



Advocacy: the voice of small business in government

Testimony of

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***U.S. House of Representatives
Committee on Small Business
Subcommittee on Workforce, Empowerment, and
Government Programs***

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Fort Collins, Colorado
Topic: Small Business Expensing-Job Growth Through the
Tax Code

Chairwoman Musgrave, Congressman Beauprez, and Members of the Subcommittee, thank you for the opportunity to testify and submit comments to the record today. My name is Jim Henderson and I am the Regional Advocate for Region VIII in the Office of Advocacy at the U.S. Small Business Administration (SBA). Created by Congress in 1976, the Office of Advocacy of the SBA is an independent voice for small business within the federal government; therefore the views expressed in this statement do not necessarily represent the views of the Administration or of the SBA. The Chief Counsel for Advocacy, Thomas Sullivan, a Senate confirmed Presidential appointee, directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. The Office of Advocacy identifies the small business community's regulatory issues of concern through economic research, policy analyses, and small business outreach.

Since small businesses do not have the time and resources to insert themselves into the rulemaking process, Advocacy was created to directly advance their views, concerns and interests. As the Regional Advocate for Region VIII, I am charged with being the eyes and ears for the Chief Counsel for Advocacy by listening and responding to concerns of small businesses in Colorado, Montana, North Dakota, South Dakota, Utah and Wyoming. I also work with state officials on small business-friendly initiatives.

The Subcommittee has requested Advocacy's views on the beneficial impact of the increased expensing limit contained in Section 179 of the Internal Revenue Code.

Advocacy believes Section 179 is having a significant positive impact on small businesses because it increases their cash flow and dramatically reduces the paperwork necessary to account for the capitalization of purchased business property. Using 1999 tax data, 69 percent of businesses that elected to expense their purchases were sole proprietors and individual farmers. This represents approximately 2.9 million businesses.

We at the Office of Advocacy praise Chairwoman Musgrave, Congressman Beauprez and the Subcommittee for your leadership and commitment to improving the regulatory environment in which small business must operate so that they may grow and succeed. In 2003, the Chief Counsel for Advocacy testified before the House Committee on Small Business and the Subcommittee on Tax, Finance and Exports in support of the increase in the Section 179 expensing limit and the need to make it permanent. We were very pleased that legislation to increase the expense limit passed that year and in 2004 legislation passed to extend the expensing increase through the end of 2007.

Section 179 permits small firms to expense the cost of purchased business equipment placed in service during the tax year. Without Section 179, small businesses would have to depreciate the cost of business assets by using permitted depreciation methods. Prior to recent legislation the permissible expensing amount was \$25,000 and it was phased out dollar for dollar for investments in excess of \$200,000. Thus, small firms were required to utilize the more complicated depreciation methods if their business investments reached \$225,000 in a single year.

In the past two years, Congress has passed and the President has signed two important pieces of legislation that increased the availability of Section 179 to small businesses. The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) increased the amount of business investment a small business can expense from \$25,000 to \$100,000,¹ increased the limit for phasing out expensing from \$200,000 to \$400,000,² and indexed both amounts to inflation from 2003 through 2005. The American Jobs Creation Act of 2004 (AJCA) extended the increased expensing amount and phase out limit through 2007. The previous \$25,000 and \$200,000 limits will go back into effect in 2008. Advocacy believes the expensing limits should be extended as called for in Chairwoman Musgrave's legislation H.R. 1678. Ultimately, Advocacy hopes the limits will be made permanent.

Expansion of the expensing provisions of Section 179 is important to small businesses right here in Colorado. Mark Patterson, a tax accountant with the firm Stockman Kast Ryan and Company in Colorado Springs, recently told me he has many clients that have taken advantage of Section 179's increased expensing provision. Specifically, Mr. Patterson advised a new medical clinic that started in 2003 to use Section 179. Starting a medical clinic requires a significant amount of upfront capital investment. The clinic availed itself of the Section 179 expensing provisions which increased its working capital allowing it to hire two key employees further ensuring the success of the clinic. Additionally, the clinic's chance of being successful was increased because it was able to have the latest equipment and technology from day one.

¹ In 2004 the expense allowance was \$102,000. The amount for 2005 has not been announced.

² In 2004 the maximum expensing allowance was \$410,000. The amount in 2005 has not been announced.

H.R. 1678 will extend the availability of the larger expensing limit until 2010. This important legislation will have a direct effect on the viability of small businesses. A firm's cash flow is increased by the use of Section 179 expensing.³ Section 179 also decreases the cost of tax compliance for small firms. An Office of Advocacy study on federal regulatory burden in 2001 showed that tax compliance costs for firms with fewer than 20 employees was twice as much, per employee, as large firms with more than 500 employees. Tax compliance cost \$1200 per employee for very small firms versus \$562 for large firms.⁴ Thus, Section 179 addresses two vital areas of concern for small businesses; it increases cash flow⁵ by lowering their tax liability and it reduces the cost of compliance and recordkeeping that is required by other methods of depreciation.

The President's 2006 fiscal year budget requests that the increased expensing amounts established by JGTRRA be extended permanently. Congressman Wally Herger who is a co-sponsor of H.R. 1678, has also introduced H.R. 1388, which if enacted would achieve the President's goal. The Office of Advocacy supports this legislation as well.

Small business firms need tax reform that will focus on three primary areas: lower rates, simplified compliance, and predictability. It is intuitive that lower rates are good for the development of small businesses. The Office of Advocacy has produced research

³ See CRS Study RL31852, *Small Business Expensing Allowance: Current Status, Legislative Proposals, and Economic Effects*, by Gary Guenther, p. 7 (May 9, 2005).

⁴ See *The Impact of Regulatory Costs on Small Firms*, an Advocacy funded study by W. Mark Crain and Thomas D. Hopkins (October 2001).

⁵ See *The Impact of Tax Expenditure Policies on Incorporated Small Businesses*, an Advocacy funded study by Innovation & Information Consultants, Inc., Concord MA (April 2004), (this study found that accelerated depreciation provisions account for 2.4% of business receipts for business with less than \$5 million in annual revenue).

that shows that increasing marginal tax rates on business income reduces the chances that entrepreneurs will open new firms while it increases the likelihood that they will exit the market.⁶ Conversely, the study reveals that decreasing marginal tax rates across the board would actually spur entrepreneurship by increasing the rate of new firm formation and slowing the rate of firm closure. Complexity of the tax laws adds an additional burden to small firms which is not reflected in the marginal rate. Similar to tax complexity is the concept of tax permanence. Advocacy research shows that when there is less predictability in the tax code there is less economic predictability. Sunset provisions, phase-outs, and threshold levels introduce a higher level of variability in small firm expectations. Certainty in the tax code engenders confidence in small businesses allowing them to make decisions for the future.⁷

Section 179 directly addresses simplified compliance and establishes lower tax liability for small firms. The passage of H.R. 1678 will provide predictability until 2009. Small businesses are always better off when they can plan for the future with certainty. The Office of Advocacy strongly supports H.R. 1678 because it provides smart tax reform and is beneficial to the small business community.

⁶ In a study funded by the Office of Advocacy it was found that marginal tax rates have an effect on individuals' decision to enter into entrepreneurial activities. Reducing rates may lead to increased entrepreneurial activity and survival. See *Taxes and Entrepreneurial Activity: An Empirical Investigation Using Longitudinal Tax Return Data*, by Donald Bruce, Ph.D., and Tami Gurley (March 2005).

⁷ See the working paper by Dr. Radwan Saade, *Rules Versus Discretion in Tax Policy*, is located at www.sba.gov/advo/stats/wkp02rs.pdf.

Madam Chairwoman, this concludes my prepared remarks. Let me state again what a pleasure it is to have had this discussion here in Colorado on this important small business tax issue. I would be very happy to try to answer any questions you might have.