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Double the Deduction for Small Business Start-Up Costs

By Anne Kim, Ryan McConaghy, and Tess Stovall

Small businesses are the engine of American job growth and the seedbed of innovation. Many of the world's greatest companies began as one person with one idea, tinkering in the garage. But getting a new venture off the ground is not as easy it should be. A doubled deduction for start-up costs can help entrepreneurs move a rung up the ladder and get closer to realizing their dreams.

THE PROBLEM

Starting a small business is expensive.

Many Americans dream of working for themselves and many are already doing so—at any given time, as many as 7% of American workers are actively in the process of starting a business, and one in ten Americans is self-employed.¹ The government should be doing more to help small businesses and entrepreneurs get off the ground.

Small businesses are the engines of American job growth.

Small businesses employ slightly more than half of the American workforce and create half of the nation's gross domestic product.² In 2004, small businesses accounted for all of the new jobs created in America—they generated nearly 1.9 million net new jobs while bigger companies actually shed workers.³ In the first quarter of 2007, before all sectors began to show declines, small business accounted for 74% of net new jobs. From 1994 to 2004, small businesses were responsible for 60 to 80 percent of net new jobs and provided two out of every three workers with their first job.⁴ Small businesses are also the lifeblood of the rural economy—nine out of ten businesses in rural America are small businesses.⁵

But business start-up costs can be steep.

Fledgling entrepreneurs face a host of expenses even before they open their doors—everything from legal and accounting fees to advertising and signs, supplies and equipment, tools, licensing, permits and other costs of regulatory compliance, rent and utility deposits. On average, new firms inject about \$80,000 into their business during the first year of operation.⁶ The vast majority of small business owners—between 80% and 90%—also invest significant amounts of their own money into their businesses.⁷ These budding enterprises are also more dependent on personal capital at startup than after they become established businesses. For small businesses, outside debt financing, such as bank loans or credit cards, makes up 40% of injected capital in their first year as opposed to 62% three years later.⁸ As a result, beginning entrepreneurs are investing the most, and in need of the most relief, at the very moment they are taking on the challenge of building their business.

THE SOLUTION

Double the deduction for small business start-up costs

Congress should double the deduction for start-up costs from \$5,000 to \$10,000 to help entrepreneurs get off the ground and sustain their small businesses.

This proposal would help many small businesses owners looking to start their own business.

This proposal would help the more than 600,000 Americans who start their own business every year.⁹ And in times of recovery from economic downturns, even more Americans look to start their own businesses. During the period of recovery from the 2002 economic downturn, the number of Americans starting their own businesses rose 5.7% from 2002 to 2003, compared to a 1.7% increase from 1997 to 1998 during the economic boom of the 1990s.¹⁰ As the economic forecast begins to look up in 2009 and 2010, more Americans may decide to follow their dreams and start their own businesses. This proposal will help to make some dreams possible and less costly.

This new tax break would help simplify the tax code.

By doubling the deduction for start-up costs, more small businesses will be able to deduct costs in the first year and avoid the complicated calculations associated with depreciating and amortizing capital equipment purchases over a period of many years. This proposal will help entrepreneurs navigate the complicated tax code more easily and sustain their small businesses.

This proposal is affordable.

Doubling the current deduction for business start-up costs from \$5,000 to \$10,000 would cost only \$700 million per year, \$4 billion over five years and \$9 billion over 10 years.¹¹

THE ROLLOUT

Ideas for launching and rolling out the double deduction for start-up costs

- **Hold a press conference** with local entrepreneurs who recently started a new business.
- **Release a short report** documenting the number of small businesses in the state and their contributions to the local economy in terms of the number of jobs created and the total number of new businesses. Highlight the new ideas and innovations being created.

CRITIQUES & RESPONSES

Double the deduction for small business start-up costs

It's too expensive.

Doubling the deduction for start-up costs would cost only \$700 million per year. This is a small price to pay to keep small businesses—the engine of American job growth and innovation—growing.

Encouraging the growth of small businesses will also help grow and sustain the middle class. Owning your own business is a big part of the American dream for many people, and the federal government should be doing more, not less, to help people reach those aspirations of success.

It will only help people who were going to start their own business anyway.

Even for those who have long dreamed of being their own boss, finding the financing to start a new business can seem like a daunting endeavor. Doubling the startup deduction to cover more of the expenses that average entrepreneurs face can only help to get more potential owners and operators off of the sidelines. The expanded credit will also help those who were already preparing to take the plunge, but this will only increase their chance of success and help them make a greater contribution to our economic recovery.

Won't this lead to people taking irresponsible risks?

No. Doubling the startup deduction will go a long way toward making it easier to get a business off the ground, but by no means will it be a full substitute for the private savings and borrowed financing needed to start a successful business. New entrepreneurs will still have much of their own wealth on the line and a clear stake in the success or failure of their business.

APPENDIX

Details of the doubled deduction for start-up costs

This proposal would double the allowable deduction for business start-up costs from \$5,000 to \$10,000. Business start-up costs include intangible expenses that are incurred before the commencement of business operations, such as advertising, travel, surveys, training and professional fees paid to lawyers and accountants.¹²

This deduction allows small business owners to receive a larger tax break on intangible expenses other than capital equipment costs for computers, equipment, furniture, etc., which can be deducted separately.

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■ ENDNOTES

- 1 Small Business Administration, "The Small Business Economy for Data Year 2006: A Report to the President," December 2007, available at http://www.sba.gov/advo/research/sb_econ2007.pdf.
- 2 Small Business Administration, "The Small Business Economy 2008: A Report to the President," 2009, available at http://www.sba.gov/advo/research/sb_econ2008.pdf.
- 3 Small Business Administration, "The Small Business Economy for Data Year 2006: A Report to the President," December 2007, available at http://www.sba.gov/advo/research/sb_econ2007.pdf.
- 4 Small Business Administration, "The Small Business Economy 2008: A Report to the President," 2009, available at http://www.sba.gov/advo/research/sb_econ2008.pdf.
- 5 Small Business Administration, "An Empirical Approach to Characterize Rural Small Business Growth and Profitability," February 2006, available at <http://www.sba.gov/advo/research/rs271tot.pdf>.
- 6 Alicia Robb, Janice Ballou, David DesRoches, Frank Potter, Zhanyun Zhao, and E.J. Reedy, "An Overview of the Kauffman Firm Survey: Results from the 2004-2007 Data," The Kauffman Foundation, April, 2009, available at http://www.kauffman.org/uploadedFiles/kfs_fourth_040709.pdf.
- 7 Small Business Administration, "Expected Costs for Startup Ventures," November 2003, available at <http://www.sba.gov/ADVO/research/rs232tot.pdf>. Solo entrepreneurs invest an average of \$8,026 of their own money into their businesses. For team ventures, the average amount invested is \$37,975.
- 8 Alicia Robb, Janice Ballou, David DesRoches, Frank Potter, Zhanyun Zhao, and E.J. Reedy, "An Overview of the Kauffman Firm Survey: Results from the 2004-2007 Data," The Kauffman Foundation, April, 2009, available at http://www.kauffman.org/uploadedFiles/kfs_fourth_040709.pdf.
- 9 Small Business Administration, "The Small Business Economy 2008: A Report to the President," 2009, available at http://www.sba.gov/advo/research/sb_econ2008.pdf. In 2007, 637,100 new small businesses were created.
- 10 Marilyn Adams, "The economy is brutal, but their business booms," USA Today, February 6, 2008, available at http://www.usatoday.com/money/industries/retail/2009-02-01-retail-success-recession_N.htm.
- 11 Third Way estimate based on the current take-up rate for this deduction and the potential number of small businesses that could be eligible for the benefit.
- 12 See IRS Publication 535 for details on deduction of small business start-up expenses, available at <http://www.irs.gov/publications/p535/ch08.html#d0e5397>.