



*A Small Business Blueprint  
For Virginia's Future*

**Recommended Small Business Policy Issues  
for the 2016 General Assembly Session**



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## **Introduction**

### ***What is the Virginia Small Business Partnership?***

The Virginia Small Business Partnership was founded in 2010 and that same year hosted the first-ever Virginia Small Business Summit. The inaugural Summit attracted over 180 small business owners from across the Commonwealth who attended to talk about issues important to them and solutions to those specific issues. The Summit has continued as a yearly event, with the sixth annual Summit planned for this coming November.

Each year, the Summit provides a unique opportunity for small businesses to gather together and generate policy recommendations to help move Virginia forward. By providing a forum for policymakers and small businesses to work together to help solve problems and advance small business policies, we strive to improve the climate in Virginia for small businesses.

The proposals and solutions discussed at the Summit are compiled into a document and presented to the Governor and members of the General Assembly. The *Official Findings of the Virginia Small Business Summit* have led to a number of legislative proposals and have provided ideas for Virginia lawmakers.

### ***Why are these recommendations so important?***

Virginia is consistently ranked among the best places to do business in the nation, and that record speaks for itself. There is still important work that needs to be done, however. We are at a point where we cannot continue to rest on our laurels. Our traditional industries are not as in demand as they once were. Federal contracting, for example, has taken a huge hit due to budget cuts in Congress. Yet contracting has been, up until this point, one of the main pillars of our economy. It is incumbent upon us to adapt and evolve.

To do so, Virginia must continue to maintain a competitive edge by enacting policies that attract and retain businesses and investment. In order to do that, Virginia must do all that it can to support small businesses, which account for nearly 98% of all employers in the state. We believe the policy recommendations in this document will spur job growth, increase investment, and help small businesses prosper. It is our hope that they will be strongly considered by legislators and the administration during the upcoming General Assembly session.



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## ***Issue One: Implementing Business Tax Reform***

### ***Background***

A favorable tax environment is one of the most important determinants in whether or not businesses locate in Virginia, and similarly, whether businesses – especially small businesses – already operating here are able to grow and flourish. Through business tax reform, Virginia can help businesses both large *and* small, while creating a tax structure that is equitable and encourages economic growth.

Our recommendations on business tax reform are twofold, and can be considered either together or separately.

First, we recommend the elimination of several burdensome and outdated business taxes, with replacement revenue to come from broadening the sales tax to some currently-exempted industries.

Second, we recommend capitalizing on our growing STEM-educated workforce by implementing a business tax holiday for startups in industries that we want to attract to the Commonwealth (high technology and cyber security, for example).

### ***Recommendations***

***Recommendation: Restructure taxes in a way that encourages businesses to incorporate in Virginia – expand the sales tax to services except for healthcare, while reducing/eliminating income tax brackets, eliminating the BPOL tax, the machine and tool tax, and the merchants capital tax.***

Businesses in 171 localities in the Commonwealth of Virginia are subject to three taxes that are levied regardless of whether or not a business makes a profit: the Business Professional Occupation Licensing (BPOL) tax, the Machine and Tool (M&T) tax, and the Merchants Capital (MC) tax.

The BPOL tax is levied on a business's gross receipts, regardless of whether or not that business makes a profit. This tax is particularly burdensome on small businesses that are in their first years of operation. The M&T tax is levied against a business's machinery, regardless of whether or not the business has expensed out the machinery. This tax



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discourages businesses from purchasing new equipment, even if that equipment would make the business more efficient or create the need for new jobs. The MC tax is levied on a business's inventory that is physically stocked in a particular locality on a certain day of the year.

We believe that these taxes restrict job growth. The challenge here is that cities, counties, and municipalities depend on the revenues from these particular taxes, and would be negatively impacted if those taxes were eliminated without a way to replace lost revenues. Our proposal results in a revenue-neutral tax code reform that is favorable to businesses and encourages growth. It will also be a strong incentive for businesses to locate, re-locate, and/or expand their operations in Virginia.

We strongly encourage the Commonwealth to consider the different scenarios laid out by the Thomas Jefferson Institute for Public Policy that address this issue. Under each scenario, the sales tax is broadened to include business-to-consumer services that are currently exempt. Healthcare remains un-taxed under all scenarios, as do business-to-business services. Under the Thomas Jefferson Institute's models, the sales tax revenues collected from these industries would be allocated to the localities that eliminated the BPOL, M&T, and MC taxes in order to make those localities whole. One scenario is even projected to create 77,000 private-sector jobs, increase investment by \$340 million, and increase disposable income by \$2.78 billion.

***Recommendation: Institute a business tax holiday for startups/entrepreneurs who establish new businesses in Virginia within qualified sectors of the economy.***

According to census data, Virginia has one of the largest shares of STEM-trained workers (17% of the workforce) of any state in the country, with more new graduates earning science, technology, engineering, and math degrees each year. We need to do our best to keep those highly-skilled, highly-paid positions right here in Virginia. That is why we are suggesting a 3 to 5 year business tax holiday for businesses launched within qualified industry sectors.

While Virginia currently has a "Capital Gains Exemption for Technology Businesses," which rewards investments in technology, biotechnology and energy startups by exempting capital gains from state income tax, we think more can be done to help new businesses in these sectors grow and thrive – not just through investments but also through reducing the overall cost of doing business.



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Several examples of business tax holidays exist from across the country and even internationally. We recommend the General Assembly draw from these experiences and best practices to develop a tax holiday scenario that seeks to nurture and expand the Commonwealth's leadership in STEM sectors.

Examples include:

- *Atlanta, GA.* The City of Atlanta, GA amended their tax code just this spring to adopt a provision called the "New and Emerging Business Ordinance." This ordinance provides a tax exemption for new and emerging technology businesses, as well as an exemption for businesses from paying the City's license fee for those classified as high technology, life sciences and intellectual property.
- *New York.* Governor Andrew Cuomo launched "Start-Up NY" in 2013, making a promise to businesses to "move here, expand here or start a new business here and pay no taxes for 10 years." In order to qualify for the program, businesses must locate at least some operations in designated tax-free zones around the state on or near State University of New York campuses, create new jobs and have a business vision that aligns in some way with the university. If companies fail to reach their job creation targets, their tax benefits will be prorated. The program has been a bit slow to get off the ground, however, owing in part to a slow certification and permission process (only 54 companies have been given the go-ahead so far) and the fact that New York has the eighth-highest income tax rate in the country.
- *Los Angeles, CA.* Created in 2010 and extended through 2015, the City of Los Angeles' business tax holiday waives companies from paying municipal business taxes for three years if they create jobs in the city. From 2010 to 2012 (when the program was extended through 2015), the city saw a 150% increase in businesses coming to the city, and rather than a loss in revenue from diminished gross receipts taxes, the city has seen a net increase from new business, sales and hotel taxes, with over 1,200 new firms grossing \$500,000 and above taking advantage of the holiday.
- *Singapore.* The ASEAN region's economic powerhouse owes a lot of its success to its friendly corporate tax structure. One example is the "Tax Exemption Scheme for New Start-Up Companies" provision. Under the scheme, qualifying new companies are given full exemption on the first \$100,000 of income and a further 50% exemption on the next \$200,000 of income for the first three consecutive years in business.



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## ***Issue Two: Encourage Workforce Readiness Certification***

### ***Background***

As desperately as job-seekers want to find work in today's economy, employers want to find qualified workers to fill open positions. Across the Commonwealth, positions remain unfilled because the workforce is not educated and trained to meet employers' needs. This "skills gap" can only be closed through a robust and targeted education system that works with local employers to identify needs, and then ensures that graduates have the skills to meet those needs.

Virginia schools need to prepare graduates for life beyond the classroom. Too many high school and college graduates enter the workforce without the basic "soft skills" that employers desire. The importance of fundamental skills like basic writing, basic math, leadership, and critical thinking cannot be overstated, yet far too few students graduate with a mastery of those skills.

It will take the combined efforts of government leaders, business leaders, and education leaders to ensure that the goals of the education system and the needs of industry are aligned. Through these efforts, Virginia's small businesses will prosper, high school and college graduates will be productive and contributing members of their local economies, and the Commonwealth and its citizens will be positioned for long-term economic success and prosperity.

***Recommendation: Seriously commit to creating, implementing, and/or promoting a universal workforce readiness certification program.***

One of the biggest complaints we continue to hear at each of our annual Summits is that graduates are not prepared for the realities of the workforce. What many people are not aware of (and the numbers below will demonstrate), is that Virginia has had a Career Readiness Certification program, administered through the Virginia Community College System (VCCS), since 2004. The number of students taking advantage of this certification program is anemic, however. In 2014, less than 10,000 certificates were issued statewide. Since 2008, the earliest year for which we have data available, the total number of certificates is roughly 52,000. Yet according to the Department of Education's Integrated Postsecondary Education Data System (IPEDS), Virginia awarded over 131,000 postsecondary degrees for graduation year 2012-2013 alone. That's not to mention the 46,000+ vocational school degrees awarded to high school graduates in 2012-2013. Clearly,



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we are not doing enough to prepare the tens of thousands of Virginians entering the workforce each year for the challenges ahead.

Why hasn't the Career Readiness Certification program taken off? Speaking objectively, it is very difficult to find information on how to enroll and what the associated costs might be. VCCS's website leads the user to enter their zip code to find a local certification center. The results page lists any number of workforce development centers and community colleges within the radius of the user's specified area. Navigating through to each resulting institution's website to find out more about enrolling in the program leads to little to no additional information – any mention of the Career Readiness Certification program at all is conspicuously absent. In addition, there does not seem to be very much “buy-in” from the business community. It would seem that with the outcry in the business community on the need for this kind of certification, the Commonwealth would want to work closely with the private sector to ensure their support.

The Career Readiness Certification program has made so little of an impact that other institutions are developing their own solutions. In fact, the Virginia Small Business Partnership has been asked to help consult WHRO/SkillsOnline on the development of their program. Their goal is to create a well-rounded certification program that takes students through a series of issue-based modules. Modules will include topics such as employment-related financial literacy, internet use and safety, workplace ethics, and more. This certification program will ultimately be made available free of cost to libraries, career centers, community colleges, and post-secondary educational institutions. Governor Terry McAuliffe and Secretary of Commerce and Trade Maurice Jones were both on hand in December 2014 to help launch the program.

We recommend that the General Assembly take a hard look at both the existing program, as well as the programs that have been developed elsewhere throughout the Commonwealth, and make a decision on which scenario would benefit our workforce the most. Then, we advise you to buckle down and throw your full support behind it so that it doesn't become yet another feel-good program that lacks the teeth to actually make a difference. Ensure that information on the program is readily available in every high school, vocational academy, postsecondary institution, and workforce development center, and is also detailed on one central website – the fewer hoops that potential students have to jump through, the better. To the extent possible, we highly encourage an online certification process so that students can log in from anywhere to complete course materials. We would recommend the Commonwealth encourage its higher education institutions to offer





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Continuing Education (CE) credits for successful completion of the program. We would like the General Assembly to also consider options that would ensure adoption by the business community. This might include offering tax credits to employers for hiring workers who have attained their workforce certification.



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## ***Issue Three: Incentivize Partnerships between Larger and Smaller Businesses***

### ***Background***

When the Commonwealth awards procurement and contracting opportunities to larger businesses, they typically include set-aside goals for subcontracting with SWaM (Small, Women and Minority-owned) businesses. It is our general experience, however, that these contracts lack the enforcement to actually ensure that small business subcontracting goals are met.

There is also an opportunity to help foster relationships between larger and smaller businesses, outside of the traditional state contracting and procurement scenarios. With increased consumer consciousness of where their products are coming from, we have to look no further than the restaurant industry to find an example of where a larger business – in this case a restaurant chain – can benefit from working with small suppliers (local farmers) in order to source their ingredients locally and is then able to turn around and promote themselves to patrons as “farm to table” (while being able to upcharge for those menu options). This is a kind of win-win scenario that benefits both large and small businesses.

### ***Recommendations***

***Recommendation: Re-evaluate how state contracts are written, so that larger businesses are rewarded for utilizing small businesses.***

While large businesses may include language in their RFP responses detailing how much of their contract award will go towards SWaM subcontracts, once the contract is awarded, there is nothing legally binding them to actually use those SWaM businesses.

We believe larger businesses would be more motivated to follow through with engaging SWaM businesses if incentives were written into state contracts. We recommend the General Assembly pass legislation that directs state contracting officers to include incentive bonuses within state contracts above a certain threshold amount. In the construction industry in particular, there already exist a number of incentive bonuses – including bonuses for completing work ahead of schedule and under budget. An incentive bonus for utilization of Virginia-based small businesses could be modeled after those examples. Linking an incentive bonus to contracts above a certain threshold –\$10 million for example – would



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ensure that the officers at the agencies administering those contracts are already well-equipped to handle structuring and implementing such a plan.

***Recommendation: Institute a local sourcing tax credit.***

In order to help encourage larger businesses to utilize small businesses outside the arena of state contracting, we support the adoption of a local sourcing tax credit. An example we could use to model ours after is the “Qualified Products Local Sourcing Credit” introduced in the New York State legislature earlier this year. Their proposal would have instituted tax credits on a sliding scale, from a \$1,500 credit for 20% of net sales attributed to qualified local products, all the way up to a \$25,000 credit for 100% of net sales attributed to qualified local products.



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## **Issue Four: Promote Entrepreneurial Access to Capital**

### **Background**

In the past, if you had an idea for a business or product, you would go to the bank to secure a loan to get your business off the ground. These days, banks simply aren't lending at the rate or with the terms our startups and entrepreneurs here in Virginia need to get going. Lack of traditional funding sources has led many startups and entrepreneurs to instead seek startup capital through angel investors and crowdfunding. We should do whatever we can to encourage and expand these opportunities.

The Small Business Administration (SBA) offers to partner with many lending institutions to get working capital in the hands of small business owners for purposes that include working capital, equipment purchase and facility renovation or expansion, requirements. However, the requirements for access to that capital generally include 3 years of financial statements to be included with the loan application. Thus, no business younger than three years is likely to gain access to this source of potential lending during the critical start-up phase.

The Commonwealth currently encourages investment in startups through two provisions in the tax code. First, we have the "Capital Gains Exemption for Technology Businesses," which exempts entrepreneurs and investors from paying state income tax on long-term capital gains throughout the life of their investments in early-stage technology, biotechnology and energy startups. For the same industries, we also have the "Qualified Equity And Subordinated Debt Investments Credit," which equals 50% of qualified business investments – up to \$50,000 – in a taxable year. These are both very positive, beneficial tax treatments, but the Commonwealth could serve a far larger role than just making provisions in the tax code.

***Recommendation: Look for ways to nurture and expand access to capital beyond just favorable treatments in the tax code.***

We would like to see the Commonwealth take an active leadership role in advancing angel investing and crowdfunding platforms. We recommend the Commonwealth develop and maintain a statewide network of angel investor and crowdfunding groups. The state can seek a grant through the United States Economic Development Administration to do so, as the state of Washington did recently. An essential component of this network would be a strong online presence. Ideally, startups would be able to go to this state-maintained website to connect with angel investors filtered by region, business sector, funding need,



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and more. This site should then be linked to the Business One Stop portal, since as it stands, Business One Stop only details state-based financing, loans, and incentives.

We also urge the Commonwealth to call upon the expertise and perspectives of angel investors at the highest level of state government, by naming an appointee from the angel investing community to the Virginia Economic Development Partnership Board.



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## **Conclusion**

We believe we have developed and put forth some meaningful and thought-provoking recommendations to help the Commonwealth grow and prosper well into the future. We believe there is a strong role for us as a small business community to consult with the Administration and the General Assembly on these and many other issues affecting our livelihoods. That said, our final recommendation would be to please count on the Virginia Small Business Partnership as a partner to depend upon for reliable, informed, and non-partisan perspectives, and to call upon us as a resource for connecting state government to the voices of small business.

Thank you for your time and consideration, and we look forward to working closely with the Administration and General Assembly during the 2016 session!