3,905,490	-3,211,426	-4,719,570	-2,862,986	2,930,957	27,459,611	613,321,529
S corporations											
Number of businesses	3,341,606	829,112	561,043	601,851	451,424	375,165	291,775	107,685	60,895	52,898	9,757
Total receipts	4,232,565,964	12,854,180	34,707,120	101,156,434	164,133,276	268,746,940	453,325,584	380,630,873	424,509,024	1,115,580,928	1,276,921,604
Salaries and wages	449,732,962	2,693,180	2,241,561	11,108,682	23,540,794	43,368,279	61,680,182	54,161,344	48,364,801	105,627,726	96,946,412
Net income (less deficit)	213,681,780	10,414,073	3,251,698	9,177,254	12,154,281	16,306,001	25,688,763	21,831,927	17,631,789	45,809,116	51,416,878
Partnerships											
Number of businesses	2,375,375	1,284,396	397,461	262,423	147,948	110,698	89,675	36,829	20,925	19,416	5,603
Total receipts	2,722,174,031	34,844,097	13,089,999	28,078,848	41,095,591	66,570,786	128,217,169	117,247,715	133,678,247	379,353,241	1,779,998,339
Salaries and wages	244,927,745	4,237,840	881,925	3,246,966	5,225,898	9,925,742	20,120,293	17,110,418	18,315,986	41,756,140	124,106,537
Net income (less deficit)	301,398,218	-36,718,902	1,944,464	11,573,255	11,790,856	14,183,975	21,169,546	19,915,489	24,962,215	58,934,127	173,643,193
Nonfarm sole proprietorships											
Number of businesses	19,710,079	13,308,130	4,255,216	1,386,675	464,131	199,666	75,173	15,213	4,085	1,626	164
Total receipts	1,050,202,446	92,765,579	214,878,166	212,129,044	160,614,412	135,213,726	109,652,563	50,843,281	26,699,964	28,529,938	18,875,774
Salaries and wages	95,672,919	993,350	7,144,332	18,700,772	21,490,154	20,746,013	15,273,970	5,382,943	2,701,369	2,087,330	1,152,687
Net income (less deficit)	230,308,100	17,327,947	73,527,163	61,530,438	35,693,606	24,424,487	11,947,356	3,107,472	1,561,178	1,176,225	12,227

Source: IRS Integrated Business Data available at http://www.irs.gov/taxstats/bustaxstats/article/0,,id=152029,00.html

Profitability of C-corporations varies considerably across size of business. C-corporations with business receipts of less than $5 million in aggregate had *negative* net income in 2003. In contrast, C-corporations with business receipts of $50 million or more comprised less than 1 percent of all C-corporations, yet received 84 percent of all C-corporation receipts and accounted for more than 100 percent of all net income of C-corporations (exceeding 100 percent due to net losses among smaller C-corporations).

III. Advantages and Disadvantages in the Tax Code Applicable to Small Businesses

A wide range of tax advantages and tax disadvantages exist for small business. While not attempting to provide a complete inventory, this section outlines several features of the tax system that differentially impact small and larger businesses. Guenther (2008) provides an analysis of additional tax provisions benefiting small business, including accounting rules and tax incentives for private equity investments in small companies.[6]

Double tax on C-corporation income

Because smaller businesses can more easily operate as pass-through entities -- that is, sole proprietorships, partnerships, or S-corporations -- subject to only a single level of taxation, the double tax on equity earnings of C-corporations may represent an implicit tax advantage to small business operating in pass-through form.[7]

There are certain factors, however, that limit the scope of this advantage for small pass-through entities (or limit the disadvantage faced by C-corporations). Importantly, dividends paid to tax-exempt shareholders (such as pension funds) by C-corporations are not taxable. As a result, not all equity earnings of C-corporations are subject to double taxation. Small pass-through entities may be unable to access equity financing from tax-exempt institutional investors and, furthermore, income from partnerships and S-corporations paid to a tax-exempt owner is subject to tax as unrelated business income.

Many economists and tax attorneys believe an integrated tax structure with a single level of taxation for all businesses would be preferable to the current double tax on C-corporation earnings.[8] Elimination of the double tax on corporate earnings, everything else equal, would reduce total business tax collections. If total business tax collections were to be held unchanged, other offsetting business increases would be required that could differentially impact small and large businesses.

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[6] Gary Guenther, "Small Business Tax Benefits: Overview and Economic Rationales," CRS Report for Congress, Congressional Research Service, RL32254, March 3, 2008.

[7] C-corporations are subject to a graduated corporate income tax schedule, beginning at a 15 percent tax rate on the first $50,000 of income and 25% on the next $25,000 of income. At higher levels of income, the benefit of these lower rates is taken away through higher marginal rates that reach 39 percent. For corporations with income exceeding $18.3 million, the applicable tax rate is 35 percent.

[8] See, for example, Department of the Treasury, "Integration of the Individual and Corporate Tax Systems: Taxing Business Income Once" (January 1992); R. Glenn Hubbard, "Corporate Tax Integration: A View from the Treasury Department," *Journal of Economic Perspectives*, Vol. 7, No. 1, Winter 1993, pp. 115-132; and President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*, November 2005, p. 124.

Small Business Expensing (section 179)

As a result of the Economic Stimulus Act of 2008, signed into law on February 13, 2008, businesses may immediately deduct as an expense rather than depreciate over a period of years the cost of up to $250,000 of qualifying property placed in service in 2008. The amount of qualifying property that may be expensed is reduced by the amount of investment in excess of $800,000, which serves to limit the expensing benefit to smaller businesses. Qualifying property is generally equipment and computer software.

Prior to the enactment of the Stimulus Act, businesses could deduct only the first $128,000 of qualifying property in 2008. The amount eligible for expensing was reduced for investment in excess of $510,000. These dollar values, indexed for inflation, are set to apply in 2009 and 2010. The amount of property eligible for expensing is scheduled to decline to $25,000 beginning in 2011 (as temporary provisions enacted in recent years expire).[9]

Expensing reduces the cost of acquiring qualifying property since the immediate deduction of the acquisition cost confers greater tax savings in present value than a deduction of the same dollar amount spread over a period of years. In addition, many small businesses may face financing constraints so that the enhanced cash-flow from expensing may increase the ability of the business to undertake new investment. As a result, expensing is thought to increase capital investment by small businesses. The temporary increase in expensing in 2008 may also accelerate the purchase of investments by businesses from future years.

Because productivity, wages and living standards are closely tied to increases in capital investment, policies that increase investment are desirable. Conventional economic analysis generally concludes that expensing is an effective stimulus to business investment relative to a rate reduction because the benefit of expensing is directed only at <u>newly</u> purchased capital goods whereas a rate reduction also benefits previously acquired assets. The tax savings accruing to income from previously acquired assets, while providing a cash-flow benefit, is not generally considered to provide as significant of an investment stimulus as a direct tax reduction on the purchase of new capital.[10] This is especially true for a temporary incentive because the income generated from new investment may arise largely in periods in which the temporary rate reduction is no longer in effect.

Expensing, however, does nothing to reduce the tax burden on entrepreneurial effort that generates returns in excess of the opportunity cost of capital. These and all other cash flows of the business remain subject to the statutory tax rate applying to business income. In contrast, a rate reduction may encourage additional entrepreneurial effort that can boost production from existing and new tangible capital, as well as from intangible capital. There is also evidence of a significant investment response by small businesses from permanent reductions in the tax rate applying to business income.[11]

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[9] The Economic Stimulus Act of 2008 also permits all businesses to expense 50 percent of the cost of qualifying investments placed in service in 2008 (so-called "bonus depreciation"). There is no dollar limitation on the amount of property qualifying for bonus depreciation.

[10] See, for example, analyses of alternative business tax reform proposals comparing expensing and rate reduction in Department of the Treasury, "Approaches to Improve the Competitiveness of the U.S. Business Tax System for the 21st Century," December 20, 2007.

[11] See Robert Carroll, Douglas Holtz-Eakin, Mark Rider and Harvey S. Rosen, "Entrepreneurs, Income Taxes, and Investment" (January 1998). NBER Working Paper No. W6374.

Alternative Minimum Tax

Small C-corporations are exempt from the corporate alternative minimum tax (AMT). For this purpose a small corporation is defined as one with average gross receipts less than $7.5 million for all three-year periods beginning after 1993 and before the current taxable year. For the first three-year period, average gross receipts must be less than $5 million. No corporate AMT applies in the first year of a corporation's existence. There is no exception from the individual AMT for businesses operating as sole proprietorships, partnerships, or S-corporations.

Some pass-through business owners believe the individual AMT creates disproportionate burdens on pass-through entities by not permitting a deduction for state and local income taxes on business income, while permitting such a deduction at the entity level under the corporate AMT. Of course, individual shareholders in C-corporations are also not permitted under the individual AMT to deduct state and local income taxes on business income taxed to individuals as dividends or capital gains.

Because C-corporations are subject to a double tax, it is unclear whether these differences between the corporate AMT and the individual AMT create disparate tax burdens for pass-through businesses relative to C-corporations. Elsewhere, I have written that the corporate AMT is difficult to justify on either efficiency or equity grounds.[12] Some tax reform proposals would repeal both the corporate and individual AMT.[13]

Wage versus Capital Income

In contrast to incorporated businesses (including S-corporations) and certain partnerships, all of the return to sole proprietorships is taxable as wage income rather than at least in part as capital income. Wage income, in addition to being taxable under the income tax, is also taxable under Social Security and Medicare self-employment taxes. In 2008, the Social Security (OASDI) self-employment tax is 12.4 percent on the first $102,000 of self-employment income. The Medicare (HI) self-employment tax is 2.9 percent on all self-employment income. One-half of self-employment tax is deductible from the computation of taxable income for income tax purposes. For many sole proprietorships, some of the income earned by the business is a return on capital investments in excess of what would normally be paid as wages and salary of the business owner. When this return is taxed as wages, it is taxed at a higher rate than if it were able to be identified as capital income. This extra tax disadvantages sole proprietorships and other entities that do not distinguish a portion of earnings as capital income.

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[12] Andrew B. Lyon, *Cracking the Code: Making Sense of the Corporate Alternative Minimum Tax* (Brookings Institution), 1997.

[13] See for example, President's Advisory Panel on Federal Tax Reform, *Simple, Fair, and Pro-Growth: Proposals to Fix America's Tax System*, November 2005, which would repeal the corporate and individual AMT (although it would deny the deduction for state and local income taxes for both individuals and businesses). House Ways and Means Chairman Charles Rangel introduced a bill, H.R. 3970, in October 2007 which would repeal the individual AMT, but not the corporate AMT.

Deductible Expenses

Toder (2007) states that small business owners may be more able to represent personal expenses (such as home office expenses or automobile use) as deductible business expenses compared to larger businesses. In the other direction, strict rules on the deduction for home offices may prevent some business owners from claiming expenses that are legitimately tied to the operation of a business. The varying willingness of business owners to claim deductions for certain business expenses may create a tax disadvantage to some owners and a tax advantage to other owners. At low tax rates business owners may be more willing to sacrifice these deductions than at higher tax rates.

Tax Compliance

Recent IRS estimates of non-compliance suggest that small business fails to report a significant amount of taxable income. Non-compliance by small business is estimated to be significantly greater than for large businesses. IRS research is unable to determine conclusively whether the extent of non-compliance is tied to tax complexity or the absence of other controls, such as independently audited financial records to satisfy external investors or reduced IRS examination rates (audits) of smaller businesses.

Based on a random examination of returns for tax year 2001 conducted under the National Research Program of the IRS, the IRS calculated that net under-reporting of business income from pass-through entities, including sole proprietorships, was 43 percent.[14] Under-reporting of non-farm sole proprietorships was estimated at 57 percent, and under-reporting of farm income was estimated at 72 percent. In contrast, IRS estimates that wage income of all taxpayers was under-reported by only 1 percent. Based on older compliance estimates, the under-reporting rate of large C-corporations (assets exceeding $10 million) is approximately 14 percent. **Table 2** shows the estimated tax gap, i.e., the reduction in tax payments before enforcement actions, and the net under-reporting rate for various forms of business income and non-business income.

As noted by Slemrod (2004) and Toder (2007), non-compliance does not necessarily benefit small business owners. When non-compliance in a sector is significant, competition may bid down prices facing consumers in that sector and reduce the return to business owners. However, a compliant business owner is at a competitive disadvantage when operating in a business sector in which non-compliance is prevalent.

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[14] Internal Revenue Service, "IRS Updates Tax Gap Estimates," IR-2006-28, Feb. 14, 2006, available at: http://www.irs.gov/newsroom/article/0,,id=154496,00.html and "Tax Gap Figures," available at: http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf

**Table 2.—Under-reporting Estimates,
Selected Items for Individuals and Corporations**

Type of Income	Tax Gap ($ billions)	Under-reporting Percentage
Total Individual Under-reporting Gap	**197**	**18%**
Individual business income	**109**	**43%**
non-farm sole proprietor	68	57%
farm income	6	72%
rents & royalties	13	51%
partnership, S corp, estate and trust	22	18%
Individual non-business income	**56**	**4%**
wages,salaries, tips	10	1%
interest income	2	4%
dividend income	1	4%
capital gains	11	12%
Total Corporate Under-reporting Gap	**30**	**15%**
small corporations (assets less than $10 million)	5	29%
large and medium corps (assets > $10 million)	25	14%

Source: IRS, "Tax Gap Figures," (2006). Under-reporting percentages for corporations computed by Toder (2007).

Tax compliance may be affected by the probability of IRS audit. The proportion of returns audited, i.e., the audit coverage rate, for individuals reporting business income is significantly lower than for large corporations, although generally higher than individuals without business income (**Table 3**). However, even if small businesses report a significantly smaller percentage of their income than larger businesses, it may be inefficient to redirect IRS audits to smaller businesses given the smaller amount of income earned by small businesses.

Table 3.— Selected IRS Audit Coverage Rates

Type of Return	Audit Coverage Rate (2007)
Individuals	
Individuals with business income reporting total gross receipts greater than $25,000	2.8%
All individuals	0.9%
S-Corporations	
1120S Corporations	1.3%
C-Corporations	
Assets less than $10 million	0.9%
Assets between $10 million and $250 million	13.9%
Assets greater than $250 million	27.2%

Source: Internal Revenue Service Data Book 2007 (March 2008), Table 9.

Compliance Costs

Slemrod (2005) estimates the federal tax system imposes a total compliance burden of $135 billion, of which $85 billion represents compliance costs imposed on individual taxpayers, $40 billion represents compliance costs imposed on businesses other than sole proprietorships, and $10 billion represents the cost of the Internal Revenue Service.[15]

The compliance cost of the tax system to small business may be quite high. Small businesses may fail to claim all tax benefits to which they are entitled due to complexity and recordkeeping costs.

[15] Joel Slemrod, testimony to the House Ways and Means Committee, June 8, 2005.

In a study for the IRS, DeLuca et al. (2007) provide estimates of compliance costs for small businesses other than sole proprietorships for tax year 2003.[16] The estimates are derived from a survey of small business taxpayers representative of the nearly 7.2 million partnerships, S-corporations, and C-corporations with assets less than $10 million.

The IRS study estimates that these businesses spent between 1.7 billion and 1.8 billion hours on tax compliance and incurred out-of-pocket expenses of between $15 billion and $16 billion. If the time spent on tax compliance is valued at $40 per hour (an annual salary of $83,200), the total compliance cost to small businesses is between $83 billion and $90 billion, or an average burden of about $12,000 per small business. This estimate significantly exceeds Slemrod's estimate of business compliance costs.

Table 4 shows that compliance costs (including time costs valued at $40 per hour and out-of-pocket expenses) are a significant cost to small businesses relative to gross receipts. For the smallest businesses (total receipts less than $10,000) compliance costs exceed revenue. Even for businesses with receipts between $100,000 and $500,000, compliance costs are about 5 percent of total receipts. For low margin businesses, these compliance costs can represent a significant percentage of net income and, for many businesses, can exceed net income.

From these estimates, it is apparent that compliance costs represent a very significant implicit tax on small business income.

Table 4.— Total Compliance Costs as a Percentage of Total Receipts

	Number of businesses (thousands)	Time and money burden as a percentage of receipts
All small businesses	7,243	1.4%
Total Receipts		
0 or less	895	n.a.
Less than $10,000	815	217.7%
$10,000-$20,000	303	47.0%
$20,000-$50,000	677	26.2%
$50,000-$100,000	715	14.8%
$100,000-$500,000	2,029	4.7%
$500,000-$1 million	705	1.9%
Over $1 million	1,104	0.5%

Source: DeLuca et al. (2007), Table 12 (average of low and high reported values, valuing time at $40 per hour)

[16] Donald DeLuca, Scott Silmar, John Guyton, Wu-Lang Lee, and John O'Hare, "Aggregate Estimates of Small Business Taxpayer Compliance Burden," Proceedings of the 2007 IRS Research Conference, available at http://www.irs.gov/taxstats/article/0,,id=174701,00.html.

IV. Conclusion

Let me leave you with some final thoughts on the design of the tax system.

It is vital for the future standard of living of Americans to have a tax system that promotes the long-term growth of the economy. Entrepreneurship, innovation, and capital investment play a key role in economic growth, and small businesses are an important contributor to these factors.

Economists generally believe that a low rate, transparent tax system that does not distinguish businesses based on their size is the best way to maximize the productive capacity of the economy.

It may appear counterintuitive, but tax incentives come at an economic cost. Among these costs are the compliance burdens created by special incentives, which hit small businesses the hardest. Compliance costs are a form of inefficiency in the economy. The time and out-of-pocket expenses that businesses spend in navigating complex tax rules produce no economic benefit for society. A simpler tax system would allow these business resources to be channeled into more productive activities that add to the future growth of the economy and increase the standard of living of all Americans.