Why it matters to startups:

Startup founders, employees, and investors all stand to benefit from tax policies that incentivize contributing to new, innovative companies that can't pay the high salaries or promise the returns that larger companies can. Tax credits, like for research and development (R&D), help startups fund critical and often costly research. Others, including Section 1202 of the Internal Revenue Code—often called qualified small business stock, or QSBS—encourage investment in and enable talent acquisition at early stage startups. State angel investment tax credits attract investors, though comparable provisions do not exist at the federal level.

On the other hand, complex, discriminatory tax frameworks discourage startup growth. Several countries have considered or adopted digital services taxes that, while directed at large U.S. technology companies, could impose trickle down costs for the startups that rely on the services these companies provide. And states, like Maryland, unsuccessfully attempted to follow suit. And while the OECD framework for the adoption of a global minimum tax rate and would eliminate DSTs has been agreed to, the deal must be passed by acquiescing legislatures, including the U.S. Congress, where it faces an uphill battle.

Key takeaways:

- Providing tax benefits to investors and startup founders and early employees can increase capital, talent, and opportunities for nascent companies.
- Policymakers can improve on existing tax benefits to make them more accessible to startups.
- Discriminatory international or interstate tax frameworks, like digital services taxes, that are targeted at large companies still stand to increase costs for nascent startups with limited budgets.

What policymakers can do:

Policymakers should explore ways to expand or alter existing tax benefits to help startups offset their liabilities while encouraging investment. One way to do that would be to make it easier and more useful for more startups to take advantage of the existing R&D tax credit, such as by expanding the definition of what qualifies as R&D to include common software development activities like user experience research and design. Policymakers should also preserve and expand existing benefits for startup investors and employees, including QSBS, and expand the Opportunity Zones program to include more areas. Finally, Congress could explore the creation of a federal tax credit for angel investors to incentivize startup investment, as is offered in a number of U.S. states.

Concerning tax regimes at the state and global levels, U.S. policymakers should continue use the tools at their disposal to push back against discriminatory digital services taxes that will ultimately stifle startup growth and innovation by making it harder for emerging companies to access the critical products and services they need to thrive.

Startup Spotlight

Actionfigure
(Washington, DC)
Matt Caywood, Fo-Founder & CEO

Actionfigure develops tools to make transportation data convenient and accessible.

"QSBS incentivizes people to reinvest money from returns on startup investments into new startups. ...[W]e had an investor who had a liquidity event, but because of QSBS tax treatment, he was incentivized to reinvest that money into a bunch of other startups and be a seed investor in new companies. And investment in startups is exactly what the government should be incentivizing."