Taxes

Overview

NVCA is advocating for tax policy changes that will encourage new company formation. This can be accomplished by focusing on how and where the tax code impacts entrepreneurship and modernizing the rules in the code to better reflect the realities of the entrepreneurial business model.

The reason to do so is clear: new businesses are the engine of job creation in the United States, creating an average of about 3 million new jobs each year and accounting for virtually all net new job creation, according to data from the U.S. Department of Labor and the U.S. Census Bureau. Encouraging new company formation will help policymakers achieve each of the major stated goals for tax reform, which include economic growth, job creation, and expanded economic opportunity.

Startups are a unique business model which does not fit neatly into the definition of either large or small business, where most business tax reform conversations have been focused. While startups begin as small enterprises, their objective is significant growth and scale opportunity. These are new companies taking incredible risks against long odds to become the next generation of successful American businesses.

As a startup is going through the lifecycle of the entrepreneurial ecosystem, it normally generates losses while taking multiple rounds of investment capital to build the business. Therefore, proposals such as a corporate rate reduction or small business expensing will have a limited impact on the survival rate of startups, most of which do not have profits (some will be completely pre-revenue) unless and until they achieve some level of success. Therefore, tax policy should continue to encourage patient capital investment and consider discrete policy changes where the tax code impedes or ignores the entrepreneurial business model.

Startups generally have to operate for years using investment capital to develop a novel product, and so the investment environment is absolutely critical to entrepreneurship. The U.S. has done a good job over the last 35 years at sustaining tax policy that encourages patient, long-term investment and the country has benefited significantly as a result.

However, where the U.S. has done quite poorly is with rules in the tax code that seem to forget startups exist. Whether it’s trying to curb a perceived tax abuse that inadvertently sweeps startups into the definition, or writing rules that focus only on the circumstances of large companies, all too often tax policy just overlooks the startup ecosystem. Tax policy is one of the most powerful economic levers that policymakers have at their disposal. In fact, a healthy startup ecosystem is a major determinant in the ability of the country to realize economic progress in an increasingly competitive global economy.

Policy Recommendations

Implement reforms to encourage new company formation

Tax reform should also be an opportunity to encourage new company creation by changing rules in the tax code that ignore or unintentionally penalize startups.

- **Research & Development Tax Credit Reform** – Make the R&D credit work for startups, where a disproportionate amount of innovation is taking place in the American economy.

- **QSBS Reform** – Simplify and expand the Qualified Small Business Stock (QSBS) rules so they can function more effectively as an important incentive for investment in early stage startups.

- **382 Safe Harbor** – Protect innovative startups from punitive tax rules that discourage investment in innovation by creating a safe harbor for startups from the Net Operating Loss limitation rules under Section 382.

- **Stock Options Tax Deferral** – Allow startup employees a reasonable period of time to defer paying taxes on exercised stock options.

Maintain tax policies that are fundamental to economics of the entrepreneurial ecosystem

Tax reform should avoid increasing taxes on entrepreneurial investment and activity. Increasing taxes on the ecosystem would be a terrible miscalculation at a time when we find ourselves in a global competition to build the next generation of companies.

NVCA will continue to support sensible partnership tax rules that have facilitated the creation and growth of the venture capital industry and the entrepreneurial ecosystem.

- **Capital Gains Rate and Carried Interest** – A globally competitive capital gains rate applicable to carried interest earned by venture capitalists.

- **Capital Gains Rate Differential** – A meaningful differential between the capital gains rate and ordinary income rates to encourage risk investment and entrepreneurship.