



Tax Relief? An Innovative Proposal to Nurture New Entrepreneurs



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John Olson: Welcome to the Federal Reserve Bank of Atlanta's Economic Development podcast series. I'm John Olson with the Federal Reserve Bank of San Francisco.

Today I'm speaking with Bob Friedman, the founder and board chair of the Corporation for Enterprise Development, or CFED. CFED has proposed the idea that local and state governments can facilitate job creation by providing federal tax preparation assistance to new businesses and the self-employed. CFED proposed this idea as part of the "Big Ideas for Job Creation" project, which was sponsored by the Institute for Research on Labor and Employment at the University of California at Berkeley and supported by the Annie E. Casey Foundation. The project was a call to academics and economic development practitioners to design jobs programs for cities and states that would lead to net new job creation in one to three years. CFED's idea, entitled "Tax Benefits for Entrepreneurs," is one of five winning ideas from the Big Ideas for Job Creation project we are featuring in this podcast series.

Bob, thank you for speaking with us today.



Bob Friedman: Thank you so much for providing the opportunity.

Olson: Bob, it's not immediately obvious how tax preparation assistance could result in more jobs. Tell us more about the "tax benefits for entrepreneurs" idea and how it would work.

Friedman: It's a great question and I have to confirm your hypothesis that a connection is not obvious. I think the two facts you need to know are: one, that most new jobs, in fact, all the net new jobs being created in this economy over the last 30 years, have come from new businesses under four years old, and mostly under one year old, and most of those are self-employed. Combine that with the fact that the tax system through Schedule C (self-employment taxes) reaches 22 million self-employed each year, including two million new filers each year, and compare that to the U.S. microenterprise industry, which right now reaches 250,000 low-income entrepreneurs each year and only a tenth of them, or 25,000, with

microenterprise services.

So, Schedule C preparation could be a window into reaching the 22 million self-employed businesses and two million new ones each year. We impose a lot of burdens on those businesses tax-wise, and right now publicly supported tax assistance sites like the Volunteer Income Tax Assistance, or VITA programs, are not allowed to provide Schedule C tax preparation for low-income entrepreneurs.

Olson: And what's the magnitude of the impact of your proposal? How many jobs do you expect it would create? And what would be the cost of administering this program?

Friedman: Without doing anything to actual tax burdens and benefits right now, if we simply allowed both public- and private-service tax preparers to prepare self-employment returns, the cost is negligible. In fact, if we simply allow VITA sites to serve the self-employed, there would be no net new funding. There might need to be some preparation. And in pilots, we were able to reach already tens of thousands of entrepreneurs at the earliest stages of setting up their business with substantial benefits.

Right now, if you are self-employed you have to pay employer and employee share of FICA, that is payroll taxes, which can amount to 13 percent to 15 percent of your earnings in the first year; that's more a matter for the federal government. But if there were some kind of introductory rate, or for the first year, businesses wouldn't have to pay taxes up to, say, \$25,000 in income, there might be a cost of \$1,500 per tax return, but we think you could get as many as a million businesses starting or starting better.

Olson: What action are you calling for from policymakers and practitioners to overcome those barriers to implementing this type of program?

Friedman: The first and easiest step would be to allow VITA sites, tax prep sites, to serve the self-employed and prepare Schedule C. We have piloted this, we think it really costs virtually nothing, and the results will be felt on tens of thousands of businesses; it already in fact has.

By allowing Schedule C to be prepared by preparers, it brings a number of existing tax benefits, which are there in the tax code, into the purview of the self-employed. For example, there are several tax benefits that you can only get access to if you file the return, and those rebates could be available, and are available, to businesses that file.

Olson: In your paper, you described the Self-Employment Tax Initiative as a successful example of this idea. Tell us about that program and the results so far. And, are there any other programs that have been implemented that have had promising results?

Friedman: We initiated the Self-Employment Tax Initiative pilot in 2008 with 16 microenterprise and tax prep providers. They reached 30,000 self-employed businesses and recouped \$30 million in benefits, or an average of about \$1,000 per filing business. Fifty-two percent of those businesses were start-ups (first-time businesses), and we think that's just the beginning of what's possible.

And then you asked about other programs. As we all know we've been reading about the reduction in payroll taxes for the next two months, and then maybe for the next year. Among those that would be eligible for those reduced rates would be new businesses and the self-employed. We think the impact of that could be on the millions. New businesses over the last 30 years have generated between 2.2 million and 3.6 million new jobs each year. We are now at the low ebb of that, at about 2.2 million jobs per year. A new self-employment tax credit, we think, could move us up closer to the historic high; that is, we could add a million jobs a year at the cost of a few billion dollars, which would more than be made up for by the eventual taxes those businesses pay as they grow.

Olson: *Well, Bob, those certainly are promising results. So thank you for sharing that, and thank you for joining us today.*

Friedman: Thank you so much. I really appreciate and would welcome inquiries and suggestions.

Olson: *Well, this concludes our podcast. We've been speaking today with Bob Friedman, CFED's founder and chairman of the board. CFED is online at www.cfed.org.*

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