alliantgroup®

Entrepreneur

The Road Ahead For Entrepreneurs and Tax Reform

There is much talk in Washington about tax reform but what does it mean for entrepreneurs?

BY DEAN ZERBE, former Senior Counsel to the Senate Finance Committee and
alliantgroup National Managing Director

The possibilities of sweeping tax reforms happening in the next year are remote, with the only real glimmer being a possible deal as part of addressing the shutdown/debt ceiling. That's further down the line—call me after the elections, but I would still say it is highly unlikely for the next three years.

Why is that? It is not for lack of effort or commitment by Rep. Dave Camp *(R-MI)*, Chairman of the House Ways and Means Committee, and Sen. Max Baucus *(D-MT)*, Chairman of the Senate Finance Committee. They have certainly been pulling on the oars of tax reform.

In this case, the fault does lie in the stars – i.e., the Congressional leadership and the administration. The two parties leadership roles are poles apart on what they want to accomplish in tax reform, with the Democrats looking to emphasize corporate tax reform and raising significant revenues *(tax increases)* and the Republicans wanting broader business tax reform *(more on that below)* and that reform be revenue neutral *(no net tax increases).*

Another dividing line between the parties has been whether there should be a discussion of only corporate tax reform, which, as readers know, is a primarily bigger entity, or business tax reform, that would encompass all types of businesses *(including pass-thru's such as LLC's, S Corp's, and partnerships)*. Most start-ups are organized as a pass-thru. Chairman Camp has had some success in moving the discussion towards business tax reform, but it is taking a good deal of educating congressmen and senators to understand that most start-ups and the 93 percent of businesses organized as pass-thru's don't benefit from corporate tax reform.

Overlaying these divisions is the simple reality that tax reform is not a priority for the administration. *(Note: I don't say that as a criticism. The administration has other items on its "to do" list. That's fine, but tax* *reform isn't one of them.)* That makes it all the harder for Chairmen Camp and Baucus to push the rock.

So, all that said – if you were going to have tax reform, what are the possibilities that might matter to entrepreneurs?

Capital Gains Tax. Always of interest to investors – the general betting is that capital gains *(currently 20 percent plus 3.8 percent ACA add-on)* would go up in a deal on tax reform. The Democrats have been keen on increasing the rate and bringing it closer in line with taxes for ordinary income *(top rate 39.6 percent plus 0.9 percent Medicare tax).* What has surprised me is what used to be a "never retreat" position of the Republicans gave way in the deal this past January that saw the capital gains rates go from 15 percent to 20 percent. In discussions with Republican staff, the comment was that they just were not hearing of this as a priority from constituents. I could see capital gains going up to 25 percent *(plus the 3.8 percent add-on).*

Dividends. Will stay linked with capital gains. When they go up, so do dividends..

Ordinary Income. While some Democrats will want to see the top rates go up further, this is where the Republicans dig in. The real fight will be on deductions and credits *(think mortgage and charity),* which both sides have indicated some openness to scaling back. The rough difference is that Democrats would use the savings from limiting deductions *(it can be hundreds of billions of dollars over ten years, depending on how you limit the deductions)* for more spending, while the Republicans would use the money to offset lowering the ordinary income rates. Same bed dreaming different dreams. At a minimum, ordinary income rates stay the same, and it's hard to see a deal Republicans are willing to take that doesn't have a reduction in the rates.

Estate and Gift Tax. Nothing happens. This dog sleeps. Some view the estate tax as too generous, some want to eliminate the estate tax. Most members view that this was a good deal *($5 million per person indexed for inflation and 40 percent rates)* and don't want to kick the slumbering hound.

International Tax and Repatriation. No repatriation without international tax reform – no dessert without spinach. Move to a territorial system. Chairman Camp's proposal is the early-bird blueprint for what reform in this area would look like.

Corporate Tax. The corporations are banging for a rate of 25 percent. My read is that the lowest the rates could go *(keeping revenue neutral and getting rid of various deductions and credits)* is around 28 percent. This will not make the corporate folks happy, and they will be even more unhappy when the tax-writing committees get to 28 percent by goring ox and slaying sacred cows. Many of the corporate folks are happy for reform if it gets the rate to 25 percent and does so by getting rid of the other fellow's tax benefits. Awakening will be rude.

Entrepreneurs and Startups. Credit the Senate Finance Committee for putting together a useful compilation of proposals on innovation and startups. In addition to some standards – increased expensing for startups and small businesses, there are also suggested proposals on Section 1202 stock *(expanding dollar caps $75 million and also allow S Corp's and LLC's to be eligible).* Also included is expanding the availability of credits *(especially the R&D tax credit)* to startups and allowing its deduction against the AMT – all good ideas.

As a general note, both sides of the aisle are open to proposals to help startups and entrepreneurs ,and I am interested to hear from readers what they think would be useful for Congress to consider.

The Bottom Line: While tax reform is being talked about, it will be a long and winding road before any big changes in law occur. Entrepreneurs need to not wait for Washington, but they do need to sharpen their pencils to make certain that they are taking full advantage of what is already available at the state and federal level to lower their taxes.

Dean Zerbe is alliantgroup's National Managing Director based in the firm's Washington D.C. office. Prior to joining alliantgroup, Mr. Zerbe was Senior Counsel and Tax Counsel to the U.S. Senate Committee on Finance. He worked closely with then-Chairman and current Ranking Member of the Finance Committee, Senator Charles Grassley (R-IA), on tax legislation. During his tenure on the Finance Committee, Mr. Zerbe was intimately involved with nearly every major piece of tax legislation that was signed into law – including the 2001 and 2003 tax reconciliation bills, the JOBS bill in 2004 (corporate tax reform), and the Pension Protection Act. Mr. Zerbe is a frequent speaker and author on the outlook for short-term and long-term changes in tax policy, as well as ways accounting firms can help their clients lower their tax bill.

SOURCE: http://www.entrepreneur.com/article/229503