

TAX COMPLIANCE & PLANNING TRENDS

House Committee on Small Business Recommends 7 Key Changes to Internal Revenue Code

The U.S. House Committee on Small Business, calling the Internal Revenue Code an obstacle to entrepreneurial growth and progress because of its size, complexity, and age, proposed last Thursday seven specific changes to the Code that the Committee believes can be, "accomplished in a short period of time - and without delay." The provisions, which include a standard deduction for the home office, a provision for shorter depreciation schedules and a deduction for health insurance for self-employed entrepreneurs, are contained in the report, "Seven Ways to Stimulate the Economy by Updating the Internal Revenue Code."

The report says further that business classifications used by small business result in higher taxes and in effect, there are two business tax systems in the United States.

Noting numerous calls over the years for comprehensive reform of the Code, the Committee on Small Business says that a targeted modernization of particularly outdated provisions of the Code can streamline the Code and make it fair to small businesses.

The Committee identified specific provisions in the Code as outdated and complex, and in some cases, causing unfair burdens on small businesses, recommending specific solutions targeted to the problems. Consider the seven key changes proposed by the Committee:

Outdated Provision 1: Home Office Deduction

This complexity means that the majority of home-based small businesses miss out on a deduction to which they are lawfully entitled.

Proposed Solution:

Allow for a reasonable standardized deduction for people using their home as part of their business.

Outdated Provision 2: Limits on Deductions & Burdensome Record keeping Requirements for Electronic Business Equipment

Small firms lose time and money. Many small firms forego investment in new technology and lose competitive edge.

Proposed Solution:

Allow taxpayers who can prove substantial business use of electronic equipment to deduct a greater portion of the cost without having to keep detailed records.

Outdated Provision 3: Indexing for Inflation the Cost of Vehicles used in Business

Entrepreneurs lose thousands of dollars annually because they can't depreciate the true value of their vehicles.

Proposed Solution:

Allow a small business owner who uses an automobile for work-related purposes over 75 percent of the time to recover the true cost of the vehicle (with a price of at least \$25,000) during the standard 5-year recovery period.

Outdated Provision 4: Use of Extended Depreciation Schedules

Entrepreneurs end up paying taxes that are higher than necessary and can't recover costs in a timely manner.

Proposed Solution:

Allow small businesses to use shorter depreciation schedules that are in line with today's technological and market realities.

Outdated Provision 5: Self-employed Entrepreneurs Pay Tax Twice on Health Insurance Premiums - as Employees and as Business Owners

Millions go without adequate (or any) health insurance.

Proposed Solution:

Allow self-employed entrepreneurs to deduct cost of health insurance premiums in the same manner as large firms.

Outdated Provision 6: A 50% Limit on Small Business Deduction for Business Meals & Entertainment Costs

Most small firms lack advertising budgets and business meals and entertainment are important tools used by entrepreneurs to grow their businesses.

Proposed Solution:

Raise the small business limit for deduction of business meals and entertainment to 80% or 100%

Outdated Provision 7: Investment Incentives for Small Business have been Eliminated by a Reduction in Long-term Capital Gains Taxes

With long-term capital gains rates practically the same as the rate for sales and exchanges of qualified small business stock (QSBS), the goal [of a 1993 law] of moving investment to smaller businesses has been thwarted. Without this incentive, business investment will increasingly go to larger companies with less risk.

Proposed Solution:

Restore incentives to prompt those with capital to invest their money in U.S. small businesses.

Summary of Recommendations

Building on their analysis of tax provisions passed since 1993 that have ended up eliminating incentives for investment in small business, the Committee's report argues that the entity classifications that small businesses use affect the Code's fairness and says that, in effect, there are two business taxation systems in the United States:

Whether it is because of changes in technology, or structural deficiencies with the way the provision was written, there are many tax code provisions that do not provide benefits to smaller businesses simply because of the entity classification that most small businesses operate under. Most large entities pay their taxes through the corporate tax system, while most small businesses are Subchapter S corporations, partnerships, or Schedule C or F businesses and pay taxes for their business earnings on their personal returns. As a result, many small firms lose business deductions that are not available on their personal returns.