Empowering a Pro-Growth Economy by Cutting Taxes and Regulatory Red Tape

Testimony of

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Before the

Committee on Financial Services
United States House of Representatives

The Honorable Jeb Hensarling, Chairman
The Honorable Maxine Waters, Ranking Member

Protecting small business, promoting entrepreneurship

Chairman Hensarling, Ranking Member Waters and members of the committee, thank you for hosting this important hearing today and for the opportunity to provide testimony on the impact of the "Tax Cuts and Jobs Act" on economic growth and entrepreneurial risk-taking, along with future policy actions that can be taken to encourage entrepreneurship, capital formation and access, and strong small business growth.

My name is Karen Kerrigan and I serve as President & CEO of the Small Business & Entrepreneurship Council (SBE Council), a nonprofit, nonpartisan advocacy, research and education organization dedicated to protecting small business and promoting entrepreneurship. For nearly 25 years, SBE Council has worked on a range of private sector and public policy initiatives to strengthen the ecosystem for healthy startup activity and small business growth. The work of this committee has had a significant impact on our members, entrepreneurs and the small business community and SBE Council appreciates its bipartisan efforts to improve capital formation and capital access for small businesses and entrepreneurs.

"Tax Cuts and Jobs Act" Fueling Confidence and Growth

As we cross the six-month point of the newly implemented "Tax Cuts and Jobs Act," many indicators find that its effect has been very positive for small businesses. The new tax law is helping to fuel momentum in the economy, improve consumer confidence, and enable job creation, higher wages and more business investment. The combination of regulatory relief and certainty, along with tax relief, is a powerful policy mix that has markedly improved the business environment, revenues and sales for small businesses, and their growth opportunities.

Small Businesses Are Confident

The significant uptick in small business confidence that followed the 2016 elections continues to this day. Various surveys report comparable findings: small business confidence is exceptionally high.

● According to the second quarter 2018 Wells Fargo/Gallup Small Business Index survey, "small-business owners' optimism continues to be strong -- near a 10-year high."

● The NFIB's Small Business Optimism Index for May 2018 reported that optimism reached its second highest level in the organization's 45-year history.

● The Spring 2018 Bank of America Business Advantage Small Business Report (released April 26, 2018) reported that "confidence in the economy – both at the national and local levels – is the highest it's been since 2015 and the second-highest in the history of the report."

An important take-a-way from these various reports is that small business confidence has stayed strong and consistent over a year and a half, which is producing positive activity from this sector

- such as expansion, hiring, and investment – all of which are critical for innovation, our economy and its competitiveness.

Such confidence has translated into actions by small businesses that help build local communities and job opportunities. For example, NFIB's May 2018 Index showed that "compensation increases hit a 45-year high at a record net 35 percent." The Spring 2018 Bank of America (BoA) Report aligns with the NFIB's finding in terms of how the growing economy, along with tax relief, are providing a boost to small businesses and allowing small firms to better compete in the economy. In fact, entrepreneurs surveyed in the BoA report identified changes to the tax code as a "game-changer" for the health of their businesses. As noted within the report:

- *Fifty-eight percent cite the new tax policy as a 'game-changer' for small businesses overall, and 63 percent say it's made them more optimistic about their own business' outlook.*
- *Thirty-seven percent have altered their 2018 business plans as a result of the new code. – 34% say it will significantly alter their business trajectory*
- *Seventy-one percent expect to receive savings resulting from the new tax policy, and many plan to use these funds to fuel growth, including investing back into their business (37%), awarding raises and bonuses to employees (21%) and hiring more employees (14%), expand operations (14%), pay off a loan (12%), make capital improvements (12%).*

A LendingTree survey (May 2018) also found that small businesses expect to benefit from the new tax law, with 65% responding that they plan to see savings. According to the survey, 35% will pay down debt, 15% plan to pass tax savings onto employees thru increased wages and benefits, 9% will invest more in the business, and 7% will hire more employees. Each and all of these actions taken by small business owners are important to the health and viability of their firms, as well as for the strength of the economy.

Obviously, extra capital for small businesses provides these firms with the resources they need to retain and compete for human capital – a growing challenge for many businesses, but especially small businesses. Tax savings and a growing economy (more revenues) are helping small businesses in this regard, as noted by each of the surveys highlighted in my testimony. While some small businesses are boosting wages immediately due to tax relief, a significant number of others plan to do so over the coming year. For example, the Wells Fargo/Gallup Small Business Index (Q2 2018) finds "59% of owners say they are very or somewhat likely to offer salary or wage increases to their workers over the next 12 months, and 52% say they are likely to offer bonuses or new benefits."

While these surveys demonstrate that many small business owners generally understand the new tax law and are using it to their advantage in the growing economy, there are many others business owners who are still working to determine its impact and provisions. In that regard, SBE Council is providing regular education and information through our platforms, enews and communications to help entrepreneurs navigate and understand the new provisions to ensure they can leverage the changes to their advantage in 2018.

Consumer Confidence Boosting Small Business Growth

According to The Conference Board *Consumer Confidence Index*, consumer confidence rose in May to a three-month high, and is the best in 17 years: "Overall, confidence levels remain at historically strong levels and should continue to support solid consumer spending in the near-term." Confident consumers are active consumers, and small businesses are benefitting from their confidence and buying activity.

In terms of retail sales, the Census Bureau's report on May's data showed an increase at double the expected rate, registering at 0.8% (versus an expected 0.4%). It is also worth noting that 0.8 percent growth is double the average monthly growth rate looking at data back to 1992. Over the past year, total retail sales were up 5.9 percent, and 6.4 percent excluding autos, 4.9 percent excluding gasoline, and 5.1 percent excluding both autos and gas.

Confidence about the future of the economy, the positive job outlook, tax cuts benefitting families and individuals, and wage increases generated by small, mid-size and large businesses are all having an impact on consumer activity. As noted by the NFIB May 2018 Index, small businesses are the beneficiaries of this activity as sales trends are at the highest level since 1995.

SBE Council members are reporting much stronger activity from their larger corporate clients and general B2B activity as well. Business investment has picked up markedly, which is a dramatic departure from the "investment gap" that the economy experienced from the great recession throughout the recovery period. This "gap" was substantial as noted by my organization's "Gap Analysis" series published during the course of 2016, which reported that "Real gross private domestic investment grew at an average annual rate of 1.8 percent from 2007 to 2016, compared to the 4.9 percent average growth rate from 1956 to 2016." This difference left a real gross private domestic investment gap of at least $1.4 trillion (in 2009 dollars) in 2016.

Thankfully, business investment is on the rise. In the second estimate of first quarter GDP released by the U.S. Bureau of Economic Analysis on May 30, fixed nonresidential investment growth was revised up from an original estimate of 6.1 percent to 9.2 percent, including structures investment growth upgraded from 12.3 percent to 14.2 percent, equipment from 4.7 percent to 5.5 percent, and intellectual property products from 3.6 percent to 10.9 percent. Such investment serves as a positive for future economic growth.

It is also very encouraging to see money returning (repatriated) to the United States from abroad, which is capital that can be re-deployed for investment purposes. Business spending by large companies significantly benefits small business in their supply chains. In fact, a September 2010 Business Roundtable report (Mutual Benefits, Shared Growth: Small and Large Companies Working Together) found that "the U.S.-parent operations of the typical U.S. multinational buys goods and services from more than 6,000 American small businesses; buys a total of more than $3 billion in inputs from these small-business suppliers; and relies on these small-business suppliers for more than 24% of its total input purchases." The Business Roundtable estimates that "U.S. parents of U.S. multinationals purchase an estimated $1.52 trillion in intermediate inputs from U.S. small businesses, which is about 12.3% of their total sales."

This fertile environment consisting of a better business environment, strong consumer confidence, and improved revenues and sales for small businesses means entrepreneurs have a very favorable outlook moving forward. The recent BOA report for the second quarter of 2018 reflects that buoyancy:

● *Fifty-four percent expect the national economy will improve over the next 12 months (vs. 52 percent in spring 2017, 29 percent in spring 2016 and 48 percent in spring 2015).*

● *Sixty percent believe their revenue will increase in 2018 (vs. 48 percent in spring 2017 and 51 percent in spring 2016).*

● *Sixty percent plan to grow their business over the next five years (vs. 56 percent in spring 2017 and 55 percent in spring 2016).*

● *Twenty-two percent plan to hire (vs. 18 percent in spring 2017 and 22 percent in spring 2016).*

There are many solid signs in the economy for entrepreneurs and small businesses. The policy ecosystem and positive business environment are helping to strengthen small firms and provide growth opportunities. To fully benefit from these positive conditions, many entrepreneurs and small businesses require or will need capital to help launch new enterprises, scale, compete for business or expand. That makes the work of this committee, including the many valuable bipartisan reforms it has already passed, all the more important.

Reforms Are Still Needed to Help Small Business Leverage the Growing Economy

The House Financial Services Committee and its members have championed and advanced many significant reform initiatives. If enacted into law these reforms will help entrepreneurs and small businesses take advantage of growth opportunities. Capital is the fuel that drives entrepreneurship and economic growth, and small businesses and startups need a continuous flow of capital to launch, compete and grow.

Conditions have certainly improved since the Great Recession and its aftermath. Lending is on the rise (but still not back to pre-recession levels), and hopefully the "Economic Growth, Regulatory Relief, and Consumer Protection Act" (S. 2155), recently signed into law by President Trump, will help ease lending to small businesses. As I noted above, capital provided by the "Tax Cuts and Jobs Act" is helping many entrepreneurs self-finance business expansion and investments, but growth and startup capital remains elusive for many others, which is why regulatory improvements and fixes are needed.

There's been improvement in the online lending space as some of the nation's largest "FinTech" small business lending platforms are quietly helping many entrepreneurs with their capital needs. A May 31, 2018 study, "The Economic Benefits of Online Lending to Small Businesses and the U.S. Economy" reported that just five of the largest lending platforms funded nearly $10 billion in online loans from 2015 to 2017, generating $37.7 billion in gross output, creating 358,911 jobs and $12.6 billion in wages in U.S. communities. The study found that 24 percent of these borrowers are microbusinesses with less than $100,000 in annual sales and two-thirds have less than $500,000 in annual sales. So online lenders are definitely filling an important niche, and small business borrowers are becoming better educated about this type of financing.

The Jumpstart Our Businesses Startup Act (JOBS Act) included solid reforms that have helped boost Initial Public Offerings (IPOs) and deliver many startups the funding they need through regulated crowdfunding (Title III crowdfunding). It took the Securities and Exchange

Commission (SEC) four long years to develop and implement the rules around regulated crowdfunding, which is why it has taken longer than expected to get traction through this promising funding approach. Regulation crowdfunding is quietly funding companies and doing what its supporters, like us, hoped it would. To date, there are nearly 1,000 active campaigns (about 600 of those are fully funded), where $132 million has been committed from 133,883 backers (investors). The average raise is $247,456. A wide array of sectors are represented, with application software companies leading the pack followed by beverages (alcoholic), computer hardware, entertainment and the autos industry.

There is great promise with regulated crowdfunding, again a bipartisan effort that began in this committee. With some reforms and tweaks, the leaders of this community believe it can flourish as a solution for startups and small businesses. Such changes to improve crowdfunding and to make it more appealing for small businesses include raising the amount that can be raised (which is currently $1 million), allowing issuers to "test the waters," allowing for special (or single) purpose vehicles, provide simplified rules for advertising, legal clarity for platforms, and removing the caps for accredited investors, among other changes.

SBE Council, along with the economic development community at large, are excited about the "opportunity zones" created by the "Tax Cuts and Jobs Act." The Opportunity Map is now complete – meaning all the zones have been selected by Governors, and the U.S. Treasury has certified these zones. Now the market can be engaged and investment can begin. Regulated crowdfunding can have a positive impact in these areas, along with impact investing. The various reforms that have already passed this committee will also add greatly to the capital needs of these zones (if enacted into law), which largely have not benefitted from the economic recovery.

This committee has focused on reforms that modernize/streamline rules and update thresholds, and the same needs to be done with Section 1224 Small Business Stock.

Qualified Small Business tax (loss) treatment under Section 1244 of the I.R.S. code (QSB 1244) allows for investors to deduct losses taken on investments in C Corp startups to be deducted against ordinary income. QSB 1244 was passed as part of the Small Business Investment Company Act of 1958, the spirit of which was to mobilize more capital into innovate startups. The current thresholds were last updated in 1978, which are: the first $1,000,000 of outside, individual tax payer(s) (angel investors) capital receives 1244 treatment; $100,000 per year of 1244 losses deductible against ordinary income (for joint tax returns); $50,000 per year of 1244 losses deductible against ordinary income (for single filers).

The Consumer Price Index has risen 363% since 1978. If the above thresholds were inflation adjusted, the levels would be: $3,630,000 of outside investors' capital would qualify for de-risking under 1244; $363,000 per year of 1244 losses could be deductible for joint filers: $181,500 per year for single filers. These changes would be consistent with the laudable changes recently made to the QSB 1202 laws, which now provide for the first $10M of profits that qualify under 1202 to be excluded from taxes.

This change can help up-and-coming entrepreneurial ecosystems outside Silicon Valley as well as Opportunity Zones where many new investors and family offices are interested in impact investing.

SBE Council continues to support the many bills that were born from this committee's work. Getting these bills signed into the law will strengthen and improve the capital markets and encourage capital formation and access for our most innovative firms. As many of the committee members know, SBE Council is on record in support of the "Helping Angels Lead Our Startups Act" (H.R.79/ S. 588), "Fostering Innovation Act" (H.R. 1645/S.2126), "Encouraging Public Offerings Act" (H.R. 3903/S. 2347), "Small Business Audit Correction Act of 2018" (H.R. 6201/S.3004), Micro-Offering Safe Harbor Act (H.R. 2201), and "Small Business Mergers, Acquisitions, Sales, and Brokerage Simplification Act of 2017" (H.R. 477) to name just some of the bills that will lead to powerful results for entrepreneurs and small businesses.

Also, recent action taken by the committee on H.R. 5877 Main Street Growth Act (H.R. 5877), the Small Company Disclosure Simplification Act of 2018 (H.R. 5054), and H.R. 5756, to require the Securities and Exchange Commission to adjust certain resubmission thresholds for shareholder proposals are supported by SBE Council.

With regard to giving small businesses a permanent voice at the SEC, we look forward to seeing progress in finding an Advocate for Small Business Capital Formation, a position that was required by law in December 2016. The office, and advocate, will be an important point of contact for entrepreneurs and small businesses and can help to spur change and new approaches that will be beneficial to capital formation. The position has yet to be filled.

I would be remiss if I did not mention the need for additional tax reforms that modernize and simplify the tax code for small businesses. I would urge committee members to take a look at the "Small Business Tax Simplification Act" (H.R. 3717), a bipartisan product of the House Small Business Committee. Several Financial Services Committee members also serve on the Small Business Committee, including Ranking Member Nydia Velazquez one of the chief sponsors and architects of the legislation, which provides common sense administrative fixes and solutions that reduce costs, complexity and uncertainty for small businesses. H.R. 3717 will make a meaningful difference for small businesses.

Once again I thank committee members for inviting SBE Council to be a part of the important hearing today, and I look forward to your questions and a discussion on how we can strengthen entrepreneurship and small business success in the growing economy.

Respectfully submitted by,

Karen Kerrigan