TAX

WHY IT MATTERS TO STARTUPS?

Startup founders, employees, and investors all stand to benefit from tax policies that incentivize investment, enable growth, and support people pursuing entrepreneurship. For instance, immediate expensing for R&D costs helped many startups fund critical and costly research. The 20% deduction for pass-through business income helps to bring parity between pass throughs and S corps and supports small business growth. 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. The favorable tax treatments of carried interest and capital gains similarly incentivize investors to fund startups. And the child tax credit (CTC), which was temporarily expanded in 2021, and is set to contract in 2025, can help founders who are parents—especially mothers— pursue entrepreneurship.

On the other hand, complex, discriminatory tax frameworks discourage startup growth. For example, digital ad taxes, which have been pursued across multiple states and in other countries, target the provision of low cost services on which startups rely. These taxes could result in increased costs, stretching a startup's already slim budget.

WHAT POLICYMAKERS CAN DO?

Key provisions of the Tax Cuts and Jobs Act are set to expire beginning at the end of 2025, while others have already begun to phase out. Policymakers should work to implement and extend provisions that help support startups including those that help startups stretch their funds further, enable entrepreneurship as a career pathway, allow startups to attract employees, and incentivize investment in startups. To help startups stretch their limited funds, policymakers should lower the overall tax burden for startups, including by preserving a low corporate rate and the 20% deduction for pass through income and by returning to immediate expensing for R&D costs while also making the R&D tax credit more useful for startups. Congress should prioritize legislation to permanently expand the child tax credit and explore other tax incentives to help women founders and women in the workplace. Policymakers should also expand existing benefits for startup investors and employees, like QSBS, and should preserve current benefits to investors, like the capital gains rate and the treatment of carried interest. Lawmakers could also explore other avenues to encourage investment like a federal angel tax credit.

KEY TAKEAWAYS

- Providing tax benefits to investors, startup founders, and early employees can increase capital, talent, and opportunities for nascent companies.
- Policymakers can also consider new benefits to strengthen the startup ecosystem—for example by expanding QSBS or implementing a federal angel tax credit—to drive startup investment.
- Congress should return to immediate expensing for R&D costs, which helps incentivize startups' innovative efforts.

★ Startup Spotlight ★

Ecobot
(Asheville, NC)
Lee Lance, Co-founder & CEO

Ecobot is a mobile and cloud platform optimizing fieldwork by speeding along regulatory approval and lowering costs.

"When R&D can be immediately expensed, it allows small, early-stage technology companies to immediately re-invest those dollars in building more innovative solutions. When it's amortized over five years, it suddenly feels irrelevant. Not worth the time to track, because what matters to a startup is THIS year. We don't have the luxury of thinking in five-year blocks."