

# The Washington Post

## Small Businesses Brace for Tax Battle

Under Obama Plan, Some Entrepreneurs' Bills Would Soar

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Monday, April 27, 2009

Gail Johnson doesn't think of herself as wealthy. The former pediatric nurse has spent 20 years building a chain of preschools and after-school programs that accommodate sick children so working parents can keep their jobs.

But, like most small-business owners, Johnson reports her profit on her personal tax return. In a typical year, she and her husband make more than \$500,000, according to her accountant, a figure that throws them squarely into the ranks of the richest Americans -- and makes them a prime target for the Obama administration's tax policy.

Since last year's campaign, President Obama has vowed repeatedly not to increase taxes for families making less than \$250,000 a year. That pledge, while politically popular, has left him with just two primary sources of funding for his ambitious social agenda: about 3 million high-earning families and the nation's businesses.

Johnson, with her company, falls into both categories. If Obama's tax plans are enacted, her accountant estimates that her federal tax bill -- typically, around \$120,000 a year -- would rise by at least \$23,000, a 19 percent increase.

"You hear 'tax the rich,' and you think, 'I don't make that much money,'" said Johnson, whose Rainbow Station programs are headquartered near Richmond. "But then you realize: 'Oh, if I put my business income with my wages, then, suddenly, I'm there.'"

Across the nation, many business owners are watching anxiously as the president undertakes expensive initiatives to overhaul health care and expand educational opportunities, while also reining in runaway budget deficits. Already, Obama has proposed an extra \$1.3 trillion in taxes for business and high earners over the next decade. They include new limits on the ability of corporations to automatically defer U.S. taxes on income earned overseas, repeal of a form of inventory accounting that tends to reduce business taxes, and a mandate that investment partnerships pay the regular income tax rate instead of the lower capital gains rate.

### 'A Permanent Target'

Business groups say they're bracing for even more battles with the administration.

"They're desperate for revenue. And therein lies the concern of the broader business community," said R. Bruce Josten, chief lobbyist for the U.S. Chamber of Commerce.

"We're going to be a permanent target, and we understand that," added Catherine Schultz, vice president for tax policy at the National Foreign Trade Council. "The way they see it, corporations don't vote."

Obama has proposed some business tax breaks, but those proposals have been dwarfed by the tax increases under consideration, particularly his plan to let tax cuts enacted by former president George W. Bush expire for high earners.

Administration officials say they would simply restore rates in effect during the Clinton administration for every dollar of income over \$250,000 (\$200,000 for individuals). The plan is intended to counter years of rising inequality in which wealth has been concentrated at the top of the income scale.

From 1979 to 2006, after-tax incomes rose by \$863,000 -- more than 250 percent -- for the top 1 percent of households, compared with \$9,200 -- or 21 percent -- for middle-income households, according to a recent analysis of IRS data by the nonpartisan Congressional Budget Office. By allowing the Bush tax cuts to expire next year for upper-income taxpayers -- but keeping the cuts that benefit middle-income families -- Obama has said he hopes to "restore some balance to the tax code."

### **A Big Issue for Small Firms**

Republicans and business groups argue that Obama's plan to tax the rich would strike some of the nation's most productive businesses. Though certain very large companies must organize as separate entities that are taxed twice -- on profits and shareholder dividends -- most smaller businesses opt to be taxed only once by reporting their profits on the personal tax returns of their shareholders.

Most of these businesses make much less than \$200,000 a year, though the precise figure is in dispute. Treasury Secretary Timothy F. Geithner has said the tax increase would affect about 2 percent of taxpayers with small-business income. An analysis by the Bush Treasury Department found that 7 percent of filers with business profit were in the top brackets in 2006. More recently, the nonpartisan Joint Committee on Taxation, which evaluates tax policy for Congress, projected that 3 percent of filers with business profits -- about 750,000 taxpayers -- were likely to face higher taxes in 2011 under Obama's proposal.

Whatever the figure, Republicans argue that those who fall into the upper brackets tend to be firms with the greatest capacity for job creation. In a 2007 survey, the National Federation of Independent Business found that about 15 percent of small-business owners -- and half of those with at least 20 employees -- said they expected their household income to exceed \$200,000. In the Washington region, Census figures show one in seven families earn more than \$200,000 a year.

"For the vast majority of people who earn less than \$200,000, raising taxes on higher earners might not sound so bad. Yet a lot of small businesses are in that category," [Sen. Charles E. Grassley](#) (R-Iowa) said in a recent radio address. "Tell these business owners their taxes will go up; odds are, they'll cut spending . . . stop hiring and lay people off."

That's what worries Johnson. She conceived her business in 1989 while teaching at Virginia Commonwealth University. Through her nursing students' clinical practices, she saw firsthand the problems that a sick child can pose for working mothers, causing them to miss work and putting their jobs at risk. "I started out thinking I could provide a service for kids with acute medical needs," she said.

The idea eventually spawned nine, full-service campuses that serve sick and well children from infancy through age 14. New schools opened last year in Austin, Charlotte and Gainesville, Va., each with about 75 employees.

Johnson declined to say whether she voted for Obama. But she said she ignored his tax plans until her husband, who handles real estate and construction for the schools, mentioned it one day. "I've since talked to my accountant," she said. "And, oh, my gosh!"

The accountant, Carroll Hurst, said Johnson is unlikely to owe any federal taxes this year due to accounting changes that confer a one-time tax benefit. But in a typical year, he said, Johnson and her husband earn about \$515,000 from various entities related to the schools. They claim around \$90,000 in deductions -- much of it contributions to charity -- reducing their taxable income to around \$425,000. Johnson said the sum they take home in wages is "substantially less."

In a typical year, Johnson's federal tax bill would be about \$120,000. But starting in 2011, the higher marginal rates would add about \$13,000 a year, Hurst said. Capping the value of itemized deductions at 28 percent would add another \$10,000, for a total increase of \$23,000.

And Johnson's tax bill stands to grow dramatically if Obama were to revive a plan to apply Social Security tax to income over \$250,000 instead of capping it at the current \$106,800. Because Johnson is an employee and an employer, she would have to pay both portions of the tax, Hurst said, tacking another \$30,000 onto her bill.

Johnson said such an increase would force her to consider scaling back operations.

"You can try to pass it on to consumers. But if you raise tuition, you put pressure on family budgets," she said. "For us, we're caught between the devil and the deep blue sea."

Other business owners are also nervous. Jim Murphy, president of EST Analytical in Fairfield, Ohio, which sells analytical instruments to environmental testing labs and pharmaceuticals, said his company is struggling in the sluggish economy. But if profit returns to pre-recession levels -- about \$455,000 -- Murphy said his accountant estimates that Obama's proposals could add \$60,000 to his \$120,000 tax bill.

"The misconception is that guys like me take [our profits] and put it into our pockets," said Murphy, who employs 47 people. "But the money the company earns in a given year is used to buy additional inventory so we can grow and hire." A 50 percent tax increase, he said, would be "really painful."

Not all business owners are complaining. Marc Friedman, who earns about \$350,000 a year operating Ace Hardware stores in the District and Baltimore, said he wouldn't mind the extra \$35,000 to \$50,000 he stands to lose to the IRS.

"The small-business community feels there's a disproportionate amount of tax placed on us, and it's true," Friedman said.

But government services "can't be paid for equally by everyone," he said. "It's a big burden, but we're fortunate to be successful."