Statement for the Record for Associated Builders and Contractors

Testimony of
Rich Shavell

Before the
House Small Business Committee
Subcommittee on Economic Growth, Tax and Capital Access

On
“Tax Extenders and Small Business as Employers of Choice”

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Thank you for the opportunity to appear today in front of your Committee. My name is Rich Shavell, and I am testifying today on behalf of Associated Builders and Contractors (ABC), a national construction industry trade association with 70 chapters representing nearly 21,000 chapter members. I am President of Shavell & Company, P.A., a full service CPA and consulting firm that focuses on services to closely-held commercial contractors. These are the general contractors, subcontractors, highway, and infrastructure contractors who build many of the great projects in South Florida and Southeastern United States.

The subject of this hearing is highly appropriate, as small businesses are indeed the employer of choice for the average American, not only within the commercial construction industry, but throughout the US economy as a whole. They provide the engine for economic growth and job creation, and reflect the spirit of free enterprise in its most basic form. Moreover, small businesses, particularly small contractors are excellent employers for several reasons:

- First, there is plenty of opportunity for workers choosing a career in commercial construction because the industry currently faces a labor shortage. I recently met with a small contractor who must turn down work because he cannot field sufficient numbers of qualified workers - and he is not alone.
- Secondly, training is available for new workers to the industry and in most cases these individuals do not even need to pay for apprenticeship training if they meet certain employment requirements.
- Third, there is excellent money for workers pursuing a career in the commercial construction industry. Via the ABC Institute (www.WeTrain.org) in South Florida, the Department of Labor has quantified the value of being a graduated Registered Apprentice at over $300,000 during the career of the typical worker.¹
- Fourth, the construction industry fosters the realization of the American Dream. The majority of the owners of my clients started out in the field working for someone else. Through effort and determination many construction workers find themselves picking-up small jobs and working them with their peers after hours and on weekends. Anecdotal evidence suggest that seasoned workers can earn significant amounts of money this way until they are ready to leave their regular position to pursue their own businesses on a full-time basis.

The term small business can be parsed in many ways, be it number of employees, amount of annual revenue, or any number of other metrics, but perhaps the most useful proxy is the use of pass-through entities. The pass-through structure is the simplest, most straightforward option for small, closely-held and family-owned Main Street businesses that have little use for the capital markets. As a result, according to a 2011 study by Ernst & Young, nearly 95 percent of all US businesses are structured as pass-through entities.² These pass-through businesses generate 54 percent of all net business income, and employ 54 percent of all private sector employees.³

In other words, small business is the employer of choice for most Americans because that is simply where the jobs are. According to the Small Business Administration, small businesses account for nearly two thirds of all net new jobs.⁴ Construction is no different- according to Tax Foundation analysis of US Census data, the 94 percent of contractors structured as pass-through entities employ over 75 percent of the more than 7.5 million workers employed in the industry.⁵
And, as noted above, given the inherently entrepreneurial bent of the skilled trades, today’s laborer or independent contractor is likely to be tomorrow’s small business employer.

The single biggest challenge facing small business today is widespread uncertainty—uncertain economic prospects, an uncertain regulatory environment, and uncertain tax policy. While the Congress can’t very well control the ebb and flow of the business cycle, it can and must do better to relieve the self-inflicted economic constraints caused by regulatory overreach and anti-growth tax policies.

After years of Congressional showdowns and kicking the can on marginal tax rates, business owners finally got some needed tax certainty in 2013 when the “fiscal cliff” ended in permanent policy for the first time in over a decade. Unfortunately for the pass-through community, certainty is no salve for onerous tax policy. The terms of the fiscal cliff agreement took a 35 percent top rate on pass-through businesses, one that mirrored the C-Corp rate, and raised it to 39.6 percent. With the coincidence of Affordable Care Act implementation (and its associated taxes) in the same year, the combined marginal rate for many Main Street businesses surged nearly 25 percent higher than that faced by the Fortune 500. This sudden structural disadvantage gives a window into why permanence must not be an end goal in and of itself—first and foremost the aim must be to set prudent tax policy that helps the economy and its key driver, the small business.

We ask Congress to now take a step in that direction - of prudent tax policy - by rectifying a problem it put in place almost 30 years ago. In 1986 Congress passed legislation that was intended to curb abuses by aerospace and defense contractors and how they utilized the Completed Contract Method. The required use of the Percentage of Completion Method (PCM) was forced upon all businesses that perform construction services. There were a few carve outs, namely for home builders. But commercial contractors got the short end and have been increasingly paying for it ever since.

A “small contractor” exception was put in place in 1986 with a $10 million average annual revenue threshold, demonstrating Congress’ intent to shield these small businesses. Yet this figure was not indexed for inflation and almost 30 years later the threshold has never been updated. By comparison, the Small Business Administration’s current standard puts the definition of a small contractor in certain construction categories at $36.5 million. Congress needs to do three things:

1. First, update the small contractor threshold in section 460(e) from $10 million to $40 million;
2. Index the threshold going forward; and
3. Eliminate the Section 56(a)(3) add back requirement for Alternative Minimum Tax (AMT) purposes.
This third item eliminates the requirement that long-term contracts be reported under the PCM solely for AMT purposes. And a further horrific result is that the small contractor must then go through complex computations under the look-back method solely for AMT purposes. By eliminating the AMT adjustment, as we recommend, this onerous look-back requirement is eliminated for so many small businesses.

Next Congress needs to finally address the so-called tax “extenders,” the 52 tax provisions and incentives that expired at the end of 2014, just days after having been renewed retroactively. These assorted tax provisions have little in common, other than the fact that they are temporary, and now, having been lumped together at some point over the years, are presumed to be extended each year in perpetuity. The problem, of course, is that many (if not all) of these provisions are premised upon stimulating or otherwise incentivizing economic behavior, so unless enacted well in advance they yield diminishing returns. While Congress may be able to go back and retroactively extend tax policies to apply to the previous year, contractors don’t have the same luxury with their capital investments and business planning.

This year is a perfect example of the trouble with the current practice. As the year end approaches, the small business owner must project their 2015 taxes both with and without these tax provisions. They are left with a terrible choice: pay-in more taxes based on these laws not being effective or take the chance that the law will be passed. This is no way to do business, and the cash flow impact can limit expansion plans, force contraction, affect hiring decisions and even employee benefits that may or may no longer be available to employees.

Going back to the imperative of prudent tax policy, it is incumbent on Congress to go through these measures line by line to determine what belongs in the underlying tax code, and what should be allowed to expire or stand on its own merits, however temporarily, without hijacking the broader package.

The House has already done yeoman’s work in separating out broad based tax policies from rifle shot carve-outs, passing half a dozen key extender provisions on a permanent basis, and establishing a strong bipartisan agreement in favor of tax relief and certainty for small business. These bills include top priorities for ABC and the construction industry, in particular making permanent increased expensing under Section 179 and 50 percent bonus depreciation, respectively.

In a capital-intensive business such as construction, expensing and accelerated depreciation create a tremendous incentive to invest in equipment that might otherwise be cost prohibitive. The ability to write off up to $500,000 in qualified purchases under Section 179 strongly encourages this sort of spending, while the precipitous drop to $25,000 under current law (after the expiration of last year’s extenders bill) would have a disastrous effect, as cautious contractors opt to delay or forego these purchases altogether. More cavalier counterparts, on the other hand, are stuck with big ticket items and an unexpected tax bill as they find themselves unable to utilize these anticipated accelerated deductions.
Likewise, traditional extenders such as the research and development (R&D) tax credit enjoy a wide, bipartisan consensus in Congress and should be made part of the permanent code. The R&D credit in particular has been extended 16 times since 1981, and is effectively viewed as part of the code, but in the meantime has turned into a must-pass vehicle for extraneous policy to attach itself to. Other sensible policies supported by contractors needlessly tied up in the extenders include:

- 15-year straight-line cost recovery for qualified leasehold, restaurant and retail improvements;
- the abbreviated five-year built-in gain holding period for S Corporations;
- the 179D deduction for energy efficient commercial buildings;
- Empowerment/Enterprise Zone Credits; and
- Work Opportunity Tax Credits

Small businesses are the employer of choice for most Americans, but without a commitment – and action - by Congress this status may be soon jeopardized. Congress needs to:

- End the annual extenders debacle and make permanent those provisions that belong in the underlying code.
- Fix the unfortunate and unintended accident of 1986 whereby all construction contractors regardless of size are now forced to report income under the percentage-of-completion method; and
- Address the recently inflated income tax rates that now befall profitable small businesses structured as pass-through entities.

Some of this can be done piecemeal, through easy fixes, such as reform of the small contractor definition under Section 460(e); others will require the political will to pass broad-based, fundamental tax reform. Until these issues are addressed, small business is playing with one hand tied behind its back.

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iii Ibid.