The Misguided “Small Business Tax Cut”

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The desire to help small business owners is understandable, as they are an important component of our economy and communities. However, the granting of preferential tax treatment for people reporting “business income,” as some lawmakers are considering under a banner of “helping small business,” is a terribly misguided idea.

Neither of the two arguments for cutting taxes on income derived from owning a business — spurring job creation and improving affordability of capital — stands up to scrutiny.

Lowering tax rates for income derived from business will not create jobs. Why? For one, the tax savings are far too little to pay for a new employee.

Slideshow: Cutting Tax Rate on "Small Business" Pass-Through Income

This slideshow displays how different income groups would fare if Oregon lawmakers were to set a flat 6.6 percent tax rate on business income (rather than the current graduated 5, 7, 9 and 9.9 percent tax rates). Under such a plan, some people with business income would actually experience a tax increase (see slide 3).

For those who would see their taxes decline, their tax savings would come nowhere near what it takes to pay for a new employee. For no income group except the top 5 percent would the average tax savings exceed $370 (see slide 7).

For the top 1 percent, the average savings would amount to $7,648. That’s a big tax cut for sure, though still not an amount that would lead to the direct hiring of a new employee. (Of course, that money could easily be spent or invested outside of Oregon.)

The misguided policy choice of seeking to generate jobs by cutting taxes on business income in the name of "small business" is explored in depth in the Center on Budget and Policy Priorities’ (CBPP) report Cutting State Personal Income Taxes Won’t Help Small Businesses Create Jobs and May Harm State Economies (PDF).

The paper, which should be required reading for lawmakers, explains that nationwide:

- The vast majority of those who would get a personal income tax cut are in no position to create small-business jobs.
- Most small businesses make too little money for tax cuts to produce enough income to pay new employees.
- Most small business owners are not significant “job creators” and have no plans to be.
- Small businesses hire employees based on product demand, not tax levels.

Just as a tax cut for small businesses is unlikely to yield enough in tax savings to hire a new employee, it won’t generate anywhere near the capital that would amount to significant reinvestment in the business. In other words, the tax cut won’t deliver on a promise to make capital more affordable.

If the goal is to increase access to or the ability to borrow capital, there are better ways to go about it. One way would be for lawmakers to create an Oregon In-State Loan Fund, as SB 712 proposes to do (PDF). This would create a state fund that would provide capital through community banks. And community banks say it would work.

Lowering tax rates for business income passed through to personal income taxes would reduce state revenues. The lost revenue would mean less to invest in education, health and human services and public safety — key public structures that benefit small business owners and all Oregonians.

What cutting taxes on business income would accomplish is to hand a big tax cut to some very wealthy Oregonians (see slides 7, 9 and 10).

That wouldn't help small business owners or our economy.

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