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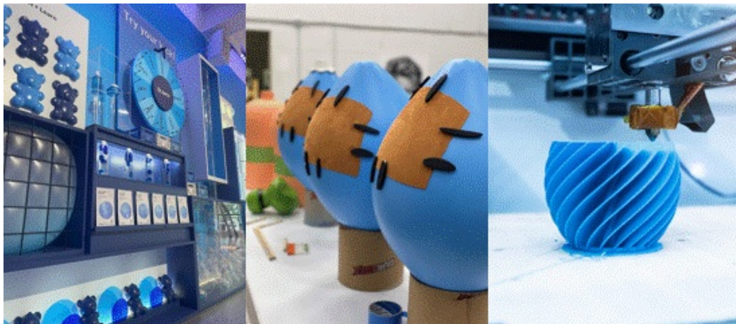

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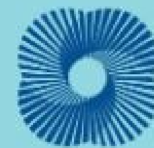

YOUR Orange County Chamber of Commerce recently attended the US Chamber of Commerce's State of American Business. What follows is our recap...

Economic insights on factors impacting small businesses and expectations for the current year are provided by Neil Bradley, Executive Vice President, Chief Policy Officer, and Head of Strategic Advocacy at the US Chamber of Commerce in Washington.

The economic performance in the fourth quarter of 2023 and throughout the preceding year has been exceptionally strong, exceeding our normal average. The overall growth rate for the economy was 3.1%, with the fourth quarter showing even better results at 3.3%, indicating an acceleration towards the end of the year. Despite concerns about a potential recession in 2023, the unemployment rate stands at 3.7%, reflecting an incredibly tight labor market by historical standards.

Contrary to earlier predictions, the US Chamber of Commerce, with a sense of pride, did not anticipate a recession. Conversations with businesses of various sizes and across different industries revealed intriguing insights. Many businesses expressed concerns about the national economy but were optimistic about their local economy and, in particular, their own businesses. Common challenges voiced included the struggle to meet growing demand. This divergence between national narratives and on-the-ground business experiences suggests that the broader economic landscape might not have been fully captured by national stories and numbers.

In summary, the overall economic outlook is positive, showcasing a robust performance

that defied earlier fears of a recession.

Inflation:

Inflation is showing signs of slowing down, prompting questions about what to anticipate in the coming year. The unease and pessimism expressed by many stem from the fact that the inflation experienced in the past couple of years have been unprecedented in the last 40 years. For the majority of Americans, this level of inflation is unfamiliar, and it has posed a substantial challenge to the economy. To address this issue, the Federal Reserve increased interest rates, though the targeted 2% inflation rate has not been achieved yet. Nevertheless, there is a noticeable trend toward that goal, even in volatile sectors like energy, where gas prices are decreasing, contributing to the alleviation of inflationary pressures. This positive trajectory suggests that we are heading in the right direction, with the potential to sustain economic growth while reducing inflation—a favorable outcome for everyone.

Looking ahead to the rest of the year, many observers turn their attention to the Federal Reserve for insights into potential actions. Current forecasts indicate a range of four to six rate cuts, with the more aggressive estimate leaning towards six cuts and the conservative estimate hovering around four. These cuts are anticipated to commence in the upcoming months, with the majority occurring in the latter half of 2024. While the prospect of six cuts may seem relatively high, it aligns with the existing economic data. However, a crucial consideration is the Federal Reserve's reliance on data, with a primary concern being the stabilization of inflation. If there are indications that inflation is resurging, some of the anticipated rate cuts may not materialize. For those less familiar with these intricacies, it's important to note that any rate cuts are likely to be incremental and small over time. While quarter-point rate cuts are typical, there is a possibility of larger adjustments based on the Federal Reserve's data-dependent approach. Overall, the expectation is for small rate cuts, but flexibility is warranted based on evolving economic conditions.

Labor Market:

The unemployment rate is currently very low, which is generally favorable for the overall economy. However, for small business owners attempting to hire, it presents challenges in terms of recruiting, retaining employees, and navigating a competitive labor market that has persisted for the past couple of years. Despite claims of a cooling labor market and a diminishing worker shortage, the reality contradicts these assertions. Examining the data reveals that there are about 71 people available for every 100 open jobs. This ratio, although seemingly improving compared to a year ago, remains notably tight by any standard.

Contrary to the normal scenario in 2019, where there were more people looking for work than advertised open jobs, the current situation indicates a scarcity of available workers. This challenging landscape is not solely attributed to the effects of the COVID-19 pandemic but also involves factors like early retirements, shifts from dual-income to single-income households, and individuals leaving paid employment to start their own businesses. An essential factor contributing to this tight labor market is demographic, with the retirement of the baby boom generation leading to a decrease in available workers.

The assertion that the current labor shortage is temporary and will soon be resolved overlooks the demographic realities of our country. The retirement of the baby boom generation has created a sustained impact, leading to what is referred to as the "silver tsunami," establishing a new normal in the labor market.

In response to the challenges of hiring, especially for small businesses, leveraging natural benefits becomes crucial. Small businesses, often perceived as familial and offering greater flexibility compared to larger establishments, can emphasize these aspects to attract potential employees. Additionally, addressing legal immigration is deemed necessary to ensure a more accessible and regulated inflow of individuals capable of working legally. Embracing innovation, automation, and artificial intelligence emerges as a positive trend among small businesses, helping them become more efficient and productive. The narrative surrounding AI, often overshadowed by concerns about job displacement, should be viewed positively as a tool that fills jobs that are challenging to fill, contributes to the growth of small businesses, and aids in meeting demand. Disregarding

pessimistic headlines, the integration of technology is a positive and transformative story for small businesses.

Compliance:

There is a recent regulation pertaining to individuals known as independent contractors, sometimes referred to as 1099 employees. Under the previous rule, consideration focused on whether the business exerted direct control over the individual's work and whether the individual had the autonomy to determine their working hours and financial outcomes. The change introduces what is claimed to be a six-part test, but in essence, it incorporates seven parts, including aspects like indirect control, reserved control, and an examination of tools utilized. This adjustment introduces considerable uncertainty in the classification process.

The significance of proper classification lies in the potential consequences if the Department of Labor identifies a misclassification. It is noteworthy that they will not inform a business of misclassifying someone as an employee; penalties, fines, fees, and back taxes will only be pursued for misclassifying someone as an independent contractor.

If a business heavily relies on independent contractors, it is advisable to review existing policies and assess whether there is any perceived or alleged exertion of control over these individuals. Consultation with legal or HR professionals is recommended to gauge any potential risks. The key is not to hastily eliminate independent contractors, recognizing their importance in business operations. Instead, businesses should conduct a thorough review, seek professional advice, and monitor developments since the regulation might face legal challenges or be subject to alterations that could impact its implementation.

During this tax season, small businesses should be attentive to potential last-minute tax changes enacted by Congress that may retroactively apply to the previous year. Congress is currently deliberating on a bill that extends certain expired provisions related to interest deductibility, the ability to expense Capital Investments, and notably, the capacity for small businesses to expense Research and Development (R&D) expenses rather than amortizing them.

Many small businesses are just becoming aware of a recent rule change by Congress, where instead of expensing employees' salaries working on new products, they now have to amortize these costs over an extended period. This alteration is expected to impact about 3 in 10 small businesses, with an average tax increase of approximately $58,000. Particularly, sectors like manufacturing and technology are likely to experience tangible effects. The legislation aims to eliminate this tax increase, reverting to the old law. This bill is anticipated to be introduced in the House soon and, hopefully, in the Senate. Beyond addressing R&D expenses, it includes other aspects that businesses should be attentive to. For instance, the bill raises the reporting threshold for independent work or sales from $600 to $1,000. Furthermore, it introduces substantive changes to the process of claiming the employee retention tax credit.

Concerning the employee retention tax credit, which has garnered attention in the news, the IRS halted processing claims while still accepting them due to concerns about fraudulent submissions. Some unscrupulous individuals were persuading businesses to submit dubious applications. In response, Congress is proposing stricter penalties for those assisting with such claims, along with more stringent safeguards. Importantly, the proposal states that claims for the employee retention tax credit filed after the end of January of this year will not be accepted.

For businesses with pending claims, a careful review is advised. If confident in qualification, proceeding with the claim is recommended, as the funds are owed under the law. However, if eligibility is questionable or if one believes they don't qualify, the IRS is providing the option to withdraw the application or submit additional information without penalties. Taking a moment to assess the situation can prevent potential penalties and ensure a smoother process with the IRS.

The Corporate Transparency Act, also known as the Beneficial Ownership Information Reporting Rule, is a recent congressional regulation that has come into effect, impacting small businesses. This rule mandates companies to disclose information about their

beneficial owners to the government, outlining who owns the company. Ownership, in this context, encompasses any entity or individual holding a 25% or greater stake in the business or exercising control over it, even if their ownership share falls below the 25% threshold.

For businesses formed before January 1, 2024, there is a one-year window to report this information to the government. In contrast, businesses formed after this date must report within 90 days of creation. Additionally, the reporting requirement extends beyond merely identifying owners; it also includes disclosing if someone directed or facilitated the filing or creation of the business.

The government's primary objective with this rule is to curb the use of shell companies for illicit activities such as money laundering and other illegal purposes. While this regulation poses an unfortunate burden for the vast majority of businesses that are entirely legitimate, it serves the purpose of enhancing transparency and preventing the misuse of business structures for unlawful activities.

Overall, the economic outlook appears positive, but small businesses are encouraged to stay informed, adapt to regulatory changes, and leverage technology to navigate challenges effectively.

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