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Tax Incentives for Small Business Hiring and Investment:

Strengthening the Backbone of the Economy

The U.S. economic recovery has continued at a modest pace in recent quarters. Private-sector employers have added jobs for 28 consecutive months, although the pace of job growth has moderated in recent months. At this critical juncture, targeted tax credits may provide additional incentives for business owners to add workers. Enacting a tax credit for businesses that hire additional workers or increase the hours and wages of existing employees would help to sustain and accelerate the recovery. A tax credit for increasing payroll would be particularly beneficial for small businesses, which account for a substantial majority of business establishments and are responsible for a significant share hiring during the recovery. Additionally, extending the 100 percent depreciation deduction for major purchases through 2012 would reduce the cost of investment and promote economic growth.

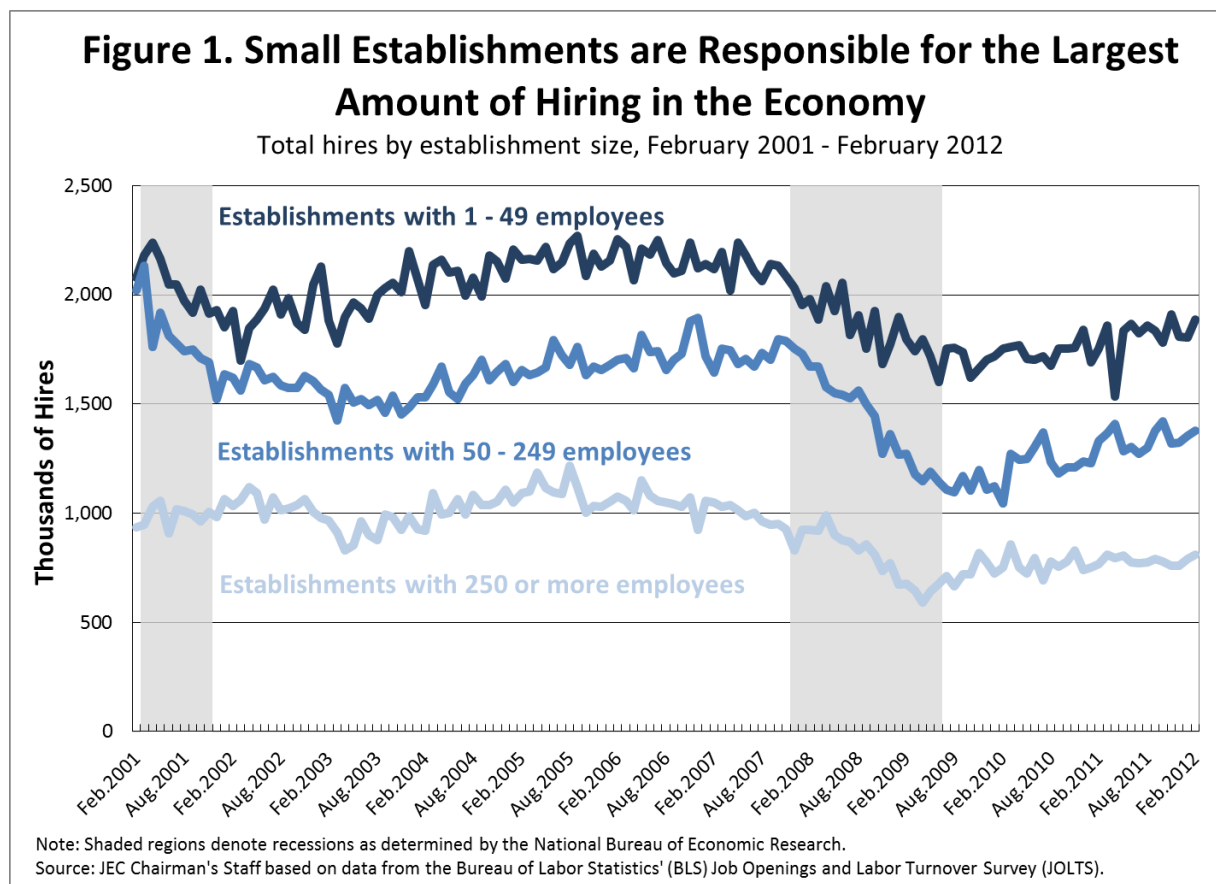
REPORT BY
THE U.S. CONGRESS JOINT ECONOMIC COMMITTEE CHAIRMAN'S STAFF
Senator Bob Casey, Chairman

The Vast Majority of Establishments Are Small Business Establishments

Nationally, 79 percent of business establishments are either single-establishment businesses with fewer than 100 employees or are parts of multi-establishment companies with total employment under 100.¹ A healthy small business sector goes hand in hand with a healthy economy. During and in the aftermath of the Great Recession, not only did demand for goods and services fall off, but tightening lending standards led to reductions in credit availability, which hit small businesses especially hard. The small business credit crunch is also the result of declining housing and commercial real estate prices, since many small business owners use real estate as collateral for a loan or line of credit.² The lingering impact of these conditions remains a drag on the small business sector.

Small Establishments Account for a Major Share of Hiring

Small businesses are responsible for a greater amount of hiring in the U.S. economy than medium-sized or large businesses (see **Figure 1**).³ Although hiring across all establishment sizes fell during the 2007-09 recession, small business hiring continued to account for a significant share of new jobs. As the labor market recovery has begun, small businesses have once again led the way. From February 2010 to February 2012, the last month for which data is available broken down by establishment size, small establishments (those with fewer than 50 employees) were responsible for 46 percent of hires, versus 34 percent for medium-sized establishments (50-249 employees) and 20 percent for large establishments (250 or more employees) (see **Figure 2**).⁴ Small establishments also accounted for the largest share of new jobs created in the years following the 2001 recession, adding 44 percent of all jobs from December 2001 to December 2003.⁵

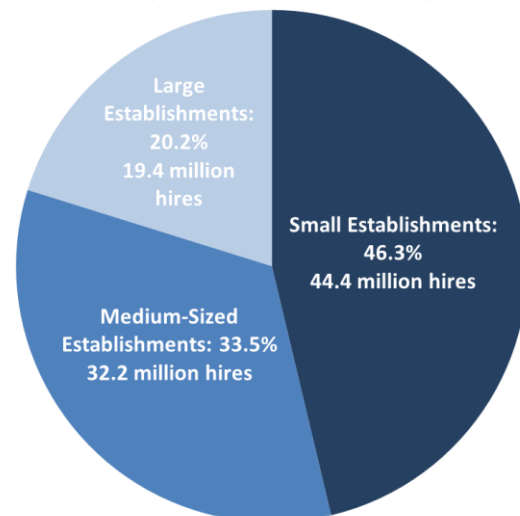


Targeted Tax Relief Can Fuel Additional Small Business Hiring and Investment

Policymakers can support job creation by targeting tax incentives to firms that increase payroll. The Small Business Jobs and Tax Relief Act (S. 2237) would provide a tax credit of 10 percent of the excess of 2012 payroll over 2011 payroll for businesses that expand payroll. In order to target the tax credit to small businesses, the proposed credit is capped at \$500,000 per firm, or 10 percent of a payroll increase of \$5 million. Businesses would be eligible to receive the credit for any increases to the payroll tax base — hiring new workers, or increasing hours or raising wages of existing employees up to the \$110,100 cap for the payroll tax. Based on current average weekly earnings of private sector employees, a business would receive a tax break of approximately \$4,200 over the course of the year for hiring an additional worker paid the average amount.⁶

Figure 2. Small Establishment Hiring Has Continued to Lead the Way During the Recovery

Share of total hires by establishment size, February 2010- February 2012



Note: For the purposes of this analysis, small establishments employ 1-49 persons, medium-sized establishments employ 50-249 persons, and large establishments employ 250 or more persons. Source: JEC Chairman's Staff based on data from the Bureau of Labor Statistics' (BLS) Job Openings and Labor Turnover Survey (JOLTS).

The proposed legislation would benefit small businesses, which are the vast majority of establishments in every state. State-specific data show that the share of small business establishments ranges from 70 percent of all establishments in the District of Columbia to 85 percent or more in Montana, Vermont, and New York (see **Table**).⁷

The nonpartisan Congressional Budget Office has determined that a well-designed tax credit for increasing payroll is among the most effective policies for promoting growth and putting people back to work.⁸ Using the payroll tax base as the basis for determining the value of the credit has the added benefit of targeting relief to middle- and lower-income workers, since credits would not be able to be claimed for increasing individual salaries beyond \$110,100 in 2012. Additionally, the Small Business Jobs and Tax Relief Act would extend the 100 percent depreciation deduction for major business investments through 2012. This would reduce the cost of capital for businesses, promoting investment and accelerating economic recovery. Without this extension, these costs would have to be deducted over the course of several years.

Sources:

¹ JEC Chairman's Staff. Calculations using data from the U.S. Census Bureau. *Statistics of U.S. Businesses*, 2009.

² Nick Carey. "U.S. Credit Crunch Hits Jobs-Rich Small Businesses." *Reuters*. May 22, 2008; See also Mark Zandi. "Jump-Starting the Job Market: How Well Will a Job Tax Credit Work." *Moody's Economy.com*. February 8, 2010.

³ The size categories used for this analysis differ from the above discussion because establishments can be a subset of a larger business enterprise. Since the hiring data are only available at the establishment level, a more restrictive definition of small business is used to account for the possibility that an establishment is a subset of a larger business enterprise.

⁴ JEC Chairman's Staff. Calculations based on data from the Bureau of Labor Statistics Job Openings and Labor Turnover Survey.

⁵ *Ibid.*

⁶ Bureau of Labor Statistics. Average Weekly Earnings of All Employees: Total Private. Tax savings calculated by multiplying this amount by 52 to determine average yearly earnings for a worker and then dividing by 10 to get the value of the tax credit for the firm. This calculation assumes that payroll would otherwise stay constant.

⁷ JEC Chairman's Staff. Calculations using data from the U.S. Department of Commerce, Census Bureau. *Statistics of U.S. Businesses*, 2009.

⁸ Congressional Budget Office. "Policies for Increasing Economic Growth and Employment in 2012 and 2013." Testimony before the U.S. Senate Committee on the Budget. November 2011.

Number of Establishments by Size of Business Enterprise, 2009

State	Small Business Establishments (< 100 employees)	Medium-Sized Business Establishments (100-499 employees)	Large Business Establishments (500+ employees)	Small Business Establishments as a Percentage of All Establishments
U.S. Total	5,899,509	353,510	1,180,446	79.4
Alabama	76,136	5,409	19,260	75.5
Alaska	16,269	1,016	2,616	81.7
Arizona	101,807	6,636	25,629	75.9
Arkansas	50,812	3,562	11,077	77.6
California	701,810	36,667	119,354	81.8
Colorado	124,422	6,200	22,375	81.3
Connecticut	71,609	4,443	13,996	79.5
Delaware	18,283	1,282	4,958	74.6
District of Columbia	14,868	1,456	4,886	70.1
Florida	398,367	16,772	76,110	81.1
Georgia	168,638	9,906	40,804	76.9
Hawaii	25,537	1,945	4,890	78.9
Idaho	36,881	2,099	5,320	83.3
Illinois	251,600	14,829	48,548	79.9
Indiana	110,850	8,604	26,563	75.9
Iowa	63,823	5,493	11,655	78.8
Kansas	58,585	4,587	11,526	78.4
Kentucky	68,323	5,170	17,168	75.4
Louisiana	80,692	5,358	17,334	78.1
Maine	33,386	2,281	4,949	82.2
Maryland	106,941	6,273	22,419	78.8
Massachusetts	135,946	8,918	25,609	79.7
Michigan	176,564	10,744	34,374	79.6
Minnesota	117,878	8,086	20,489	80.5
Mississippi	45,198	3,344	11,065	75.8
Missouri	117,586	8,028	25,278	77.9
Montana	31,400	1,431	3,495	86.4
Nebraska	41,323	3,113	7,197	80.0
Nevada	45,622	3,196	10,967	76.3
New Hampshire	30,339	1,801	5,733	80.1
New Jersey	192,199	7,913	31,074	83.1
New Mexico	35,133	2,367	7,486	78.1
New York	438,444	18,864	58,511	85.0
North Carolina	169,404	10,799	38,784	77.4
North Dakota	17,607	1,290	2,548	82.1
Ohio	192,988	14,170	49,393	75.2
Oklahoma	71,296	4,714	14,337	78.9
Oregon	88,129	5,864	14,047	81.6
Pennsylvania	231,927	15,164	51,341	77.7
Rhode Island	23,718	1,386	3,578	82.7
South Carolina	78,808	5,181	19,265	76.3
South Dakota	21,208	1,621	2,654	83.2
Tennessee	97,298	7,580	28,023	73.2
Texas	393,262	25,245	100,521	75.8
Utah	56,634	2,910	9,920	81.5
Vermont	18,366	1,067	2,134	85.2
Virginia	148,396	9,439	36,183	76.5
Washington	144,655	8,259	24,362	81.6
West Virginia	29,524	2,263	7,203	75.7
Wisconsin	111,782	7,921	21,158	79.4
Wyoming	17,236	844	2,280	84.7

Note: An establishment is defined as a single physical location where business is conducted or where services or industrial operations are performed. A business enterprise is an organization consisting of one or more domestic establishments under common ownership or control. Business enterprise size designations are determined by the summed employment of all associated establishments nationally.

Source: JEC Chairman's Staff based on data from the U.S. Department of Commerce, Census Bureau.