WRITTEN STATEMENT

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HEARING ON

"THE STARTUP SLUMP: CAN TAX REFORM HELP REVIVE ENTREPRENEURSHIP?"

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Chairman Tiberi, Ranking Member Heinrich, Vice-Chair Lee and fellow Members of the Committee,

Thank you for inviting me to speak with you today about policies that can help promote entrepreneurship, and to offer testimony about the major issues facing America's small businesses.

I was a long-time small business owner prior to founding Small Business Majority 12 years ago. For 13 years, I was the founder and CEO of ACI Interactive, an award-winning interactive communications company, and earlier I was the chief operating officer of a pioneering multimedia business. Following my years of experience running small businesses, I founded Small Business Majority to create a national organization to serve as a leading advocate for America's entrepreneurs.

Small Business Majority's mission is to empower America's entrepreneurs to build a thriving and inclusive economy. We actively engage small business owners and policymakers in support of public policy solutions, and deliver information and resources to entrepreneurs that promote small business growth and drive a strong, sustainable job-creating economy. Our extensive scientific opinion polling, focus groups and economic research help us educate and inform policymakers, the media and other stakeholders about key issues impacting small businesses and freelancers, including access to capital, taxes, healthcare, retirement and critical workforce issues.

Small Business Majority has a network of more than 55,000 small business owners across the country, with 10 offices in Washington, D.C. and eight states. We work closely with our network and with more than 1,000 local business groups to create a strong small business voice in Washington and state capitals, and deliver critical education and resources to America's job-creating entrepreneurs.

Through our daily interaction with small business owners and self-employed entrepreneurs we know that small businesses are not just the backbone of the American economy; they are its foundation. America's 28 million small businesses represent 99% of all employer firms and account for half of our nation's jobs and economic output, and their creativity spurs innovation in all sectors of the economy. According to the U.S. Small Business Administration, small businesses have created two out of three new private-sector jobs since the Great Recession.[i] Private-sector job creation at small- and medium-sized businesses has outpaced the rate of large-size companies for every month of 2017, per ADP's National Employment Report.[ii]

In order to ensure our nation's job creators can thrive and help grow our economy, it's crucial that Congress focus on policy solutions that will truly help our nation's entrepreneurs succeed. Those solutions include the need for access to responsible credit and capital, affordable and quality health coverage and tax reform that directly benefits Main Street small businesses rather than Wall Street, large corporations and a select group of wealthy individuals.

Leveling the Playing Field for Small Business through Meaningful Tax Reform

We need a tax system that benefits America's entrepreneurs who are focused on growing their enterprises and making payroll at the end of each month. Small business owners feel that our tax system primarily benefits wealthy corporate interests at their expense. They don't want special treatment; they simply want to compete on a level playing field.

Small Business Majority's polling has shown that 90% of small business owners believe big corporations are using loopholes to avoid taxes that small businesses have to pay, and 92% believe corporations' use of those loopholes is a problem.[iii] Similarly, 9 in 10 small business owners believe that U.S. multinational corporations' use of these loopholes to shift U.S. profits overseas is a problem. What's more, three-quarters believe their small business is harmed when loopholes allow big corporations to avoid taxes.

That's why we're concerned by the current proposal for tax reform. While some are touting the plan as a boon for small businesses, the reality is that it will not actually benefit most Main Street businesses and would greatly add to the deficit. Indeed, the proposal would add at least $2.4 trillion to the deficit over 10 years according to the Tax Policy Center, and would continue to put small businesses at a disadvantage by not addressing corporate loopholes.[iv]

Some claim the current proposal to cap the tax rate for pass-through entities at 25% would be a boon for small business. In fact, this would impact only a handful of small firms according to the Tax Policy Center analysis. More than 87% of pass-through entities already pay a marginal tax rate of 25% or less, and less than 2% pay the current top marginal rate of 39.6%. Moreover, if individual tax brackets are streamlined to 12%, 25% and 35%, pass-through entities that would benefit from the pass-through cap rate would include only the 1.8% earning $425,000 or more.

A startling 88% of the savings generated by cutting the pass-through rate to 25% would go to the top 1% of earners. In short, this proposal would primarily benefit hedge fund managers, lobbyists and investment bankers—not Main Street small businesses.

And, last but not least, a tax code with a large gap between top individual rates and top pass-through rates can potentially encourage wealthy individuals to game the system by simply declaring themselves pass-through business entities.

If Congress wants to offer a responsible tax cut for most Main Street small businesses, and offset that cut with a reduction in existing loopholes, allowing all businesses to deduct a modest amount of their profits would have a much greater impact.

As for corporate taxes, cutting the top rate would help some small businesses that are organized as C-corporations, especially considering small businesses are unable to take advantage of the same accounting loopholes as large corporations. But doing so without getting rid of corporate tax loopholes would greatly increase the deficit. Economists from the Tax Policy Center estimate that reducing the corporate rate to less than 26% would be impossible to offset with just a reduction in loopholes; a reduction to 20% would reduce federal tax revenue by $1.6 trillion over 10 years.[v]

This is why it's crucial to implement policies that will help all entrepreneurs rather than giving tax breaks to those who need it least. Any substantive changes to the tax code must promote economic development from the bottom-up, enacting policies that benefit small businesses, rather than the top-down. Our specific proposals include the following:

- Ensure any changes to the corporate and personal tax codes have a significant, direct benefit to small businesses and self-employed individuals, as opposed to large businesses, hedge funds and the very wealthy.
- When considering a targeted, responsible reduction in business tax rates, ensure that it is accompanied by the elimination of costly loopholes that primarily benefit the wealthy and large corporations, such that the result is revenue-positive, or at least revenue-neutral.
- Instead of reducing pass-through business income tax rates from the top down in a manner that benefits only a sliver of small businesses, we urge the committee to examine a proposal as part of regular order discussions about tax reform that would benefit small businesses from the bottom up, rather than the current top-down proposals that will only benefit wealthy individuals. For example, we propose allowing small businesses to deduct their first $25,000 in business income whether or not they file their tax-returns as a pass-through entity or as a C-Corporation. This deduction should be paid for by eliminating loopholes and be accompanied by a phase-out for businesses with $150,000-200,000 in income to ensure it is targeted to the majority of Main Street small businesses.
- Consider a modest reduction of the nominal corporate tax rate, thus reducing the actual tax rate for most C-Corp small businesses, while eliminating unfair, inefficient tax loopholes in a manner that ensures a net revenue increase to bring down our deficit and fund key programs. Loopholes that can be eliminated include offshore tax deferral and the carried interest deduction.
- Reject the current proposal for "full expensing" of all capital purchases. Small businesses can now expense their first $500,000 of capital expenditures under Section 179. Allowing for full expensing above that level would have little benefit to them.
- Oppose any efforts to reduce top individual tax rates. It is a myth that top individual tax rates adversely harm Main Street small businesses. Only 1.7% of pass-through businesses pay income tax at the top rate.[vi]
- Oppose the enactment of a "territorial" corporate tax system that would allow a select few large multinational corporations to game the system by funneling their profits to the lowest-taxation foreign jurisdictions.
- Crack down on the ability of large corporations to reduce their tax burden simply by parking their profits offshore or moving their headquarters outside the country.
- Uphold the estate tax in its current form, understanding that it currently protects virtually all small businesses and family farms.[vii]
- Ensure parity between online and bricks-and-mortar businesses with a reasonable and fair Internet sales tax solution.
- Simplify and expand the small business tax credit created by the Affordable Care Act—helping more small businesses qualify for and utilize it.
- Pass healthcare tax equity for the self-employed so that freelancers can deduct their healthcare expenses from their FICA tax obligations—just like other business entities.
- Enact the bipartisan Investing in Opportunity Act that will help revitalize economically distressed communities by, among other things, allowing investors to temporarily defer capital gains recognition if they invest in an "opportunity zone."
- Increase limits for deducting start-up and organizational expenses from the current $5,000 levels to $10,000 each.

- Allow very small firms to use a simplified method of cash accounting.

These changes will provide critical benefits to the entrepreneurs and small business owners who need it most, allowing them to grow and expand their business on a level playing field with large corporations.

Promote Policies that Increase Access to Capital

While meaningful tax reform can play a role in spurring small business innovation and job creation, a more critical issue for entrepreneurs is access to capital. Access to capital is at the core of what entrepreneurs need to thrive and grow their business. Unfortunately, too many small businesses, especially women and minority-owned firms and entrepreneurs in distressed and rural communities, are struggling to gain the capital they need to launch or grow their businesses. According to our scientific opinion polling, 90% of small business owners agree that access to capital is a problem, particularly since the Great Recession.

The Federal Reserve Bank of Cleveland found that while lending for big businesses reached record levels in 2014, small business lending hasn't caught up with pre-recession levels. There are several reasons that small business lending has lagged since the recession. The recession seriously damaged the credit of many entrepreneurs while also causing a devaluation of collateral, lowering the credit worthiness of many borrowers.

Additionally, most traditional banks of all sizes, even those offering Small Business Administration-guaranteed loans, have significantly reduced or eliminated loans below a certain threshold, typically $250,000. For traditional banks, it costs them roughly the same to underwrite a $5 million loan as it does a $200,000 loan, and these costs decrease banks' willingness to offer smaller loans.[viii] Others simply won't lend to small businesses with revenue of less than $2 million. This hits small businesses particularly hard, particularly those in minority and distressed communities, as 68% of small businesses seek loans of less than $250,000, and, 55% of employer firms sought less than $100,000 in financing in 2016.[ix]

While there are some signs that access to capital is improving in some parts of the small business community, there are significant gaps that remain in critical areas, including minority and rural communities and for women and veterans. For example, while women-owned firms are the fastest-growing segment of businesses, studies find that women do not get sufficient access to loans and venture investment. Women account for only 16% of conventional small business loans and 17% of SBA loans even though they represent 30% of all small companies. Similarly, minority business development is on the rise—the rate of minority business ownership was 14.6% in 2012 compared with 11.5% in 2007. Yet, according to the National Community Reinvestment Coalition, African-American businesses received 2.3% of SBA loans in 2013, down from 11% in 2008.

The struggle female and minority business owners face in accessing capital is illustrated by the story of an African-American entrepreneur in our network from Chicago who left a job at a multinational accounting firm to start a bake shop. As a startup, she struggled to get traditional financing from a big bank, so she turned to Accion, a nonprofit microlender, for a microloan. While she had been seeking a $50,000 loan from big banks, this microloan provided just $10,000 in funding. Still, thanks to these funds and Accion's personalized approach, this business owner was able to grow her business and sign contracts with retailers like Whole Foods, Starbucks and Amazon Fresh.

We're glad community financial development institutions (CDFIs) like Accion are filling the gap for small businesses, but there is not nearly enough capital available to entrepreneurs from CDFIs alone. New online lending opportunities offer promising new sources of capital, with alternative lending already reaching more than $3 billion a year. Yet, these new online lenders also present a risk to small business owners, with new forms of lending such as peer-to-peer lenders, merchant cash advance companies and others, operating in an almost entirely unregulated market. We must open new avenues of lending, but we can't leave small business vulnerable to unscrupulous lenders who offer loans with exorbitant interest rates or unclear terms.

There are several steps that policymakers can take to increase access to capital for entrepreneurs and unleash their potential as job creators. These proposals include:

- Maintain and expand Small Business Administration lending, counseling and procurement programs, such as 7(a), microlending and Community Advantage, while also making permanent the fee waiver on SBA-backed loans under $150,000.
- Maintain and expand funding for the CDFI Fund, an important source of small business lending. The CDFI fund is slated to be cut by $58 million in the current proposed budget; this would be disastrous for small businesses, particularly those in distressed and rural areas.
- Promote responsible lending practices by new and alternative lenders and brokers. To this end, Small Business Majority has worked with a coalition of lenders, brokers, think tanks and small business advocates to launch the Small Business Borrowers' Bill of Rights, the first-ever consensus on responsible lending practices. The Small Business Borrowers' Bill of Rights outlines a set of fundamental principles for lending and puts the rights of borrowers at the center of the lending process.
- Support the efforts of the Consumer Financial Protection Bureau (CFPB) to collect small business lending data as required by current law.
- Ensure fair and clear regulations on crowdfunding and other non-bank, non-VC sources of capital while providing safeguards for business owners and investors.
- Provide small businesses, particularly minority businesses, with increased opportunities to participate in SBA loan programs and small business development center programs.
- Support and expand all other government efforts (e.g., SBA, Commerce Department, Agriculture Department) to educate and provide resources to small business owners.

Increasing responsible lending opportunities and protections for small business owners will provide a powerful benefit to disadvantaged areas and the American economy as a whole, as entrepreneurs—especially the growing ranks of women and minorities—safely access the loans they need to build a business that generates household wealth and stability for themselves and the members of their communities they employ.

Access to Healthcare

In addition to more options to access capital, small business owners need reliable and affordable healthcare so that they can invest their time and resources into growing and expanding their businesses. Prior to the implementation of the Patient Protection and Affordable Care Act (ACA), entrepreneurs and their employees comprised a disproportionate share of the working uninsured. Indeed, in 2011 more than 6 in 10 of the nation's uninsured workers were self-employed or working at a company with fewer than 100 employees.[x] Post-ACA, the uninsured rate for self-employed individuals has fallen drastically from 31% in 2012 to 19.5% in 2015.

A recent analysis by the U.S. Treasury Department found that 1.4 million marketplace consumers were self-employed, small business owners, or both, meaning that 1 in 5 marketplace users was a small business owner or self-employed in 2014. Additionally, small businesses and self-employed entrepreneurs were nearly three times more likely to purchase marketplace coverage than other workers. The Center on Budget and Policy Priorities found that 3.1 million small business employees gained coverage through the individual marketplace after the ACA was implemented.

The strong reliance of self-employed individuals and small business employees on marketplace coverage is clear evidence that the ACA greatly reduced "job lock." Prior to the law, many individuals, particularly those with pre-existing conditions, felt tied to their jobs because they could only access affordable health insurance through employer-sponsored coverage. The ACA bans insurers from denying coverage based on pre-existing conditions or charging more based on health status, making obtaining affordable insurance through the individual marketplace a reality for millions. This has enabled a significant number of entrepreneurs to leave their jobs and start businesses, since they are no longer afraid to leave a job with health benefits now that a pre-existing condition will not prevent them from accessing comprehensive and affordable coverage.

Entrepreneurs and small business owners have also benefitted from the expansion of Medicaid. Small Business Majority's scientific opinion polling found 21% of small business owners or their employees are enrolled in Medicaid.[xi] According to the U.S. Census Bureau's 2016 Current Population Survey, there was roughly a 44% increase in the number of small business employees enrolled in Medicaid between 2013 and 2016.

For many entrepreneurs, the ability to access healthcare through the individual marketplace or Medicaid was the push they needed to start or expand their business. For example, a young business owner from Columbus relied on his previous employer's health insurance while he was getting his urban planning business off the ground due to a preexisting condition. However, in 2016, he purchased insurance through the individual marketplace and was able to pursue his dream of entrepreneurship full-time. He fears that without the ACA's pre-existing conditions protections that he would no longer be able to purchase his own health insurance and would have to leave his business, potentially putting his business partner out of business as well. Another small business owner from Ohio was unsure how much income her fledgling photography business would generate, and relied on the state's expansion of Medicaid to get health insurance while she was getting her business off the ground.

In addition to the decreases in the unemployed rates and reduced job lock, small business owners have also seen their costs stabilize. We're now seeing much smaller increases in the small group market compared to pre-ACA, where double-digit increases were often the norm. A report from the Centers for Medicare and Medicaid Services found that from 2008-2010, the average annual increase in the small group market was 10.4%; from 2011-2015, the rate dropped by half to 5.2%.

While there are some aspects of the ACA that could be improved upon, repealing the ACA would hurt entrepreneurs and small business employers and stunt job growth. Our recommendations to stabilize insurance markets include protecting robust enrollment and marketing efforts to ensure stable and healthy marketplaces with a mix of age and health risks, ensuring healthcare tax equity for the self-employed and addressing the rising cost of prescription drugs.

Healthcare is a critical issue for our nation's entrepreneurs, and they need the peace of mind that they can start and invest in their businesses without worrying about affording coverage for themselves or their employees. Ensuring access to a variety of healthcare options through Medicaid, the individual marketplaces and the small group market is critical to making sure that individuals can make the leap to seek out their own entrepreneurial path or join thriving small businesses.

Conclusion

Congress should enact policies that will encourage more entrepreneurs to start a business and support small business growth. While tax reform can and should be a key component of such policies, small business owners also need reliable access to capital and affordable health care.

Thank you again for inviting me to appear today. I look forward to your questions.

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