TAX

What is tax policy?

Congress is responsible for developing tax policy, while the Internal Revenue Service is responsible for the implementation of this policy. Federal tax policy includes several areas like personal taxes filed every year, various corporate taxes, and complex taxes on foreign profits of U.S. multinational corporations. States have their own tax systems which use credits and deductions to affect economic activity. And international bodies like the Organisation for Economic Co-operation and Development (OECD) negotiate global tax frameworks that affect the digital services startups rely on.

KEY TAKEAWAYS:

- Tax policy has a significant impact on startups and can represent a barrier to growth and formation.
- A simplified tax code is easiest for startups to navigate. Overly complicated and discriminatory tax frameworks could result in complex tax planning and passed-down costs for startups.
- A permanently expanded child tax credit would help founders afford to support their families while undertaking the risk associated with launching a startup.

Why does it matter to startups?

Tax policy can be difficult for startups to navigate. While some tax benefits exist to assist startups and investors in offsetting their liabilities, many of these provisions can be improved. Benefits like the research and development (R&D) tax credit help startups fund critical and often costly research, and Qualified Small Business Stock can incentivize investment in startups and help startups attract talent. Many states encourage angel investment through tax credits, but comparable provisions do not exist at the federal level. Other considerations, like allowing employees to defer taxes when exercising stock options, significantly impact the recruitment and retention of talent, and expanding the child tax credit can help founders support their families so they can pursue entrepreneurship. Internationally, digital services taxes that target large tech companies could result in increased costs for startup customers.

Where are we now?

While previously, companies were permitted to immediately expense their research and development costs, the Tax Cuts and Jobs Act required these expenses to be amortized. This less favorable tax treatment makes conducting R&D more expensive, particularly for cash-strapped startups. Policymakers should continue to support efforts to return to immediate expensing for R&D and consider expanding the cap on the R&D tax credit, expanding eligibility for the credit, and broadening the definition of what counts as R&D to include common software development activities. Policymakers could implement a permanently expanded child tax credit (CTC). In 2021, Congress temporarily enhanced the CTC, leading to a landmark reduction in child poverty, providing working parents, including founders, with greater opportunities to build their careers.

Policymakers should also use tax policy to incentivize investment in startups. Several states have enacted angel investor tax credits, but there is no federal equivalent. Congress should also consider reforming the Opportunity Zone program, which provides tax benefits to individuals or corporations that invest in financially distressed regions.

Globally, several countries are considering digital service taxes, which would make products and services offered by predominantly large U.S. tech companies more expensive for startups to use. While OECD members agreed to a global tax framework, its implementation continues to face headwinds. Per the agreement, DSTs are temporarily suspended pending adoption, the target implementation date continues to be pushed back. Without formal adoption, the threat of unilateral DSTs will likely continue to grow.