TAX

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. For instance, immediate expensing for R&D helped many startups fund critical and costly research. Similarly, Section 1202 of the Internal Revenue Code—often called qualified small business stock, or QSBS—encourages investment in and enables talent acquisition at early-stage startups. And the child tax credit (CTC), which was temporarily expanded in 2021, can help women founders to pursue entrepreneurship.

On the other hand, complex, discriminatory tax frameworks discourage startup growth. Several countries have considered or adopted digital services taxes (DSTs) 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. While a global framework for the adoption of a worldwide minimum tax rate and a prohibition on DSTs has been agreed to, the deal must be passed by participating countries' legislatures, including the U.S. Congress, where it faces an uphill battle.

KEY TAKEAWAYS:

- Providing tax benefits to investors, startup founders, and early employees can increase capital, talent, and opportunities for nascent companies. Policymakers can improve on existing tax benefits, like the CTC, to make them more accessible to startups and their founders.
- Discriminatory international or interstate tax frameworks, like digital services taxes, that are targeted at large companies still stand to increase costs for growing 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. Policymakers should also take steps to return to immediate expensing for R&D costs. Policymakers should also preserve and expand existing benefits for startup investors and employees, including QSBS, and should pass legislation to permanently expand the child tax credit and explore other tax incentives to help women founders and women in the workplace.

Concerning tax regimes at the state and global levels, U.S. policymakers should continue to 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

Nixsheets

(San Francisco, Calif.)
Sal Abdulla, Founder & CEO

Nixsheets provides software to simplify workflow and automation for accounting teams.

"As a bootstrapped startup, we run our company at break-even/slight profitability. We've been stuck in a holding pattern focusing on services revenue (vs. software revenue) because our software-related payroll is no longer expensable. Put another way, if I spend money on R&D, I will go from breakeven to showing a large profit. I cannot afford the tax bill, so I am not investing in additional R&D hires at the moment."