

Statement for the Record

by

Coalition to Promote Independent Entrepreneurs



**Early Impressions of the New Tax Law**

before the

Committee on Finance  
U.S. Senate

April 24, 2018

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Entrepreneurs  
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The Coalition to Promote Independent Entrepreneurs (the “Coalition”) respectfully submits this Statement for the Record concerning an April 24, 2018, hearing before the U.S. Senate Committee on Finance on “Early Impressions of the New Tax Law.”

The Coalition consists of organizations, companies and individuals dedicated to informing the public and elected representatives about the importance of an individual’s right to work as a self-employed individual, and to defending the right of self-employed individuals and their respective clients to do business with each other. We appreciate the opportunity to submit this statement setting forth our views on how we believe the *Tax Cuts and Jobs Act* (P.L. 115-97) will have a positive impact on individual entrepreneurship and the overall economy.

The Coalition’s Statement focuses on only one aspect of the *Tax Cuts and Jobs Act*, namely the newly enacted section 199A of the Internal Revenue Code of 1986, as amended (the “Code”). We believe this provision encourages independent entrepreneurship, which will lead to increased economic growth and efficiency and a more engaged and satisfied workforce. We applaud the Congress and President Trump for enacting this new provision.

## **I. New Code Section 199A Will Encourage Independent Entrepreneurship**

New Code section 199A creates a new tax deduction – of up to 20% – for pass-through entities, which include certain independent contractors. This new tax deduction offers an important new financial incentive for individuals who pursue their entrepreneurial aspirations.

The new tax deduction is available to an individual taxpayer for “qualifying business income” from certain pass-through business activities, including business income from a sole proprietorship. Because independent contractors operate sole proprietorships they are eligible to claim the deduction. The new deduction could provide qualifying independent contractors with significant tax savings.<sup>1</sup>

The deduction, among other things, helps mitigate the financial consequences of the disparate treatment of independent contractors relative to employees for purposes of Social Security and Medicare contributions. Independent contractors are required to pay 100 percent of their Social Security and Medicare contributions, in the form of Self Employment Contributions Act (“SECA”)<sup>2</sup> contributions, while employees pay 50 percent, in the form of Federal Insurance Contributions Act (“FICA”) contributions<sup>3</sup> (through employer withholding)<sup>4</sup> with the remaining 50 percent being paid by their employer.<sup>5</sup> Since the new Code section 199A deduction is available

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<sup>1</sup> For a typical independent contractor whose taxable income for the tax year does not exceed the threshold amount, currently defined as \$157,500 per year or \$315,000 if filing a joint tax return, the Code section 199A deduction, subject to certain exceptions, would be the lesser of: (i) 20 percent of the taxpayer’s qualified business income amount or (ii) 20 percent of the taxpayer’s taxable income. For an analysis of the Code section 199A deduction as it applies to independent contractors *see* Russell A. Hollrah & Patrick A. Hollrah, *New Passthrough Deduction Creates Tax Benefit for Self-Employed*, TAX NOTES, Feb. 2018, at 1051-55.

<sup>2</sup> Code section 1401.

<sup>3</sup> Code section 3101.

<sup>4</sup> Code section 3102.

<sup>5</sup> Code section 3111.

to independent contractors, but not employees, the deduction can help mitigate the financial consequences of this difference.

Even when considered without regard to any other tax provision, the new Code section 199A deduction could provide a powerful incentive for individuals to pursue self-employment, as it will encourage individuals to take the risk associated with individual entrepreneurship by permitting self-employed individuals to retain a greater portion of the income they earn.

## **II. Independent Entrepreneurship Should Be Encouraged Because it Increases Economic Growth and Efficiency**

Independent entrepreneurship represents financial self-sufficiency and promotes market flexibility and business efficiency. The Coalition submits that these are ideals that a government should encourage and support, as they lead to a strong and resilient economy.

### **A. Independent Entrepreneurship Increases Economic Growth**

By encouraging independent entrepreneurship, new Code section 199A could lead to increased economic growth by expanding the formation of new businesses and creating new job opportunities, while increasing labor-force participation and reducing unemployment.

A 2010 study on independent contractors found that independent entrepreneurship increases economic growth and efficiency.<sup>6</sup> The study identified a strong correlation between independent contracting, entrepreneurship, and small business formation.<sup>7</sup> To be sure, it found that “of the 10.3 million independent contractors identified in the 2005 CAWA survey, nearly 2.4 million had one or more paid employees.”<sup>8</sup> Furthermore, the study concluded that independent contracting “provides a first-step on the ladder to starting a small business, and creating jobs for others.”<sup>9</sup>

Individual entrepreneurship also offers a gateway out of unemployment or underemployment. A McKinsey Global Institute study concluded that independent work<sup>10</sup> may help the unemployed by providing “a critical bridge to keep earning income while they search for new jobs.”<sup>11</sup>

Several recent studies analyzing independent-contractor relationships quantified their economic impact. A January 2017 study found that “independent contractors played a large role in the economic recovery. Between 2010 and 2104, independent contractors grew 11.1 percent

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<sup>6</sup> See generally, Jeffrey A. Eisenach, *The Role of Independent Contractors in the U.S. Economy*, at 30-40 (Dec. 2010) (“Eisenach Study”), <https://iccoalition.org/wp-content/uploads/2014/07/Role-of-Independent-Contractors-December-2010-Final.pdf>.

<sup>7</sup> *Id.* at 36.

<sup>8</sup> *Id.* at 36.

<sup>9</sup> *Id.* at 42.

<sup>10</sup> The independent workforce includes: self-employed, independent contractors, freelancers, some small business owners, and many temporary workers, including those who get short-term assignments through staffing agencies. “*Independent Work: Choice, Necessity, and the Gig Economy*,” MCKINSEY GLOBAL INSTITUTE, 20 (Oct. 2016) (“McKinsey Study”).

<sup>11</sup> *Id.* at 14.

(2.1 million workers) and represented 29.2 percent of all jobs added during that time period.”<sup>12</sup> The new establishments created by these 2.1 million workers generated nearly \$192 billion in revenue from 2009 to 2014.<sup>13</sup> In the ridesharing industry, alone, the study found that the independent-contractor opportunities provided by ridesharing companies (e.g., Uber and Lyft) generated an additional \$573 million in revenue during 2014.<sup>14</sup>

Similarly, economists Lawrence Katz and Alan Krueger conducted an extensive study of alternative work arrangements – which is a broader category that includes independent contractors – and found that “all of the net employment growth in the U.S. economy from 2005 to 2015 appears to have occurred in alternative work arrangements.”<sup>15</sup>

Additional studies have found that independent entrepreneurship is often as lucrative, if not more lucrative, than full-time employment.<sup>16</sup> A recent study of freelancer workers – a group that includes independent contractors and other contingent workers – estimated that 57.3 million entrepreneurs earned \$1.4 trillion in income from freelancing during 2017.<sup>17</sup>

The many documented positive effects of independent entrepreneurs on the nation’s economy demonstrate the wisdom of government policies, such as new Code section 199A, that incentivize independent entrepreneurship.

## **B. Independent Entrepreneurship Increases Economic Efficiency**

The above-referenced 2010 independent contractor study<sup>18</sup> also found that independent-contractor relationships increase economic efficiency. These relationships promote workforce flexibility and efficient contracting by permitting contracting companies to engage independent contractors as needed instead of being forced to hire full-time employees who may be over or underutilized depending on business demand.<sup>19</sup> This, in turn, provides contracting companies with increased cash flow to invest in hiring or expansion, which can generate additional economic activity.

Another positive attribute of independent entrepreneurs is that they are liberated to work for a variety of different clients,<sup>20</sup> and can “enter, exit, or participate partially in the labor force as

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<sup>12</sup> Ben Gitis et al., *The Gig Economy: Research and Policy Implications of Regional Economic, and Demographic Trends*, American Action Forum 7 Aspen Institute’s Future of Work Initiative, 8 (Jan. 10, 2017).

<sup>13</sup> *Id.* at 18.

<sup>14</sup> *Id.* at 20.

<sup>15</sup> Lawrence F. Katz & Alan B. Krueger, *The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015*, NATIONAL BUREAU OF ECONOMIC RESEARCH WORKING PAPER NO. 22667, 7 (September 2016). The term “alternative work arrangements” includes independent contractors, on-call workers, temporary help agency workers and workers provided by contract firms.

<sup>16</sup> See *Freelancing in America: 2017*, Edelman Intelligence (Commissioned by Upwork and Freelancers Union) 43 (Sept. 2017); JOHN HUSING, OWNER-OPERATOR DRIVER COMPENSATION 8, 14 (The California Trucking Association and Inland Empire Economic Partnership 2015) available at <http://web.caltrux.org/external/wcpages/wcwebcontent/webcontentpage.aspx?contentid=309>.

<sup>17</sup> *Freelancing in America: 2017*, Edelman Intelligence (Commissioned by Upwork and Freelancers Union) 15, 41 (Sept. 2017).

<sup>18</sup> See above note 6.

<sup>19</sup> Eisenach Study at 31-31.

<sup>20</sup> *Id.* at 31.

they choose.”<sup>21</sup> The 2010 study found that labor force flexibility is correlated with economic growth and job creation, while less flexibility leads to slower growth and higher unemployment.<sup>22</sup> Similarly, the McKinsey Global Institute study found that independent work “enables people to specialize in doing what they do best and what makes them feel engaged. Engagement typically has the effect of increasing productivity ....”<sup>23</sup>

Many studies have found that most independent entrepreneurs prefer independent work relative to traditional employment. One recent study found that in 2017, 63% of freelancers started freelancing by choice, an increase of 10% since 2014.<sup>24</sup> Moreover, 50% of respondents said there is no amount of money which would incentivize them to stop freelancing and instead work at a traditional job.<sup>25</sup> And, what might be surprising to some, the McKinsey Global Institute study found that one in six people in a traditional job would like to become an independent earner. For every one independent worker who would prefer traditional employment, two traditional employees would prefer to move in the opposite direction.<sup>26</sup>

The foregoing data suggest that the incentive toward independent entrepreneurship that Code section 199A provides can be expected to increase economic efficiency and worker productivity.

### **III. Independent Entrepreneurs Are a More Engaged and Satisfied Workforce**

In addition to the positive impact individual entrepreneurship can have on the nation’s economy, this type of work also offers profound benefits to the individuals themselves.

A recent study drawn from psychology and sociology and based on data collected on nearly 5,000 individuals in the United Kingdom, the United States, Australia and New Zealand who work in a wide variety of vocations including health, finance and education, found that self-employed individuals reported significantly higher levels of “job engagement” than organization employees.<sup>27</sup> The term “job engagement” measures a higher energy level associated with task involvement.<sup>28</sup> The authors suggest that their finding that self-employed individuals tend to be significantly more “engaged” in their work could arise from greater energy inherent in feelings of engagement.<sup>29</sup>

Self-employed respondents were also found to value “challenging” aspects of work more than organizational employees, which contributes to their higher levels of job engagement.<sup>30</sup> In this context, the authors explain that job features that “challenge” an individual include financial

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<sup>21</sup> *Id.* at 39.

<sup>22</sup> *Id.* at 39.

<sup>23</sup> McKinsey Study at 14.

<sup>24</sup> *Freelancing in America: 2017*, Edelman Intelligence (Commissioned by Upwork and Freelancers Union) 25 (Sept. 2017).

<sup>25</sup> *Id.* at 29.

<sup>26</sup> McKinsey Study at 7.

<sup>27</sup> Peter Warr & Ilke Inceoglu, *Work orientations, well-being and job content of self-employed and employed professionals*, WORK, EMPLOYMENT AND SOCIETY, 8 (Aug. 2017) (“Work Orientation Study”).

<sup>28</sup> *Id.* at 4.

<sup>29</sup> *Id.* at 17.

<sup>30</sup> *Id.* at 12.

and organizational responsibility, competition with others, demanding tasks, difficult decision-making, and the requirement for innovation, personal independence and autonomy.<sup>31</sup>

Studies have consistently found self-employed individuals to report higher levels of “job satisfaction” relative to organizational employees,<sup>32</sup> especially among nonmanagerial employees.<sup>33</sup>

The characteristics the studies found to be associated with the self-employed, such as working at a high energy level, valuing challenging aspects of work, and feeling satisfied with the work, are all characteristics the Coalition submits that government policy should encourage. The *Tax Cuts and Jobs Act* does this through its creation of new Code section 199A.

#### **IV. Conclusion**

The Coalition is supportive of Congressional actions that support and encourage independent entrepreneurship, such as new Code section 199A. Such actions promote economic opportunity and growth and create an incentive for individuals to pursue a path that can empower them to become more engaged and satisfied with their work. For these reasons, our early impression of this provision of the new tax law is strongly positive. The Committee’s leadership in this important area is commendable.

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<sup>31</sup> *Id.* at 5.

<sup>32</sup> See e.g., Eisenach Study at 33-35; U.S. GOVERNMENT ACCOUNTABILITY OFFICE, SIZE, CHARACTERISTICS, EARNINGS, AND BENEFITS, GAO-15-168R 24 (2015) available at <http://gao.gov/products/GAO-15-168R>; FREELANCING IN AMERICA: A NATIONAL SURVEY OF THE NEW WORKFORCE 7 (Elance-oDesk and Freelancers Union, 2014) available at [http://fu-web-storage-prod.s3.amazonaws.com/content/filer\\_public/c2/06/c2065a8a-7f00-46db-915a-2122965df7d9/fu\\_freelancinginamericareport\\_v3-rgb.pdf](http://fu-web-storage-prod.s3.amazonaws.com/content/filer_public/c2/06/c2065a8a-7f00-46db-915a-2122965df7d9/fu_freelancinginamericareport_v3-rgb.pdf).

<sup>33</sup> Work Orientation Study at 12.