



AEO *Association for
Enterprise Opportunity*
THE VOICE OF MICROBUSINESS

Statement of the Association for Enterprise Opportunity

Before the Senate Committee on Small Business and Entrepreneurship

Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups

July 17, 2013

The Association for Enterprise Opportunity (AEO) is pleased to take this opportunity to share its views with the Committee in response to the July 17, 2013 roundtable discussion, entitled “Small Business Tax Reform: Making the Tax Code Work for Entrepreneurs and Startups.” On behalf of the nation’s nearly 26 million microbusinesses – wholly 20% of the nation’s workforce – which contribute \$4.9 trillion to the economy and employ more than 31 million people, AEO applauds the Committee for its continued engagement with the microbusiness community.

Why Tax Reform is Necessary

The state of small business (and business in general) today is vastly different from when the tax code was last overhauled in 1986. The very model of employment is changing, especially in the aftermath of the most recent economic recession. More people are taking up the mantle of entrepreneurship and creating their own jobs through self-employment. In fact, according to forthcoming AEO research, more than 19 million people are engaged in what some call the independent workforce.

And yet, both of these groups of individuals – microbusinesses (one to five employees) and the self-employed – are the most burdened by today’s complex tax code. Effective tax reform will require that the individual and business tax rates be done in tandem, since just reforming the business tax code would leave the majority of microbusinesses in the cold. The self-employed and most microbusinesses are “pass through” entities and, therefore, file business income on their personal income returns.

To put this into context, according to the U.S. Small Business Administration's Office of Advocacy, businesses like these face compliance costs that are 67% higher than their larger counterparts, often paying up to \$1,000 per employee at firms with up to five employees.

Of the 20 or so tax credits and deductions that exist for small businesses, AEO believes many are left unclaimed by microbusinesses because they are either unaware that they exist or they are too complicated to understand. As a result, these businesses end up paying a higher effective tax rate than larger businesses, which have entire tax teams and divisions.

The Corporation for Enterprise Development (CFED), an AEO partner, has found that even those who can afford outside tax advisors often walk away without a clear understanding of their own taxes. In other words, those who need the most help when tax season arrives are least able to navigate the maze that is our tax code.

Recommendations for A Reformed Tax Code that Incentivizes Business Growth

Every dollar that a business owner saves in taxes is another dollar that can be invested into growing his/her business. With the prospect of comprehensive tax reform a tangible reality in this Congress, the opportunity to create a tax code that encourages microbusiness growth and makes it simpler for the smallest of businesses to comply should not be missed.

In general, AEO believes that the self-employed and microbusinesses would prefer simple and straightforward to complex and burdensome – in other words, a lower tax rate instead of the current web of deductions and credits.

There are, however, incentives that merit consideration in any comprehensive tax reform package. The following tax incentives are immensely important to our nation's microbusinesses and directly stimulate business growth.

AEO believes that a one-time deduction for starting a business makes sense. Similar to the current tax code's start-up tax deduction for entrepreneurs, AEO believes that combining a number of existing start-up tax provisions into one simplified deduction would significantly reduce burdens on business creation. Given the barriers that entrepreneurs face, especially those in underserved communities, such an incentive would be an effective tool.

In that same vein, AEO encourages the Committee to consider maintaining the Earned Income Tax Credit (EITC), which is a federal tax credit to low- and moderate-income workers. When EITC exceeds the amount of taxes owed, it results in a tax refund to those who qualify for it. According to CFED, there are nearly 6 million people who qualify for the EITC and use their refund to support a part-time business.

The New Markets Tax Credit (NMTC), which has accounted for more than \$36.5 billion in investments in underserved communities since 2000, has been successful. The NMTC tax credit is designed to leverage capital from investors to spur economic development in urban and rural low-income communities via Community Development Financial Institutions (CDFIs), in exchange for tax credits for the investor over a number of years. While not a direct incentive to individual businesses, the NMTC directly assists entrepreneurs by funding business loans and business counseling.

In summary, we applaud the Congress' willingness to undertake the monumental task of rewriting our nation's tax code, which has not seen comprehensive reform in more than 25 years. AEO urges the Congress to focus on keeping the tax code as simple as possible for our nation's smallest businesses, so that they can spend less time on tax compliance and focus on growing their businesses.