Unintended Gender Bias in Our Tax Laws

Individual & Family Taxation Committee
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Definitions

• Bias – favoring one group over another
• Unintended – not planned or meant
• Implicit bias – unawareness or incorrect beliefs/assumptions lead to incorrect understandings of a person or group; effect of stereotypes

• Possible example in tax law:
  • Belief that businesses have tangible assets or such assets create economic growth, or greater familiarity with older business models.
  • Result: Write tax laws that favor tangible assets (depreciation, §199A UBIA cap, employee achievement award benefits, others)
Causes of unintended bias in tax law

• Data
  • Not collecting or using appropriate data.
  • Not updating data.

• Not regularly looking for unintended bias in the tax law.

• Principles of good tax policy
  • Not considering such principles regularly.
  • Ignoring basic elements of tax systems
    • Example: Ability to deduct expenses of producing taxable income as basic feature of a personal income tax.

• Focus on helping particular industries
  • But, this is usually intended rather than unintended.

• Use of ineffective approaches to helping particular industries or businesses
  • Example: Focus on tangible rather than also intangible business assets.
  • Example: Singling out particular activities to not obtain a benefit although undermines intent of the provision, such as no §199A deduction for SSTBs with high taxable income even though no such limitation exists for high taxable income C corporations.
Queries –

Why does the federal income tax ...

• Favor capital gains and qualified dividends over wage and interest income?
• Favor scholarship income over student wage income used to cover tuition?
• Favor employer-provided health insurance over self-funded health insurance?
• Assume that the standard deduction and personal/dependency exemption (or credit) should be the same across the country despite wide disparities in cost-of-living?
• Favor interest on home mortgages over student debt?
• Favor college expenses over trade school or other career training expenses?
• Favor heavy vehicles (over 6000 pounds) over lighter ones?
• Favor business expenses over employee business expenses and investment expenses?
• Favor certain income and expenses of high income individuals over lower income individuals (capital gain rate preference, large gain exclusion on sale of a home, non-taxable fringe benefits, others)?
• Favor non-SSTBs over SSTBs (§199A)?
• Favor tangible assets over intangible business assets?

  • Are any of the favored rules needed? Are they regularly reviewed?
Data Collection and Analysis Considerations

• Is sufficient data collected on demographics of who uses various tax preferences?
• What about data on those excluded from various tax preferences?
• What criteria is appropriate for determining whether a tax preference is needed and if yes, for how long, and how to evaluate its effectiveness?
• What analysis is performed on economic, social and environmental trends that may create or increase existing bias in tax rules?
• What about cost-benefit analyses?
• What evaluation can be used to test for implicit and unintended bias?
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Implicit Bias in 2017 Tax Act

1. Elimination of §§ 71 and 215 Alimony Inclusion/Deduction Regime
2. New § 162(q) Payments Related to Sexual Harassment and Sexual Abuse
3. Business Tax Expenditures – Corporate Rate Cut, New § 199A, and Changes to §§ 179 and 168(k)
Overview of Alimony Today

- Temporary maintenance to support lower earning spouse in years following separation and divorce
- Awarded upon analysis of factors prescribed by state law to determine whether alimony is necessary, *i.e.* justified by an identifiable need rather than husband’s “natural and legal duty . . . to support the wife”\(^1\)
- Income shift from high income spouse to lower income spouse may result in “divorce subsidy” (but not always) for tax purposes
- Tax savings relied upon as incentive to reach agreement in collaborative divorce proceedings and for payer spouse to agree to larger award\(^2\)
- In 2017, 98% of alimony recipients were women\(^3\)

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\(^1\) *Gould v. Gould*, 245 U.S. 151 (1917).
\(^2\) 2018 A.B.A. Section of Family Law Report to the House of Delegates.
Tax Treatment of Alimony

Pre-1942
*Gould v. Gould*\(^4\) – alimony income is includible in recipient’s income and not deductible by payer spouse

1942\(^5\) to 2018
§ 71 Alimony Income Inclusion
§ 215 Above-the-Line Deduction for Alimony Payment

Beginning 2019
No inclusion/deduction for alimony payments\(^6\)

\(^4\) 245 U.S. 151 (1917).
Operative Provisions of 2017 Tax Act

- Elimination of § 71 (inclusion) and § 215 (deduction)
- Removal of alimony from includible items under § 61(a) and “above-the-line” deductions under § 62(a)
- Effective for divorce or separation agreements entered into after 12/31/2018
- Pre-2019 divorce and separation agreements are grandfathered but NOT prenuptial agreements or § 682 alimony trusts

Congressional Intent

- “[T]o follow the rule of law in Gould v. Gould, in which the Court held that such payments are not income to the recipient”

- “[E]liminate what is effectively a ‘divorce subsidy’ under current law”

- Create parity between tax treatment of “spousal support as a consequence of a divorce or separation” and “spousal support within the context of a married couple”

- Create parity between tax treatment of alimony and child support

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**ISSUE:** Whether monthly award of $3,000 for life for support and maintenance should be included in recipient spouse’s gross income.

**HELD:** Alimony is neither includible in the gross income of the recipient spouse nor deductible by the payer spouse.

“Alimony does not arise from any business transaction, but from the relation of marriage. It is not founded on a contract, express or implied, but on the **natural and legal duty of the husband to support the wife**. The general obligation to support is made specific by the decree of the court of appropriate jurisdiction. * * * Permanent alimony is regarded rather as a **portion of the husband's estate to which the wife is equitably entitled**, than as strictly a debt; alimony from time to time may be regarded as a portion of his current income or earnings.”

Comparison of Tax Liabilities

<table>
<thead>
<tr>
<th></th>
<th>MFJ (no alimony)</th>
<th>Divorce under 71/215 Regime</th>
<th>Divorce after 2017 Tax Act</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income</td>
<td>$75,000</td>
<td>$75,000 (P)</td>
<td>$75,000 (P)</td>
</tr>
<tr>
<td>Less Standard Deduction</td>
<td>($24,000)</td>
<td>($12,000)</td>
<td>($12,000)</td>
</tr>
<tr>
<td>Less Alimony Deduction</td>
<td>n/a</td>
<td>($6,000)</td>
<td>n/a</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$51,000</td>
<td>$57,000</td>
<td>$63,000</td>
</tr>
<tr>
<td>Marginal Rate Bracket</td>
<td>12%</td>
<td>22%</td>
<td>22%</td>
</tr>
<tr>
<td>Tax Due</td>
<td>$5,739</td>
<td>$8,480</td>
<td>$9,800</td>
</tr>
<tr>
<td>Income After Tax &amp; Alimony</td>
<td>$69,261</td>
<td>$60,520</td>
<td>$59,200</td>
</tr>
<tr>
<td>Total After Tax Income within “Family Unit”</td>
<td>$69,261</td>
<td>$66,520</td>
<td>$65,200</td>
</tr>
</tbody>
</table>

P = Payer Spouse   R = Recipient Spouse

For simplicity and ease of comparison, calculations use 2018 marginal rates, do not account for children or other dependents, and do not take into account other income, deductions, credits, or taxes that might affect financial outcomes.
Consequences of Expenditure Elimination

- Expected to generate $6.9 billion in increased revenue over next 10 years\(^\text{11}\)
- Increase in “divorce penalty”, e.g. additional $1,320 in tax for single earner divorced couple making $75,000, leaving less money available for alimony
- Elimination of incentive to agree to alimony may result in more contentious divorces, increased legal costs, and smaller awards
- States that take tax treatment of alimony into consideration will need to consider net after tax income of payer spouse rather than gross income (and state laws that specifically reference gross income will need to change)

\textit{Because 98\% of alimony recipients are women, it is women who will shoulder economic hardship attributable to increase in taxes and corresponding decrease in awards.}

\(^{11}\text{Joint Committee on Taxation, Estimated Budget Effects of the Conference Agreement for H.R. 1, the “Tax Cuts and Jobs Act”, Rep. No. JCX-67-17 at 3 (Dec. 18, 2017).}\)
Implicit Bias and Policy Concerns

Return to Rule of Law in *Gould*

- Regression of law away from gender neutral statutory language in favor of rhetoric that perpetuates gender stereotypes and the subordination of women
- Assumes heteronormative view of marriage as between man and women
- Elimination of “divorce subsidy” and imposition of “divorce penalty” facilitates Code’s bias toward marriage
- Misunderstands role of alimony in modern collaborative and judicial divorce proceedings
- Assumes courts would still view alimony as excludible from gross income in light of subsequent case law, and challenging *Gould* could result in worse case scenario (inclusion with no deduction)
Implicit Bias and Policy Concerns

Characterization of 71/215 Regime as “Divorce Subsidy”

- Stereotypes of alimony as tax shelter for wealthy and wealthy women collecting alimony for life ignores reality that single earner middle and lower class families may pay MORE in tax following divorce while struggling with financial hardship of establishing two separate households.

- Reduced financial resources means reduced alimony awards and corresponding increase in difficulty for women to achieve economic self-sufficiency (raising fear that women may stay in bad/abusive marriages because divorce is not financially possible).

Leveling Down to Achieve Parity with Child Support

- Conflates purposes of alimony (temporary maintenance to facilitate economic self-sufficiency based on need) and child support (legally recognized support obligation).

- Assumes tax treatment of child support is good policy.
Implicit Bias and Policy Concerns

Re-enacting Section 71/215 Regime

- Ignores influence of tax laws in creating need for alimony in the first place (disincentive for second earner to remain in workforce after marriage)

- Disregards families for whom alimony was never awarded and single parents who were never married and struggle to pay/collect child support

- Ignores interconnected nature of tax provisions that affect ability of women to participate in market and achieve economic self-sufficiency
Implicit Bias and Policy Concerns

Need to consider demographics –
- Who is getting married? Who is getting divorced?
- Who is awarded alimony? Who isn’t?
- Why is alimony awarded?
- What are the income levels of alimony payers and recipients?
- What are income levels of those who do not receive alimony?

With a view to broader considerations and tax provisions that affect women’s ability to participate equally in market –
- Treatment of child support?
- Treatment of child care expenses?
- What is a family for tax purposes?
- Gender pay gap and discrimination in the workplace?
- Gender bias in access to capital?
Section 162(q) and #MeToo

No deduction shall be allowed under this chapter for—

1) Any settlement or payment related to sexual harassment or sexual abuse if such settlement or payment is subject to a nondisclosure agreement, or

2) Attorney’s fees related to such a settlement or payment.¹²

Workplace Sexual Harassment and Abuse

- In FY 2018, there were 7,609 charges of sexual harassment filed with the EEOC, 84% of which were filed by women, and $56 million in settlement payouts (not including payouts from litigation).  

- 42% of women say they have experienced sex discrimination in the workplace vs. 22% of men.

- Women are 3 times as likely as men to experience sexual harassment (form of sex discrimination) in the workplace.

- At least 1 in 4 women have been the victim of sexual harassment in the workplace (between 25 and 85% of women depending on how “sexual harassment” is defined) and women of color experience higher levels of harassment than white women.

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Confidentiality Concerns

- EEOC estimates that 90% of victims never take formal action due to fears of social or professional retaliation, a fear that they will not be believed, or a fear that no action will be taken.\(^\text{16}\)

- Research suggests that publicity surrounding claims of discrimination and harassment can create hostile work environment even when claims are settled with the employer.

- Lack of confidentiality forces victims to publicly present themselves as victim (stigmatized identity) and it is more likely that victims will pursue legal claims if they can avoid publicity and stigmatization.

162(q) Good Intentions Gone Bad?

**General Concerns**
- Overly broad – disallowance of “any deduction under this chapter” means attorneys’ fees incurred by victims are also not deductible
- Undefined Terminology – fails to define “sexual harassment” and “sexual abuse”
- Limited Application – disincentive does not extend to tax-exempt employers

**Implicit Bias**
- Incorrectly assumes victim preference for disclosure
- Fails to consider well-grounded fears of retaliation, social stigma, disbelief, and blame associated with publicity
- Marginalizes victims by elevating need to eliminate concealment of sexual harassment and abuse over individual victims’ needs
Marginalization of Victims

Because disallowance extends to victims as well, victims are put in position of having to choose between –

- Coming forward with claim and maintaining confidentiality through a nondisclosure agreement, while including full amount of any settlement payment in income without benefit of deduction for attorneys fees;

- Coming forward with claim and relinquishing confidentiality, such that all otherwise eligible expenses relating to the matter are deductible by both parties, while facing threat of retaliation, social stigma, disbelief, and blame; or,

- Remaining silent altogether (potentially allowing misconduct to continue).
Clarifications and Proposed Corrections

Senate Finance Committee Letter to Treasury

- August 16, 2018 letter expresses Congressional intent to except recipient’s attorney’s fees from the disallowance provision to ensure that IRS guidance and enforcement reflects that intent.

JCT Bluebook Explanation

- Attorney’s fees incurred by the beneficiary of the settlement or recipient of the payment are not subject to 162(q).
- Footnote states that technical corrections may be necessary to reflect intent.

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Guidance or technical correction reflecting this intent would fail to address implicit bias in assumption of victims’ preferences concerning confidentiality as well as applicability of statute to tax-exempt employers.

Clarifications and Proposed Corrections

Proposed EMPOWER Act (H.R. 6406, S. 2988 and S. 2994)

- Disallows any deduction for amounts paid/incurred pursuant to litigation related to workplace harassment, including sexual harassment, or for expenses and attorneys fees (other than plaintiff/claimants’ expenses/fees), or for insurance that covers the defense or liability.
- Adds new § 132H excluding from gross income any amount received in connection with a judgment or settlement of claims relating to workplace harassment (including sexual harassment) or other unlawful discrimination defined in § 62(e).
- Adds new § 1302 limiting tax imposed on employment discrimination compensation.
- Makes it unlawful for employers to condition aspects of employment on agreement to nondisclosure agreement pertaining to workplace harassment, including sexual harassment.

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EMPOWER Act addresses confidentiality concerns by disallowing all payments and expenses regardless of whether there is a nondisclosure agreement, but still fails to extend consequences to tax-exempt entities.
Other Considerations

- Need to consider who is affected by these provisions and ask those affected and their advocates: Will these proposals help or further marginalize and disempower?
- Is Tax Code appropriate mechanism to address workplace harassment and abuse?
- If so, is there a way to extend consequences to tax-exempt employers? E.g. treat payments as UBIT?
Business Tax Expenditures

1. Corporate Rate Reduction to 21%
2. New § 199A Passthrough Deduction
3. Accelerated Depreciation Enhancements, §§ 179 and 168(k)
Corporate Rate Reduction

- Corporate tax rate reduced to 21%\textsuperscript{24}
- Expected to cost federal government $1.348 trillion between 2018 and 2027\textsuperscript{25}

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*Because most women-owned businesses are not incorporated, women-owned businesses will not benefit from this expenditure.*

\textsuperscript{24} Pub. L. No. 115-97, § 13001, 131 Stat. at 2096.

\textsuperscript{25} JCT Estimated Budget Effects of the Conference Agreement for H.R. 1, the “Tax Cuts and Jobs Act”, Rep. No. JCX-67-17 at 3.
Background on Women Business Owners (WBOs)

- WBOs account for 40% of all U.S. firms and the total number of women-owned firms has increased over the last ten years by 58%
- WBOs are small businesses (99%) primarily operating as service firms (more than 60%) and continue to have challenges growing receipts and accessing capital.
- Women of color are the “driving force behind the growth of women-owned firms.” Firms owned by women of color grew at a rate of 163% during the last 10 years and today, women of color own 64% of the new women-owned businesses launched each day.


Industry Representation

- **Half of women-owned businesses** are concentrated in three industries: other services, health care and social assistance, and professional/scientific/technical services.
- Women are significantly **more likely to launch businesses** within the healthcare (10%) or education sectors (9%) than men (5% in both cases). In contrast, men are significantly more likely to start businesses in the construction and manufacturing industries (12%) than women (4%).
- Women-owned businesses **employ the most people** in healthcare and social assistance (20%), accommodations and food services (16%) and administrative, support and waste management services (13%).
- Women-owned businesses have the **highest total revenue** in wholesale trade (17%), retail trade (15%) and professional, scientific and technical services (10%).
Background on WBOs & Revenue

<table>
<thead>
<tr>
<th>Receipt/Revenue Size</th>
<th>Number of Women-Owned Firms</th>
<th>Percent of Women-Owned Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total/2012 SBO Data</td>
<td>9,878,397</td>
<td>100%</td>
</tr>
<tr>
<td>less than $5,000</td>
<td>2,497,048</td>
<td>25.3%</td>
</tr>
<tr>
<td>$5,000 to $9,999</td>
<td>1,776,343</td>
<td>18.0%</td>
</tr>
<tr>
<td>$10,000 to $24,999</td>
<td>2,722,295</td>
<td>27.6%</td>
</tr>
<tr>
<td>$25,000 to $49,999</td>
<td>1,052,900</td>
<td>10.7%</td>
</tr>
<tr>
<td>$50,000 to $99,999</td>
<td>681,243</td>
<td>6.9%</td>
</tr>
<tr>
<td>$100,000 to $249,999</td>
<td>553,503</td>
<td>5.6%</td>
</tr>
<tr>
<td>$250,000 to $499,999</td>
<td>258,398</td>
<td>2.6%</td>
</tr>
<tr>
<td>$500,000 to $999,999</td>
<td>164,824</td>
<td>1.7%</td>
</tr>
<tr>
<td>$1,000,000 or more</td>
<td>171,842</td>
<td>1.7%</td>
</tr>
</tbody>
</table>
Capital Challenges for WBOs

“I taxation plays a key role in the survival and growth of small businesses, primarily through its effect on equity infusion. The major source of equity capital for expansion of a business is reinvested profits. The amount of tax the business must pay determines the amount of money available for growth and expansion.”


In 2014, under the leadership of its then Chair, Sen. Maria Cantwell, U.S. Senate Committee on Small Business and Entrepreneurship issued a report finding that access to capital is a more severe challenge for women-owned firms and that women only account for 16 percent of conventional small business loans, and 17 percent of SBA loans; which means just $1 of every $23 in conventional small business loans goes to a women-owned business.

Majority Report of the U.S. Senate Committee on Small Business and Entrepreneurship, 21ST CENTURY BARRIERS TO WOMEN'S ENTREPRENEURSHIP (2014),

In 2017, Sen. Shaheen issued a report detailing what women entrepreneurs need to thrive that concluded, in relevant part, “women entrepreneurs are unable to access their fair share of financial capital, diminishing their chances for growth.”

Report by SBC Ranking Member Jeanne Shaheen, TACKLING THE GENDER GAP: WHAT WOMEN ENTREPRENEURS NEED TO THRIVE (2017),
§ 199A Deduction for Qualified Business Income

BACKGROUND

• The § 199A deduction is a deduction for individuals with business income that Congress included in TCJA to provide tax relief for individuals with business income and pass-thru businesses.

• Congress felt compelled to create the deduction for these businesses because the biggest tax cut in the TCJA was the corporate tax rate cut from 35% to 21%.

• Applies for tax years 2018-2025 and doesn’t reduce any SE tax owed.

“The provision reflects Congress’s belief that a reduction in the corporate income tax rate does not completely address the Federal income tax burden on businesses. While the corporate tax is a tax on capital income, the tax on income from noncorporate businesses may fall on both labor income and capital income. Treating corporate and noncorporate business income more similarly to each other under the Federal income tax requires distinguishing labor income from capital income in a noncorporate business.”

§ 199A Deduction for Qualified Business Income

§ 199A BASICS

- § 199A is a deduction for qualified business income (QBI), which is the lesser of:
  - 20% of QBI, or
  - 20% of modified taxable income
- Available for income generated through a sole proprietorship regardless of whether a taxpayer uses the standard deduction or itemizes deductions
- Effectively, the 199A Deduction is a deduction from AGI deduction and is the last deduction taken in determining taxable income

Limitations

- There are three limitations that apply to Section 199A
  1. An overall limitation based on Modified Taxable Income
  2. A second limit for wage and capital investment of certain taxpayers. The deduction cannot exceed the greater of:
     a. 50% of W-2 wages paid by the qualified business or
     b. 25% of W-2 wages of the qualified business + 2.5% of unadjusted basis of all qualified (tangible) property.
  3. A third limit that applies to certain types of specified services businesses
- The second and third limitations only apply when taxable income before § 199A deduction exceeds the following thresholds and are phased in
  - $315,000 for married taxpayers filing a joint return, or
  - $157,500 for all other taxpayers
What Is a Qualified Trade or Business?

- For taxpayers with taxable income below the taxable income thresholds, the scope of a qualified trade or business (QTB) is very broad and includes any trade or business in the United States, other than providing services as an Employee.
- As a result, the deduction is available to Sole proprietors, Independent contractors, and Owners of S corps, partnerships, and LLCs.
- If taxable income exceeds the thresholds ($315,000 MFJ, $157,500 everyone else), and business is a specified service trade or business – no deduction available.

Specified Service Business Definition Based on Section 1202: Involving performance of services in fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners or involves performance of services involving investing or trading.
Evidence of Unintended Bias: JCT Distribution of 199A

Table 3 of JCT’s distributional analysis of 199A, more than 90% of the revenue loss generated from the new pass through deduction under IRC §199A will flow to firms with income of more than $100,000 in 2018 and 2024.

- JCT found in 2018, 44% of the IRC §199A revenue loss will flow to pass-through businesses with $1,000,000 of income. Moreover, JCT projects that the 44% revenue loss distribution will increase to 52% by 2024.
- 88% (or 10,775,600) of women business owners generate revenues less than $100,000. Only 1.7% of women-business owners have receipts of $1,000,000 or more.

Joint Committee on Taxation, TABLES RELATED TO THE FEDERAL SYSTEM AS IN EFFECT 2017 THROUGH 2026 (JCX-32R-18), April 24, 2018.
Section 179 & WBOs

• Similarly, with respect to IRC §179, Kogod research has found that women business owners claimed Section 179 at significantly lower rates (47%) than existing government research finds for businesses generally (60% to 80%).

• This tax expenditure is one of the more expensive small business tax incentives (i.e., it will cost taxpayers $64.5 billion from 2017-2021), and yet no IRS or Congressional research on how it benefits women business owners, and what research we do have suggests that women business owners benefit less than businesses generally from one of the largest small business tax incentives.
Implicit Bias and Real Tax Reform

- Tax Code alone cannot resolve all of these issues (and may not be the appropriate mechanism to do so), but failure to consider bias in tax expenditure analysis further marginalizes and disempowers women and minorities.

- Comprehensive, holistic approach that considers demographic data and empirical research concerning measured effects of tax laws on women and their ability to participate in market is step in right direction.

Good tax policy and real tax reform would recognize relationship between taxation of “domestic relations” issues (alimony, child support, and access to/affordability of childcare), workplace discrimination (including sexual harassment and abuse), and women’s ability to participate equally in market and achieve economic self-sufficiency.
1. Congress should conduct oversight on tax expenditures targeted to help small businesses access capital and grow their businesses, including:
   • Requesting JCT estimate the cost and distribution of the revenue loss of small business tax expenditures (e.g., IRC Sections 1202, 179, 1244, 199A and 199A) in terms of income, industry and demographic data, including gender, race, ethnicity, and age.
   • Requesting U.S. Government Accountability Office prepare a summary of appropriate oversight recommendations for tax expenditures in terms implications of revenue loss distribution in terms of gender and other demographic data.

2. Congressional tax-writing committees should hold hearings on the issues raised in Billion Dollar Blind Spot as well as the implications of the TCJA’s enhancements to Section 179 and the new Section 199A on women-and minority-owned firms.

3. Congress should pass legislation requiring the IRS develop and publish as part of its Tax Stats series regular data on women-and minority-owned firms their ability to claim business tax expenditures.
• Founded in 2011, we conduct non-partisan research on tax issues specific to small businesses and entrepreneurs

• Develop and analyze solutions and promote public dialogue on tax issues critical to small businesses and entrepreneurs

• In June 2017, we published Billion Dollar Blind Spot: How the U.S. Tax Code’s Small Business Tax Expenditures Impact Women Business Owners

• In October 2018, we testified before the U.S. Senate Committee on Small Business and Entrepreneurship on BDBS findings and the TCJA