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Kogod Tax Policy Center

The Kogod Tax Policy Center promotes independent research on tax policy, planning and compliance issues impacting small and mid-size businesses, entrepreneurs and middle-income taxpayers.

Expanding Opportunities for Small Businesses Through the Tax Code

**Hearing of the United States Senate Committee on Small
Business and Entrepreneurship**

Wednesday, Oct. 3, 2018

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Chair Risch, Ranking Member Cardin, Committee Members and Staff, my name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. I also serve as the Managing Director of the Kogod Tax Policy Center (KTPC), which conducts non-partisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. We develop and analyze solutions to tax-related problems faced by small businesses. Thank you for inviting me, and by extension, the AU undergraduate students in my Federal Income Taxation class who are here with us today, to talk about expanding opportunities for small businesses through the tax code.

The U.S. Senate Committee on Small Business and Entrepreneurship (the "Committee" or "SBC") has a long history, dating back to its days as a select Senate committee, of working on behalf of America's small businesses on tax issues. Beginning in 1953, this Committee prepared a comprehensive survey of the impact of federal taxes on small businesses, culminating in an annual report to the Senate with key recommendations. Since then, the SBC has held more than 40 hearings over the years on tax-related concerns of small businesses. I should know—prior to joining AU's faculty, I served on the staff of this Committee, from 2009-2014, ultimately as Chief Counsel. Before public service, I worked in private practice in Washington D.C. as a tax attorney with both PaulHastings and PwC's Washington National Tax Services.

However, it was my work on this Committee that led to me to conduct ground-breaking research at American University, which we published in June 2017 in a report titled, *[Billion Dollar Blind Spot – How the U.S. Tax Code's Small Business Tax Expenditures Impact Women Business Owners](https://www.american.edu/kogod/research/upload/blind_spot_accessible.pdf)* ("Billion Dollar Blind Spot").¹ There is no question that "[t]axation plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. The major source of equity capital for expansion of a business is reinvested profits. The amount tax the business must pay

¹ Bruckner, C.L. (2017). *Billion Dollar Blind Spot: How the U.S. Tax Code's Small Business Expenditures Impact Women Business Owners*. Kogod Tax Policy Center Report, available at https://www.american.edu/kogod/research/upload/blind_spot_accessible.pdf.

determines the amount of money available for growth and expansion.”² In addition, it’s a fact that 99% women-owned firms are small businesses, according to SBA’s Office of Advocacy’s latest report on women-owned firms.³ These two facts inspired our trailblazing research in *Billion Dollar Blind Spot* to study for the first-time ever whether the small business tax incentives included in the tax code created opportunities for women-owned firms to access capital.

Existing research by academics generally, and this Committee in particular, has consistently found that women business owners struggle to access capital to grow and scale their businesses. In 2014, under the leadership of its then Chair, Sen. Maria Cantwell, this Committee issued a report finding that access to capital is a more severe challenge for women-owned firms and that women only account for 16 percent of conventional small business loans, and 17 percent of SBA loans; which means just \$1 of every \$23 in conventional small business loans goes to a women-owned business.⁴ More recently, last year Sen. Shaheen issued a report detailing what women entrepreneurs need to thrive that concluded, in relevant part, “women entrepreneurs are unable to access their fair share of financial capital, diminishing their chances for growth.”⁵ At the same time, Congress, and this Committee in particular, has worked tirelessly to enhance the U.S. tax code to aid small businesses. Small businesses have regularly testified and requested Congressional intervention to facilitate access to capital, which is a common complaint among these firms. It’s not unique to women-owned firms, just more acute.

² INTERAGENCY TASK FORCE ON WOMEN BUSINESS OWNERS, *THE BOTTOM LINE: UNEQUAL ENTERPRISE IN AMERICA*. (U.S. Department of Commerce) (1978).

³ Michael J. McManus, *Issue Brief Number 13: Women’s Business Ownership: Data from the 2012 Survey of Business Owners*, Office of Advocacy, U.S. Small Business Administration (May 31, 2017), *available at* <https://www.sba.gov/sites/default/files/advocacy/Womens-Business-Ownership-in-the-US.pdf>.

⁴ Majority Report of the U.S. Senate Committee on Small Business and Entrepreneurship, *21ST CENTURY BARRIERS TO WOMEN’S ENTREPRENEURSHIP* (2014), https://www.sbc.senate.gov/public/_cache/files/3/f/3f954386-f16b-48d2-86ad-698a75e33cc4/F74C2CA266014842F8A3D86C3AB619BA.21st-century-barriers-to-women-s-entrepreneurship-revised-v.1.pdf.

⁵ Report by SBC Ranking Member Jeanne Shaheen, *TACKLING THE GENDER GAP: WHAT WOMEN ENTREPRENEURS NEED TO THRIVE* (2017), https://www.sbc.senate.gov/public/_cache/files/2/5/25bd7ee9-a37b-4d2b-a91a-8b1ad6f5bd58/536DC6E705BBAD3B555BFA4B60DEA025.sbc-tackling-the-gender-gap.december-2017-final.pdf.

As part of our research in *Billion Dollar Blind Spot*, we detailed the legislative history and Congress' intent to provide access to capital and opportunities for growth to small businesses with respect to four specific tax expenditures (i.e., IRC §1202 – *100% Exclusion from Capital Gains Tax for Investments in Qualified Small Business Stock*; IRC §1244 – *Ordinary Loss Treatment for Investments in Small Business Stock*; IRC §179 – *Expensing for Small Businesses*; and IRC §195 – *Deduction for Qualified Start-Up Costs*). Each small business tax expenditure we studied met two criteria:

1. Congress intended the provision to stimulate growth or access to capital or investment in smaller firms; and
2. Each expenditures generated a cost to U.S. taxpayers of at least \$100 million.⁶

Ultimately, *Billion Dollar Blind Spot* raised questions as to (i) whether the U.S. tax code's small business tax expenditures were operating as Congress intended to provide access to capital to these small businesses; and (ii) whether the cost of these expenditures had been accounted for in terms of their uptake by women-owned firms.

Our research is particularly relevant in today's economy because although women business owners account for 40% of all U.S. firms and the total number of women-owned firms has increased over the last ten years by 58%, women business owners remain small businesses primarily operating as service firms (more than 60%) and continue to have challenges growing receipts and accessing capital.⁷ Women of color are leading this charge and are the “driving force behind the growth of women-owned firms.”⁸ Firms owned by women of color grew at a rate of 163% during the last 10 years and today, women of color own 64% of the new women-owned businesses launched each day.⁹

⁶ *Billion Dollar Blind Spot*, *supra* n. 1 at 7 (noting revenue loss are a key factor in Congress relies on in determining the effectiveness of a tax expenditure).

⁷ The 2018 State of Women-Owned Businesses Report, Ventureer (2018), *available at* https://about.americanexpress.com/files/doc_library/file/2018-state-of-women-owned-businesses-report.pdf.

⁸ *Id.*

⁹ *Id.*

Despite this extraordinary growth, there has been no formal government or Congressional accounting as to whether small business tax expenditures targeted to help small business access capital impact are distributed to women-owned firms. Our report is the first effort to assess how the U.S. tax code's more than \$275 billion of tax expenditures targeted to help small businesses grow and access capital impact women-owned firms.¹⁰ Specifically, we found:

- Three of the four small business tax expenditures (i.e., IRC §1202, §1244, and §179) we assessed are so limited in design that they either (i) explicitly exclude service firms (e.g., IRC §1202), and by extension, the majority of women-owned firms; or (ii) could effectively bypass women-owned firms who are not incorporated (IRC §1244) or who are service firms with few capital-intensive equipment investments altogether (IRC §179).
- Our survey data of 515 experienced, engaged women business owners corroborates these findings, and nevertheless suggests that when women-owned firms can take advantage of tax breaks, they do (IRC §195). However, neither Congress nor Treasury or IRS or SBA has ever measured how the tax code's small business expenditures impact women business owners.¹¹

¹⁰ Joint Committee on Taxation, Estimates of Federal Tax Expenditures for Fiscal Years 2017-2021, JCX-34-18 (May 25, 2018), available at <https://www.jct.gov/publications.html?func=startdown&id=5095>. The revenue loss estimates included in this testimony reflect JCT's latest revenue estimates as set forth in JCX-34-18, which include changes attributable to tax legislation through February 2018.

¹¹ *Billion Dollar Blind Spot*, supra n. 1. As part of our research, we conducted a survey of the members of Women Impacting Public Policy (WIPP) and its coalition partners. Our survey was designed to gauge whether and how familiar self-identified women business owners are with the Code sections we identified for review and whether those women-owned firms accessed them. Our intention in conducting the survey was not to prepare a statistically reliable estimate of the entire American population of women-owned firms, or even of the more than one million WIPP and their coalition partner members, but rather to gauge whether engaged, experienced women business owners, defined by their own self-selection as members of WIPP or one of its coalition partners, are familiar with and take advantage of specific tax incentives that Congress has targeted to small businesses. WIPP and its coalition partners invited their memberships to participate in the online Survey Monkey survey, which was conducted from March 9, 2017 through April 11, 2017. We received 515 completed responses from women who, on their own, or with other women, owned at least 51% of a business, from the more than 550,000 WIPP or coalition partner members invited to participate in the survey.

Our research results suggest the immediate need for Congress to conduct oversight and due a formal accounting for how existing tax expenditures create opportunities for women-business owners to access capital.

- For example, Congress designed IRC §1202, which allows angel investors to invest in qualified small business corporations, to explicitly exclude service firms. Our research found that this limitation has resulted in only a very small minority of women business owners being able to utilize it. In fact, we identified only three women business owners who had ever used IRC §1202 to raise capital for their business. Keep in mind, this is a \$6.5 billion tax break developed by the former Chair of this Committee, Dale Bumpers, to raise capital for small firms. While we expect that more than three women-owned firms have used this provision since 1993, we don't have publicly-available IRS or Treasury taxpayer data to prove it.
- Similarly, with respect to IRC §179, our survey results found that women business owners claimed this tax break at significantly lower rates (47%) than existing government research finds for businesses generally (60% to 80%). This tax break is one of the more expensive small business tax incentives (i.e., it will cost taxpayers \$64.5 billion from 2017-2021), and yet we don't have any IRS or Congressional research on how it benefits women business owners, and what research we do have suggests that women business owners benefit less than business generally from one of the largest small business tax incentives.

Our research shows that Congress and stakeholders have a billion dollar blind spot when it comes to understanding how effective small business tax expenditures are with respect to women-owned firms. This blind spot indicates Congress does not have data or research to make evidence-based tax policy decisions to expand opportunities for 40% of all U.S. firms to access capital through the tax code. In addition, our research suggests that Congress may have doubled-down its billion dollar blind spot in the most recent overhaul of the tax code, the *Tax Cuts and Jobs Act of 2017* (P.L. 115-97) (TCJA).

In particular, our initial assessment of two of the key tax investments of the TCJA (§199 and §179), which were designed based on two of the small business tax incentives we studied (§1202 and §179), confirms that questions we raised in *Billion Dollar Blind Spot* were not robustly investigated in connection with Congress' efforts on tax reform. Instead, Congress made additional investments in small business tax expenditures that our research suggests are less favorable to women business owners in terms of distribution of tax benefits, which the Joint Committee on Taxation's (JCT) April 2018 distributional analysis seems to confirm.

For example, according to Table 3 of JCT's distributional analysis of the TCJA, more than 90% of the revenue loss generated from the new pass through deduction under IRC §199A will flow to firms with income of more than \$100,000 in 2018 and 2024.¹² However, the most recent data available finds that 88% (or 10,775,600) of women business owners generate revenues less than \$100,000.¹³

This inequitable distribution is even more pronounced when considered at higher income levels: only 1.7% of women-business owners have receipts of \$1,000,000 or more, but JCT found in 2018, 44% of the IRC §199A revenue loss will flow to pass-through businesses with \$1,000,000 of income. Moreover, JCT projects that the 44% revenue loss distribution will increase to 52% by 2024.¹⁴ While many women business owners will no doubt see some benefit from IRC §199A, JCT's distributional analysis raises serious questions as to the equity of the distribution of the tax expenditure with respect to women-owned firms. In addition to concerns regarding the distribution of the revenue loss generated by IRC §199A, our research suggests additional oversight and tax research is warranted with respect to the TCJA's investments into expanding IRC §179.

¹² Joint Committee on Taxation, Tables Related to the Federal System as in Effect 2017 through 2026 (JCX-32R-18), April 24, 2018. This document can be found on the Joint Committee on Taxation website at www.ict.gov.

¹³ The 2018 State of Women-Owned Businesses Report, *supra* n. 7.

¹⁴ JCT, *supra* n. 12 at Table 3.

Congress doesn't know whether the money it has spent trying to help smaller firms access capital and grow has been well spent with respect to women-owned firms. The absence of research on these issues is contrary to recent Congressional efforts to engage in evidenced-based policy making going forward and means Congress does not have adequate data to understand whether the more than \$275 billion in tax incentives it has enacted already create opportunities to access capital for more than 12 million small businesses or 40% of all U.S. firms.

This Committee should be congratulated on holding this hearing and immediately set to work to develop the needed research to understand how and whether existing tax incentives create opportunities for women-owned firms to access capital. That noted, the existing lack of tax research and effective Congressional oversight on how tax expenditures impact women business owners constrains policymakers from developing evidenced-based policymaking on creating opportunities for small businesses through the tax code.

As next steps, we recommend the Committee employ the following strategies to develop necessary research on these issues including:

1. Requesting the Congressional tax-writing committees hold joint hearings together with this Committee on the small business tax issues identified in *Billion Dollar Blind Spot* and this testimony; and
2. Requesting the Joint Committee on Taxation develop estimates on how small business expenditures impact women-owned firms in terms of the revenue loss distribution.

We stand ready to aid the Committee in this important work on behalf of the millions of small businesses impacted by these issues.