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Subcommittee on Economic Growth, Tax and Capital Access

Subcommittee Hearing:
“Private Sector Initiatives to Educate Small Business Owners and Entrepreneurs”

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Chairman Rice, Ranking Member Chu, and Members of the Subcommittee on Economic Growth, Tax and Capital Access, thank you for the opportunity to testify on behalf of the Corporation for Enterprise Development (CFED) regarding efforts to engage, educate, and empower small business owners and entrepreneurs. As the impact of the Great Recession continues to ravage communities from South Carolina to Southern California, we applaud the Subcommittee's focus on supporting small businesses and entrepreneurs—the true engines of innovation and opportunity in our economy.

About CFED

CFED—the Corporation for Enterprise Development—was founded in 1979 on a bedrock belief in the power of America's entrepreneurial spirit. "Enterprise," you might say, is our middle name.

Enterprise development has been integral to our work over the last thirty-five years. CFED's first major publication was entitled "*Revitalizing the American Economy through New Enterprise Development*." In the mid-1980s, CFED launched the Self-Employment Investment Demonstration to test strategies for empowering low-income workers to gain a foothold in the middle class through entrepreneurship and self-employment. In the 1990s, CFED was an early advocate for Individual Development Accounts (IDAs), which empower low- to moderate-income families and individuals to save and invest in buying homes, paying for college, and starting their own businesses.

Today, CFED's work takes place in three overlapping areas: programs, research, and policy. As a field builder we provide technical assistance and training to hundreds of nonprofits across the country and we invest in social enterprises to help these organizations create pathways to financial security for millions of Americans. As a leading expert on household financial security, CFED conducts cutting-edge research on strategies that build and protect assets for low-income families, expanding the evidence base in support of actionable strategies that empower financially vulnerable families. And as a leading national advocate, CFED coordinates a grassroots network of local asset-building organizations—the Assets and Opportunity Network—and promotes federal, state, and local policies to expand economic opportunity.

Importance of Supporting Microbusiness

In our nearly thirty-five years of work expanding economic opportunity through programs, research, and policy, we at CFED have been surprised again and again by the creative and economic power of America's micro-entrepreneurs. Far from a niche market, microbusinesses—those with four or fewer employees—account for nearly 90 percent of all businesses in the country. Roughly one in six South Carolinians and Californians own and operate a microbusiness. This figure is representative nationwide.

Microbusinesses can contribute the revitalization of entire communities. Mary Gatch of South Carolina started DwellSmart as a retail shop offering products that promote healthy, sustainable living - from building products to baby clothes. While enjoying modest profitability in the store,

DwellSmart's online sales were skyrocketing. After winning the distribution rights of two large green-oriented companies, DwellSmart needed to immediately move to a location with sufficient warehouse space and a loading dock. The company found the perfect spot in an unused building in an area of downtown Charleston that was experiencing revitalization and redevelopment. With the assistance of a Charleston Local Development Corporation (LDC) loan, DwellSmart made a significant investment in rehabilitating the property using eco-friendly and sustainable products.

In a nation seeking economic recovery through job creation, supporting microbusinesses like DwellSmart is an important solution. According to the U.S. Small Business Administration, businesses created by low-income entrepreneurs have high survival rates, ranging from 57-90 percent—higher than the survival rate for all small businesses.

Despite the small size of microbusinesses, the sector is a significant contributor to American economic growth and vitality. On average, microbusinesses create 2.9 full- and part-time jobs per business. Cumulatively, these microentrepreneurs and self-employed individuals amount to millions of firms and even more jobs. These microbusinesses and the self-employed represent new transfusions of ideas, talent, competition, and entrepreneurial energy into the overall economy. Small changes to enhance the capacity of such a large and productive group could reap major dividends.

At the individual and community level, microbusiness and self-employment can serve as a ladder out of poverty and into economic stability for some of the most disadvantaged populations. Microbusinesses that survive, grow, and become profitable, enhance household income and reduce families' reliance on public assistance. These low-income entrepreneurs gain a sense of security, new skills and managerial capacity, build new support networks, and increase self-esteem.

Another example of microbusiness success comes from CFED partner Pacific Asian Consortium in Employment (PACE), a Los Angeles-based workforce, community, and business development organization. Deborah Stern attended PACE's entrepreneurial training program in June 2008 while starting a business making tamales. She won a PACE award of \$5,000, which she used to hire two employees and rent a kitchen. From there, Stern attracted media coverage and cultivated loyal fans. Today, her business is more successful than she ever dreamed: she opened a restaurant, La Guera Tamalera, in the Silver Lake neighborhood of LA, which has become an area favorite. Stern has had remarkable success, but she is not wholly unique among PACE's clients: in 2010, 65% of returning microbusiness tax clients had increased their household income.

Self-Employment Tax Initiative

Recognizing the importance of micro-entrepreneurship as a strategy for expanding economic opportunity, CFED launched the Self-Employment Tax Initiative (SETI) in 2005 with three goals:

- 1) Build assets for low-income households

- 2) Create jobs by growing and expanding microbusinesses
- 3) Increase tax revenue by bringing self-employed into the formal tax system

To accomplish these goals, SETI has awarded more than \$500,000 to 40 community-based organizations that offer free or affordable tax preparation assistance to low-income, self-employed taxpayers. These local partners have helped SETI identify, test, and refine promising practices for using the tax filing process as a means of fostering small business development.

Most of SETI's local partners are Volunteer Income Tax Assistance (VITA) programs, which provide free tax support to low- and moderate-income taxpayers. There are nearly 6,000 community-based VITA sites throughout the country. In Horry County, South Carolina, you can find VITA programs at the Chapin Library, the North Myrtle Beach Library, and the Surfside Beach Library. In Monterey Park, California, VITA assistance is offered through the Monterey Park Bruggemeyer Library. Down the road in Pasadena, you can find VITA at El Centro De Accion Social.

VITA is a brilliant example of a successful public-private partnership. In South Carolina, California, and the rest of the country, these VITA sites represent local community efforts—supported by federal grants, state and local funds, and philanthropy—to engage low-income taxpayers and ensure that they get a fair shake from the tax system. According to a 2012 National Community Tax Coalition (NCTC) report, VITA helped more than 3 million taxpayers claim \$2.2 billion in tax refunds while saving the federal government \$5.5 million in reduced processing costs.

Expanding VITA to Support Micro-Entrepreneurs

VITA represents an excellent opportunity to engage and empower micro-entrepreneurs. Frustrated by the complexity of the business tax code, many of these entrepreneurs are left with few options for learning about and accurately completing their tax filings. The inaccessibility of low-cost or free tax preparation assistance and the complexity of the tax code compel many self-employed people to seek tax assistance from costly commercial preparers. Those small business owners who do not seek—or cannot afford—help from commercial tax preparers may choose not to file taxes at all.

While the existing VITA program assists some low-income entrepreneurs, IRS restrictions on allowable VITA activities prevent many self-employed earners from receiving any assistance. For example, VITA sites are restricted to preparing Schedule C-EZ only, and self-employed taxpayers must have expenses below \$5,000.

Recognizing that VITA's narrow scope meant that sites were turning away micro-entrepreneurs who had with few other options, the National Community Tax Coalition (NCTC) led an effort with CFED and the IRS Stakeholder Partnerships, Education and Communication (IRS-SPEC) team to build on CFED's SETI program. In 2010, this partnership launched the Schedule C VITA Initiative. Through this initiative, sixteen pilot sites across the country are now able to serve a wider range of low-income entrepreneurs, including businesses with up to \$25,000 in

expenses, as long as they meet certain other qualifications such as no net operating losses, no inventory, and limits on business use of the home, among others.

In its three years of operation, the Schedule C VITA Initiative has not only brought thousands of low-income entrepreneurs into the VITA program, it has done so without reducing tax-filing quality. According to SPEC's own reviews of the sixteen VITA sites, nearly 95 percent of Schedule C returns reviewed by SPEC staff at participating sites were found to be accurate. As the initiative continues next year, it will continue exploring methods for expanding VITA assistance for micro-entrepreneurs.

Next Steps to Expand Support for Micro-Entrepreneurs

What does this mean for federal efforts to support micro-entrepreneurs?

CFED is currently exploring additional federal policy reforms that would effectively support micro-entrepreneurs. Our research is examining how three key federal policy systems—workforce, postsecondary education, and tax—support or fail to support these low- and moderate-income entrepreneurs. Later this year we will release our report detailing recommendations for reforms that would significantly expand the ways in which federal policy supports the growth and success of these entrepreneurs.

While this research will reveal new reforms worth considering, this Subcommittee need not wait to act in support of micro-entrepreneurs. In the previous Congress, Ranking Member Chu proposed one significant step forward: the Entrepreneur Startup Growth Act. This legislation, based on CFED's SETI program, would have provided additional support for micro-entrepreneur tax filing assistance. The \$1.5 million authorized by this legislation could support hundreds of local VITA sites to serve thousands of micro-entrepreneurs.

Conclusion

Chairman Rice and Ranking Member Chu, I would like to thank you again for inviting me to testify on behalf of CFED. We at CFED are eager to work with the Subcommittee to expand economic opportunity, create jobs, and support micro-entrepreneurs. I would be pleased to answer any questions you and the other members of the Subcommittee may have.