Comments

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Girls Just Wanna Have Funds: Creating Access to Equity Capital for Women-Owned Businesses Through the Tax Code

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INTRODUCTION

Undercapitalization jeopardizes a business's likelihood of survival.[1] Sufficient capital at start-up and throughout operation is critical to a business's success.[2] Therefore, creating greater access to capital generates greater economic prosperity.[3] Despite the importance of women-owned businesses[4] to the economy, women-owned businesses are more likely than men-owned businesses to be undercapitalized.[5] As such, women-owned businesses are less likely to realize the economic success of their male counterparts.

Women start their businesses with less capital than men—using only 64% of the capital, on average—and rely more heavily on owner-

1 PREMIER QUANTITATIVE CONSULTING, INC., RESEARCH ON UNDERCAPITALIZATION AS A CONTRIBUTOR TO BUSINESS FAILURE FOR WOMEN ENTREPRENEURS ii [hereinafter PQC]. PQC defines "women-owned business" as "a business where women collectively own[ ] more than fifty percent of the total equity of the business." *Id.* at 7.

2 *Id.* at 1.

3 *Id.*

4 In this Comment, a "women-owned business" refers to a business that is owned or operated primarily by women. Where the sources cited in this Comment included their definition of "women-owned business" in their work, I have included that information in the footnotes. All definitions, at a minimum, meet the description I have given here.

5 ALICIA ROBB & SUSAN COLEMAN, THE IMPACT OF FINANCIAL CAPITAL ON BUSINESS PERFORMANCE: A COMPARISON OF WOMEN- AND MEN-OWNED FIRMS (2009) [hereinafter COLEMAN, FINANCIAL CAPITAL COMPARISON]. Coleman and Robb define "women-owned business" using the following methodology:

> The method for assigning owner demographics at the firm level was to first define a primary owner. For firms with multiple owners . . . the primary owner was designated by the largest equity share. In cases where two or more owners owned equal shares, hours worked and a series of other variables were used to create a rank ordering of owners in order to define a primary owner. Firms with a primary owner that was female are classified as women-owned firms (citation omitted).

Id. at 6.

provided equity.[6] Further, women are less likely than men to use outside funding.[7] Notwithstanding the disparity in the capital they receive, women-owned businesses use capital to generate returns for shareholders as effectively as their men-owned counterparts; women-owned businesses also use their assets more effectively to generate value for shareholders.[8]

In the context of high-growth businesses,[9] women-owned businesses are even more starkly undercapitalized as compared to men-owned businesses.[10] In fact, women founders are three times less likely to receive financing through outside equity investors such as angel investors or venture capitalists.[11] Even though one in ten women in the U.S. was becoming an entrepreneur in 2013,[12] only 11% of high-growth businesses backed by venture capital investors have been

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6 *Id.* at 8, 11.

7 U.S. DEP'T OF COMMERCE, WOMEN-OWNED BUSINESSES IN THE 21ST CENTURY 17 (2010). This conclusion reflects the Department of Commerce's use of data that defines a "women-owned business" as one in which "the owner who had the greatest percent ownership of the business" is female.

> If there was more than one owner with equal ownership, then the combined ownership percentage was used to determine the predominant gender of ownership. If percent ownership was not available in the data, then primary ownership was determined by the number and gender of owners. In cases that were indeterminate, there was no attempt made to use other variables, such as hours worked, to determine primary ownership.

Id. at 17 n.9.

8 PQC, *supra* note 1, at 17.

9 SUSAN COLEMAN & ALICIA ROBB, ACCESS TO CAPITAL BY HIGH-GROWTH WOMEN-OWNED BUSINESSES 14 (2014) [hereinafter COLEMAN, ACCESS TO CAPITAL]. Coleman and Robb define "women-owned business" using the following methodology:

> The method for assigning owner demographics at the firm level was to first define a primary owner. For firms with multiple owners . . . the primary owner was designated by the largest equity share. In cases where two or more owners owned equal shares, hours worked and a series of other variables were used to create a rank ordering of owners in order to define a primary owner. Firms with a female primary owner are classified as women-owned firms (citation omitted).

Id. at 8–9. A high-growth business is a business with five or more employees. *Id.* at 9.

10 *Id.* at 8.

11 FED. RESEARCH DIV., LIBRARY OF CONG., NAT'L WOMEN'S BUS. COUNCIL, UNDERSTANDING THE LANDSCAPE: ACCESS TO CAPITAL FOR WOMEN ENTREPRENEURS, 15 (2018) [hereinafter UNDERSTANDING THE LANDSCAPE].

12 CANDIDA BRUSH ET AL., WOMEN ENTREPRENEURS 2014: BRIDGING THE GENDER GAP IN VENTURE CAPITAL 5 (2014) (citing DONNA J. KELLEY ET AL., THE GLOBAL ENTREPRENEURSHIP MONITOR 2013 UNITED STATES REPORT, 28 (2014)). Brush et al.'s own analysis entailed looking at a database of companies that received venture capital funding and determining whether there was a woman on the executive team of those companies. *Id.* at 6.

founded or led by women, and women-led ventures have received only 7% of venture funds.[13] High-growth businesses generate large numbers of jobs and increase economic impact,[14] yet women-owned businesses are substantially underrepresented among high-growth businesses.[15] Ensuring access to equity capital sources, like venture capital and angel investments, is integral to increasing the number of high-growth, women-owned businesses.[16]

In 2015, it was estimated that if women-owned businesses accessed capital equally to their men-owned counterparts, the economy would create an additional six million jobs over the following five years.[17] The barrier of access to capital for women entrepreneurs has been called a "second glass ceiling."[18] As such, the lack of access to capital for women-owned businesses is a critical disparity that if remedied would reap benefits not only for women-owned businesses but for the American economy as a whole. Motivated by this worthy goal, in this Comment I argue that access to equity capital for women-owned businesses can be increased using the tax code.

In Part I, I will contend that lack of access to equity capital for women-owned businesses is a problem Congress can solve using the Internal Revenue Code (IRC, code, or tax code). There, I will briefly detail the federal government's attitude toward women-owned businesses in the United States over time and describe the current, growing presence of women-owned businesses in the market.

In Part II, I will introduce and provide a brief explanation of key concepts related to this Comment. First, I will describe access to capital for businesses generally and the different types of relevant capital investments. Second, I will provide an overview of the tax treatment of those capital structures. Third, I will define the concept of tax expenditures and explain what are generally understood as the three goals of tax policy: efficiency, equity, and administrability.[19]

In Part III, I will discuss the ways the tax code benefits small businesses through tax expenditures. I will address the task of defining

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13 BROOKS ET AL., INVESTORS PREFER ENTREPRENEURIAL VENTURES PITCHED BY ATTRACTIVE MEN 2 (Nancy Hopkins ed., 2014) (finding a "profound and persistent preference" for entrepreneurial ventures pitched by attractive men).

14 COLEMAN, ACCESS TO CAPITAL, *supra* note 9, at 7.

15 *Id.* at 24.

16 *Id.* at 28.

17 PQC, *supra* note 1, at i.

18 *Id.* at 5.

19 Allison Christians, *Introduction to Tax Policy Theory* (May 29, 2018), https://ssrn.com/abstract=3186791[https://perma.cc/H6PA-P4MZ].

"small business" under federal law, including in the tax code, and provide a list of code sections designed to aid small businesses. I will then provide a more in-depth discussion of selected code provisions that, as they stand, exclude women-owned businesses from substantial access points to equity investments. These code provisions are sections 1202, 1244, and the newly minted section 199A.

In Part IV, I will argue that by changing the scope of sections 1202, 1244, and 199A women-owned businesses can realize greater access to equity capital. I will argue that such changes align with congressional intent and work within the tax code's gender-neutral framework, and I will discuss my recommendations in light of the goals of tax policy.

Lastly, in Part V, I will address additional considerations related to my argument. First, I will discuss the concept of gender-based taxation. Then, I will discuss whether, given the constraints of the code's gender-neutral status and the politics that would encumber any changes, the tax code is the best forum for this type of change.[20]

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[20] Although a number of other factors likely contribute to the underperformance of women-owned businesses, such discussions are beyond the scope of this Comment. *Compare* COLEMAN, FINANCIAL CAPITAL COMPARISON, *supra* note 5, at 12 (citing gender differences in values and risk aversion as documented contributing factors to the performance of women-owned firms), *and* UNDERSTANDING THE LANDSCAPE, *supra* note 11, at 1 (citing lack of network ties to financial capital and unconscious association of lack of credibility and legitimacy with women-owned businesses as factors contributing to restricted growth of women-owned businesses), *and* U.S. DEP'T OF COMMERCE, *supra* note 7, at 27 (citing for female business owners fewer hours worked and greater concern with work flexibility and family-work balance as contributors to underlying differences between male- and female-owned businesses), *with* BRUSH ET AL., *supra* note 12, at 15 (noting that even where women-owned businesses follow prescriptions such as learning the language of finance, having "big dreams," or starting businesses in high-tech industries, women-owned businesses still have not been able to access early-stage growth capital proportionately to men-owned businesses). Further, though this Comment advances an argument regarding equity capital, the ability of women-owned businesses to secure debt financing is the subject of another important debate. *See, e.g.*, UNDERSTANDING THE LANDSCAPE, *supra* note 11, at 4 (stating that Section 1071 of the Dodd-Frank Act seeks to help small businesses by requiring financial institutions to gather and submit data on credit applications by women-owned firms). Finally, it is important to bear in mind that the many factors relevant to the underperformance of women-owned businesses likely interact with one another to create a system of barriers, and this interplay deserves thorough analysis. *See, e.g.*, U.S. DEP'T OF COMMERCE, *supra* note 7, at 16:

> While gender roles have been changing, they still are shaped by centuries of historical differences in the accepted occupations and behaviors ascribed to women and men. . . . Given the long history of socialized gender distinctions and discriminatory laws, differences in attitudes and goals between male and female business owners may be a legacy of cumulative past discrimination and are perhaps not surprising.

I
DESPITE THEIR SIGNIFICANT ECONOMIC FOOTPRINT, WOMEN-OWNED BUSINESSES LACK ACCESS TO CAPITAL COMPARED TO MEN-OWNED BUSINESSES

A. Congress and Women-Owned Businesses

For over a half century, the federal government has made numerous efforts to even the playing field for women-owned businesses, some tax related, some not.[21] In 1977, President Jimmy Carter established the Interagency Task Force on Women Business Owners.[22] The task force was to (1) identify and propose solutions to barriers that discouraged women from becoming entrepreneurs and (2) propose changes to any federal programs or practices that were adverse to women business owners.[23] But with respect to taxation, the task force turned its attention to small businesses generally, instead of women-owned businesses specifically: the task force reasoned that most women-owned businesses were small businesses,[24] and it stated that "taxation is not sex-specific."[25] By declaring the code gender neutral and small businesses and women-owned businesses coextensive, the task force's proclamation limited the path to tax benefits for women-owned businesses.

Congress has also addressed women-owned businesses outside the tax code. In the past, though the task force failed to carve out specific benefits for women-owned businesses in the tax code, Congress has

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21 CAROLINE BRUCKNER, KOGOD SCH. OF BUS. TAX POLICY CTR., BILLION DOLLAR BLIND SPOT 3 (2017). Professor Bruckner's report—which, as she puts it, is a "long overdue follow-up to the 1978 Treasury Study"—and the related WOMEN IMPACTING PUBLIC POLICY, SURVEY: WOMEN SMALL BUSINESS OWNERS MISSING OUT ON KEY TAX PROVISIONS (2017) [hereinafter WIPP], inspired and greatly informed this Comment. Bruckner's report finds that women-owned businesses are severely limited in accessing capital through the tax code (including through sections 1202 and 1244, discussed herein), and, moreover, that there is an absence of tax research on women-owned businesses and thus an insufficient basis on which Congress can make tax policy decisions. BRUCKNER, *supra*. Bruckner calls on Congress to address the "blind spot"—that is, the lack of research on the effectiveness of small business tax expenditures in supporting women-owned businesses. *Id.* at 7, 22–23.

22 BRUCKNER, *supra* note 21, at 6 (discussing TREASURY DEP'T STUDY TEAM, CREDIT AND CAPITAL FORMATION: A REPORT TO THE PRESIDENT'S INTERAGENCY TASK FORCE ON WOMEN BUSINESS OWNERS (1978) [hereinafter TREASURY DEP'T STUDY TEAM]).

23 *Id.*

24 *Id.*

25 TREASURY DEP'T STUDY TEAM, *supra* note 22, at 86.

taken a more targeted approach elsewhere.[26] But today, in some cases, new initiatives more closely reflect the tandem benefit structure ushered in by the task force. That is, new federal laws and programs intended primarily to benefit small businesses are also understood to affect and benefit women-owned businesses.[27] Two examples are the Small Business Jobs Act of 2010 and the Jumpstart Our Business Startups (JOBS) Act (2012).[28]

But treating women-owned businesses and small businesses as one and the same is an imperfect analogy in any legislation. To illustrate the dilution of benefits to women-owned businesses that results when laws or programs focus on small businesses generally, one can look to the details of the Small Business Jobs Act of 2010. The Act requires the U.S. Department of Treasury to administer the State Small Business Credit Initiative (SSBCI), under which applicants for funding are required to disclose how they would use the money to provide capital for small businesses.[29] States participating in the SSBCI program have discretion to offer additional incentives; as a result, a state can offer greater incentives to those lending to women-owned businesses.[30] Only one state has done so,[31] demonstrating the dilution of benefits to women-owned businesses that can occur when programs focus on small businesses generally. Just as the discretion built into the SSBCI program has limited the ability of women-owned businesses to realize maximum benefits from the SSBCI, the scope of key small business tax provisions limits women-owned businesses' access to other important financial benefits. Such problematic attenuation renders the category of "small business" deceptively underinclusive both inside and outside the tax code.

Though analogizing women-owned businesses to small businesses in the tax code is not ideal, it is workable under the right circumstances.

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26 Among other legislation, the Equal Credit Opportunity Act of 1974, the Women's Business Ownership Act (1988), the Women's Business Development Act (1991), and the Women's Business Centers Sustainability Act (1999) represent Congress's efforts to support women-owned businesses. BRUCKNER, *supra* note 21, at 3. More recently, section 1017 of Dodd-Frank amends the Equal Credit Opportunity Act and requires financial institutions to compile data on credit applications submitted by women-owned, minority-owned, and small businesses. UNDERSTANDING THE LANDSCAPE, *supra* note 11, at 4.

27 UNDERSTANDING THE LANDSCAPE, *supra* note 11, at 4.

28 *Id.* at 3.

29 *Id.* at 3, 5.

30 *Id.* at 5.

31 *Id.*

Congress can work within this imperfect analogy to confer benefits to women-owned businesses without disrupting the code's gender-neutral framework. In this Comment, I will argue that this flawed analogy is a workable approach nonetheless, so long as women-owned businesses stand to benefit from favorable tax provisions as any small business would.

B. Women-Owned Businesses in the Market

Women-owned businesses have had an increasingly significant impact on the landscape of the American economy. As of 2016, there were an estimated 11.3 million women-owned businesses in the U.S., representing a 45% increase since 2007 in the number of women-owned businesses, compared to only a 9% increase in businesses overall.[32] Those millions of women-owned businesses were generating more than $1.6 trillion in revenues at a rate 30% higher than the national average.[33] Moreover, as of 2016, women-owned businesses employed nearly nine million individuals—an employment increase of 18% since the recession—while the rest of businesses lost jobs.[34] On the whole, as of 2016, women were majority owners in 38% of the nation's businesses, representing almost a full 10% increase since 2007.[35]

Women-owned businesses are diverse and, aside from the fact that they are owned by women, no single characteristic defines them. In 2007, 88% of women-owned business were nonemployer businesses, meaning that they had no paid employees.[36] Average receipts for

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32 AMERICAN EXPRESS OPEN, THE 2016 STATE OF WOMEN-OWNED BUSINESSES REPORT 3 (2016) [hereinafter AMERICAN EXPRESS OPEN]. This report is based on data from the U.S. Census Bureau's Survey of Business Owners. *Id.* at 9. The 2012 Survey of Business Owners defines "women-owned or female-owned business" as a business where "[w]omen own 51 percent or more of the equity, interest, or stock of the business." U.S. CENSUS BUREAU, 2012 SURVEY OF BUSINESS OWNERS, STATISTICS FOR ALL U.S. FIRMS BY INDUSTRY, GENDER, AND RECEIPTS SIZE OF FIRM FOR THE U.S. AND STATES: 2012 (2015), https://factfinder.census.gov/faces/tableservices/jsf/pages/productview.xhtml?pid=SBO_2012_00CSA05&prodType=table.

33 AMERICAN EXPRESS OPEN, *supra* note 32.

34 *Id.*

35 *Id.*

36 NAT'L WOMEN'S BUS. COUNCIL, WOMEN-OWNED FIRMS IN THE U.S. 10 (Jan. 2012). The National Women's Business Council uses data from the 2007 U.S. Census Bureau's Survey of Business Owners. *Id.* at 2. The 2007 Survey of Business Owners defines "women-owned business" as a business where "[w]omen own 51 percent or more of the interest or stock of the business." U.S. CENSUS BUREAU, 2007 SURVEY OF BUSINESS OWNERS, STATISTICS FOR ALL U.S. FIRMS BY INDUSTRY, GENDER, AND RECEIPTS SIZE OF FIRM FOR THE U.S. AND STATES: 2007 (2007), https://factfinder.census.gov/faces/affhelp/jsf/pages/

women-owned businesses were $153,546, but for nonemployer women-owned businesses, average receipts were $26,479.[37] The industries[38] (defined more specifically in the corresponding footnotes) with the most women-owned businesses were other services,[39] health care and social assistance,[40] and professional, scientific, and technical services.[41] Regarding choice of entity, 43.9% of women-owned businesses were formed as sole proprietorships, 24.8% as limited liability corporations (LLCs), and 24% as corporations.[42] Finally, the majority of women-owned businesses are small businesses.[43] This suggests the analogy between small businesses and women-owned businesses is on its face sufficient. However, there is more work that must be done within this framework to create a truly level playing field between men- and women-owned businesses, given the economic potential women-owned businesses wield in today's market.

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metadata.xhtml?lang=en&type=dimension&id=dimension.en./ECN/SBO/2007.SEX#main_content [https://perma.cc/38DT-MNGF].

37 NAT'L WOMEN'S BUS. COUNCIL, WOMEN-OWNED FIRMS IN THE U.S. at 12.

38 *Id.* at 13. This report classifies industries by the North American Industry Classification System (NAICS). *Id.* at 71.

39 "Other services" include establishments primarily engaged in activities such as equipment and machinery repairing, promoting or administering religious activities, grant making, advocacy, providing dry cleaning and laundry services, personal care services, death care services, pet care services, photofinishing services, temporary parking services, and dating services. *Id.* at 73.

40 "Health care and social assistance" is composed of establishments providing health care and social assistance to individuals and represents a continuum from firms providing medical care or social assistance exclusively. *Id.* at 72.

41 "Professional, scientific, and technical services" include establishments specializing in providing professional, scientific, and technical activities that require a high degree of expertise and training, including but not limited to lawyers, accountants, bookkeepers, architects, engineers, those providing payroll services, specialized design services, computer services, consulting services, research services, advertising services, photographic services, translation and interpretation services, and veterinary services. *Id.* at 73–74.

42 COLEMAN, FINANCIAL CAPITAL COMPARISON, *supra* note 5, at 17.

43 BRUCKNER, *supra* note 21, at 11 (citing WIPP, *supra* note 21). The WIPP survey was an opt-in online survey of women business owners. WIPP, *supra* note 21, at 7. The survey was sent to WIPP's members and associates, as well as members of its coalition partners. *Id.* Bruckner also relies on census data in her discussion and references the census definition of "women-owned business" as "businesses in which women own 51% or more of the equity or stock" (citation omitted). BRUCKNER, *supra* note 21, at 6.

II
INTRODUCTION TO FINANCIAL CAPITAL, TAX EXPENDITURES, AND TAX POLICY

To understand how small businesses benefit from the tax code, it is first important to understand the capital structures of the businesses themselves. The next step is then to understand what the tax consequences are for different types of investments. Finally, the last piece of the puzzle is to address how and why some small businesses—or any other group or sector of taxpayers—can benefit from certain tax provisions, while others cannot.

A. Capital Structures

Businesses are financed through debt and equity. The focus of this Comment is access to outsider equity. Growth-oriented businesses typically require substantial amounts of external capital, in the form of both debt and equity.[44] Debt is capital funding with an obligation to be paid back and where the lender does not acquire ownership in the business.[45] By contrast, equity is money received for some part of ownership.[46] Both debt and equity can be further categorized by owner, insider, or outsider funding.[47] Such distinctions refer to the nature of the investor. Owner equity is capital supplied by the owner herself.[48] Insider equity refers to capital sourced from friends, family, and acquaintances.[49] Outsider equity is secured from third-party, arm's-length sources, such as venture capitalists and angel investors.[50]

Businesses and investors have important choices to make when it comes to capital structure. Investors may be willing to bear more or less risk; some may seek the position of a prioritized creditor in the event of bankruptcy, while others may opt for the control and the share of growth and profits that equity holders enjoy.[51] In addition to these basic considerations, businesses and investors must also consider the

44 COLEMAN, ACCESS TO CAPITAL, *supra* note 9, at 2.

45 PQC, *supra* note 1, at 8.

46 *Id.*

47 *Id.*

48 *Id.*

49 *Id.*

50 *Id.* at 9.

51 JOINT COMM. ON TAXATION, OVERVIEW OF THE TAX TREATMENT OF CORPORATE DEBT AND EQUITY 1 (May 20, 2016) [hereinafter TAX TREATMENT OF CORPORATE DEBT AND EQUITY].

different tax consequences that result from debt and equity investments.[52] Such treatment is discussed below.

B. Tax Treatment of Capital Structures

Neither the IRC nor Treasury regulations offer a definition of debt or equity for tax purposes.[53] Instead, the IRS employs a facts and circumstances test to determine whether an instrument should be classified as debt or equity; this test has been refined by federal case law.[54] The relevant inquiry is "whether, in both substance and form, an instrument represents risk capital entirely subject to the fortunes of the venture (equity), or an unqualified promise to pay a sum certain on a specified date with fixed interest (debt)."[55] Additionally, section 385 of the IRC authorizes the Secretary of the Treasury to promulgate regulations providing guidance as to whether an interest in and relationship to a corporation is that of a shareholder, who provides equity, or a creditor, who provides debt.[56]

Debt and equity, lack of definition notwithstanding, are treated differently in the IRC, and each type of investment has different tax consequences for the business and the investor. For the business, issuing neither debt nor equity for cash is a taxable event.[57] Regarding debt, principal payments on debt are not deductible, but interest payments by a business are generally deductible, with a number of limitations.[58] Further, if business debt is modified, canceled, or changed in another way, the business debtor will realize income from the cancellation of indebtedness, unless certain limitations apply.[59] In terms of equity, when a business pays out dividends or other returns to equity holders, such payments are generally not deductible by the business.[60] If dividends or returns on equity are not paid out, there is no tax consequence to the business.[61]

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52 *Id.*

53 *Id.* at 13.

54 *Id.*

55 *Id.* at 13 n.57 (citing as an example U.S. v. Title Guarantee & Trust Co., 133 F.2d 990, 993 (6th Cir. 1943) for equity); *Id.* at 13 n.58 (citing Gilbert v. Comm'r, 248 F.2d 399, 402 (2d Cir. 1957) for debt).

56 26 U.S.C. § 385 (2017).

57 TAX TREATMENT OF CORPORATE DEBT AND EQUITY, *supra* note 51, at 4.

58 *Id.*; 26 U.S.C. § 163 (2017).

59 26 U.S.C. § 61(a)(12) (2017); 26 U.S.C. § 108 (2017).

60 TAX TREATMENT OF CORPORATE DEBT AND EQUITY, *supra* note 51, at 4.

61 *Id.*

From the investor prospective, tax consequences relate to how income generated by an investment is treated under the code. Those who invest with debt receive interest payments, which are treated as ordinary income.[62] Similarly, equity investors in C-corporations[63] may receive dividends, which are also included in ordinary income.[64] Further, should equity holders sell their interest, they will realize a gain or loss on the sale.[65] If the interest is held for more than a year, a gain will be taxed at a favorable capital gains rate, but the loss will be used only to offset capital gains, with the exception of $3000 that will offset ordinary income.[66]

The tax treatment of capital can be modified to the advantage of businesses and investors when Congress chooses to do so. Such benefits conferred through the tax code are known as tax expenditures, explained below.

C. Tax Expenditures and the Goals of Tax Policy

Tax expenditures are internal revenue losses attributable to tax provisions that provide special tax treatment to various groups of taxpayers or economic sectors.[67] Tax expenditures may take the form of exclusions, exemptions, deductions, credits, preferential tax rates, or deferrals of tax liability.[68] Tax expenditures are distinguished from provisions that are part of the normal income tax structure and are analogous to direct government outlay programs that require one to meet certain criteria in order to qualify.[69] Tax expenditures are a measure of the economic benefits that the various groups targeted by the expenditure receive.[70]

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62 26 U.S.C. § 61(a)(4).

63 C-corporations are distinguishable by the tax treatment of their profits. Profits of a C-corporation are taxed to the corporation itself when earned, and then are taxable again to the shareholders of the corporation when paid out in the form of dividends—the infamous corporate "double taxation." I.R.S., CAT. NO. 15150B, PUBLICATION 583, STARTING A BUSINESS AND KEEPING RECORDS 3 (Jan. 2015).

64 26 U.S.C. § 301(c)(1) (2017).

65 *Id*. § 1001.

66 *Id.* § 1222; § 1(h); § 1211(b).

67 JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2018–2022 2 (Oct. 4, 2018).

68 *Id.*

69 *Id.*

70 *Id.*

Relatedly, the tax policy debate is firmly rooted in three principles: efficiency, equity, and administrability.[71] Efficiency describes the belief that taxes should not distort economic outcomes. This does not mean that Pareto-efficiency ("when no one can be made better off without making someone else worse off"[72]) need be achieved; rather, taxation should aim to create minimum disruption.[73] Equity refers to the concept of fairness. This principle breaks down into two theories: (1) the benefits theory, whereby people pay taxes in proportion to the benefits they receive in return, and (2) the ability to pay theory, which contends that the taxes people pay should correspond with their ability to do so.[74] Equity can also be conceptualized horizontally and vertically. Horizontal equity suggests that similarly situated people should be treated similarly, and vertical equity suggests that differently situated people should be treated differently.[75] Finally, administrability refers to both sides of the coin: ease of compliance for the taxpayer and ease of enforceability for the government.[76] Later, I will use this framework to evaluate my recommended changes to the scope of certain tax expenditures.

III
Overview of Small Businesses in the Tax Code

A. Introduction to Small Businesses in the IRC

Congress has made many efforts to support small businesses through the tax code.[77] However, it is important to note that not all small businesses are considered equal under federal law, even within the code itself.[78] An exhaustive analysis of how small businesses are defined under the law falls outside the scope of this Comment,[79] but the definition used by the Small Business Administration (SBA) is worth detailing here.

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71 Christians, *supra* note 19.

72 *Id.* at 16.

73 *Id.* at 11, 16–17.

74 *Id.* at 10–11.

75 *Id.* at 15–16.

76 *Id.* at 23.

77 *See, e.g.*, GARY GUENTHER, CONG. RESEARCH SERV., SMALL BUSINESS TAX BENEFITS: CURRENT LAW AND ARGUMENTS FOR AND AGAINST THEM 6–9 (2018).

78 *Id.* at 4; *see also* Mirit Eyal-Cohen, *Down-Sizing the "Little Guy" Myth in Legal Definitions*, 98 IOWA L. REV. 1041 (2013).

79 *See, e.g.*, Eyal-Cohen, *supra* note 78.

In the Small Business Act of 1953, Congress gave the SBA the power to define the scope of certain federal programs intended to aid small businesses.[80] The Act defines a small business as one that is independently owned and operated and not dominant in its field of operation.[81] The Act delegates to the Administrator of the SBA the power to set detailed standards and definitions, which provide a more specific definition of small businesses.[82]

Today, the SBA publishes size standards in order to define whether a business qualifies for government programs and preferences designed to support small businesses.[83] Size standards are published by industry, and the size limits are either in terms of number of employees or annual receipts.[84] The SBA also uses base size standards as limits specific to certain industries. The employee-based standard, which applies to the mining and manufacturing industries, for example, has a base of 500 employees.[85] The receipt-based standard applies to most nonmanufacturing industries and has a base of $7 million in average gross receipts.[86]

The legislative history of the Small Business Act of 1953 provides two important guiding principles for agencies setting eligibility parameters for small businesses. First, the definition of small business should reflect critical differences among industries. Second, federal programs employing those standards should be designed to help eligible businesses improve their performance.[87] Tax provisions are not required to match or stay within SBA standards, but Congress could choose to draft them this way.[88]

Differently, the tax code offers no uniform standard for small businesses.[89] Quite to the contrary, there are at least twenty-four different definitions of a small business throughout the tax code.[90] Most provisions use receipt, asset, or employment size to define

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80 GUENTHER, *supra* note 77, at 2.

81 15 U.S.C. § 632(a)(1) (2017).

82 *Id.* § 632(a)(2)(A).

83 13 C.F.R. § 121.101(a) (2018).

84 *Id.* § 121.201.

85 GUENTHER, *supra* note 77, at 2.

86 *Id.*

87 *Id.*

88 *Id.* at 3–4.

89 *Id.* at 4.

90 Douglas K. Barney et al., *Just How Small Is Your Small Business?*, NAT'L PUB. ACCOUNTANT (Aug. 1, 2003), https://www.thefreelibrary.com/Just+how+small+is+your+business%3F-a0107492826 [https://perma.cc/7SMX-2NDZ].

businesses that qualify, but some also use different standards in addition to or as an alternative to those, such as choice of entity.[91] Further, by comparison, when it comes to employment and receipt size, the code is more restrictive—size limits for small businesses throughout the tax code are much smaller than the SBA standards.[92] Congress has the discretion to create different small business definitions for each provision and thus can tailor its definitions to policy objectives.[93]

According to the Congressional Research Service (CRS), small businesses stand to benefit from a considerable number of tax provisions.[94]

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91 *See* GUENTHER, *supra* note 77, at 4. *See, e.g.*, 26 U.S.C. §§ 1202, 199A (2017).

92 GUENTHER, *supra* note 77, at 4.

93 *Id.*

94 *Id.* at 6–9. Specifically, the CRS notes the following:

- Section 179 (allowing businesses to deduct expenditures on qualified depreciable assets),
- Section 446 (allowing eligible partnerships and C-corporations to use cash basis accounting),
- Section 1202 (allowing investors to exclude 100 percent of gains on the disposition of qualified small business stock held for five or more years),
- Section 45R (allowing small employers to take a non-refundable credit for health care contributions),
- Section 474 (allowing qualified small businesses to use LIFO method in estimating base-year value of inventories),
- Section 195 (allowing start-up businesses to deduct expenses and amortize remaining expenses),
- Section 44 (allowing qualified small businesses to claim a non-refundable credit for expensing incurred in complying with Americans with Disabilities Act requirements),
- Section 1244 (allowing taxpayers to deduct any loss on the disposition of qualified small business stock as ordinary, not capital, loss),
- Section 1242 (allowing taxpayers who invest in small business investment company (SBIC) stock to deduct from ordinary income all losses on dispositions of SBIC stock),
- Section 263A (exempting qualified small businesses from requirement that businesses acquiring real or tangible property for resale include the direct and indirect costs allocated to the property in the estimated value of inventory),
- Section 41 (allowing qualified businesses to claim a payroll tax credit using all or a portion of their unused research tax credit for the current year),
- Section 45E (allowing qualified small businesses to take a non-refundable credit for costs incurred in establishing pension plans), and
- Section 163(j) (allowing eligible small businesses to deduct business interest within limits set by the Tax Cuts and Jobs Act).

Sections 1202, 1244, and 199A will be discussed in greater depth below.

B. Selected Tax Expenditures Benefiting Small Businesses

Tax provisions can help small businesses generate and preserve capital. One way the tax code aims to help small businesses is by creating incentives for equity investments in small businesses.[95] Tax provisions that increase after-tax return on investment or reduce after-tax losses create such incentives for investor-taxpayers.[96] Second, tax provisions can also help small businesses by reducing the amount of income on which they pay taxes, which allows businesses to keep more capital.[97] In this Part, I will introduce two sections that work to benefit the investor, sections 1202 and 1244, and one new section that aims to benefit the business owner, section 199A. I have chosen these sections because each illustrates how the code helps small businesses on both the investor side and the business side.

1. Section 1202

Section 1202 allows noncorporate taxpayers, including taxpayers structured as pass-through entities,[98] to permanently exclude from gross income 100% of the gain from the sale or exchange of qualified small business stock (QSBS) that has been held for more than five years.[99]

A qualified small business stock is stock in a C-corporation that is a qualified small business that meets the active business test.[100] The stock must be originally issued after August 10, 1993, and acquired by the taxpayer at its original issue for either money or compensation for services.[101] A qualified small business is any domestic C-corporation with aggregate gross assets[102] not exceeding $50 million before or

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95 *Id.* at 14; *see, e.g.*, 26 U.S.C. §§ 1202, 1244 (2017).

96 *See, e.g.*, 26 U.S.C. §§ 1202, 1244.

97 *See, e.g.*, *id.* § 199A(c)(1).

98 A pass-through entity means that income and expenses, or profits or losses, “pass through” to the personal tax return of the business owners. Sole proprietorships, partnerships, and S corporations are pass-through entities. *See* I.R.S., *supra* note 63, at 3.

99 26 U.S.C. § 1202.

100 *Id.* § 1202(c).

101 *Id.* § 1202(c)(1).

102 Aggregate gross assets means the amount of cash and the aggregate adjusted bases of other property held by the corporation. *Id.* § 1202(d)(2).

immediately after the issuance.[103] The active business test requires that at least 80% of the assets of the corporation are used in the active conduct of one or more qualified trades or businesses.[104] Such qualified trades or businesses do not include: performance of services in fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset is the reputation or skill of one or more employees; any banking, insurance, financing, leasing, or investing business; any farming business; any business involving the production or extraction of crude oil products and the like; and any business of operating a hotel, motel, restaurant, or similar business.[105]

Section 1202 also includes a per-issuer limitation.[106] Under the limitation, the exclusion for a taxpayer with eligible gain from the disposition of one or more stocks issued by a corporation is limited to the greater of the following: $10 million, reduced by the amount of gain taken into account for prior years from the disposition of stock from that same issuing corporation, or ten times the aggregate adjusted bases of stock issued by that corporation and disposed of by the taxpayer during the year.[107]

Section 1202 was added to the code under the Clinton administration in 1993 to spur investment in small businesses and create jobs.[108] By rewarding investment in small businesses, section 1202 set out to provide venture capital to growing enterprises.[109] The five-year requirement of this section was intended to provide access to "patient" capital for small start-up businesses in manufacturing and other industries.[110]

As it was originally enacted, section 1202 provided only a 50% exclusion.[111] Even at 50%, evidence showed that the provision accomplished its goal of lowering the cost of capital by increasing stock

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103 *Id.* § 1202(d).
104 *Id.* § 1202(e)(1).
105 *Id.* § 1202(e)(3).
106 *Id.* § 1202(b).
107 *Id.* § 1202(b).
108 103 CONG. REC. 11,598–99 (1993).
109 *Id.* at 11,653.
110 GUENTHER, *supra* note 77, at 15.
111 H.R. 2264, 103d Cong. § 13,113(a) (1993).

prices.[112] Then, in 2010, the full 100% exclusion was introduced (albeit temporarily at the time).[113] As a result, investors didn't realize the full extent of section 1202's benefits until 2015, when the stock acquired in 2010 had been held by investors for longer than the statutory five years.[114]

When the exclusion increased to 100%, there was a healthy level of debate about the provision's eligibility criteria.[115] At a hearing before the Senate Finance Committee, the Senate heard testimony on the matter of increasing the gain exclusion to 100% or eliminating tax on the gain from sale of QSBS altogether. Those testifying praised Congress's efforts to incentivize investment in small businesses by upping the tax benefit for investors, but heavily criticized the provision's narrow scope.[116] In fact, Dr. Toder of the Urban Institute testified that the consequence of the narrow scope of the provision was not simply that some businesses might be excluded but that capital would be directed away from businesses that don't qualify, as investors place their capital in investments that benefit from the exclusion and forgo those not eligible.[117] Most criticized was the C-corporation limitation; those who testified to this issue cited the irony in limiting the tax benefit—which was intended to increase funding for small businesses—to C-corporations, when most small businesses are formed

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112 GUENTHER, *supra* note 77, at 15–16 (citing David A. Guenther & Michael Willenborg, *Capital Gains Tax Rates and the Cost of Capital for Small Business: Evidence from the IPO Market*, 53 J. FIN. ECON. 385, 401 (1999)). Presumably, the increase in stock prices was a result of an increase in demand stemming from investors seeking out the exclusion.

113 Small Business Jobs Act of 2010, Pub. L. No. 111-240, § 2011, 124 Stat. 2504, 2554 (2010).

114 Tony Nitti, *Tax Geek Tuesday: Making Sense of the New '20% Qualified Business Income Deduction'* (Dec. 26, 2017, 8:48 AM), https://www.forbes.com/sites/anthonynitti/2017/12/26/tax-geek-tuesday-making-sense-of-the-new-20-qualified-business-income-deduction/#4f9ddad744fd [https://perma.cc/M8AW-NNAU].

115 *Trade and Tax Issues Relating to Small Business Job Creation: Hearing Before the S. Comm. on Fin.*, 111th Cong. 48, 74, 99 (2010) (statements of Bill Rys, Tax Counsel, National Federation of Independent Business, and Eric Toder, Institute Fellow, Urban Institute and Urban-Brookings Tax Policy Center, and National Venture Capital Association).

116 *Id.*

117 *Id.* at 74 (statement of Eric Toder, Institute Fellow, Urban Institute and Urban-Brookings Tax Policy Center).

as pass-through entities.[118] In 2015, the 100% exclusion was made permanent.[119]

2. Section 1244

Section 1244 allows individuals to treat a loss on a section 1244 stock—which would normally be treated as a capital loss—as an ordinary loss, thereby reducing gross income.[120] Section 1244 stock is stock in a domestic, small business corporation[121] that, during the last five years ending before the date of the loss, derived more than 50% of its aggregate gross receipts from sources other than royalties, rents, dividends, interests, annuities, and sales or exchanges of stock or securities.[122] The stock must be issued in exchange for money or other property.[123]

Section 1244 also includes a per-year limitation on losses treated as ordinary under the section, which limits ordinary loss treatment to amounts not exceeding $50,000 for an individual or $100,000 in the case of a husband and wife filing jointly.[124]

Section 1244 was added to the code in 1958 as part of the Small Business Tax Revision Act of 1958.[125] The provision was intended to encourage financing of small businesses by decreasing the risk for investors.[126] Treating what would otherwise be capital losses as ordinary is a benefit to the investor-taxpayer because capital losses can ordinarily offset only capital gains;[127] therefore, treating losses from

118 *Id.* at 77 (statements of Bill Rys, Tax Counsel, National Federation of Independent Business, and Eric Toder, Institute Fellow, Urban Institute and Urban-Brookings Tax Policy Center).

119 Protecting Americans From Tax Hikes Act of 2015, Pub. L. No. 114-113, § 126(a), 129 Stat. 2242, 3054 (2015) (codified as amended at 26 U.S.C. § 1202).

120 26 U.S.C. § 1244(a) (2017).

121 *Id.* § 1244(c)(3)(A). A small business corporation means that the aggregate amount of money and other property received by the corporation for stock, as a contribution to capital, and as paid-in surplus does not exceed $1 million, determined at the time of the issuance of stock, and including amounts received for such stock and all other stock previously issued.

122 *Id.* § 1244(c)(1).

123 *Id.* § 1244(c)(1)(B).

124 *Id.* § 1244(b).

125 Small Business Tax Revision Act of 1958, Pub. L. No. 85-866, § 202(b), 72 Stat. 1607, 1676 (1958).

126 JOINT COMM. ON INTERNAL REVENUE TAXATION, SUMMARY OF THE SMALL BUSINESS TAX REVISION BILL OF 1958, at 1 (1958).

127 26 U.S.C. § 1211 (2017).

the sale of QSBS as ordinary allows the taxpayer to offset ordinary income, thus minimizing the risk for the investor.

3. Section 199A

Section 199A, brand new to the code, allows up to a 20% deduction for qualified business income from a qualified trade or business operated directly or through a pass-through entity.[128]

Qualified business income (QBI) is the net amount of qualified items of income, gain, deduction, and loss with respect to any qualified trade or business, but not including qualified REIT dividends, cooperative dividends, or publicly traded partnership income.[129] Qualified items of income, gain, deduction, and loss are those items connected with the conduct of a trade or business in the United States that are included in taxable income (without regard to the deduction from section 199A[130]).[131] Excluded are any capital gains or losses, dividends, interest income that is not allocable to the trade or business, certain foreign personal holding company income, annuities not received in connection with the trade or business, and any item of deduction or loss allocable to any of the excluded amounts described.[132] Compensation paid to the taxpayer for services rendered to the trade or business is also excluded.[133] To phrase this in a way that is deceivingly simple, with limitations, QBI is ordinary income, less ordinary deductions earned from a pass-through business, but excluding any wages earned as an employee.[134]

Next, a qualified trade or business means any trade or business other than a specified service trade or business or the trade or business of being an employee.[135] A specified service trade or business means a trade or business described in section 1202(e)(3)(A), but not including engineering or architecture or the performance of services that consist of investing, trading, or dealing in securities.[136] The cross-reference to

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128 I.R.S., *Tax Cuts and Jobs Act, Provision 11011 Section 199A - Qualified Business Income Deduction FAQs*, https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-qualified-business-income-deduction-faqs [https://perma.cc/N99M-GXSW] (last updated July 16, 2019).

129 26 U.S.C. § 199A(c)(1) (2017).

130 *Id.* § 199A(e)(1).

131 *Id.* § 199A(c)(3).

132 *Id.*

133 *Id.* § 199A(c)(4).

134 Nitti, *supra* note 114; *id.* § 199A.

135 26 U.S.C. § 199A(d)(1).

136 *Id.* § 199A(d)(2).

section 1202(e)(3)(A) excludes additional industries from section 199A, specifically any trade or business 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 is the reputation or skill of one or more employees.[137]

However, there is an exception for taxpayers whose taxable income is less than the threshold amount plus $50,000 ($100,000 for joint returns):[138] those taxpayers can claim the deduction, even if they operate in a trade or business that would otherwise be disqualified under the section.[139] But the deduction will be taken on a modified QBI, which is the applicable percentage of qualified items of income, gain, deduction, loss, W-2 wages, and unadjusted basis immediately after acquisition of qualified property allocable to the trade or business.[140] Note that W-2 wages are included in this version of QBI, although they weren't included in the original calculation. The applicable percentage means 100% reduced by the percentage equal to the ratio that taxable income in excess of the threshold amount bears to $50,000 ($100,000 for joint returns).[141] The applicable percentage cannot be less than zero.[142]

Generally, the amount of the section 199A deduction is equal to the lesser of (A) 20% of QBI or (B) 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of all qualified property.[143] Qualified property is tangible property held and used by the qualified trade or business.[144] However, there is both an exception and a phase-in that apply to the limitation in (B) above.[145] First, an exception applies to a taxpayer whose taxable income does not exceed a threshold amount; rather than receiving the lesser of the two, that taxpayer simply gets the 20% deduction.[146] The threshold amount is $157,500 for an individual, or $315,000 for joint returns.[147] Next, the

137 *Id.* §§ 1202(e)(3)(A), 199A(d)(2)(A).
138 26 U.S.C. § 199A(d)(3)(A).
139 *Id.* § 199A(d)(3)(A)(i).
140 *Id.* § 199A(d)(3)(A)(ii).
141 *Id.* § 199A(d)(3)(B).
142 *Id.*
143 *Id.* § 199A(b)(2).
144 *Id.* § 199A(b)(6).
145 *Id.* § 199A(b)(3).
146 *Id.* § 199A(b)(3)(A).
147 *Id.* § 199A(e)(2)(A).

phase-in provision applies to taxpayers whose taxable income does not exceed the threshold amount by more than $50,000 (or $100,000 for joint returns) and for whom 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of qualified property is less than 20% of QBI.[148] Those taxpayers can take the 20% deduction reduced by the amount that bears the same ratio to the excess amount as the amount that the taxpayer's taxable income exceeds the threshold amount bears to $50,000 ($100,000 for joint returns).[149] The excess amount is defined as the excess of 20% of QBI over 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after the acquisition of all qualified property.[150]

Section 199A was introduced to the code as part of the Tax Cuts and Jobs Act (TCJA).[151] Like the provisions discussed above, section 199A was intended to benefit small businesses, particularly those organized as pass-through entities.[152] Commentators after the fact have suggested that this new deduction was Congress's attempt to balance out the immense cut to the corporate tax rate in TCJA, which otherwise would have left small businesses in the dust.[153] Section 199A's scope and slippery definitions are the subject of a great, ongoing debate,[154] as section 199A is a brand-new code provision, and only a proposed regulation has been issued thus far.[155]

As the preceding discussion demonstrates, sections 1202, 1244, and 199A offer significant benefits for businesses that qualify. But the limited scopes of these provisions, in both choice of entity and industry, largely exclude women-owned businesses.[156] In the next Part, I will argue that the scopes of the above provisions need to be amended in

148 *Id.* § 199A(b)(3)(B)(i).

149 *Id.* § 199A(b)(3)(B)(ii).

150 *Id.* § 199A(b)(3)(B)(iii).

151 Tax Cuts and Jobs Act, Pub. L. No. 115–97, § 11011, 131 Stat. 2054 (2017) (codified as amended at 26 U.S.C. § 199A (2017)).

152 115 CONG. REC. H10253 (daily. ed. Dec. 20, 2017) (statement of Rep. Byrne).

153 *See, e.g.*, Tony Nitti, *Understanding the New Sec. 199A Business Income Deduction*, TAX ADVISER (Apr. 1, 2018), https://www.thetaxadviser.com/issues/2018/apr/understanding-sec-199A-business-income-deduction.html [https://perma.cc/PSS4-HMQT].

154 *See, e.g.*, Richard Rubin, *What's a Service Business? That's Now a Multibillion-Dollar Tax Question*, WALL ST. J. (Oct. 16, 2018, 3:57 PM), https://www.wsj.com/articles/whats-a-service-business-thats-now-a-multibillion-dollar-tax-question-1539682200 [https://perma.cc/7FMZ-FNP3].

155 Qualified Business Income Deduction, 83 Fed. Reg. 40,884 (Aug. 16, 2018) (to be codified at 26 C.F.R. pt. 1).

156 *See* WIPP, *supra* note 21, at 6–7.

order to include more women-owned businesses and that such amendment would be consistent with congressional intent.

IV
BY CHANGING THE SCOPE OF KEY PROVISIONS IN THE TAX CODE, WOMEN-OWNED BUSINESSES CAN ACHIEVE GREATER ACCESS TO EQUITY CAPITAL

Given Congress's design, women-owned businesses' best bet is to attempt to benefit from tax provisions designed to support small businesses, as the code is facially neutral. Yet, because of the limited scope of key provisions, many women-owned businesses are unable to take full advantage of tax expenditures intended to help small businesses.[157] More specifically, limitations based on choice of entity and industry tend to exclude women-owned businesses.

Congress should amend the scopes of key tax expenditures that target small businesses in order to confer equal benefits to more women-owned businesses. The changes I propose below align with congressional intent for those tax expenditures; moreover, the changes would not disrupt the facially neutral status of the IRC. Rather, the proposed amendments are intended to increase the number of women-owned businesses that can benefit under the tax code without offending these principles.

A. Entity Limitations

First, Congress should expand the scope of sections 1202 and 1244 beyond C-corporations. The majority of small businesses are formed as pass-through entities.[158] So, too, are the majority of women-owned businesses.[159] Because both sections 1202 and 1244 were enacted to benefit small businesses by incentivizing investors to allocate equity capital to them, expanding the scope of sections 1202 and 1244 to include entities other than C-corporations would be consistent with the purpose of the law.

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[157] BRUCKNER, *supra* note 21, at 10; *id.* at 3.

[158] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-15-513, SMALL BUSINESSES: I.R.S. CONSIDERS TAXPAYER BURDEN IN TAX ADMINISTRATION, BUT NEEDS A PLAN TO EVALUATE THE USE OF PAYMENT CARD INFORMATION FOR COMPLIANCE EFFORTS 6–7 (2015) [hereinafter GAO].

[159] *See* BRUCKNER, *supra* note 21, at 11 (discussing GAO, *supra* note 158, at 6–7).

Moreover, removing entity restrictions as a criterion is more likely to benefit small businesses than other criteria included by Congress. Congress can limit these sections in other ways, and it has. For instance, though both sections include a limitation somewhat analogous to a receipt test, the two limitations are glaringly dissimilar. Section 1202 limits aggregate gross assets to $50 million—a ceiling fifty times higher than section 1244's cap, which is a $1 million limit on the aggregate of money and other property of a business.[160] Surely, whether a business has $50 million worth of assets versus $1 million in cash and property is far more relevant to its status as a small business than the legal distinction between a pass-through entity and a C-corporation. The disparity between sections 1202 and 1244's aggregate asset limits demonstrates that Congress should reevaluate and restructure existing criteria in order to support small businesses, rather than excluding all pass-through entities. In fact, using alternative criteria might allow Congress to more directly achieve its goal of helping businesses that are truly small.

Nonetheless, another solution might be easier still: it could be argued that the choice of entity problem posed here can be remedied on the taxpayer side. Business owners make an important choice when it comes to how to structure their business, and one option at their disposal is to form a corporation.[161] It follows that women-owned businesses could incorporate in order to qualify for sections 1202 and 1244. However, choosing the corporate form as a small business brings about a number of concerns. Generally, the cost of being a corporation is higher than other business structures, as corporations are required to engage in extensive record keeping, operational processes, and reporting.[162] For a small business, the cost of maintaining its corporate status might therefore outweigh any potential tax upside. Unless a small business should have to choose between a manageable entity structure that best supports its operations and availing itself of tax benefits designed to help small businesses, asking a women-owned business to simply incorporate solves one problem but creates another.

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160 26 U.S.C. §§ 1202(d), 1244(c)(3)(A).

161 I.R.S., *Forming a Corporation*, https://www.irs.gov/businesses/small-businesses-self-employed/forming-a-corporation (last updated July 29, 2019) [https://perma.cc/RAF6-QZSY].

162 U.S. SMALL BUS. ADMIN., CHOOSE A BUSINESS STRUCTURE, https://www.sba.gov/business-guide/launch-your-business/choose-business-structure#section-header-1 (last visited Aug. 31, 2019) [https://perma.cc/DL4T-6ZJJ].

Still, a somewhat better option exists for a women-owned business structured as a limited liability company (LLC). An LLC women-owned business might be able to sidestep some of the corporate burdens by electing to be taxed as a corporation. An LLC is a business organized under state law that may be classified as a partnership, corporation, or an entity disregarded as separate from its owner for tax purposes.[163] An LLC can elect to be classified as a C-corporation by filing Form 8832, a process known as "checking the box."[164] By checking the box, the business will be taxed as a corporation, which means it can take advantage of tax provisions limited to C-corporations while avoiding the other regulatory burdens that fall on corporations outside the tax code.[165] However, that business will be subject to double taxation and any other corporate tax burdens as a result of its corporate classification.[166] Therefore, for many small businesses, this measure is likely to be costly, possibly even prohibitively so.

B. Industry Limitations

Further, Congress should do away with the industry exclusions in sections 1202 and 199A. The industry exclusions in section 1202 pose a great problem for women-owned businesses, which is compounded by section 199A's incorporation of those limitations by reference.

To begin, section 1202 alone excludes several industries. Section 1202 excludes the following: performance of services in fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset is the reputation or skill of one or more employees; any banking, insurance, financing, leasing, or investing business; any farming business; any business involving the production or extraction of crude oil products and the like; and any business of operating a hotel, motel, restaurant, or similar business.[167] This list excludes more than 78% of women-owned businesses.[168]

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163 I.R.S., CAT. NO. 27940D, PUBLICATION 3402, TAXATION OF LIMITED LIABILITY COMPANIES 2 (2016).

164 I.R.S. FORM 8832, ENTITY CLASSIFICATION ELECTION (2013).

165 *See* I.R.S., *supra* note 163, at 3.

166 *Id.*

167 26 U.S.C. § 1202(e)(3) (2017).

168 WIPP, *supra* note 21, at 9.

Because section 199A references section 1202(e)(3)(A), section 199A cuts out many of the same businesses as section 1202. Thus, the following industries are excluded from section 199A: 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 is the reputation or skill of one or more employees.[169] This still excludes more than 67% of women-owned businesses.[170]

Rather than cutting out a laundry list of industries, Congress could achieve the same end—benefitting small businesses—by different means. In both section 1202 and 199A, Congress already uses tests other than industry limitations. Section 1202 limits aggregate gross assets to $50 million, and section 199A includes a complex exception and phase-in based on taxable income.[171] Therefore, Congress could abandon industry exclusions and instead use these types of criteria exclusively, either as they are currently written or in a more restrictive form. Additionally, Congress could implement an employee-based limitation for sections 1202 and 199A. An employee-based limitation might be an alternative means of tightening the scope of these provisions in lieu of excluding entire industries, but in addition to a gross receipts test or the like.

Alternatively, Congress could limit these provisions by the source of a business's receipts, rather than by the industry that it operates in. Here it is useful to compare the industry limitations of sections 1202 and 199A with the limitation of another section designed to benefit small businesses, section 1244. Section 1244 excludes only businesses that derive more than 50% of their aggregate gross receipts from royalties, rents, dividends, interests, annuities, and sales or exchanges of stock or securities.[172] This means that section 1244 effectively uses a test based on the source of receipts, rather than gross receipts or industries themselves. Therefore, a "source of receipts" test is an effective alternative to excluding a long list of industries, and it is a test that Congress has already used in a provision intended to benefit small businesses.

The preceding discussion demonstrates that Congress has recognized—and has already put to use—alternative means of limiting

[169] 26 U.S.C. §§ 1202(e)(3)(A), 199A(d)(2)(A).

[170] WIPP, *supra* note 21, at 9. This number is assuming that "other services" are excluded.

[171] 26 U.S.C. §§ 1202(d), 199A(d).

[172] 26 U.S.C. § 1244(c)(1).

the scope of tax provisions intended to benefit small businesses. By way of example, section 1202's aggregate gross asset test and section 199A's taxable income-based exception and phase-in currently operate alongside the restrictive industry and entity limitations in the same provisions.[173] Also, although section 1244 imposes an entity limitation, it also limits aggregate money and property and excludes businesses deriving gross receipts from enumerated sources.[174] With so many tests like these in play, it is hard to imagine there isn't a better configuration of such tests that doesn't exclude so many women-owned businesses.

Further, the Small Business Act of 1953 (SBA) supports the use of receipt- and employment-based limitations, rather than entity- and industry-based limitations. Recall that the SBA employs size standards by industry based on gross receipts and number of employees to determine whether businesses qualify for a number of federal programs. Notably, many women-owned businesses fit comfortably within receipt standards imposed in sections 1202, 1244, and 199A—88.5% of women-owned businesses report annual receipts below \$100,000.[175] Many women-owned businesses would also likely fit within any employee standard, as just over two-thirds of women-owned businesses reported fewer than ten employees.[176]

Congress could amend code provisions intended to benefit small businesses to follow SBA standards. Indeed, some code sections that help small businesses even include references to SBA programs.[177] The benefits of including the same or similar standards as the SBA in the tax code are at least twofold. First, uniformity across criteria would help small businesses access federal programs and benefits both inside and outside the code. Second, if Congress is wedded to limiting tax provisions by industry, SBA standards allow it to continue to do so. Congress could use receipt and employee limitations within industries to more precisely narrow the scope of each industry limitation as it sees fit.

As mentioned above, small businesses enjoy no single definition under the law—a confusing point that is particularly prevalent in the tax code. Therefore, for each provision, it is up to Congress to identify which type of small businesses it intends to benefit and refine criteria

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173 *Id.* §§ 1202, 199A.
174 26 U.S.C. § 1244.
175 BRUCKNER, *supra* note 21, at 11, 12.
176 WIPP, *supra* note 21, at 7.
177 *See, e.g.*, 26 U.S.C. § 1244.

accordingly. In sections 1202, 1244, and 199A, the objective is clearly to benefit small businesses, but the exclusions of pass-through entities or service businesses—which excludes the majority of women-owned businesses—results in unequal access to tax benefits between women-owned businesses and other small businesses. Therefore, Congress should opt for alternative means of restricting the scope of these provisions. Congress could tighten other limitations and, in exchange, eliminate those that are problematic. Alternatively, Congress could introduce a new system of limitations analogous to SBA standards.

C. Changes in Scope Evaluated Under the Goals of Tax Policy

Recall that the three goals of tax policy are efficiency, equity, and administrability. The proposed changes to sections 1202, 1244, and 199A do not offend these three goals.

First, although any taxation necessarily distorts economic efficiency, the proposed changes here likely create no more distortion than would any provisions designed to benefit small businesses. Indeed, tax benefits such as these change the behavior of investors and business owners by design; therefore, it can be argued that economic distortion is not a primary concern of Congress when it comes to such tax expenditures. However, true economic analysis of these recommendations will be the only conclusive data that indicate the effects of such changes.[178]

Second, the proposed changes increase the equity, or fairness, of benefits for small businesses by creating equitable access to such benefits for women-owned businesses. This assessment assumes that it is a duty of government to remove economic and social obstacles that act as barriers to equal and successful participation in the economy.[179] Tax expenditures and progressive tax rates can be understood as consistent with this notion,[180] and so can federal programs that benefit women business owners specifically. Applying that argument here, Congress would promote equality by adopting the proposed changes in

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178 Bruckner calls out the lack of data currently available and the absence of research surrounding how small business tax expenditures affect women-owned businesses. BRUCKNER, *supra* note 21, at 22–23. One of her recommendations is that Congress "should charge the [Joint Committee on Taxation] with preparing a formal estimate of the taxpayer cost and distribution by industry of the Code's small business tax expenditures claimed by women business owners." *Id.* at 23.

179 Alberto Alesina et al., *Gender-Based Taxation: A Response to Critics*, VOX CEPR POLICY PORTAL (Feb. 15, 2008), https://voxeu.org/article/gender-based-taxation-response-critics#fn2 [https://perma.cc/EE5P-6HTZ] [hereinafter *Response to Critics*].

180 *Id.*

scope of these provisions because the ability of women- and men-owned businesses to receive tax benefits would be equalized. Moreover, equal treatment of women- and men-owned businesses of the same size is a clear representation of horizontal equity, under which similarly situated taxpayers are treated similarly.

Third, there would be some degree of administrative and compliance costs associated with these changes. For Congress, amending the scope of these provisions might be burdensome, depending on the political climate. However, amendments of this kind would certainly be less costly than the overhaul that would be required if Congress went a step further and added provisions specific to women-owned businesses to the code, a concept explored below. For the taxpayer, compliance costs would decrease in some ways but increase in others. If the entity and industry limitations changed, businesses that were previously ineligible would need to find ways to comply with provisions that they are newly eligible for. However, that cost is likely outweighed by the benefits to be reaped under such provisions. Further, if Congress chose to create a uniform "small business" test, small businesses overall might see greater ease in compliance with one, uniform test to measure up to, and would likely take advantage of more beneficial provisions for which, under one set of standards, they would qualify.

V
FURTHER CONSIDERATIONS

Two additional considerations are relevant to my argument. The first is whether gender-based taxation is a viable alternative, and the second is whether the code is the best means for reform in this area. These two ideas are somewhat related. Gender-based taxation arguments do not typically arise in the context of women-owned businesses, as women-owned businesses must look to tax policy favoring small businesses because the code is gender neutral.[181] Therefore, any argument that proposes to change that status would almost certainly determine the tax treatment of women-owned businesses. Moreover, there is a chance that any changes made in order to benefit women-owned businesses could be viewed as a form of gender-based taxation.

181 TREASURY DEP'T STUDY TEAM, *supra* note 22, at 86.

The economic argument for gender-based taxation is based on the different elasticities of the labor supply.[182] The argument goes as follows: if optimal taxation principles demand a lower tax on goods more sensitive to tax, and if female labor supply is more sensitive to income tax rates than male labor supply, it follows that females should be taxed at a lower income tax rate than males.[183] Further, a policy argument in favor of gender-based taxation is that other gender-based policies are routinely implemented by Congress (such as those discussed in the first Part of this Comment), therefore the lack of tax policy supporting women specifically is the exception to the political rule.[184]

However, ultimately, gender-based taxation might not be politically feasible. Indeed, as the Interagency Taskforce report in 1978 made clear, the tax code is definitively gender neutral,[185] and to declare otherwise could create political backlash for both Congress and taxpayers. For Congress, explicitly favoring women in tax policy would likely mean sweeping changes to all tax policy affecting the role of both single and married women in the market and the home, such as tax policies regarding childcare and household division of labor and income.[186] Should the overhaul take the form of tax cuts for women, as the economic argument goes, it would undoubtedly increase the deficit. Further, for women taxpayers, gender-based tax policies could create a stigma analogous to the welfare stigma, which deters individuals from accessing means-tested programs.[187]

The second consideration, whether the tax code is the best forum for improving women-owned businesses' ability to access equity capital, naturally follows from, and is closely related to, the problems that arise

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182 Alberto Alesina et al., *Gender-Based Taxation and the Division of Family Chores*, 3 AM. ECON. J. 1, 2 (2011).

183 Gareth Hutchens, *Pink and Blue Forms: Is Gender-Based Taxation Really As Crazy As It Sounds?*, GUARDIAN (June 7, 2018, 11:31 PM), https://www.theguardian.com/australia-news/2018/jun/08/pink-and-blue-forms-is-gender-based-tax-really-as-crazy-as-it-sounds [https://perma.cc/V9UG-LJWG] (discussing Alberto Alesina & Andrea Ichino, *Gender Based Taxation* (Mar. 5, 2007), https://zeus.zeit.de/online/2007/23/Gender.pdf [https://perma.cc/B35V-73JX]).

184 *Response to Critics*, *supra* note 179, at 1–2.

185 TREASURY DEP'T STUDY TEAM, *supra* note 22, at 86.

186 *See, e.g.*, *Response to Critics*, *supra* note 179; Hila Shamir et al., *Questioning Market Aversion in Gender Equality Strategies: Designing Legal Mechanisms for the Promotion of Gender Equality in the Family and the Market*, 27 CORNELL J.L. & PUB. POL'Y (forthcoming 2019).

187 Livia Gershon, *The Health Threats of Welfare Stigma*, JSTOR DAILY (Jan. 30, 2018), https://daily.jstor.org/the-health-threats-of-welfare-stigma/ [https://perma.cc/F73U-66DP].

with gender-based taxation. A series of important questions must be answered in order to determine whether reform is best accomplished through tax policy changes. The first question is whether the government should endeavor to increase equity capital for women-owned businesses. The number of programs supporting women business owners outside the tax code and tax provisions supporting small businesses seem to lead to the conclusion that the government has assumed this role, but this is probably a politically charged inquiry.

If the federal government should take on this task, the second question follows: should the federal government create new or improved targeted programs, tax expenditures that favor small businesses and tangentially confer benefits to women-owned businesses, or both? In this Comment, I have argued that changing the scope of such provisions is one way to create access to capital for women-owned businesses, but such an argument does not preclude other federal programs that support women business owners. Therefore, to achieve the most meaningful change, Congress could both amend problematic limitations in tax provisions that benefit small businesses generally and bolster programs that support women-owned businesses specifically.

CONCLUSION

Women-owned businesses have established themselves as a pillar of the American economy and promise significant opportunities for growth. Lack of access to equity capital is a well-documented barrier for women-owned businesses. By amending the scope of key tax expenditures within a gender-neutral tax code, Congress can place women-owned businesses on equal footing with all small businesses and thereby enable women-owned businesses to achieve greater access to capital, realize their economic potential, and create benefits for all.