# National Small Business Network

# Solutions for the Fiscal Cliff that Rebuild a Sustainable Economy and Government

**NSBN Policy Recommendations November 2012**

**Unfortunately, America's fiscal problems and tax issues have now reached critical mass. Our national debt now exceeds our entire annual Gross Nation Product. Both Presidential candidates and most Members of Congress campaigned on the critical importance of reducing budget deficits and lowering the debt. If there was one clear message in the election outcome it was stop the political propaganda and game playing and find realistic solutions to our country's problems.**

The December 31st "fiscal cliff" is actually a "fiscal opportunity" for this Congress to stop just talking about deficit reduction and actually do it, while still selectively continuing policies that help rebuild a sustainable economy. Because of prior Congressional decisions, the 2001 and 2003 tax rate reductions, many long standing tax expenditure economic incentives, special provisions to stimulate the recession economy such as the 2% payroll tax reduction, and the increased estate tax exemptions are all expiring in 6 weeks. Middle income Alternative Minimum Tax relief and other provisions expired in 2011 and have not even been debated in the 2012 Congress. The latest CBO estimate is that even if all of the "fiscal cliff" stimulus provisions are allowed to expire it will only reduce 2013 GDP by .5%, with a recovery starting again in the second half of the year and continuing into 2014. Whenever you remove $1 Trillion of annual debt financed stimulus from a $15 Trillion economy, it will have economic impacts, but it has to happen. This is also far less economic impact than the 2008 recession which resulted from excessive speculation encouraged by overly loose tax and fiscal policy. Some of the expiring provisions are important for rebuilding a balanced and sustainable economy, but others are not.

On the expenditure side, unless Congress enacts a more logical deficit reduction program, the federal budget also faces mandated sequestration under the Budget Control Act of 2011. This may negatively impact the current weak economy by reducing governmental employment and private sector purchasing and makes illogical "across the board" program cuts. In the year since the "Super Committee" process failed, this Congress should have developed a better alternative for deficit reduction, but it did not. The Congress hasn't even passed a detailed Federal budget in the last 4 years, so the likelihood of developing a better alternative in the next 6 weeks seems unlikely.

The current projected annual budget deficits will also require an increase early next year in the Federal borrowing limitation, with the potential of a Congressional deadlock which could result in a default on our national obligations, with severe domestic and international economic impacts. Threatening to default on our debt is not a realistic option. Neither American voters, the international holders of our sovereign debt, or the leaders of other world countries facing similar problems have yet to see effective Congressional action to control our deficits and reduce our

debt. We need to prove that we can rebuild a logical Federal budget process and a robust economy.

## What <u>this</u> Congress needs to do in 2012:

The election is now over. It is time for the 112th Congress to put politics aside and use its few remaining days to discuss, and actually enact, solutions to the problems that face us. Even with the potential short-term economic consequences projected by CBO we recommend that the 112th Congress take the five actions listed below. The recommendations include both budget expenditure items and "tax expenditure" items since they have the same fiscal impact. A lower tax rate on a specific kind of income, or a tax credit or deduction for a specific type of expenditure, is no different than a direct federal transfer payment or program expenditure. The long term value of every tax expenditure decision needs to be balanced against the value of the budget expenditures that would need to be reduced in a balanced budget. The recommendations are in priority order, based on items having greatest fiscal benefit with the lowest potential negative economic consequences.

1. **Pass, with bi-partisan support, an increased federal debt limitation that should be adequate for <u>at least 2 years</u>, with provisions for realistic budget controls and deficit reduction targets.** The intent is not to encourage expanding the debt. This should, however, provide the 113th Congress with time to develop workable fiscal solutions and will assure the international holders of our debt that the US dollar is still the logical currency for international exchange and investment.

2. **Stop covering up the hard fiscal decisions with "business as usual" continuing resolutions, and continued deficit borrowing that passes our government debt on to the next Congress and the next generation.** Instead, the Congress should clearly demonstrate to American taxpayers, to the holders of our national debt, and to the rest of the world's governments, that the US Congress recognizes the severity of our fiscal problems and can work together to solve them. If the Congress ignores its own "fail-safe "deficit control provisions, there will be little faith left in our ability to solve the problems facing us.

3. **Allow the 2001 and 2003 "Bush" tax cut provisions to expire as scheduled on 12-31-12**. The country can no-longer afford the loss of revenue from these tax cuts and the effect they have had on the economy. Congress should use this additional revenue to provide more targeted tax incentives for direct investment in domestic businesses that employ Americans and to reduce the deficit. Treasury research found that only 20% of the benefit of the personal tax reductions went to pass-through business entities that have employees. The loosely targeted Bush tax reductions provided an equal incentive for individuals to make foreign stock investments as well as domestic investments. They also provided an equal incentive for speculative investments such as traded stocks, financial derivatives, instead of actual long term direct investment to start or grow a business and create jobs. This contributed to the speculative bubble, and the eventual economic collapse, that created the need for massive stimulus programs, which further increased the debt. Continued lower

and middle income tax relief for those with joint AGI under $250,000 could also be enacted by the new Congress for 2013.

4. **Allow the budget sequestration process to occur with two significant changes.** Congress should have been able to find a better solution for deficit reduction, but knowing they would probably not be able to, they enacted the sequestration solution, and should use it an interim solution. The legislation however had two major flaws which should be corrected by this Congress.

   a. **Reduce the FY 2012/13 mandated reductions by 50%** to adjust for the first full year's cuts being applied over only 6 to 9 fiscal year budget months. This will give federal agencies, program recipients, and the overall economy, a year to transition to the new budget realities.
   b. **Change the reduction allocation formula**, which was copied from the prior Gramm Rudman Hollings Act language, which applies the cut across the board at the individual program level. This is inefficient and illogical. Instead, amend the process to apply the budget reductions at the agency level. Rather than weakening all programs, this would allow agencies to identify and adequately fund the most important and effective programs and eliminate less important programs and their administrative expense. This prioritization process is also important for a long term budget control process and maximum program effectiveness as explained in long term recommendation number 1 below. All agencies should then be required to report to the Congress before the end of the 2012/13 fiscal year to explain the basis on which they prioritized their 2012/13 funding and their program priorities for future budget years. This will allow Congress to provide review and direction, as well as rebalance of expenditures between programs and agencies based.

5. **By December 15th, pass an extenders package of the highest economic value tax expenditure incentives which expired last year or will expire on 12-31-12,** including business investment deductions or credits, R&E credits, the middle income AMT exemption, the 2% payroll tax reduction, and other provisions such as those in the Senate Finance Committee approved extenders bill. This will provide some certainty that businesses need to make investment decisions for 2013. Quick passage is also needed to enable the IRS to properly administer 2012 returns. The highest long term economic benefit from tax dollars generally comes from targeted incentives for long-term private domestic investment in businesses and equipment, not from tax cuts for the very wealthy, or public works projects.

## Congressional actions needed in 2013 and beyond:

America is in trouble and the future economic security of our citizens is in doubt. After years of deficit spending, 9.4% of last year's federal budget was spent just paying the interest on past spending, even at today's historically low interest rates. Fiscal mismanagement from too much spending and too little tax revenue has put a burden of over $550,000 in unfunded Federal obligations on every American household. Over the past 4 years, federal spending has been 24.4%

of GNP but revenue has only been 15.4% of GNP. Last year's official deficit alone was over $1.1 Trillion, for a total cumulative sovereign debt of over $16 Trillion. This exceeds our entire annual Gross National Product, and is 6.5 times total annual Federal tax revenues. Even these amounts do not include the large unfunded future obligations for federal retirement benefits, veterans benefits, Social Security, Medicare, and Medicaid, which are currently estimated to be over $115 Trillion, or over 48 times total annual Federal tax revenue.

The status of the dollar as the world's reserve currency for international transactions is also being challenged, with potentially severe devaluation consequences if it loses that function. Last year our sovereign credit rating was downgraded by a major rating agency, with warnings from others. The only thing protecting us from significantly higher interest rates for our national debt is the current weak demand for capital and the fact that other major countries have similar debt problems. If Treasury average interest rates rise to only 6%, as some European countries are now experiencing, the annual interest on the debt would consume 39% of current total Federal tax revenue.

The broad "middle class" prosperity that drove our economy for the last 100 years is disappearing as more of our national wealth is concentrated in the top 1% of the population. The top 1% of the population controls over 35% of total personal net worth and 43% of financial assets. From 1982 to 2011 the income of this the top 1% of the population increased from 12.8% of total personal income to 21.3%. The top 20% of the population now earns 50% of total income and the bottom 20% earns only 3.4%. As an individual's income increases, they generally spend a progressively smaller percentage of their disposable income on consumption which reduces the economic multiplier of their income on the general economy. This decline of the nation's middle class is resulting in declining total consumption and a permanent decline in jobs that depended on that spending.

In the past, our technological innovation and high workforce skills increased individual productivity and were a major factor in our manufacturing and economic growth. Today, that advantage is rapidly declining as first the production, then the engineering, and now the research and development of new technologies has moved to other countries. The quality of our education system and the skills of our workforce are also declining in relation to other countries, particularly in key science and engineering areas. In addition, the world has become an open market for both consumers and investors. Much of our nation's individual and business investment is now being directed to stocks and bonds of foreign businesses that hire foreign workers and benefit foreign economies. Ironically, we continue to reward foreign investments with the same special income tax incentives on capital gains and dividends as direct investments made to start or grow an American business that hires American workers.

Our current partisan political process seems unable to confront and correct these problems, even though adequate information is available to recognize the problems and develop workable solutions. Political conflict has let these problems grow into a national and international economic crisis that resulted in the recession we are still facing and a loss of faith in America's future. After the failure of the Special Select Committee on Deficit Reduction to overcome these political biases, **solving this economic crisis is now the responsibility of every member of Congress**! Although the scale is much larger, the government's problems of expense control, income generation, and maintaining credit worthiness are really no different than those faced

everyday by America's businesses and families. If Americans can logically solve these problems as individuals, why can't we resolve our economic problems as a nation?

The following recommendations for action in the 113th Congress may not be politically easy to implement, but every year we fail to correct the problems, the consequences of inaction, and the costs of correction, grow larger. Collectively these economic issues present just as much a risk to America, and our citizen's way of life, as any foreign military threat. Many members of the Congress served our country in the armed services. Overcoming these economic threats will require the same patriotism, sacrifice, and a willingness to work together for the common good.

**It is time to put aside partisanship and political self-interest. It is time to think about the economic security of our country, of our children, and of the generations that will follow. It is time to Put America First!**

These policy recommendations are based on data from recent reports by the JCT, CRS, CBO, special Presidential Commissions, and numerous economic research organizations. Many of these background reports are available on the NSBN website at http://www.NationalSmallBusiness.net/issues.htm. This report focuses on using the extensive information available to make logical, information driven, non-partisan, recommendations for re-building a sustainable American economy.

## The Goal:

We share the general goals of the President's Commission on Fiscal Responsibility and other deficit reduction research groups for progressively returning to a sustainable federal fiscal policy. Most have suggested an initial 10 year plan, starting with the 2012 budget, to progressively eliminate annual deficits and reduce the federal debt to 60% of GDP by 2025, and 40% of GDP by 2035, while keeping maximum total Federal tax revenues below 21% of GDP. We also share the conclusion of the other groups that **deficit reduction will require both significant spending cuts and some revenue increases**. We believe that about 50% to 60% of deficit reduction should come from tighter budget control over all areas of federal expenditures, including "entitlement" programs and military spending, with the remainder to come from additional tax revenue.

We believe that the public debt is now so large in relation to the country's expected economic potential and current tax revenue collections that building sustainable economic growth and reducing the debt will require immediate action by the 113th Congress in at least six areas.


1. Budgeted Program Expenditures Page 6
2. Off-Budget Expenditures Page 7
3. Regulatory Program Efficiency Page 7
4. Tax Policy Page 8
5. Social Insurance Programs Page 12
6. Workforce and Population Page 13
7. Monetary Policy Page 14

## 1. Budgeted Program Expenditure Control Recommendations:

The purpose of government is to provide a stable structure in which people can live and work, and to provide important services collectively that individuals cannot effectively provide for themselves. Unfortunately the federal budget has grown so large that it is difficult for decision makers to evaluate its program effectiveness, or understand the long-term economic impacts of spending policies.

A. **Develop a multi-tiered performance based budgeting process** similar to successful businesses and several state governments which have "re-invented" their budget processes. Congress should regularly evaluate program expenditures and agency budgets in relation to the value and efficiency of the services delivered. This approach rewards the program's current importance to citizens, rather than historical expenditure levels. Prioritization based on clearly defined performance measures should occur at the program level, department level and finally between agencies. The process should focus on minimizing "non-value added costs" that do not significantly improve service delivery, and on identifying programs that provide the greatest benefit to taxpayers in relation to their cost. Current service level, "use it or lose it" budgeting, or "across the board" percentage reductions such as sequestration, often waste resources on in-efficient or unneeded programs, and under-fund more beneficial programs. Review and replace, when possible, intergovernmental and private contractor "cost plus" reimbursement agreements, which often reward inefficiency, with programs that reward cost reduction.

B. **Put a greater emphasis on analyzing the broader economic impacts of all legislation** and budget allocations prior to adoption. Too often legislation is crafted to look revenue positive during the 10 year scoring period without considering longer term revenue consequences. A perfect example was Congress using the short term tax revenue from allowing the conversion of taxable IRAs to Roth IRAs to "pay for" the Bush tax cuts, without considering the long term loss of tax revenue. Revenue scoring also often focuses only on potential federal tax revenue without adequate consideration of the governmental administrative costs and private sector compliance costs. The now repealed expansion of Form 1099 purchase reporting in the 2010 health reform bill was an example of this.

C. **Develop a stronger and more detailed 10 year running budget and revenue plan** for the federal government with a congressionally adopted policy to keep expenditures below projected revenues over the 10 year period with a goal to reduce the national debt below 60% of GDP by 2025.

D. **Using the 10 year budget plan as a base, assure that annual budgets are evaluated by the Congress and approved at least 3 months prior to the start of each fiscal year.** This would allow agencies to more efficiently make transitions needed for future funding and program changes. Doing this will require catching up on the budgeting process and making it a top priority at the start of every congressional session. The recent habit of not passing agency budgets until well after the start of a budget year shows a basic lack of proper control over the expenditure process, and encourages wasteful spending and program disruption. The government should also search for and reclaim unused prior year grants and revenue sharing expenditures and reuse the funds in current budgets.

E. **When short-term economic stimulus or "emergency" deficit spending is needed to help the economy through cyclical downturns or natural disasters, legislation should provide a source of offsetting revenue** later in the 10 year budget planning period. The focus of any short term economic stimulus incentives should also be on creating long-term jobs that are likely to continue beyond the funding period.

F. **Develop a bi-partisan strategic National Economic Growth Plan** identifying the best potentials for future international traded sector economic growth. Identify, and invest in, the kinds of education and training programs needed to develop the workforce skills to successfully compete with other countries in the future. This will also reduce the need for foreign workers to provide needed skills. Maintain and improve our economic infrastructure and develop sustainable energy sources needed for the future. Improve government programs, regulatory policies, and tax policies to encourage and support future economic growth in these key economic sectors, within the legal limits of international trade agreements.

G. **Expand the roles of the Office of Management and Budget (OMB), the Congressional Budget Office (CBO), and the Government Accountability Office (GAO), to help the Congress better evaluate the comparative performance and cost efficiency of agencies and programs.** Detailed and unbiased evaluations of program performance and value are necessary for a successful performance based budgeting process.

## 2. Off- Budget Expenditure Control Recommendations:

A. **There should be no continuing off budget expenditures**, for military activity, disaster assistance, or any other purpose. Congress should review and approve supplemental budget authorizations for any non-budgeted expenditures at least every 6 months, including making adjustments to other budget items, or providing additional revenue if necessary. Recurring "emergency" spending needs, such as disaster assistance, should be budgeted for based on average expected expenditures. There is no value to having a budget for fiscal control unless all significant expenditures are included.

B. **Congress must also prevent the growth of unfunded future budget commitments** such as federal employee retirement benefits, veteran's benefits, or other programs, by properly accounting for estimated future liabilities and providing adequate reserves in current program budgets for the future payments. For example, the VA indicates that almost 45% of the 1.6 million veterans from the Iraq and Afghanistan wars are seeking disability compensation. When possible, convert new federal employee and military retirement benefits from defined benefit programs to defined contribution plans which will automatically prevent the growth of unfunded pension obligations.

## 3. Regulatory Program Recommendations:

Regulatory programs are an important function of government, but also result in both regulatory agency expense, and significant non-value added compliance costs for businesses and individuals.

The Federal government should expand, and make permanent as part of the regulatory process, a "Regulatory Efficiency Initiative" building on recent efforts by the Administration and Congress. Much of the non-value added cost of the current regulatory structure results from poor regulatory design and poor coordination of new regulatory legislation with the existing regulatory processes of other Federal agencies and with state regulatory processes. The result is overlapping regulatory responsibilities and duplicate administrative costs, as well as duplicate reporting and compliance costs for businesses. Unfortunately regulatory agencies, like other organizations, naturally seek to enlarge their responsibilities, employee base and budgets. Without careful Congressional oversight, regulatory programs can grow beyond their original need adding to governmental cost and private sector burden.

A. **When budgeting for regulatory agencies, Congress should demand increasingly efficient performance results**, and should base program funding, and state government or private sector cost reimbursements, on the use of the most efficient administrative processes and technologies. This would include improving economies of scale from using or combining existing agencies and administrative processes, and using combined reporting and compliance programs with state governments when appropriate. State government program partners and private service providers should be required to use standardized electronic reporting and accounting software to reduce costs and improve program accountability. The non-value-added cost impacts on the private sector, on state governments, and on the economy, must also be considered in evaluating the need for, and performance of, all regulatory programs.

B. **Expand the responsibility of the OMB, CBO, and GAO to assist the Administration, the Congress, and agency management in developing a more coordinated and economically efficient regulatory structure**. This could include recommendations for consolidating similar federal regulatory requirements, reporting processes, and possibly agencies. The process should also include continuation and expansion of initiatives to work more directly with the states to coordinate taxation and regulatory programs, and share reporting information and regulatory overhead costs.

## 4. Tax Policy Recommendations:

High taxes are not the cause of our current economic and under employment problems. With the exception of payroll taxes, most American businesses pay Federal taxes only when they are profitable. The current federal tax level on individuals and “pass-through” business entities is lower than it was during times of economic prosperity and growth, and is lower than most other leading industrial nations. The tax rate on large corporations appears higher than the stated tax rate of other nations, but when adjusted for US business tax incentives and other taxes imposed by foreign countries, such as value added taxes, it is similar to other leading industrial nations.

For the past 10 years tax rates have been lower than historical averages, particularly on the wealthy who are receiving an increasing percentage of all income. This is a major cause of our spiraling debt. The lower rates encouraged speculation, but as the last 10 years have proved, they did not promote sustainable economic growth. A common definition of insanity is doing the same thing again and expecting a different outcome, and we can't afford to continue the current economic trends.

Tax law can be a major factor in economic decisions by both businesses and individuals, including the selection of their type of business entity. It is also one of the few remaining strategic tools to provide targeted economic incentives for domestic business growth. International agreements now limit our ability to use tariffs and other trade restrictions. Other nations such as China have used domestic tax policy very effectively to target international economic growth. Tax policies that "broaden the base and reduce the rate" would reduce the ability of Congress to provide such strategic incentives. Flat tax structures encourage speculation instead of long term direct investment, and encourage movement of investment capital anywhere in the world the potential return is highest. This benefits wealthier investors, particularly if capital gains rates are lower, but may also result in a declining national economy, increased unemployment, and unsustainable national debt.

A. **Selectively increase the total Federal tax burden up to a maximum of 21% of GDP with all the increase dedicated to reducing budget deficits and the debt**, until the debt is reduced below 50% of GDP. The current total federal tax burden, including, income tax, payroll tax, corporate tax and estate tax is estimated to be about 18 % of total GDP. The largest share of this additional tax revenue should come from high income taxpayers who benefited the most from the low tax rates of the last 10 years. Much of this revenue increase could occur just by allowing prior tax reductions to expire as scheduled. Unfortunately, the additional 3.8% investment tax provisions of the PPACA will increase the tax burden, but will not produce significant net revenue for deficit reduction because of increased health care program costs. When individuals benefit from something, they understand their obligation to pay for it, even when that is difficult. Congress also needs to understand it's obligation to the nation, and to future generations, to pay down our debt from past expenditures, regardless of political motivations.

B. **Reduce the economic impact of higher maximum personal tax rates on small business growth, by separating out, in the personal tax code, a category of "Small Business Operating Income" (SBOI).** This would be income that a taxpayer receives from pass-through business entities or from a Schedule C or F in which the taxpayer materially participates**.** By doing this, Congress could provide much better targeted incentives such as lower tax rates or special deductions. This would incentivize small business reinvestment and growth, without the high revenue loss that results from tax reductions on all forms and sources of personal income. Treasury Department research found that only 20% of the benefit of the personal tax reductions in the Bush tax cuts went to pass-through business entities that have employees.

   As many economists and others have pointed out, increasing maximum rates on personal income may discourage small business investment and growth which has been the best source of net employment growth. This is because most small businesses are "pass-through" taxpayer entities that report their business income on their personal tax return <u>on top</u> of their other normal salary and investment income. As a result, small business income is often taxed at the maximum personal tax rate and also causes the phase out of the individuals AMT exemption. This adds additional tax burden on small business income and discourages reinvestment and business growth.

Separate treatment of a limited amount of active business income would encourage small business growth, and allow better equality with the effective tax rate on larger businesses, particularly if C corporation rates are reduced. It would also give business owners an incentive for reinvesting in their business, rather than municipal bonds or dividend paying stocks which offer lower risk and higher tax benefits. The provision should not apply to investment partnerships or other holding companies which are not active businesses. A maximum limit on the special treatment of this income of perhaps $500,000 per business and per taxpayer could limit the total amount of the tax expenditure. This would encourage direct new domestic business investment in equipment, facilities, and employees rather than speculative investments in the secondary market, and even foreign markets, which currently receive preferential tax treatment. To prevent the incentive from being nullified by the Alternative Minimum Tax, a matching tax treatment for this income must also be added to the AMT provisions.

**C. Adjust the calculation of the capital gains tax to remove inflation distortions**. Long-term equity capital investment provides stability for a business and for the economy. However, much of the taxable "capital gain" from the sale of a truly long-term investment is actually just the monetary inflation that occurred over the investment period. The true value or purchasing power of the sale proceeds may be no greater than the economic value of the original investment, even though there may be a significant "taxable" gain. Using Bureau of Labor Statistics (BLS) inflation data, the percentage of taxable gain resulting just from the monetary inflation for a business or other asset sold in 2012 is 82% for investments that had been held 40 years: 56% for 30 years, 39% for 20 years and 22% for 10 years. Taxing this inflationary change, rather than the true economic gain is unreasonable and unjust. More importantly, failure to adjust for inflation makes the optimum tax incentive holding period for capital assets just 366 days. This encourages short term speculation, and discourages long term capital investments needed for economic growth. Rather than a lower flat rate on investments held for 366 days or more, the amount of taxable gain on investments held more than a year should be proportionally reduced by adjusting the basis amount by the monetary inflation over the investment period. The adjustment would be a simple multiplication based on an IRS published grid of cumulative BLS year to year inflation change data. Although recent inflation has only been 3% or 4%, the Federal Reserve has been increasing the money supply at 8 to 10 times the true economic growth rate which could lead to dramatically higher inflation in the future. If any special tax rate is continued on capital gains, limit the special rate to capital gains to direct investments in US businesses or other US based assets such as real property that are held for two years or longer. Winning or losing on shorter term secondary speculative investments such as traded stocks or other financial instruments, particularly foreign investments, provides no more direct benefit to business growth or the economy than gambling in Las Vegas. Research has also shown there is no direct effect of lower capital gains rates on general economic growth. "Carried interest" income for investment firm general partners should also be taxed at regular income rates.

D. **Permanently extend the H.R. 5297 exclusions on the gain of Section 1202 qualified small business stock** including removal of the "add back" in the AMT calculation. This could revitalize an important tool for small business financing, particularly if general capital gains rates increase.

E. **Review all tax expenditure provisions and tax rate incentives for their true value** as an economic and employment incentive. Reduce or eliminate those of lesser value. Continue or expand the targeted tax incentives such as business deductions, credits, and accelerated write-offs that most effectively support direct domestic business investment and employment. To get the best impact from tax expenditures do not waste resources on retroactive incentives, or general tax reductions that are not directly linked to increased investment, employment, or other desired economic activity.

F. **Allow the 2001-2003 "Bush" tax cuts to end if they were extended into 2013**, including the lower rates and unlimited reductions for capital gains and dividends.

G. **Enact simple, consistent, targeted tax incentives for business investment in depreciable capital equipment and nonstructural real property** improvements of up to $200,000 in purchases per year. A higher limit could be provided for industry sectors identified in a national economic growth plan as having the highest potential for increasing export sales and American job growth. Limited provisions should also be made to allow deduction of non-structural business real property improvements to property owned by the business owner under the same terms as leased property.

H. **Restore some of the historic progressivity of the tax code** which has been reduced in recent years in both the income tax and estate tax rate structure. Add a 41% tax rate for joint filer taxable income over $5 million until the debt is significantly reduced. Adjust the Estate Tax rate brackets so they apply progressively on taxable estates above the $5 million exclusion. If a lower tax rate is continued on dividend income, limit the lower rate based on the amount of dividend income or total AGI.

I. **Modernize and simplify the tax code, and provide targeted tax expenditure incentives that promote small business growth and job creation.**

- Provide better equality in the Alternative Minimum Tax exemption on small business income with C corporation income.
- Remove the remaining listed property reporting requirements on portable business computers and communication equipment.
- Permanently equalize the deductibility of self-employed health insurance premiums at the business level.

- Limit and simplify state income tax and business activity taxes for out of state businesses which restrict interstate commerce and can add a heavy administrative burden on businesses without significantly increasing total state revenues.

- Improve the incentives for direct equity investment in small US businesses.

- Provide equitable employee “cafeteria” benefit options for pass-through businesses.

- Modernize the outdated “luxury” automobile depreciation limits.

- Update and coordinate all tax code inflationary adjustment provisions.

- Return the contribution date for regular IRA investments to the extended due date to encourage retirement contributions, and change Roth IRA limits to allow direct contributions from higher income individuals without a two-step transfer.

- Revise the tax code provision requiring Form 1099K reporting of payment card processing to require processors to report the net payment amount after credits, cash advances, and processing fees, rather than the gross purchase amount.

A more complete analysis of these issues may be found on our website at www.NationalSmallBusiness.net in the policy paper on “Small Business Tax Code Modernization.”

J. **Expand the roles of the Joint Committee on Taxation and Congressional Budget Office** to provide the Congress with a broader analysis of the long-term economic impacts of proposed tax legislation, including government and private sector administration costs, in addition to the scoring of short term federal revenue impacts.

## 5. Social Insurance Program Recommendations:

The funding deficit for the social insurance programs, Social Security and Medicare, deserves separate evaluation, because they are dedicated programs with a separate payroll tax funding source. Both programs are currently underfunded for their projected future benefit payout and have a negative cash flow. This is a result of rapid growth in benefits paid out for the large number of “baby boomers” now retiring with substantially increased life expectancies, and a declining growth in the working population and average taxable wage base. The problem was compounded by the 2011-12 reduction in the employee FICA tax rate as a short-term economic stimulus. Making these programs sustainable is technically simple, as any insurance actuary knows, and should have been done years ago.

There are only 3 options to restoring stability – Increase the payroll tax rate or maximum wage limit; further limit the benefits to those most in need; or provide additional funding for the programs from general revenue sources. In selecting a balanced solution from those alternatives it is important to remember that the programs were intended as “social insurance” safety nets for those who need them most, not as pre-paid benefit programs for every citizen. People buy many

kinds of insurance every year; even though most never collect any actual benefit from it. If current benefit levels are going to be continued with projected participant levels, payroll taxes would have to increase on current wage earners, with negative economic impacts. The current payroll tax base limits for the programs are also regressive by limiting the tax contributions from higher income wage earners while taxing all the wages of lower income workers.

A. **Increase the Social Security early retirement, and full retirement, ages** to better reflect current life spans and working patterns.

B. **Continue the current method of taxing Social Security benefits to reduce the net after tax benefit** to those with other income. The estimated value of the taxes paid on social security benefits should be transferred from general revenues to the Social Security "trust fund."

C. **Continue to work to reduce the actual cost of health care**, particularly "end of life" care, which is the major cost factor for both individuals and the Medicare and Medicaid programs. The provisions of the 2010 PPACA did not adequately reduce overall health care costs and additional health care cost control reforms are needed including limitations on high cost - low benefit services. For more information on needed health care reforms see our Policy Paper on Health Care Reform at www.NationalSmallBusiness.net/issues.htm .

D. **Remove the Social Security taxable wage limitation so it matches the Medicare program provisions** to increase contributions from higher income individuals**.**

## 6. Workforce and Population Recommendations:

The root cause of any long term governmental deficit is a cost of governmental services that exceeds the economic and tax revenue contribution of its citizens. As a result, an important factor in restoring economic sustainability is the composition and average economic productivity of the US population. Two hundred years ago we had a vast continent, with seemingly unlimited resources and a great need for people to develop it. We now face a different world where technology advances in agriculture, manufacturing, and most other types of businesses, have reduced our need for labor in relation to our GDP. This has been compounded by a "flatter world" which has caused many of our middle income jobs to be "out sourced" to lower cost foreign workers in foreign economies, reducing the domestic economic multiplier of our consumption expenditures.

The percentage of our population, who are unemployed, under employed, unemployable, or prematurely "retired", continues to grow. Many citizens simply do not have the skills needed for todays higher value, higher income jobs. This results in lower per capita economic productivity, lower consumer spending, and greater need for governmental social program expenditures, but with lower per capita income tax and payroll tax revenues to pay for the government programs.

A. **Develop a more comprehensive national economic and workforce redevelopment plan**. Target Federal tax incentives and education programs toward developing the workforce skills needed to compete in the future world economy.

B. **Provide stronger incentives in unemployment and social welfare programs** to get more recipients into retraining and work experience programs. Partner with private businesses, trade groups and state Employment Departments to develop training programs to match specific regional workforce needs.

C. **Provide significant, simple and consistent incentives for business to hire and train military veterans, the disabled and displaced workers.**

D. **Stop avoiding the issue of immigration policy reform.** Review and update US immigration laws to resolve long standing issues such as: the quantities and skills of foreign guest workers needed for the current economy and the process for admitting them; the status and citizenship options of long-term illegal alien residents and their children; and the current need for giving automatic citizenship to children born in the US of non-citizen parents.

## 7. Monetary Policy Recommendations: *The last resort Option*

The last option to reduce the national debt burden is to use the government's ability to simply print more money to pay our national debt. It is the simplest alternative, but also one of the worst. Monetary policy decisions are made by the Federal Reserve Bank, not the Congress. Since August of 2009, the Federal Reserve has increased the M1 monetary supply by over 20% and during the last 12 months it continued to increase it at an 18% seasonally adjusted rate. This is well beyond the growth rate of the economy. Much of this monetary expansion is being used to "purchase" Treasury notes to fund the deficit in an accounting maneuver that would be illegal in the private sector. When the money supply is increased significantly beyond the growth rate of an economy the potential for future inflation and devaluing of the currency can occur.

Much of our money supply is currently absorbed by its role as the world's "reserve" currency for international transactions and foreign bank reserves. If we increase the supply to a level which foreign and domestic holders see as excessive, they may abandon the dollar and move to other currencies or exchange systems resulting in a rapid excess supply of dollars and devaluation. If excessive growth in the money supply results in higher inflation, the true value of every American's savings and investments is reduced and the cost of basic necessities such a food and energy increases. In addition to the negative impacts on every American's life, particularly on our poorest citizens, high inflation rates will increase federal program costs and borrowing interest costs, which may increase the national debt, rather than reduce it.

**Working together, we can correct our fiscal crisis, reduce our national debt, and rebuild a sustainable economy. But, we can only do it if we put politics aside, and Put America first!**

This report was prepared for the National Small Business Network by:
Eric Blackledge and Thala Taperman Rolnick, CPA

National Small Business Network P. O. Box 639 Corvallis, OR 97339

Phone 541-829-0033 Fax 541-752-9631 Email Eric@NationalSmallBusiness.net
Related research and information is available on our website at www.NationalSmallBusiness.net