



### Encouraging Entrepreneurship: A Microenterprise Policy Agenda for a New Political Era

The start of a new administration and a new Congress bring the opportunity for a new and reinvigorated policy agenda to support microenterprise development. Although the demands on federal and state budgets pose challenges to efforts to promote new policies, in a time of economic crisis policy makers also seek initiatives – such as microenterprise development – that can create jobs and help stabilize family incomes.

Anticipating a new policy environment in Washington, members of the Microenterprise Anti-Poverty (MAP) Consortium<sup>1</sup> last year began crafting a policy agenda supportive of microenterprise. The agenda is broad, including not only recommendations for increased funding for microenterprise development organizations, but also regulatory and tax policies that could improve the flow of capital to community-based lenders, provide an improved tax environment for sole proprietors, and remove barriers to self-employment faced by particular groups of low-income individuals. These recommendations are based, in part, on a number of pilot and demonstration programs funded by the philanthropic community that shed light on how to improve policies toward microentrepreneurs. This guide provides a summary of the MAP agenda,<sup>2</sup> describes some of the philanthropic initiatives that support the underlying policy ideas, and outlines how funders can further support policy development.

#### A broad agenda for microenterprise policy

There are a number of ways in which public policy can support emerging entrepreneurs as they contend with the current economic environment. As described below, policy can play a key role in five areas:

- Expand the existing infrastructure of community-based microenterprise programs that provide technical assistance and financing;
- Expand access to private markets and sources of capital;
- Revise tax policies to better support emerging entrepreneurs;
- Enable low-income individuals to use entrepreneurship as a pathway out of poverty; and
- Provide access to affordable health care to small and microenterprises.

**Expand the existing infrastructure of community-based, nonprofit microenterprise and financial organizations that support entrepreneurs.** A number of existing federal programs provide funding to microenterprise organizations. These include: the SBA Microloan, PRIME (Program for Investments in Microentrepreneurs), and Women's Business Center programs; the Community Development Financial Institutions (CDFI) Fund; the USDA's Rural Business

<sup>1</sup> MAP, an informal collaboration of organizations, typically comes together monthly to discuss and coordinate efforts in support of microenterprise policy. MAP was formed more than a decade ago, and includes CFED, AEO, FIELD, the Center for Rural Affairs, and a representative drawn from the state microenterprise associations.

<sup>2</sup> A more extensive discussion of the MAP Consortium policy agenda can be found in the Winter 2008 issue of the Federal Reserve Bank of San Francisco's *Community Investments* journal, available from [http://www.frbsf.org/publications/community/investments/0812/klein\\_wayman.pdf](http://www.frbsf.org/publications/community/investments/0812/klein_wayman.pdf).

Enterprise Grants and Intermediary Relending programs; HHS' Job Opportunities for Low-Income Individuals; and Community Development Block Grants. Funding for many of these programs was cut during the Bush Administration, hindering the level of outreach and services that microenterprise programs could provide. The MAP agenda recommends expanded funding for these programs.<sup>3</sup> It also supports three policy measures that, when implemented, would provide additional sources of sorely needed capital for microenterprise and other community and economic development efforts:

- The Housing and Economic Recovery Act of 2008 (PL: 110-289) enabled Treasury-certified CDFIs to join the Federal Home Loan Bank system. Membership provides CDFIs, including those that engage in microlending, with access to capital that can be loaned to entrepreneurs. Although specific implementing rules are still being developed, CDFIs are eager to review them.
- The Full Faith in Our Communities Act of 2007 (S. 2528) would provide below market-rate capital in the form of a bond guaranteed by the U.S. Treasury Department to a nonprofit lender for community or economic development purposes for low-income people and communities.
- Advocates are encouraging Congress to create an economic development grant program that could provide funding for microenterprise programs. The program would be funded as a percentage of profits currently going to repay the Resolution Funding Corporation (REFCORP) obligation.

**Implement policies that expand access to private markets and sources of capital.** The federal government also can play an important role in expanding the ability of low-income entrepreneurs to access private sources of capital. Specific recommendations include:

- Expanding the Community Reinvestment Act to require the reporting of small business loans.
- Amending the Telecom Act of 1996 to provide affirmative permission for full reporting of utility and telecom payment information to credit rating agencies, to potentially improve the credit scores of low- and moderate-income individuals.
- Allowing individuals to access their retirement accounts for business purposes.
- Improving enforcement of the HUB Zone program, which provides federal contracting opportunities for small businesses in distressed areas, and other small business contracting targets.
- Ensuring that efforts to improve energy efficiency and implement green technologies recognize the roles that very small businesses can play.

**Create tax policies that support emerging entrepreneurs.** Many microentrepreneurs are surprised when they file their taxes for the first time and discover that they must pay payroll taxes both as an employer and an employee. The recently passed American Recovery and Reinvestment Act (the “stimulus package”) included the “Making Work Pay” tax credit that will allow an estimated 10.8 million individuals and households<sup>4</sup> that report self-employment income to receive a tax credit of up to \$400 (\$800 if filing jointly). This credit can help offset the impact of payroll taxes, and potentially bring entrepreneurs into the tax system, which can provide other benefits. Microentrepreneurs face other challenges with the tax system; in fact, the National Taxpayer Advocate stated in her 2006 Report to Congress that the IRS' Small Business/Self-Employed division was not adequately helping small business filers. There are several ways that Congress and the new administration could create a more supportive environment:

- Encouraging the IRS to actively extend the capacity of and available training for its successful Volunteer Income Tax Assistance (VITA) program to serve low-income taxpayers with self-employment income. Currently, many IRS offices discourage or forbid volunteers from filing Schedule C self-employment returns because of the increased complexity involved in completing the returns.

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<sup>3</sup> In fact, several of these programs received additional funding through the American Recovery and Reinvestment Act of 2009, also referred to as the stimulus package.

<sup>4</sup> Estimate developed by CFED's Self-Employment Tax Initiative (SETI). For more information on SETI visit: <http://www.cfed.org/focus.m?parentid=32&siteid=2530&id=2643>.

- Advocating that the recently passed “community VITA” appropriation be used to establish VITA demonstration projects to serve low-income, self-employed households.
- Requiring the IRS Small Business/Self-Employment division to expand its “first-time filer” initiative through demonstration projects that would explore how the IRS and nonprofits can better serve this constituency; and
- Directing the IRS to study the specific needs of first-time filers and how to better resolve the cash-flow dilemma faced by the self-employed in regard to payroll taxes.

**Enable low-income individuals to use microenterprise as a pathway out of poverty.** Many of our lowest income Americans turn to self-employment as a means to create a job or to supplement a low-wage job. But too often federal programs that support these individuals – by providing a safety net or workplace skills – fail to recognize self-employment as an option. There are four steps that policymakers can take to open the self-employment path for the poorest Americans.

- Reform the asset means tests in public assistance programs to enable the acquisition of business assets.
- Promote microenterprise as an eligible activity for recipients of Temporary Assistance for Needy Families (TANF) and Social Security Disability Insurance.
- Encourage microenterprise as a prisoner re-entry strategy.
- Expand matched savings accounts for business capitalization, including appropriating \$5 million for the newly authorized Beginning Farmer and Rancher Individual Development Account program.

**Ensure that health coverage reforms address the particular needs of low-income entrepreneurs.** Access to affordable health care coverage is one of the biggest issues facing microentrepreneurs and other small businesses. As Congress moves to craft a health care reform proposal, it is important to consider the special needs and circumstances of self-employed entrepreneurs.

### What funders can do

*Provide matching funds for grantees applying for federal funds.* Most federal sources for microenterprise require a local match – something grantmakers can provide.

*Invest in outcomes research that demonstrates the return on public investment in microenterprise development.* Policy makers want and need data demonstrating that investment of public resources yields positive outcomes. This is particularly true in the case of funds obtained through the recently approved stimulus bill, which are targeted toward job creation. It is expensive for microenterprise programs to conduct research that tracks business growth and survival, job creation and other positive outcomes resulting from microenterprises. Funders can play an important role by supporting organizations' research and data collection.

*Invest in demonstration and pilot programs that identify needed policy change.* Many of the policy recommendations above emerged from demonstration and pilot programs funded by private and corporate foundations. For example, such support allowed the Corporation for Enterprise Development to develop the Self-Employment Tax Initiative, which is the source of many of the tax policy recommendations included here. (See box on next page.)

*Support education and advocacy efforts that promote the above policy changes.* For grantmakers willing to invest in policy, there are a number of national organizations (including some members of the MAP Consortium) that inform Congress and federal agencies about policy changes that could benefit entrepreneurs. In addition, state microenterprise associations play a key role in advocating for microenterprise-friendly policies at the state level.

## Exploring the Use of the Tax Code to Support Microenterprise: The Self-Employment Tax Initiative

The Self-Employment Tax Initiative (SETI), a CFED (Corporation for Enterprise Development) project now in its fourth year, identifies ways the tax code and the tax filing process can be tools for scaling up the delivery of financial services and business literacy to millions of micro and small businesses annually. SETI grew out of recognition that while a relatively small percentage of microbusinesses were seeking microloans or business training, community and free tax preparation programs were serving a large segment of low-income taxpayers with self-employment income. Many of these tax providers had developed post tax day self-employment training curricula – in effect becoming microenterprise training programs. In addition, they were beginning to identify the specific issues that microentrepreneurs faced in seeking to interface with the federal tax system.<sup>5</sup>

SETI provides grants to and partners with local community-based, free tax providers to help them to better identify the characteristics of the self-employed; links the microenterprise field with volunteers in the VITA/tax preparation field; identifies beneficial tax and business strategies for the self-employed, and promotes sound tax policy for the self-employed.<sup>6</sup> To date, CFED has funded 31 local partners – which include both microenterprise organizations, such as Central Vermont Community Action and ACCION USA, and free tax preparation sites such as AccountAbility Minnesota and the United Way of King County, Wash. The 16 local partners funded to provide services for tax year 2008 will complete an estimated 14,000 Schedule C tax returns; of these, 6,900 filers will receive EITC refunds totaling \$9.9 million.<sup>7</sup> SETI staff also has met with IRS staff to discuss particular tax challenges facing the newly self-employed, and has worked with state microenterprise associations that are examining how state tax policies can support entrepreneurship. Looking forward, SETI plans to partner with several other national organizations to launch a campaign to promote the new “Making Work Pay” tax credit as another key benefit for self-employed entrepreneurs. SETI has received funding from the Annie E. Casey Foundation, Capital One and the Citi Foundation.

<sup>5</sup> CFED Web site, <http://www.cfed.org/focus.m?parentid=32&siteid=2530&id=2772>.

<sup>6</sup> CFED Web site, <http://www.cfed.org/focus.m?parentid=32&siteid=2530&id=2530>.

<sup>7</sup> Estimate provided by SETI staff on March 20, 2009.

### For more information

A more extensive discussion of the MAP Consortium policy agenda can be found in the Winter 2008 issue of the Federal Reserve Bank of San Francisco's *Community Investments* journal, available from [http://www.frbsf.org/publications/community/investments/0812/klein\\_wayman.pdf](http://www.frbsf.org/publications/community/investments/0812/klein_wayman.pdf). For more information on the MAP Consortium, contact CFED at [info@cfed.org](mailto:info@cfed.org). The Association for Enterprise Opportunity, the national trade association for microenterprise programs, also engages in advocacy. For information on its policy agenda, visit <http://www.microenterpriseworks.org/index.asp?sid=25>. Information on state microenterprise associations, including links to existing SMAs, can be found on CFED's Web site at <http://www.cfed.org/focus.m?parentid=32&siteid=2501&id=2502>. For more information on CFED's Self-Employment Tax Initiative, visit <http://www.cfed.org/focus.m?parentid=32&siteid=2530&id=2530>.

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