**Testimony of**
**Rebecca Oyler**
**Legislative Director**
**NFIB/Pennsylvania**

**Before the**
**House Select Subcommittee on Tax Modernization and Reform**
**February 20, 2018**

The National Federation of Independent Business is Pennsylvania's leading small business organization representing over 14,000 small and independent businesses in the Commonwealth. NFIB members represent virtually every sector in Pennsylvania's economy. A typical NFIB member employs five or fewer workers and generates gross sales of $400,000 per year.

Joining me today is Warren Hudak, chairman of NFIB's State Leadership Council and president of Hudak and Company, a Central Pennsylvania-based small-business accounting firm specializing in payroll services, bookkeeping, sales tax services, and advanced tax transaction analysis. Warren also serves on the board of the Pennsylvania Society of Enrolled Agents (PSEA) and on the Business Advisory Council of the Council on State Taxation (COST). We would like to thank Chairman Evankovich for inviting us here today.

Pennsylvania has not fared well in the economic competition among the states. Despite being the 6th largest economy in the nation, it ranks 48th in creating new jobs. State tax policy is a critical tool that can be used to attract growth, inspire innovation, and encourage businesses to invest in the future and create economic opportunities for its citizens. But if misapplied, it can also be hostile to entrepreneurship, hinder job creation, and drive productive taxpayers out of business—or out of the state altogether.

Many Pennsylvania small businesses are organized as "pass-through" businesses, paying business taxes through personal returns. In fact, about 80% of businesses in Pennsylvania, employing 55% of the private-sector workforce, are organized as Sole Proprietors, Partnerships, Subchapter-S corporations or Limited Liability Companies (LLCs).

Over 98% of Pennsylvania businesses are small, and they create two out of every three new jobs. Tax policy has always been a top priority for these businesses and for NFIB for two reasons:

First, lower taxes mean more resources business owners have to invest in and grow their businesses, hire employees, and boost their local economies. The growth and investment in the U.S. economy at the national level after the passage of the Tax Cuts and Jobs Act should serve as a valuable lesson on the importance of tax policy to economic activity.

The second reason tax policy is critical to small businesses is because of the complexity of the federal and state tax codes. Tax compliance is one of the most expensive burdens the government imposes on small-business owners (66% higher than for larger companies) because small businesses typically do not have in-house accountants or tax compliance staff to manage onerous tax reporting and paperwork requirements.

NFIB's January 2018 Small Business Optimism Index set an all-time record for the number of small business owners reporting "Now is a Good Time to Expand," registering at 32%, the highest level in the history of the survey. Actual earnings climbed 11 points from December, the highest level reported since 1988. Many businesses are hiring and expanding, and 31% plan to raise wages to attract and retain talented employees, the highest in more than 28 years. This good news is a direct result of regulatory reform and tax cuts in Washington that put resources back into the pockets of small businesses to grow and expand.

Unfortunately, Pennsylvania businesses won't enure the same benefits from these changes as those located elsewhere. Late last year, Governor Wolf's Department of Revenue published a tax bulletin disallowing depreciation of capital investments for corporations, reversing a policy dating to 2001 designed to encourage investment. The federal reforms permit immediate 100% depreciation to boost the economy, and the Governor's action makes Pennsylvania the only state where this benefit cannot be realized fully by companies at the state level.

Likewise, Pennsylvania is the only state in the nation not to allow for personal income tax deferral when property is exchanged for similar property, so-called "like kind" exchanges. The Commonwealth also limits expense deductions for qualified equipment under the personal income tax to $25,000, while much of the nation follows federal expensing rules. Adding to the state's tax complexity, a new provision requires domestic companies that hire out-of-state contractors to withhold Pennsylvania income tax on behalf of these nonresident businesses, a complicated requirement that puts small businesses at a costly disadvantage. Solving these tax issues for pass-through businesses will increase opportunities for growth and investment for small businesses.

Whenever possible, Pennsylvania should consider conforming its tax laws to federal standards to simplify taxes for businesses and remove barriers to economic growth.

The Commonwealth's high tax rates continue to hinder the competitiveness of businesses located here. When compared to other states' personal income taxes, Pennsylvania has the 17$^{th}$ highest tax burden in the nation, 2.16% higher than the U.S. average.[1] This drain on economic growth is a primary reason why job creation remains stagnant.

NFIB would have serious concerns about any proposals that would raise the tax rate paid by pass-through entities, including Subchapter S corporations, or limit the number or types of businesses that are eligible. The damage this action would cause to Pennsylvania small business owners and our economy far outweighs any potential corporate net income taxes to be collected.

Over the past decade, businesses have moved to other states with more favorable tax environments; some have simply failed. The inability to foster an environment that would encourage entrepreneurs to create jobs has engendered an exodus of the best and brightest young people to states with favorable climates for business.

[1]Ratio of personal income tax to personal income (http://www.ifo.state.pa.us/download.cfm?file=/Resources/Documents/SR2018.pdf).

Since 2007, a significant majority of counties in Pennsylvania saw more taxpayers move out than move in. Only nine of the state's 62 counties saw a rise in their overall number of taxpayers. Over the next 10 years, the retired population in the state will grow by almost 600,000. At the same time, the number of working-age Pennsylvanians will drop by over 180,000. The aging of our adult population, along with the exodus of young families and entrepreneurs from our state to more tax-friendly states, creates a worker problem and promises to exacerbate our fiscal challenges in the years ahead unless the state takes action to stem the tide.

The subcommittee also should consider the impact on the state budget of tax-free zones and other taxpayer-funded economic development programs. Many of these programs punish long-established Pennsylvania businesses that now must shoulder the tax liabilities of their competitors or finance projects and take on risks the private sector isn't willing to assume. These firms then are forced to charge higher prices than their competitors who pay no taxes.

History has demonstrated that governments have not been particularly successful at picking winners in the market. If the political command economy really worked, the Soviet Union would have won the Cold War. Subsidies of capital costs cannot compensate for a hostile tax environment. If the Commonwealth is prepared to commit hundreds of millions of dollars for economic development programs, it should be willing to reduce business taxes by hundreds of millions of dollars and allow entrepreneurs to make the capital allocation decisions.

NFIB believes a more effective, pro-growth tax strategy would: put an end to taxpayer-funded economic development programs that support a select few; simplify the tax code to position Pennsylvania as a taxpayer-friendly state for entrepreneurs to create and businesses to build and invest; and reduce the state's tax burden on job creators. Such a strategy would encourage people to come—or to come back— to Pennsylvania as a burgeoning center of economic opportunity.

On behalf of the small-business men and women of the NFIB, thank you for allowing us to appear before the committee. We would be happy to answer questions.

# # #