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Tax Bill Would Deliver Big Cut for Small Businesses

By Norman Leahy

A bill introduced Wednesday by Rep. Randy Hultgren (R-Ill.) promises to cut federal taxes on small- and medium-sized businesses, a move Hultgren hopes will "give these employers room to grow by giving them back time and resources."

Hultgren's bill, H.R. 5374, the "Bring Small Businesses Back Tax Reform Act," would reduce taxes for sole proprietorships, S corporations and partnerships.

Under current tax law, income and losses from such businesses pass directly to their owners, and are taxed at the owners' personal income tax rates.

According to the nonpartisan Tax Foundation, these so-called "pass-through" businesses account for nearly 60 percent of the net corporate income in the United States, and employ nearly 50 percent of the nation's workers.

In some cases, pass-through businesses can face marginal tax rates of 50 percent or more, when adding federal, state and self-employment taxes together.

Hultgren's bill would set the federal tax rate on the first $150,000 of income from pass-through businesses at 10 percent, and establish a 20-percent rate for the first $1 million of income.

Currently, the 10-percent rate applies to only the first $18,150 for married couples filing a joint federal tax return.

The highest federal income tax rate, 39.6 percent, applies to incomes over $457,600 for married, joint tax filers.

Hultgren's bill would also allow pass-through businesses to immediately expense all investment in equipment. Under current tax law, businesses are allowed to deduct a portion of the cost of such investments over several years, and sometimes even decades, depending on the useful life of the equipment purchased.

The legislation would also simplify cash accounting for tax purposes for all businesses with gross receipts less than $25 million.

Cash accounting is used mostly by small, personal services business. Under cash accounting, these businesses can delay booking income on sales into the next tax year, which can be helpful for firms that are highly cyclical, making most of their profits at some times of the year, and much less at others.

Current tax law states pass-through businesses must have annual, gross income of $5,000,000 or less during the three preceding tax years in order to qualify for cash accounting, though some classes of pass-through businesses such as partnerships with "C" corporation partners, are not allowed to use cash accounting at all.

Hultgren believes his bill will allow pass-through companies to focus on growth.

"Governments tax [pass-through businesses] capital like it is personal income," Hultgren said, "and it isn't working."

"As small businesses go, so goes the American economy. It is time we give them the freedom, means and flexibility to expand and create jobs."

Not all economists are on board with the idea of cutting taxes for pass-though companies.

An October 2015 study from the National Bureau of Economic Research (NBER) that looked at the growth of pass-throughs from 1980 until 2011, said the rise in the number of these entities is directly linked to the increase in income inequality.

According to the NBER, the "growth of income from pass-through entities accounted for 41 percent of the rise in the income of the top 1 percent."

The NBER contends "if pass-through activity had remained at 1980's low level," then "strong but straightforward assumptions imply" federal tax receipts would have been "approximately $100 billion higher" than they otherwise were in 2011.

Part of the reason is pass-through business income is taxed just once, at the owners' income tax rate. Income from traditional corporations is taxed twice — once at corporate level, and a second time as personal income.

Alfredo Ortiz, president and CEO of the nonpartisan Job Creators Network, told AMI Newswire such double taxation is one reason pass-throughs have gained in popularity.

Small business owners, Ortiz said, "incorporate as pass-throughs to avoid the corporate tax code's double taxation of corporate and dividend income that regularly exceeds 50 percent of earnings."

"Reducing the tax burden small businesses face," Ortiz said, "would allow Main Street to increase investment, hiring, and expansion, reducing income inequality and increasing economic growth."