COMMERCE COMMITTEE TESTIMONY

March 16, 2010

H. B. No. 5498 (RAISED) AN ACT CONCERNING MICRO BUSINESSES.

S. B. No. 22 AN ACT CONCERNING SMALL BUSINESS ASSISTANCE.

S. B. No. 23 AN ACT ESTABLISHING A QUALIFIED SMALL BUSINESS JOB CREATION TAX CREDIT.

S. B. No. 450 (RAISED) AN ACT ESTABLISHING A REVOLVING LOAN FUND FOR SMALL BUSINESSES

Senator LeBeau, Representative Berger and members of the Commerce Committee, I am Ron Cretaro, Executive Director of Connecticut Association of Nonprofits (CT Nonprofits). We are the largest membership organization in Connecticut dedicated exclusively to working with nonprofits in Connecticut. Our membership numbers more than 500 organizations, 300 of which are health and human service purchase of service contractors with the State of Connecticut. Others members, including arts and culture, agricultural, environmental, economic development and educational organizations also hold contracts with Connecticut state government.

I am here today to support **H.B. 5498, An Act Concerning Micro Businesses,** especially Section 4, which makes nonprofits eligible for loans. I am also here to ask you to amend appropriate sections of SB 22, SB 23, and SB 450 to include nonprofit organizations in the definition of small business; to make nonprofits eligible to participate; and to regard them as respected contributors to our State's economy.

According to the Connecticut State Labor Department data: Nonprofit employment represents approximately 11% of all Connecticut employment:

2008: 185,677 (approximately 4% increase)
2007: 180,654

Total nonprofit wages paid: 2008: $8.7 billion
2007: $8.1 billion

(Note: This above data does not separate 501(c)(3)charitable nonprofits from other 501(c) nonprofits.) Over 85% of all nonprofit employment and wages are in two categories defined by the Labor Department: a) Health Care & Social Assistance (includes hospitals) b) educational services (includes colleges & universities).

According to the National Center For Charitable Statistics for 2008, there are **12,334 nonprofits or public charities in Connecticut**. and an additional 2,051 private foundations, which are also charitable nonprofits. Those 12,324 have a total revenue of $26.7 billion and total assets of $75.7

billion. There are an additional 5,960 other 501(c) nonprofits in Connecticut which are not charitable. (civic leagues, labor organizations, chambers of commerce, veterans organizations, cemeteries, credit unions, social and recreational clubs, etc.). Of the 12,334 number, 7,175 organizations have gross receipts of $25,000 or more and must report annually to the Internal Revenue Service.

Over 93 percent of nonprofits have an annual income of $1 million or less, and nearly 75% of all charities have annual expenses of less than $500,000. (Source: The Urban Institute, National Center for Charitable Statistics, Nonprofit Almanac 2008).

Further, nonprofits have too few alternatives when it comes to accessing capital and credit. What is particularly missing is a vehicle to provide loan guarantees when the State of Connecticut fails to execute a contract or pay a provider on time. In 2009, a survey of our membership revealed that 42% of respondents had received late payments from the state, with some upwards of 60 days late. Late payments by the state create a cash flow problem for nonprofits that ultimately lead to one of two actions: use money from budget reserves and lose out on valuable interest that those funds would otherwise accrue in the bank, or access a credit line from a bank and pay interest on those funds. Both actions are a direct result of the state not paying a provider on time for contracted services.

For information purposes, there are approximately 700 individual organizations which contract with Connecticut State Government for health and human services. The cumulative amount of those contracts approaches $1.3 billion.

I wish to be clear. There are opportunities available in some communities for nonprofits to access revolving loans for cash flow that are provided through nonprofit financial entities such as the Hartford Economic Development Corporation or the New Haven Community Loan Fund. However, this access does not exist evenly in all parts of the state, except through commercial entities. Unfortunately, banks have tightened their lines of credit and are less likely to provide a loan if they are unsure that the state will ultimately pay on the contract – as is the case both with late payments and the current threats of cuts and rescissions due to the budget deficit. That is why some form of loan guarantee would be of invaluable assistance to nonprofits. We are critical partners with the state in the delivery of health and human services and help the state accomplish its mission of serving the people of Connecticut. We hope that the state will support us in these efforts.

We would appreciate your assistance in addressing this issue.

<u>Additional Points about the Role of Nonprofits as Employers</u>

- Connecticut's charitable nonprofits and their employees are on the front lines of helping Americans when they are sick or hungry or poor and disadvantaged; conducting research to prevent and cure disease; offering opportunity through education; protecting our environment; and enriching our lives through the arts, faith, and other programs, many of which lessen the burdens of government.
- Longstanding federal policy extends tax-exempt status to organizations that dedicate and restrict themselves to these activities that serve the public good. In addition, these organizations must return all surplus revenues to their missions, and not to the benefit of individuals or shareholders, and must provide extensive public disclosure of their financials and other activities.
- While required to return surpluses to their missions rather than pay income taxes, nonprofit organizations do pay payroll taxes as employers and unrelated business income taxes.
- Small nonprofit employers have the same limitations and disadvantages as their for-profit counterparts, and would be placed at a disadvantage in competition for employees if they are not treated equally in incentives.

Nonprofits add real value to local communities and individual lives providing valued benefits to Americans everyday, including:

- *Entering the World:* community hospitals, health clinics, home health aides
- *Nurturing the Young:* after-school care, youth development programs
- *Lifelong Learning:* nonprofit preschools and kindergartens to elementary through post-secondary
- *Feeding the Body:* food banks, meals on wheels, soup kitchens
- *Fueling the Mind:* arts and culture, public radio, literacy groups, libraries
- *Earning a Living:* workforce development, credit counseling, child care
- *Healing the Body:* blood banks, clinics, substance abuse centers, disease eradication
- *Protecting the Body:* domestic violence centers, elder care, public health campaigns
- *Sheltering the Body:* homeless shelters, affordable housing developers, assisted living
- *Exercising the Body:* youth sports, summer camps, sports clubs
- *Nurturing the Spirit:* places of worship, service organizations, volunteer centers
- *Departing the World:* hospices, organ donation organizations

Federal Small Business Tax Credit and Nonprofits:

President Obama recently announced details of the small business tax credit that he proposed in his State of the Union address. Fortunately, unlike the White House's first enunciation of its national health insurance reform, this proposal included nonprofits as potential targets. The message is that nonprofits are employers too.

The plan is to give small businesses a $5,000 tax credit for each new worker hired in 2010. Employers would also get a credit for raising their payroll either through wage increases or increased hours, equivalent to offsetting the increase in their required Social Security tax contributions. Nonprofits would be able to participate by taking the tax credit against their quarterly withholding payments.

If nonprofits are able to hire new workers, the credit will work for them. The White House is motivated partly by the news of a 5.7 percent increase in the nation's GDP in the fourth quarter of 2009, without a corresponding increase in hiring. Employers may be investing in equipment and inventory (or not cutting inventory as quickly as before), but they are still skittish about hiring. A tax credit might incentivize employers to start employing. Maybe it might be the reverse for nonprofits: the availability of a credit for their grantees might stimulate foundations to up their grantmaking.

From this proposal nonprofits would not only get a useful subsidy, but they even get to take the credit quarterly, if they pay withholding on an estimated basis, easing ever-present cash flow problems that will only be tougher with increased personnel costs.

Reminder, 501(c)(3) nonprofits pay the employer's match of an employee's Social Security taxes, called FICA, just like for-profit employers do. Employers file Form 941 with the Internal Revenue Service quarterly identifying the number of workers they employ and their "taxable Social Security wages"—and their taxable Medicare wages too. The Form requires employers to send the IRS 6.2 percent of the employee's wages as the employee's contribution to Social Security and to match that with 6.2 percent contributed by the employer. That is a real cost to nonprofits that the proposed credit would help defray. Unlike other employers, 501(c)(3)s are exempt from withholding and paying federal unemployment taxes, the so-called FUTA contribution, but other 501(c)s are required to pay FUTA.]

But as national policy to stimulate hiring, the policy has some of the earmarks of the Carter Administration's New Jobs Tax Credit followed after a year by the Targeted Jobs Tax Credit program, the subject of much debate regarding its effectiveness and efficiency as an employment booster. The Administration has suggested structural improvements over the TJTC and its Clinton-era successor the Work Opportunity Tax Credit (WOTC). Times and missions are different; the Carter and Clinton jobs tax credit programs were aimed at hiring people from the welfare rolls, the Obama program is meant to boost a fragile economic recovery.

Nonetheless, there are areas of concern:

Defining small business: Any corporation can apply to the program, but their maximum tax benefit will be capped at $500,000—or, if the firm takes credits of $5,000 per worker, 100 workers. That low threshold, the Administration reasons, would make the credit attractive to small businesses and relatively useless to larger ones. We suspect that isn't true. The TJTC, which had a much lower cap, still ended up being sucked up by larger businesses. Of course, even the SBA definition of "small" isn't all that small--the typical size limit for Small Business Administration 7(a) loan eligibility is 500 employees, though for some industries it is 750 or 1,000 or even higher. If the bigger applicants hit the cap quickly, as they might, they could suck up much of the money that might otherwise go to small firms whose new hiring might be slower.

Tax credits for typical hires: The TJTC was reviled by some as the "Burger King tax credit," giving employers an economic benefit for hiring employees whom they would have hired anyhow. The Obama Administration acknowledges that there's no foolproof way to prevent this. If the credit for new hires (or increased payroll or increased hours) is based simply in comparison to a firm's fourth quarter 2009 numbers, all 2010 hires would qualify for the tax credit. In his speech at Chesapeake Machine, the President acknowledged the problem and presented his rationale: "Now, it's true that in some instances this tax credit will go to businesses that were going to hire folks anyway. But then, it simply becomes a tax cut for small businesses that will spur investment and expansion. And that's a good thing, too." (). The Carter-era tax credit, which at one point subsidized 2.1 million workers, but according to the New York Times, studies at the time suggested only "a tiny fraction of employers that knew about the credit at the time said it had prompted them to hire more workers."

Targeting: Unlike the WOTC and TJTC, this tax credit is not specifically targeted to very low-income, welfare-eligible, or unemployed workers. The maximum eligible employee's salary eligible for the tax credit is $106,800, not because the White House was trying to target the credit, but because that is the maximum wage subject to Social Security taxes, the baseline measure for the government and employers to determine increases in hiring or wages. There's a reason for the limited income-targeting: the objective is jobs, not jobs for certain income classes of people. Also how will firms in declining industries or businesses in particularly hard-hit states would be able to benefit? The White House hopes that recent inventory investments increases indicate pent-up hiring, even in hard-hit areas, likely to be spurred by the credit, but there is no industry or geographic targeting in the program.

Gaming the system: There are ways that employers might try to "game" the system. For example, what about firing and then rehiring employees? That won't work, because the benchmark hiring or wage level is the firm's fourth quarter 2009 numbers. But what about firing one $50,000 employee, then rehiring two $30,000 employees? With the $10,000 increase in salaries, the firm has a measurable wage increase that might be eligible for a tax credit. What about closing down and then reopening under a new name as a new business, with all "new" hires eligible for a start-up business $2,500 per-hire credit? Not allowed. It may be possible for a (for-profit) firm to combine this tax credit with others geared to new hires (WOTC, empowerment zone credits, etc.), potentially getting more credit than the new wages are worth, something the White House doesn't want to see happen. The Administration believes that the program is reasonably designed to root out program malefactors, but it isn't clear what the Administration will do with wrongdoers—or with firms (including nonprofits) that may hire someone new in 2010, take the quarterly credit, but then lay the person off at the end of the year due to other circumstances. Will the firm have to pay back the credit and pay a penalty? Tax credits for job creation are considered reasonably efficient, according to a Congressional Budget Office study, but the CBO warned that administration would be difficult.

Finding money If approved by Congress, the jobs tax credit program would cost $33 billion, which the White House hopes would be paid for from repaid Troubled Assets Relief Program funds, But there may be other claimants for those dollars, and the White House might actually face some difficulty in simply reprogramming TARP dollars without Congressional approval. The President was publicly effusive about the Senate's passage of PAYGO ("pay-as-you-go") budget rules, meaning that new federal spending has to be offset by commensurate cost-savings cuts in other programs or new tax revenues. Unless the Administration is going to ditch its prioritization of the costly national health insurance reform, securing funding for the jobs tax credit might be very difficult due to the combination of PAYGO and competing national priorities.

Congressional approval: The President cannot enact a change in corporate taxation rules by fiat. He needs Congress to weigh in and support his proposal. But there are other competing proposals in Congress, including a bipartisan plan co-sponsored by Charles Schumer (D-NY) and Orrin Hatch (R-UT) that would provide jobs tax credits based on a different formula in 2010 and a lower level of credits in 2011, undoubtedly a more expensive plan. Senator Tom Harkin (D-IA) thinks the necessary budget commitment to this ought to be in the $80 billion range. The President proposes, but Congress modifies and ultimately approves and appropriates the funding. What Congress will do with the jobs tax credit in the President's budget is hard to predict.

What will be the impact of the small business jobs tax credit? The White House estimates one million firms will participate, and the Assistant Treasury Secretary Allen Krueger cited sources estimating the credit will catalyze the creation of six million new jobs. A Cornell economist thinks that the credit could knock 2 percent off the nation's 10 percent unemployment rate. Dependent on defense contracting for about two-thirds of its business, Chesapeake Machine laid off four employees last year, but is looking to hire a machinist and hopes to add four or five workers this year. But the credit will only work if businesses—and nonprofits—see an economic uptick warranting the new hires, as the Chesapeake Machine owner himself noted: "That tax credit…is not going to be the deciding factor, but it'll help."

If the program makes it through Congress, or if proposals from members of Congress take hold, one hopes that the tax credit will work and spark a jobs recovery. But the downside of this program, and many of the Great Recession initiatives proposed by this White House, the past White House, and Congress, is the continuing pattern of responding to economic crisis with corporate subsidies . Former Labor Secretary Robert Reich worries that this tax credit and the proposed exemption of small businesses from capital gains taxes "give(s) ammunition to supply-siders who think the way out of this awful economy is simply to cut taxes on businesses."

Reich suggests that the best job-creating program would be for the federal government to support state and local government budgets: "The best and fastest way for government to prime the pump is to help states and locales, which are now doing the opposite. They're laying off teachers, police officers, social workers, health-care workers, and many more who provide vital public services. And they're increasing taxes and fees. They have no choice. State constitutions require them to balance their budgets. But the result is to negate much of what the federal government has tried to do with its stimulus to date."

Reich's plan would be a job-saving and job-creating program that would have huge benefit to nonprofits, increasing their "business" (through government contracts) and supporting needed new hires and wage increases. There's some real benefit for nonprofits in the President's jobs tax credit, but bolstering the vitality of nonprofits as employers as well as service-providers will take much more.