

The Definition of Small Business in the Marketplace Fairness Act of 2013

- by -

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The Marketplace Fairness Act of 2013, S. 743 (“MFA”) seeks to define when businesses must collect sales taxes on transactions with residents who do not have so-called nexus in the states in which the business itself has nexus. Specifically, the MFA exempts business with sales of \$1 million or less of annual out-of-state sales from collecting sales taxes in states where the business does not have a nexus.²

This short note seeks to analyze three questions: (1) how the definition of small business in the MFA compares to the definition of small business used by other government agencies; (2) whether there is empirical evidence to support the definition of small business in the MFA; and (3) how many small businesses there are nationwide and what proportion of those business are small minority- and women-owned businesses (“SMWBs”).

The Definition of Small Business

There is no precise definition of small business in the economics literature. Indeed, the Small Business Administration (“SBA”), the authority on business size standards for Federal government programs, has allowed the threshold for what is (and what is not) a small business to vary by industry.³ The SBA definition uses employment size of a firm as the defining factor of what is a small business for certain industries and average annual sales over the previous three years for other industries. For example, any mail-order retailer with sales of less than \$35.5 million is considered a small business under the SBA’s definition. Other industries have

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² See <http://www.gpo.gov/fdsys/pkg/BILLS-113s743rfh/pdf/BILLS-113s743rfh.pdf>.

³ See http://www.sba.gov/sites/default/files/files/Size_Standards_Table.pdf

thresholds of \$10 million (*e.g.*, a group of doctors); \$5 million (*e.g.*, dry cleaners); or as small as \$750,000 (*e.g.*, various types of farms). Similarly, the SBA thresholds by employment levels vary significantly across industries: from as small as 50 employees (for gas stations) to as many as 1,500 employees (for airlines).⁴

Such variation in the definition of small business by industry makes complete economic sense. What is a small business in the economic consulting sector is very different from what is a small gas station and what is a small gas station is very different from what is a small farm or small airline.

Is There Empirical Evidence Supporting the Definition of Small Business in the MFA?

The definition of small business in the MFA does not allow for any such variation by industry, which is inconsistent with the differences across retail businesses and sectors and thus the economic logic underlying the SBA's existing rules.

I should note that the SBA's definition of small business is supposed to hold for all federal agencies. However, under current law, federal agencies that would like to use an alternative size standard through the federal rulemaking process are required to go through a multi-step process, including seeking the approval of the SBA's Administrator.⁵

There is no evidence that I am aware of that would support the notion that the appropriate definition of small business is less than \$1 million of out-of-state sales. Indeed, there is no publicly available data correlating small business, as defined by the SBA, with an out-of-state sales figure. And, no publicly available data suggests that \$1 million in out-of-state annual sales – as opposed to some other dollar amount – differentiates appropriately between small businesses, including SMWBs, and other businesses in the U.S. It is very likely that many small businesses under the extant SBA rules would be “large” businesses under the MFA's definition of a small business.

⁴ Ibid.

⁵ See, *e.g.*, <http://www.fas.org/sgp/crs/misc/R40860.pdf>

How Many Small Businesses Are In the U.S. And What Proportion Are SMWBs?

In 2010, the most recent year data are available, the Census Bureau estimated that there are roughly 27.8 million small businesses in the United States. These businesses represent 99.7 percent of all employers and employ roughly half of the private-sector labor force.⁶

The most recent year for which data on the number of the demographics of small business are available is 2007. In that year, there were roughly 27 million small businesses. Roughly 7.8 million of these were owned by females and another 4.6 million were equally owned by males and females. In addition, 1.9 million were owned by African Americans; 1.6 million were owned by Asian Americans; 2.3 million by Hispanics; 237,000 by Native American/Alaskans; and 38,000 by Hawaiian/pacific islanders. The data also show that 3.7 million were owned by veterans.⁷

Female owned small businesses employed 7.5 million people, while businesses equally owned by males and females employed another 8.1 million people. African American owned businesses employed 910,000 people and Asian owned businesses employed 2.8 million. Hispanic owned businesses had 1.9 million people on their payrolls. Native American/Alaskan owned businesses employed 185,000 people, while Hawaiian/pacific islander owned firms employed 38,000 people. Finally, veteran owned businesses employed 8.2 million people.⁸

Conclusion

The definition of small business in the MFA is not supported by any available empirical evidence. It would be better, as a matter of policy, to allow the definition to vary by retail sector, consistent with SBA's existing rules. If the MFA's definition is set too low in some retail sectors, it will impose so-called transactions costs (or compliance costs) on some businesses – many of which may be owned by women, African Americans, Hispanics, Asian Americans, Native

⁶ U.S. Small Business Administration, Office of Advocacy, "Small Business Profile: United States," February 2013.

⁷ Ibid.

⁸ Ibid.

Americans/Alaskans, Hawaiian/pacific islanders, and veterans – which is economically inefficient. And if it is set too high for other retail sectors, the MFA will not achieve its stated purpose. If Congress and the President want to establish a MFA safe harbor for small businesses, it would seem like using thresholds based on, and consistent with, SBA regulations would make more economic sense, especially since such definitions allow appropriately for differences across industries.⁹ Such a definition is also less likely to harm SMWBs.

⁹ Former Senator Byron Dorgan advocated this approach in prior iterations of the MFA. See “Streamlined Sales Tax Simplification Act,” S.2153 (109th Cong) Sec. 4(d) (establishing a process for SBA to recommend a small business definition to Congress).