

**Testimony of
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House Finance Committee
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The National Federation of Independent Business is Pennsylvania's leading small-business organization representing 14,000 small and independent businesses in the Commonwealth and about 325,000 nationwide. 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 Chairmen O'Neill and Wheatley for inviting us here today to speak about the Department of Revenue's collection practices. NFIB has been fielding many questions and complaints from our members about an inordinate number of state tax notices and audits accusing business owners of underreporting income, demanding unusual amounts of documentation, and levying penalties for not making estimated payments, even when payment is made timely and in full.

These notices have caused quite a bit of concern amongst our tax preparer and accountant members, whose clients continue to come with them in hand for help, as well as our small-business members who have received them. We are glad for the opportunity today to pass on much of the information they have shared with us on their experiences.

Small businesses create two out of every three net new jobs and employ almost half of Pennsylvania's private workforce. Despite their critical importance to the economy, small businesses are heavily burdened by the costs of government regulation and are particularly sensitive to tax burdens, mainly because the vast majority do not have the luxury of employing in-house staff to navigate tax laws and compliance like larger companies do.

As a result, the cost for small businesses to comply with the current tax code is 66% higher than for larger companies. The cost of tax paperwork—as much as \$74 per hour for preparation and compliance—is the most expensive burden that government imposes on small-business owners.

NFIB has heard dozens of stories in recent months from many of our tax professionals and small-business owners about intimidating and nerve-wracking notices they or their clients have received from the Department of Revenue. The stories come with frustrating accounts of delayed

refunds, unexpected charges without prior notice, threats to revoke tax licenses even when filings were current, and uncertainty about how to appeal or how to comply. Calls to the Department of Revenue have not always been helpful. The biggest complaints we have fielded about this deluge of notices is that, after complying with a tight timeframe for a response (often 15 days) and being pulled away from their work to respond, business owners often got no response, and a few months later, they got a second notice as if they had never completed the first.

One common notice is a letter from the Bureau of Individual Taxes informing the taxpayer that the department is conducting a review of the owner's personal income tax return and requiring additional information related to a line on the PA Schedule C. The letter then requests a vague and inordinate amount of documentation to support claims the taxpayer has made. We have heard numerous variants on this notice.

A grocery market owner in a rural area received this notice a few months ago requesting that he "provide detailed breakdown and documentation to support the amount claimed for cost of goods" purchased for his market. The owner was stunned by the vagueness of the request and was not sure how to respond. He called the Department of Revenue and was told that he should just provide a breakdown by category and a sampling of "maybe six invoices." The categories in his grocery business are rather broad, including grocery, tobacco, meat, and gas items, etc., and six invoices are not representative of the scope of his business. He found the request highly unusual and somewhat intimidating, but put in many hours of his time to craft a response.

Another notice is the result of the department extrapolating expected income from gross credit card sales or other third-party data and flagging a business whose reported income does not match the expected total. Based on data used in the extrapolation, some businesses are flagged for a notice if they fall outside the expected income range. The businesses targeted for these notices are questioning how the Department of Revenue determined the numbers because the expected revenue on the notices is sometimes shocking.

A furniture store that reported around \$900,000 in sales in a recent year received a notice from the Business Pass Through Office asking for documentation because they were expected to have reported \$1,960,000 that year based on the extrapolated calculation from gross credit card sales. The owner spent all summer providing documentation and answering questions, all while he and his brother were conducting a going-out-of-business sale for their family's three-generation, 112-year-old-business. The issue was finally resolved after several months of trouble and no more tax or interest owed. But had their income been as high as the department expected, the going-out-of-business sale may not have been necessary!

A home cleaning business member also received this notice, which alleged an additional tax liability of almost \$2 million. Further investigation revealed that the department estimated sales based on the business's NAIC code and assumed it was a commercial cleaning business and not a home cleaning business.

This particular business pursued the issue because of the amount of the alleged tax liability. It is very likely that many small businesses with smaller—but not insignificant—bills end up paying them rather than assume the cost of fighting them.

During this year's amnesty period, many business owners reported receiving notices of tax due that had been previously resolved. One tax professional said this was the case for as many as 50% of the notices her clients received. Others questioned whether it was appropriate for the state to have the authority to claim taxes it says were owed from many years ago, one as far back as 1979, having never previously notified the taxpayers of the liability.

Lastly, business owners have sometimes received notices that defy logic. One received a notice via certified mail from the Bureau of Collections and Taxpayer Services notifying her that she must appear at a scheduled conference to resolve the matter of \$2.17 due.

To encourage economic growth and investment in Pennsylvania, tax policy should be competitive with other states and not make compliance with our tax laws difficult and intimidating for small businesses. While NFIB is supportive of efforts to assist taxpayers to comply with our tax laws, we would also ask that consideration be given to the cost to our state's economy of imposing this enforcement burden on our small business men and women.

To this end, we would like to suggest the following steps be considered when discussing improvements to the process:

1. **Provide reasonable due dates to respond to notices.** The documentation requested often requires more time to compile than the notice provides.
2. **Offer a more specific description of the documentation that is being requested.** "Documentation to support the amount claimed" is not sufficiently descriptive. Providing a timeframe, number of invoices, or other more detailed description of the information requested would be most helpful.
3. **Acknowledge when a customer's response to a notice was received.** Even if the response has not yet been processed, providing acknowledgement by letter that the response was received by the department would reassure the customer. It would also be helpful if the department could ensure that a second notice would not be received by those who already responded to the first.
4. **Improve contact with the department for questions and clarification.** Customer service agents answering the phone should have the information they need to answer questions. Another way to contact the department, other than the phone number provided on the notice, would improve communication as well (for example, email or more helpful information on the website).
5. **Do not pursue tax collections where the cost to the state and the taxpayer clearly exceeds the amount of tax to be collected.**
6. **Consider providing a statute of limitations on the assessment and collection of taxes,** as is the case with the IRS and in many other states.

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.