The “Startup Act” – Catching the Economic Winds

The “Startup Jobs and Innovation Act”, properly evangelized within the economic development eco-system, can be reasonably expected to create jobs by nudging innovative technologies into the promised land of commercial success.

The “Startup Act” addresses major concerns of small technology businesses and startups. The government’s focus on bolstering startups is well-directed… “To jump-start economic recovery through the formation and growth of new businesses…”, …and well-founded. Paraphrasing Congress’ findings, “From 1980 to 2005, companies under 5 years old accounted for nearly all jobs created in the United States…accounting for 3M jobs annually…”. Therefore, “To get Americans back to work, entrepreneurs must be free (incentivized) to innovate, create new companies, and hire employees.”

The employee-hiring ability of technology-based entrepreneurial ventures relies largely upon continued 1) Economic (including tax related) Incentives, and 2) Capital Investment.

Incentivizing and funding such early stage companies requires unflinching resolve given the operating losses typically experienced while a technology’s functionality and value proposition are market-tested, adjusted and re-tested until validated. Only then making the way clear to pursue economies of scale for production and marketing functions.

This resolve to support startups in many ways rests with the government which has adjusted tax code to create investor-friendly treatment to transform otherwise unacceptable risk-reward investment propositions into compelling deals.

Further, entrepreneur-friendly tax code has been created to help minimize the risk-taking inherent in the effort to bring innovation to the market and create good-paying technology-oriented jobs.

To be effective, the ‘good news’ about these entrepreneur-encouraging, investor-compelling, job-creating government-tendered incentives must find it’s way to the investors and entrepreneurs; and economic development agencies at state and local levels make the perfect evangelists.

So, let’s get to preaching the virtues of the “Startup Act” (note: “small business” and “startup” are used interchangeably):

Small Business (SB) Expensing
The small business expensing limitation was permanently restored to $500,000, thus encouraging small businesses to continue investing in economy-of-scale-producing assets that improve top line and bottom line performance. This means the SB can fully write off investment ‘costs’ as current expenses (up to $500,000) instead of fractionally allocating deductions against those costs over the course of multiple years.

The SB gets the profit-boosting effects from the employment of key assets AND the tax-reducing effects from fully deducting the cost of those assets in the current year.

The financial picture of the company is much brighter from these dual benefits and becomes a more attractive funding opportunity for investors who can justify better terms with the SB for the use of their capital.

If expensed costs can’t be applied against taxable income, then an investor may become a pass-through loss beneficiary as addressed below.

Small Business Investors
The attractiveness of certain small businesses to investors is greatly increased when 100% of an investor’s gains on such investments can be excluded from capital gains taxes.

Further, the qualifying criteria for a business to be able to offer such favorable tax treatment are less strict now. This means investors can find more of these opportunities. Likewise, more businesses can entice investors with this highly favorable capital gains tax treatment.

Investors as Beneficiaries of Startup Pass-Through Losses
Investors (in certain cases) can be the beneficiaries of losses being ‘passed through’ from the SB (where the business wouldn’t be able to apply said losses against taxable income).

Startups Benefit From “R&D” Tax Credits As Payroll Tax Offset
The PATH Act (“Protecting Americans from Tax Hikes”), related to the “Startup Act”, allows the technology-based startup, which is commonly rich in “qualifying research expenditures” and associated tax credits, but often lacking in taxable income, to now apply “R&D” tax credits against payroll taxes. Startups in this case, among other criteria, are firms with less than $5 million in annual gross receipts.

Instead of suffering the inability to take advantage of R&D tax credits due to taxable income restraints, the startup can now use these tax credits to offset their payroll taxes by as much as $250,000 per year for as long as five years.

Startup Cost Expensing Level Raised
In the same vein as SB Expensing discussed above, startups will be able to fully deduct up to $10,000 (up from $5,000). This is another $5,000 that can be written off as an expense versus depreciating fractionally over a 15-year allocation timeline.

Cash Accounting
The cash accounting method is both less complicated and less costly to maintain, while reducing regulatory risk, versus more sophisticated tax methods required in the past. More small businesses can use this favorable method; now firms with up to $10M in gross receipts, up from $5M, can opt in.

It’s not a reach to expect that a small business would save money from less complexity associated with their taxes. These savings, and the attention that would otherwise be focused on complex tax compliance matters, could be used to improve a venture’s chances for success.

Favorable winds are at the back of the entrepreneur and investor alike. But, if their respective sails aren’t set to catch those winds then the creation of good-paying jobs and the realization of market-transforming innovations will be less robust than it could be otherwise.

Those close to the entrepreneur and private investor, that is, anyone directly or indirectly tied to the economic development eco-system (you know who you are), would do well to take it upon themselves to “inform and educate” as it is safe to assume that the intended beneficiaries of this favorable legislation are focused on developing cutting edge technologies and making the next deal, and not so much on deciphering government policy.