Testimony of Kris Carpenter
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Sanctuary Spa & Salon
Billings, Montana
Before the United States Senate Finance Committee

June 28, 2011

Chairman Baucus and Members of the Committee, my name is Kris Carpenter and I am a salon and spa owner from Billings, Montana. Thank you for the opportunity to testify before you about what I have experienced in my industry regarding tax compliance.

I opened Sanctuary in 1998 and have been in business for 13 years. In 2010, I opened 2 new businesses: The Joy of Living-a gift store for women and The Joy of Kids-a children's gift store. I employ 40 women in my 3 businesses, 22 of them are salon and spa service providers that accept tip income and 8 guest service members receive tips from a tip-out pool provided by the service providers.

In addition to running my salon and two other retail businesses, I am a member of the Professional Beauty Association (PBA). PBA has over 8,000 members representing salon and spa owners, manufacturers and distributors of salon and spa products, and individual licensed cosmetologists.

Small businesses are the backbone of America's economy and the salon industry is an industry of small businesses. 82% of salon establishments with payroll employees have fewer than 10 payroll employees. According to 2008/2009 data, the salon industry is a vibrant and growing part of the U.S. economy, with more than 900,000 establishments and annual sales of nearly $40 billion. More than 1.1 million professionals work in personal appearance occupations industry-wide and one out of three do so in self-employment rather than employment-based situations; a fact that is central to the salon and spa problem of tax complexity and compliance.

Senator Snowe's introduction of S. 974, the Small Business Tax Equalization and Compliance Act, is promising news to me and my fellow salon owners. The legislation originally came about because salon owners, like me, contacted Congress about the widespread problems associated with tip reporting. In addition to extending existing law to permit salon employers to claim the 45(b) tip tax credit that's currently available only to restaurant employers with tipped employees, the bill also provides much needed assistance to the federal government by improving tip reporting in all sectors of the salon industry.

The expanded credit is a matter of fairness and directly relates to compliance issues. Like the restaurant industry, salon owners must collect and report tip information from its employees to the Internal Revenue Service (IRS), and pay FICA taxes on the reported tips. However, unlike the restaurant industry, salons are not eligible to claim the tax credit for FICA taxes paid on tips.

The credit would also serve as an offset to the significant costs related to complying with tip tax laws. We must educate employees about tip reporting laws, persuade our employees to comply, keep records of reported tips, and report the income to the IRS. Additional costs of accepting tips on credit cards along with the fact that many credit card companies charge extra fees for tip transactions add to a small business owner's costs. The salon employer is facing a matching FICA liability equal to 7.65% of tips earned and the additional administrative costs. The actual full cost to the employer is closer to 10%. The extension of the 45(b) tax credit to salon owners will bring needed tax relief to help offset the costs of complying.

One of the greatest compliance challenges as an employer is being put in an adversarial position with employees in an industry where employment isn't the only way to receive income. Worker classification is the issue that separates salons from other tipped industries. Unlike most tipped industries, a significant segment of the salon industry is classified as self-employed. While two salons may look the same, one may classify the people behind the chairs as employees while the other may classify its workers as self-employed (or independent contractors). The focus on tips in employment situations is encouraging employees to leave employment for self-employment, and leads employers to reclassify their workers as self-employed.

The bottom line is that the tip-reporting burden is greatest on small business owners and compliance efforts need to be approached with these dynamics in mind. Self-employment is significant and growing. If casino employees are expected by their employer to report all of their tips, they cannot unplug their roulette tables and set up down the street. A waitress cannot just take her tables and open a basement cafe. But a hairdresser or massage therapist can easily find a less formal "self-employment" situation, where there is no employer to withhold from them.

The compliance portion of S. 974 adds simple information reporting requirements to salons with employees and salons that classify their workers as self-employed, in addition to requiring that salon owners provide educational materials to their workers on tip reporting.

While it is possible that some individuals working in such a manner report all of their tips and income as self-employment income, it is well documented that the lack of third party reporting and withholding reduces compliance. There is no question that the greatest source of compliance is a paycheck subject to withholding. So what's at risk here for salons is not only the reporting of tips and the related expense, but the loss of employees. What's at risk for the Treasury is not just the reporting of tips, but the reporting of income altogether.

Submitted with this testimony is an overview of the salon industry that indicates the size of the non-employed sector.

These are not just statistics for me. In 2010, the average hourly wage of all of my 22 service providers (half are full-time and half are part-time employees) was $14.31 an hour and the average reported tip income was $6.33 an hour before their 10% tip-out to support staff (who pay their own taxes on the tip-out). I pay my employees a fair wage, pay 65% of full-time employee's health insurance premiums, and provide them with a 401(k) and profit sharing opportunities. (Benefits you would not find in a "self-employment" position.)

Ten years ago, Sanctuary began recording in our point of sale software the tips received by our employees. It is recorded for the employee in the guest's name and the amount of tips received. Daily, our bookkeeper deposits the tip income into a tip holding checking account until the next payroll date when the tips are paid to the employees along with their regular paycheck. Taxes are withheld and paid and the FICA match is paid by Sanctuary.

To me, the amount recorded was astounding. On average, prior to this accounting, I estimate that 25% of the actual tip income was reported to Sanctuary by our employees and paid to the IRS. Over this 10-year period, we will have reported $1.7 million in tip income from our employees. And remember, I am a salon in Billings, Montana where our average service sales ticket is only $46. In 2010, we reported tip income of $225,261. Tip income in 2010 was 15.1% of our service sales. The cost to the company to match the FICA taxes on the employee's tip income was $16,387. This places a significant burden on my business' ability to stay profitable while continuing to provide other benefits for our employees.

I believe it is vital for my employees to report all of their income in order to create a better future. A few years ago, I had a banker do a projection of 10 of my highest income employees' ability to qualify for a first-time homebuyer loan. Without their tip income reported, only 1 employee would have qualified for this loan to purchase their first home. With tip income reported, 6 more of my employees would be qualified buyers.

Over the past 10 years, I have lost several employees to the lure of "renting a chair." It takes up to 2 years for Sanctuary to train a newly licensed cosmetologist to perform the services my business offers our guests. Because Sanctuary pays an hourly wage, these new employees are paid for every hour worked and all training time. After this investment, we have experienced the effects of a work force able to "rent a chair" and take our business' customers with them. The ease of not reporting income and tip income along with the common misconception that "tips are gifts-not income" by individuals in my industry puts my business at a competitive disadvantage.

I believe it's unfair that individuals in our industry are able to take an extra $5+ an hour in unreported income. Teachers, soldiers, bankers, grocery clerks and other workers in this country aren't allowed that "choice" with their income. I'd like to see the gap in this unlawful practice narrowed.

Doing the right thing should not put people at a disadvantage to those who do not.

Suggestions:

1. **Congress should pass S. 974.**

   The low-cost provisions of S.974 have bipartisan support in Congress. Salon owners reluctant to comply because of the costs of the FICA match will be relieved of that burden. It will help the salon industry and the Treasury will increase its collections of taxes owed.

2. **The IRS needs to systemize contacts with the self-employed.**

   It is the IRS's contact with the employers in the industry that has increased compliance in that segment. There is not an equal level of contact with the self-employed.

   The compliance provision of S. 974 would systemize taxpayer contacts by requiring that the correct form be issued to self-employed workers by the establishment. In a simple way, this third party action provides a point of contact for the IRS.

3. **The IRS needs to connect the license with the tax filer.**

   The most universal arm of government in the salon industry is the state board. It's the one place where everyone in the industry meets. Every individual needs a professional license before they begin practicing. Every salon needs a facility license before they can open. Licenses need to be classified according to taxpayer type. This would provide a cross-reference link for both the individual and the business.

I thank you for this opportunity to share some ideas.

I appreciate your support for our industry of small businesses, look forward to working together toward a long-term solution and I welcome your questions and comments.

Thank you.

Economic Snapshot of the Salon and Spa Industry

June 2011

Salon Industry Snapshot

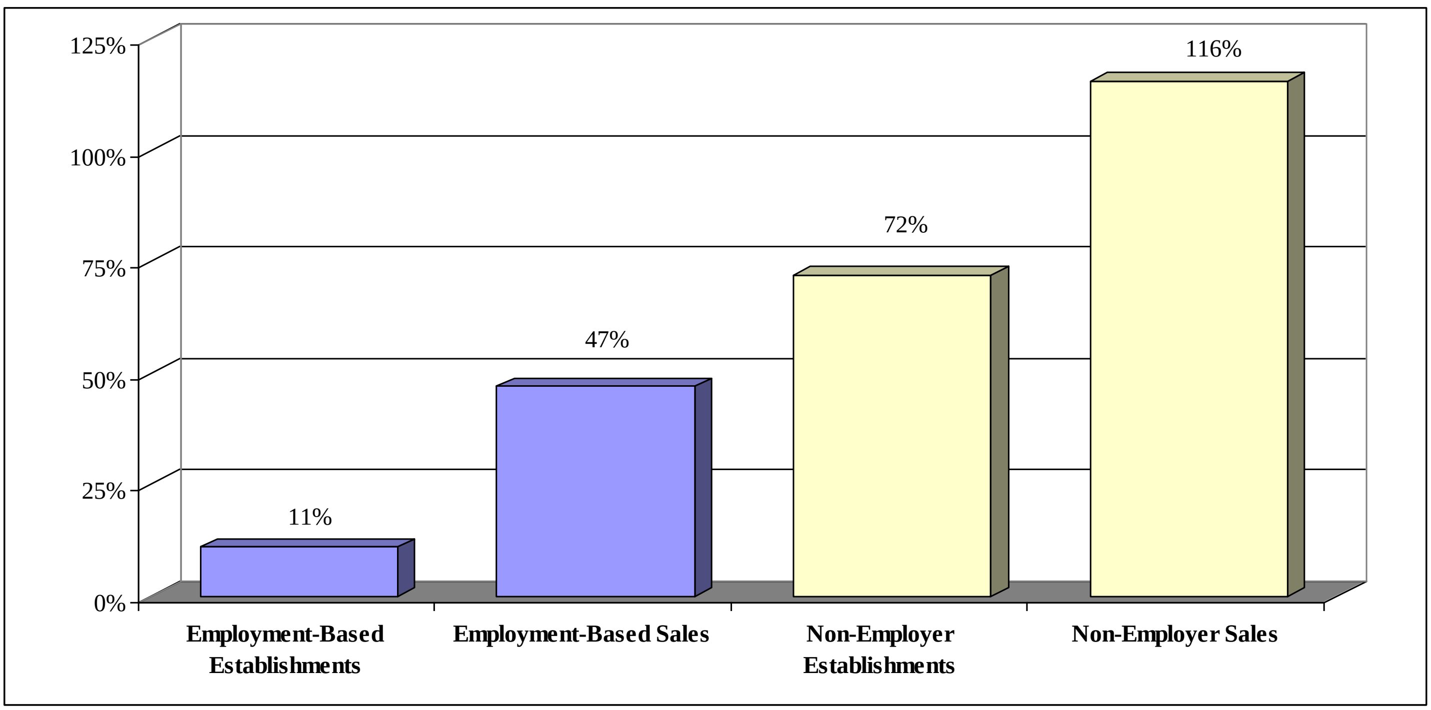
- The salon and spa industry is a vibrant and growing component of the U.S. economy, with more than 900,000 total establishments and annual sales of nearly $40 billion.

Salon Establishments With Payroll Employees	
2009 Establishments	88,876
2009 Sales	$21.2 billion
Non-Employer Salon Establishments*	
2008 Establishments	824,119
2008 Sales	$18.8 billion

Source: Bureau of Labor Statistics, U.S. Census Bureau; 2008/2009 figures

- The salon and spa industry registered steady growth over the last decade, with the strongest gains seen in the non-employer sector. The number of non-employer salon and spa establishments increased 72 percent in the last decade, while their sales jumped 116 percent. In comparison, the number of employment-based salon and spa establishments increased 11 percent over the last decade, with their sales rising 47 percent.

Salon Industry Establishment and Sales Growth Over the Last Decade
Employment-Based Salons versus Non-Employer Salons



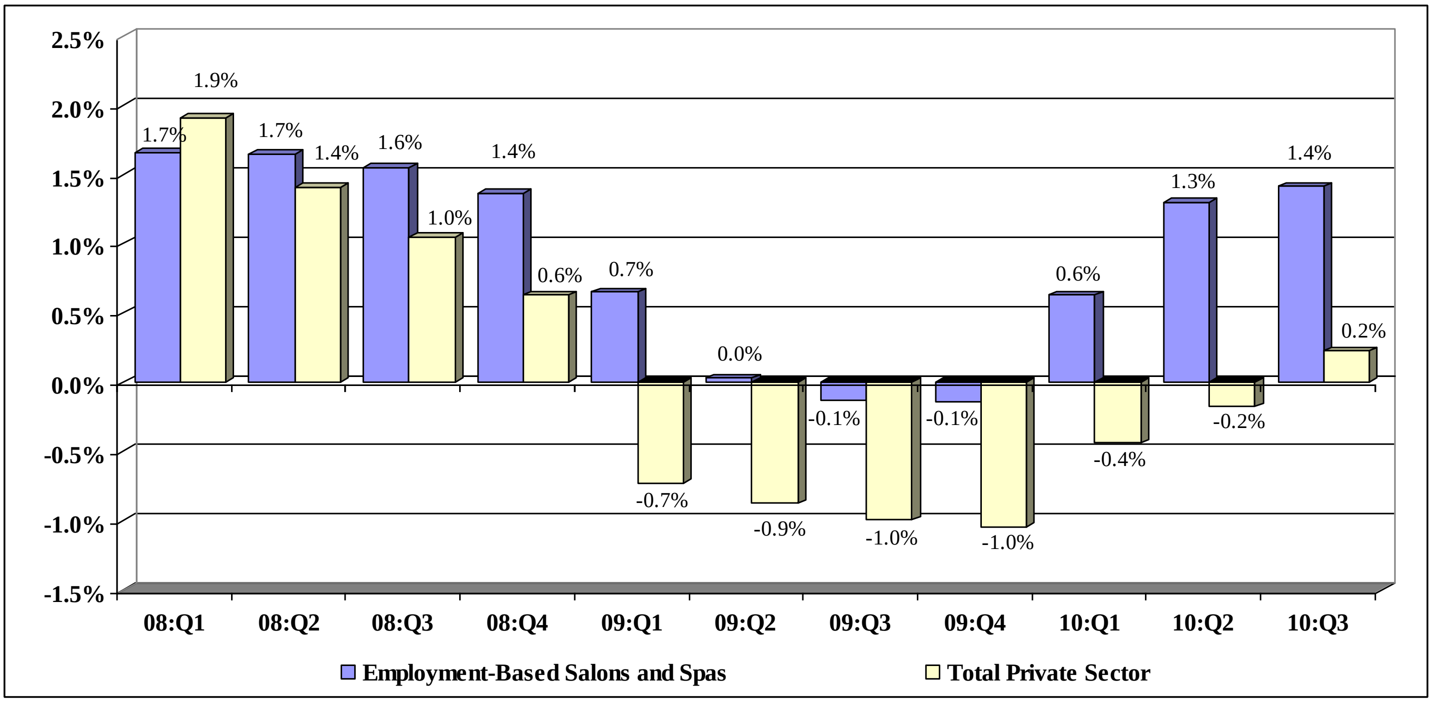
Source: Bureau of Labor Statistics, U.S. Census Bureau

*A Non-Employer Establishment is a business entity that has no paid employees. For data purposes the federal government counts each distinct business income tax return filed by a non-employer business as an establishment. As a result, an individual such as an independent contractor could be classified as a non-employer establishment. Non-employer businesses may operate from a home address or a separate physical location. Examples of non-employer establishments in the salon industry could include 1) a small salon business owned and operated by one individual, where this individual provides all of the services, 2) a salon business of any size that does not have regular paid employees, but may have independent contractors working in their establishment, 3) an individual that leases a chair as an independent contractor, 4) an individual that cuts hair out of their home, and 5) an individual that provides salon-related services as an independent contractor in the entertainment or fashion industries.

The Salon and Spa Industry Outperformed the Overall Private Sector During the Recession

- The Great Recession of the late 2000s took a tremendous toll on the nation's private sector. At the depth of the recession, the national economy was losing tens of thousands of businesses each quarter. Between the fourth quarters of 2008 and 2009, the national economy experienced a net loss of more than 92,000 private-sector business establishments – a decline of one percent.
- In comparison, the nation's salon and spa industry performed relatively well during the recession. Although growth in the number of employment-based salons and spas slowed during the recession and briefly turned negative, the declines were much less severe than the overall private sector. Between the fourth quarters of 2008 and 2009, the salon and spa industry experienced a net decline of only 130 establishments – or just 0.1 percent.

Salon and Spa Industry Outperformed the Private Sector During the Recession
Number of Establishments with Payroll Employees: Salons/Spas vs. Total U.S. Private Sector
Percent Change From Same Quarter in Previous Year



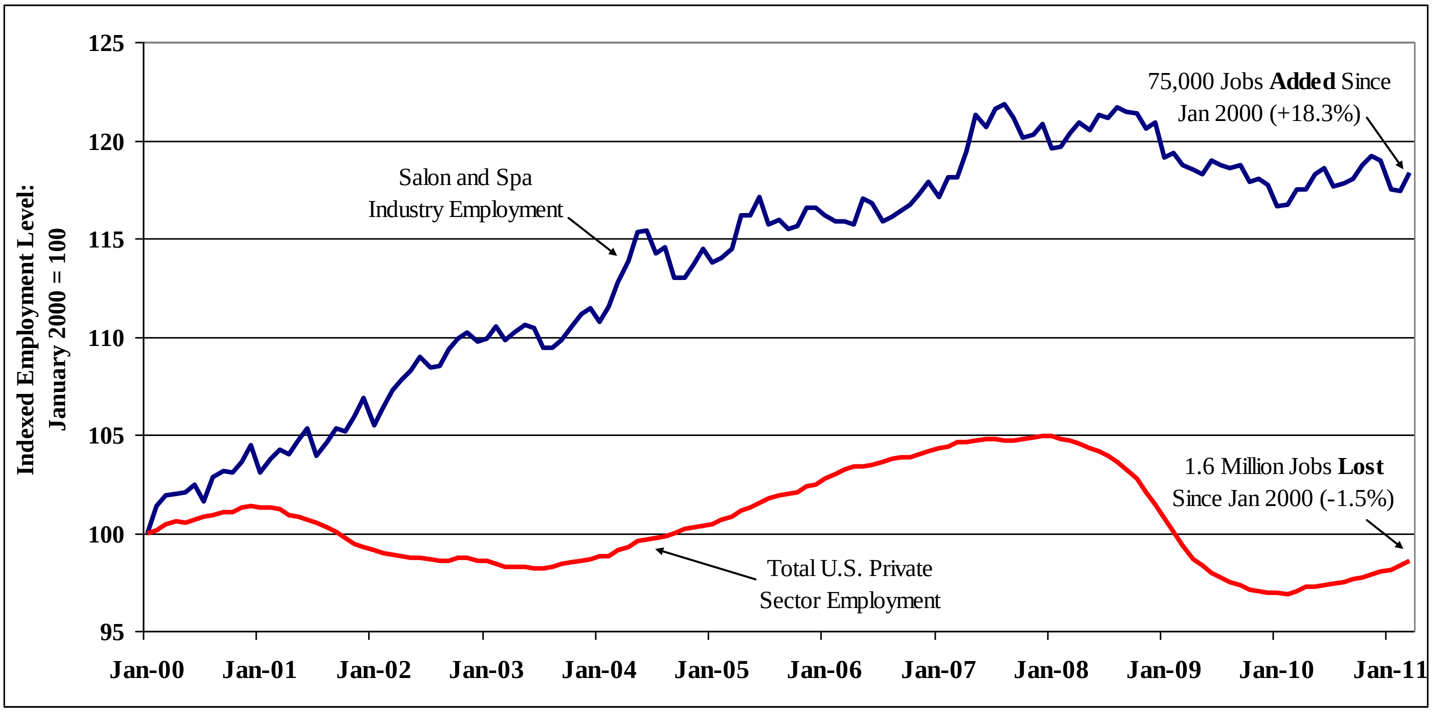
Source: Profession Beauty Association analysis of data from the Bureau of Labor Statistics

The Salon and Spa Industry Provided Much Needed Job Growth During the Lost Decade

- One only has to look at recent history to see that the salon and spa industry is an engine of job growth for the U.S. economy, even when many other industries are shedding jobs. During the challenging economic period of the last 11 years that included two recessions, job growth in the U.S. economy stagnated. In fact, there were 1.6 million fewer private sector jobs in the economy in March 2011 than there were in January 2000 – a decline of 1.5 percent.
- In contrast, employment-based salons and spas added 75,000 jobs during the same period, which represented an increase of more than 18 percent. This substantial growth occurred despite back-to-back job losses in 2009 and 2010, when the salon industry was negatively impacted by the recession. Overall, salon industry job growth outperformed the overall economy in nine of the last 11 years.

No Lost Decade for the Salon and Spa Industry

Employment Trends from January 2000 to March 2011: Salons/Spas vs. Total U.S. Private Sector

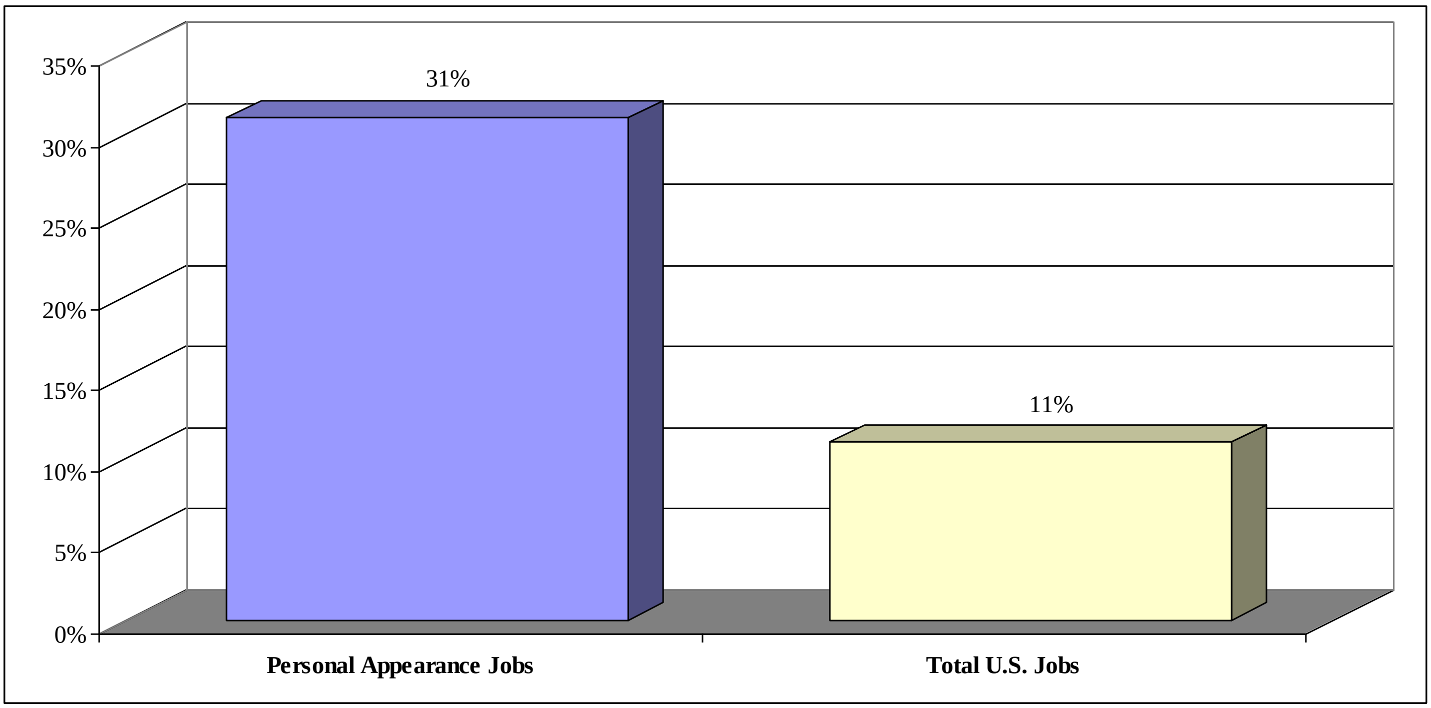


Source: Profession Beauty Association analysis of data from the Bureau of Labor Statistics

The Salon and Spa Industry is Projected to Post Steady Job Growth in the Future

- Not only did the salon and spa industry provide much needed job growth during the sluggish last decade, it is poised to post steady growth well into the future. According to the Bureau of Labor Statistics, the number of personal appearance jobs is projected to jump 31 percent between 2008 and 2018, nearly three times the rate of growth of total U.S. employment (11 percent) during the same period.
- All of the major personal appearance occupations are projected to post job growth stronger than the overall economy between 2008 and 2018. The number of skin care specialist jobs is projected to jump 51 percent, while hairdresser, hairstylist and cosmetologist positions are expected to increase by 31 percent.

Projected Job Growth: 2008 to 2018
Wage and Salary Employment



Source: U.S. Department of Labor, Bureau of Labor Statistics

Projected Salon Industry Job Growth: 2008 to 2018
Wage and Salary Employment

Occupation	Job Growth: 2008 to 2018
Skin Care Specialists	51%
Hairdressers, Hairstylists, and Cosmetologists	31
Manicurists and Pedicurists	24
Makeup Artists, theatrical and performance	21
Shampooers	20
Barbers	12
TOTAL PERSONAL APPEARANCE JOBS	31%

Source: U.S. Department of Labor, Bureau of Labor Statistics

One Out of Three Salon-Industry Professionals is Self-Employed

- Overall, more than 1.1 million professionals work in personal appearance occupations in the United States, according to the Bureau of Labor Statistics. Individuals in these occupations have a much higher rate of self-employment, as compared to the overall workforce.
- Thirty-three percent of all individuals in personal appearance occupations are self-employed. In comparison, only seven percent of the overall U.S. workforce is self-employed.
- Of the 770,000 Hairdressers, Hairstylists and Cosmetologists, 35 percent (or 267,000) are self-employed.
- Barbers have the highest proportion of self-employed individuals, at 54 percent.

Number of Individuals in Personal Appearance Occupations

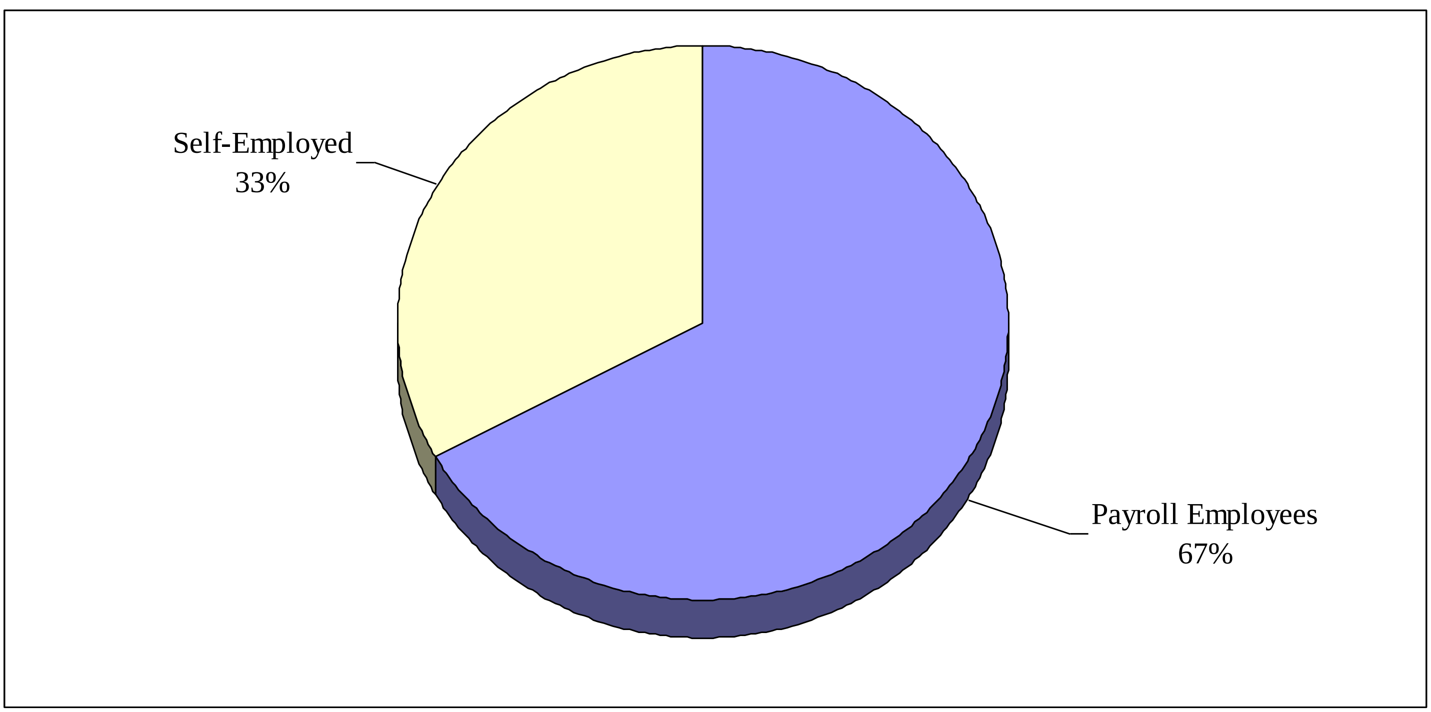
Personal Appearance Occupation	Total Employees in Occupation	Self-Employed Proportion	Total Self-Employed in Occupation
Hairdressers, Hairstylists, and Cosmetologists	770,000	35%	267,000
Barbers	96,000	54	52,000
Other Personal Appearance Workers*	273,000	19	53,000
TOTAL INDIVIDUALS IN PERSONAL APPEARANCE OCCUPATIONS	1,139,000	33%	372,000

Source: U.S. Department of Labor, Bureau of Labor Statistics; 2010 data

*Includes the following occupations: Makeup Artists, theatrical and performance; Manicurists and Pedicurists; Shampooers; and Skin Care Specialists

Distribution of Individuals in Personal Appearance Occupations

Payroll Employees versus Self-Employed



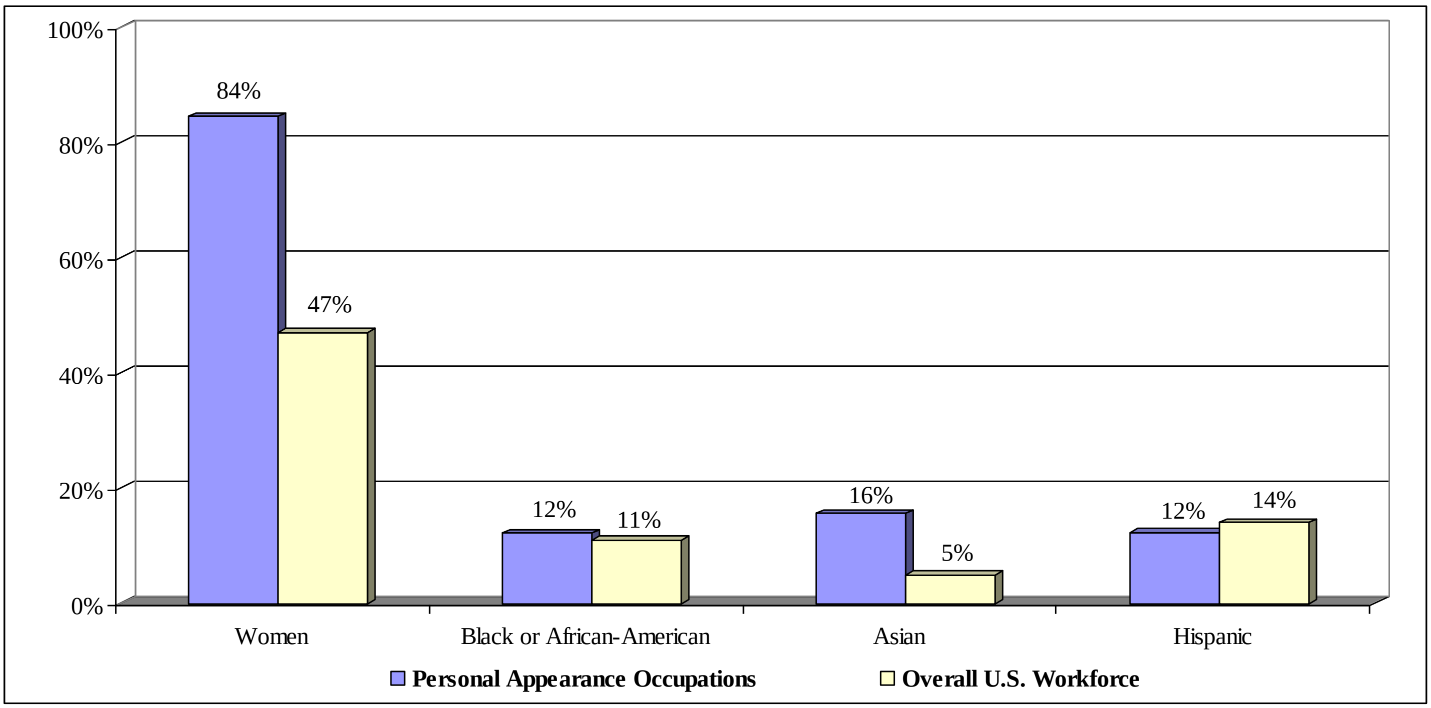
Source: U.S. Department of Labor, Bureau of Labor Statistics; 2010 data

The Salon and Spa Industry Provides Career Opportunities for Individuals of All Backgrounds

- The nation's salon and spa industry provides first jobs and career opportunities for individuals of all backgrounds, and has a broader representation of women and minorities than the overall U.S. workforce.
- Eighty-four percent of individuals in personal appearance occupations are women, compared to 47 percent of employed individuals in the overall U.S. workforce.
- Twelve percent of individuals in personal appearance occupations are Black or African American, compared to a national average of 11 percent.
- Sixteen percent of individuals in personal appearance occupations are Asian, compared to just five percent of the overall U.S. workforce.
- Twelve percent of individuals in personal appearance occupations are of Hispanic origin, slightly below the national average of 14 percent.

Breakdown of Employed Individuals by Gender, Race and Ethnicity

Personal Appearance Occupations versus Overall U.S. Workforce



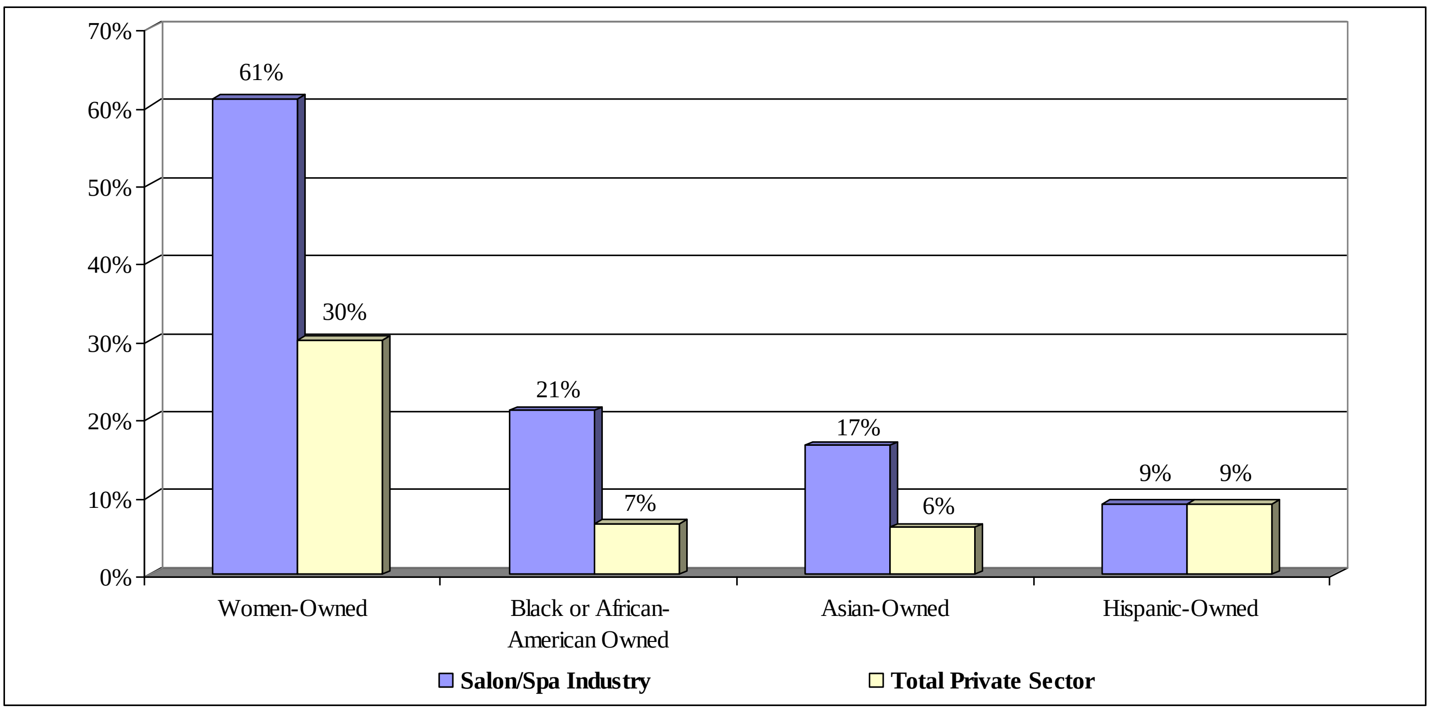
Source: Bureau of Labor Statistics; 2010 data

The Salon and Spa Industry Provides a Path to Ownership Opportunities

- Not only do salons and spas provide employment opportunities for individuals of all backgrounds, they also give individuals the experience to own businesses of their own.
- Sixty-one percent of salon businesses are owned by women, compared to just 30 percent of businesses in the overall private sector.
- Twenty-one percent of businesses in the salon industry are Black or African-American-owned, versus just seven percent of total private sector businesses.
- Seventeen percent of salon businesses are Asian-owned, nearly three times the six percent Asian-ownership rate for businesses in the overall private sector.
- Nine percent of salon businesses are owned by individuals of Hispanic origin, matching the proportion of Hispanic business ownership in the overall private sector.

The Salon and Spa Industry Provides Ownership Opportunities for Women and Minorities

Proportion of Businesses Owned by Women and Minorities



Source: U.S. Census Bureau; 2007 Economic Census; represents all businesses