S. HRG. 107–745

# UNLEASHING THE POWER OF ENTREPRENEURSHIP: STIMULATING INVESTMENT IN AMERICA'S SMALL BUSINESSES

## ROUNDTABLE

BEFORE THE

## COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

MAY 22, 2002

Printed for the Committee on Small Business and Entrepreneurship

Available via the World Wide Web: http://www.access.gpo.gov/congress/senate

U.S. GOVERNMENT PRINTING OFFICE

82–488 PDF WASHINGTON : 2002

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP

ONE HUNDRED SEVENTH CONGRESS

JOHN F. KERRY, Massachusetts, *Chairman*

CARL LEVIN, Michigan
TOM HARKIN, Iowa
JOSEPH I. LIEBERMAN, Connecticut
PAUL D. WELLSTONE, Minnesota
MAX CLELAND, Georgia
MARY LANDRIEU, Louisiana
JOHN EDWARDS, North Carolina
MARIA CANTWELL, Washington
JEAN CARNAHAN, Missouri

CHRISTOPHER S. BOND, Missouri
CONRAD BURNS, Montana
ROBERT F. BENNETT, Utah
OLYMPIA J. SNOWE, Maine
MICHAEL ENZI, Wyoming
PETER G. FITZGERALD, Illinois
MIKE CRAPO, Idaho
GEORGE ALLEN, Virginia
JOHN ENSIGN, Nevada

PATRICIA R. FORBES, *Democratic Staff Director and Chief Counsel*
EMILIA DISANTO, *Republican Staff Director*
PAUL H. COOKSEY, *Republican Chief Counsel*

# C O N T E N T S

## Opening Statements



## Participants



* Comments, if any, are located between pages 11 and 133.

PREPARED TESTIMONY AND APPENDIX MATERIAL SUBMITTED

# UNLEASHING THE POWER OF ENTREPRENEURSHIP: STIMULATING INVESTMENT IN AMERICA'S SMALL BUSINESSES

---

**WEDNESDAY, MAY 22, 2002**

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP,
*Washington, D.C.*

The Committee met, pursuant to notice, at 9:35 a.m., in room 428-A, Russell Senate Office Building, the Honorable John F. Kerry, (Chairman of the Committee), presiding.

Present: Senators Kerry and Bond.

## OPENING STATEMENT OF THE HONORABLE JOHN F. KERRY, CHAIRMAN, SENATE COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, AND A UNITED STATES SENATOR FROM MASSACHUSETTS

Chairman KERRY. Good morning everybody. Thank you so much for taking time to join us today. We have a powerhouse gathering of individuals with political, business, and entrepreneurial experience, and I think it is very exciting to have all of you here to share some thoughts in this roundtable form of a small business hearing, with quotation marks around the word "hearing."

I am very, very grateful to all of you. Some of you have traveled some distance. For others, it is a closer trek. But for all of you, time is valuable and we very much appreciate your sharing time with us today.

We are going to have colleagues join us as well. Senator Bond will be here a little bit later and other colleagues will be in and out. One of the things we have found on the Committee in the past few years is that it really helps—this is just a better way to get at issues. The hearings tend to have their own formalized structure and end up not being quite as dialogue-prone, and sometimes even constructively contentious.

So I have found, and I think Senator Bond shares with me the sense that this can be a much more productive way of really getting at issues, figuring out an agenda, and getting everybody's participation. I think it is a very positive way to do things and I hope you will share that sentiment. Some of you have participated before, many of you have not, but I think you will find it is a very productive way to proceed forward.

As you know, we added the word entrepreneurship—and I do not take it lightly. Sometimes things happen around here that are cosmetic, but I do not view the addition of the word "entrepreneurship" to the Committee's title as cosmetic. Entrepreneurial activity has its own special qualities, I think, and most of you here would agree. While all small business is inherently somewhat entrepreneurial, there is an entrepreneurial epic and style and series of hurdles that, for the kinds of longer-term growth enterprises that we are trying to encourage, require a special set of disciplines and knowledge of how to take advantage of certain kinds of opportunities.

It is interesting that of the 600,000 to 800,000 start-ups annually in the United States, only 1,000 of them receive what we know as venture capital funding, and usually for more than $1 million. The vast majority receive either informal and/or angel investor-type funding of anywhere from $5,000 to $50,000 and wind up at some point turning the corner, many of them, and becoming one of those companies that then qualifies for the more traditional kinds of funding.

What is interesting to think about is so how do you measure at the very beginning those kinds of companies? Are there some traits and ways in which one can distinguish immediately who has got the best opportunity to be that kind of company and get them on a track where they find that funding sooner? Could we have more success stories if we had a way, a set of criteria or ways in which to determine that?

There is a whole area of entrepreneurship that is different in America today. We do this better than anybody else. We have the most—even though we do not always find capital flowing as readily as we would like it to, and part of the discussion here today ought to be how do we get access to capital. We are always trying to refine that. That is the purpose of the SBA.

But there is a lot more to small business than just the SBA. The SBA is one kind of relationship and often it is more the SBIR, SBIC, 7(a), 8(a) sort of lending programs. There is a whole other set of small business hurdles and needs that are purely entrepreneurial that never need to touch the SBA and we ought to be thinking about those a lot and that is part of the purpose of this morning's effort.

There are so many opportunities now. It is extraordinary when you think about it. The changes in the marketplace are just phenomenal. If you go back to the 1980s, you all remember the books that were being written about Japan, Inc., and the end of the American era and the next century was going to be the Asian century, China and/or Japan, et cetera.

Frankly, the people who proved that wrong were not the U.S. Government or anybody else but business. American business buckled down. We had that terrible word called "downsizing," but it was effectively a sharpening of the pencil, really. It was a natural process by which people became more competitive and there was some winnowing out, and we obviously did extraordinarily well during the 1990s.

At the same time, what Alan Greenspan called the "virtuous cycle" transitioned into the "irrational exuberance" that cost a lot of people, and we are still going through that particular adjustment right now. But the basics are still there, and there is an awful lot of money out there seeking good deals and I think it is time to go back to basics.

There is a disturbing trend that I think most of you would agree, and I am not sure how it impacts the small business piece, but that is the trend towards the earnings scandals of Wall Street, the Enron/accounting practices and the drive towards what we have seen—I guess the way to phrase it, and this is mostly a larger company phenomenon, but I think it spills over into and has an impact on smaller entrepreneurial efforts, and that is the growth by accrual, growth by merger, growth by acquisition rather than by creation of product and expansion of sales per se.

The phenomenon by which CEOs have had these rather remarkable increases in options and the ways in which companies have created, I guess, a Wall Street-oriented quarterly report that does not, in fact, reflect what we all look for in price earnings ratios. I think that is one reason why there are still a lot of inflated, overinflated values in the marketplace today and some room for some adjustment still that we may or may not suffer over the course of the next months.

Anyway, all of this is subject to discussion today in whatever form you would like it to take.

I have to go to a press conference with the National Mayors for housing shortly.

We do have two pieces of legislation that are particularly important that we are discussing, also, the BRIDGE Act, which is a piece that a number of you here have worked on and I am anxious for further discussion of that. I think you are all familiar with the details of it, but it essentially sets aside tax liability as collateral for lending to help firms retain working capital that they cannot get otherwise because banks are closing the credit lines. It is a lot harder to get credit below larger amounts of money today. A lot of small companies, small businesses, are just shut out.

So that is one approach, and I am very grateful to Congressmen Jim DeMint and Brian Baird—thanks very much—for their cosponsorship of the BRIDGE Act in the House of Representatives. We look forward to a good discussion on that.

The second piece of legislation is a piece that I have championed for some time. When Dale Bumpers was here as chairman in 1993, we passed a targeted capital gains reduction. I have reintroduced a capital gains bill with a zero capital gains tax for stock in small businesses with market value of up to $1 million. The stock must be held for 3 years. We may change that time period to 5 years. It was set during the period when the time return on investment had ratcheted down so significantly. I think we are back into a more normal cycle now and we probably ought to ratchet it back up.

But this is for critical technology areas, the theory being that that could excite the movement of a lot of capital to those areas where the highest value-added jobs are created and where the United States has the greatest interest in trying to create and hold on to market share and be at the lead.

I thank Doug Tatum very, very much, CEO of Tatum CFO Partners, and I am very grateful for his input. He has been really instrumental in helping us design the BRIDGE Act and I think he will make an important contribution to the discussion today.

While I am not here, Patty Forbes will facilitate the dialogue, she will be in charge, and I think she has a lot of experience in helping to pull useful information from participants.

So thank you again for being here. We appreciate it very, very much, and if I could turn to my colleagues from the House for their opening thoughts, I would like to do that.

[The prepared statement of Senator Kerry follows:]

**COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP**
**UNITED STATES SENATE**

**Roundtable entitled**
**"Unleashing the Power of Entrepreneurship:**
**Stimulating Investment in America's Small Businesses"**

**Chairman John F. Kerry**
**Wednesday, May 22, 2002**

Never before have so many opportunities existed for America's small businesses. The technology explosion, medical advances, a shrinking globe, the renewal of urban communities, and the building of new and powerful communications networks are all changes transforming our economic landscape and opening doors for entrepreneurship and innovation. The boundaries and limits of the traditional "bricks and mortar" small business are being redrawn to fit a new era.

Throughout the 20th century, the entrepreneurial spirit drove our advances in technology and business development. In recent years, the pace of change has accelerated. In the new 21st century economy, risk-taking and entrepreneurship lie at the heart of modern business and society.

Indeed, American entrepreneurship and its interrelated values of independence, risk-taking, and innovation continue to define us as a Nation. Consider the case of entrepreneur Michael Dell who founded his own mail-order PC company in 1984 at the age of nineteen. Today, Dell Computer Corporation has over 34,000 employees generating over $31 billion in annual revenue. Twenty-eight years ago, Federal Express opened its doors as a small, start-up enterprise. Today, FedEx employs over 200,000 employees and contractors and operates in 211 countries. These are just two of many success stories.

In the future as before, those small business owners, those leaders, that succeed will take considerable risks to build their companies into cutting-edge enterprises. The odds of failure are high. Small business owners gamble their personal savings and wealth on the fortunes of their endeavor. They borrow from their family members, extend their credit, and do whatever is necessary to raise the funds they need. Fortunately, we as a nation have created a culture and climate that encourages entrepreneurs to take these risks.

The benefits of entrepreneurship cannot be understated. Small, start-up firms serve as incubators for tomorrow's ideas. Entrepreneurs, through their innovations, improve our quality of life. They create jobs, generate new wealth for reinvestment, and enhance U.S. competitiveness abroad. In fact, small businesses with fewer than 500 employees make up nearly 97 percent of all U.S. exporting firms. Companies with fewer than 20 employees have been the most successful exporters – they are the fastest growing both in numbers of exporters and in numbers of export dollars.

In a perfect world, a perfect market, financing would always be available for businesses that offer profitable results. But we don't live in a perfect world. Obtaining enough capital to finance business growth and expansion is a perennial concern of entrepreneurs, one that is intensified in an economic downturn. For many promising small businesses, bank lending, private equity and venture capital can often prove distant and elusive. Ideally at some point in its life-cycle, a young enterprise "turns the corner" and is able to obtain external financing. Why and at what age does it occur? These are important questions for policymakers seeking to facilitate small business investment, growth, and innovation.

The ways in which large and small firms obtain funds differ significantly. Although venture capital receives considerable attention, most new investments are generated by entrepreneurs and other individuals who are informal or "angel" investors. Each year, only about 1,000 out of 600,000-800,000 start-up businesses use formal venture capital--usually for investments over $1 million. The vast majority of start-up firms rely on informal investors who invest $1,000 to $50,000. Increasingly, in successful industries, informal investors are taking greater risks with investments well over $50,000.

While there are reports that over the past few months, fewer banks are cutting back on their lending to small businesses, overall access to capital is still a problem. Hamstringing the small business sector hurts us in two ways – it slows down the country's economic recovery and significantly reduces job creation. The economic downturn has drastically affected the ability of small businesses to tap into bank lending. After lending record amounts in 2000 and 2001, bankers have drawn the purse strings tight. Just a year ago, big lenders were making cash-flow loans as small as $5 million. Now, many won't lend less than $35 million, shutting out smaller companies. The banks that have cut back on lending to small businesses continue to cite economic uncertainty as a factor.

A survey conducted in February by the National Association of Manufacturers (NAM) found that more than a third of small and medium-sized manufacturers are finding it more difficult to obtain credit from their longstanding bank lenders. The benefits of the Federal Reserve's interest rate cuts have not trickled down to many manufacturers, or small businesses in general. Instead, banks have resorted to tighter lending standards and higher fees. Credit availability has been adversely affected by loans lost in the collapse of the Internet bubble, and more recently, by the fallout from the Enron affair. The end result is a slowdown in business investment and growth. More than a quarter of respondents in the NAM survey said the effect of bank rationing of credit was to delay capital spending projects.

Fostering small business opportunities, capital investment and entrepreneurship should be a cornerstone of our economic policy. Should the United States lose its lead in innovation and risk-taking, the costs could be enormous. Already, other countries are reforming their markets and laws to facilitate entrepreneurial activity. Europe has a burgeoning venture capital industry. To maintain American economic leadership, government should adopt policies and practices which encourage market-driven small business investment. As lawmakers, we should strive to create an economic playing field which does not act as a barrier to capital formation. Economies which lead in the 21st century will be those which ensure ready access to capital for promising enterprises.

Sustaining and promoting small business growth and entrepreneurship demands innovative public policy solutions which harness the power of the market to funnel capital and resources towards America's most promising ventures. I have introduced two pieces of legislation for just that purpose: the BRIDGE Act and the Affordable Small Business Stimulus Act.

The BRIDGE Act will help ensure that entrepreneurial businesses have access to the capital they need to continue creating jobs and stimulating the economy. The bill will allow small, fast-growing businesses to temporarily defer up to $250,000 of income tax liability which would be set aside in a BRIDGE account and could be borrowed against for business purposes. The Affordable Small Business Stimulus Act, in addition to other provisions, would encourage small business capital formation by expanding capital gains incentives for long-term investments in qualified small business stock.

Since most of you are familiar with these bills, I will not take time to describe them in detail now. I would like to thank my Senate cosponsor, Senator Snowe, and my House colleagues, Congressmen Jim DeMint and Brian Baird who have sponsored the House version. In addition, I would like to thank Doug Tatum, CEO of Tatum CFO Partners, for his dedicated work in developing the BRIDGE proposal.

For small and rapidly-growing businesses, as our speakers will make clear, the lack of adequate capital is the primary limit to achieving their full potential. Innovative proposals such as the tax deferral included in the BRIDGE Act or the small business capital gains incentives included in the Affordable Small Business Stimulus Act are essential policy tools. They will help bridge the capital funding gap and mobilize resources for small business investment and capital formation. By harnessing market-driven solutions to the capital financing shortage, Congress can make a meaningful contribution to the engine of growth in America, our small businesses and entrepreneurs.

Thank you for your contribution to today's roundtable. Our exchange of ideas is critical to creating sound and effective small business policies. I regret that time demands will not allow me to stay for the full duration of the meeting. In my absence, the discussion will be facilitated by my Staff Director, Patty Forbes. I look forward to working with all of you in the days and weeks ahead to ensure that the needs of America's small businesses are addressed.

## STATEMENT OF THE HONORABLE BRIAN BAIRD, A REPRESENTATIVE IN CONGRESS FROM WASHINGTON

Mr. BAIRD. First of all, thank you all for being here. I have just come back from yet another trip back to my district, and I can tell you, what I hear from our small businesses is that the need for capital right now is the critical determining factor, not just in the growth, but in the survival of many, many businesses and particularly high growth rate businesses. With the recession, more and more businesses are saying to me that they just cannot get the capital to expand, and yet it is the expansion on which their survival may depend.

As the Senator knows, the BRIDGE Act is an effort to address that. My good friend Jim DeMint and I have worked on this for a couple of years now and the goal is, as many of you know, to try to find a mechanism whereby rapid growing businesses can obtain capital. The somewhat speculative nature, by nature of a rapid growth business, makes it difficult for them to go to a bank or traditional lending institution and get the capital, because for the banks or lending institutions to do the due diligence necessary to verify that the loan is a good one costs so much overhead for them that they would have to charge a prohibitive interest rate.

So as the folks from Tatum have pointed out, this places fast-growth businesses in essentially a no man's land where they need and could benefit from capital to grow, but they cannot obtain the capital that would allow them to grow, and the bill we have put forward essentially allows almost a self-lending mechanism whereby tax liabilities are deferred and can then be used to fund expansion. Those, however, would be paid back to the Treasury with interest so that the net capital cost to the Treasury is actually a positive in the sense that, over time, they will return an interest on that. We believe it is a creative way to provide a fast-growing and large potential employing sector of our economy with capital.

I applaud my good friend, Jim DeMint, for his leadership and I know he will have some things to add to that.

[The prepared statement of Congressman Baird follows:]

**Testimony for Congressman Brian Baird**
**Senate Small Business Roundtable**
**May 22, 2002**

Distinguished members of the Senate Small Business Committee, members of the small business community, I appreciate this opportunity to speak on behalf of the Bridge Act. Senator John Kerry, Senator Olympia Snowe, Rep. Jim DeMint and I introduced the Bridge Act to provide a practical solution to the access to capital obstacles faced by thousands of emerging growth businesses. I am happy to say that in a city where new ideas are rarely acted upon, this hearing stands as a testament to the strength of this innovative idea.

In many small businesses, the first year you set up shop with your wife, your kids, your next door neighbor and your credit cards. It is after you have survived the first three years or so, that you start employing people, that is when you grow. And the bill we are working on will provide the opportunity for small fast growing companies to get through those beginning years and create a successful business.

I go back to Southwest Washington almost every weekend, and when I'm home I talk to many small business owners who are caught in "the beginning years." They have customers out there, but they can't grow fast enough and do not have the resources to keep up with demand. The Bridge Act is a common sense measure that allows fast growing businesses to defer paying federal taxes for five years. Rather than paying Uncle Sam, our bill gives small businesses an opportunity to invest in their workforce and in their infrastructure right when they need to do this the most. Ultimately, there is little or no cost to this bill because the small businesses will need to pay this money back to the government with interest.

The need for this bill could not be greater. My home state of Washington has the second highest unemployment rate in the country, and many communities across the nation are still in the throes of a recession. Emerging growth companies are the businesses that are going to deliver this country out of a recession and put our country's unemployed back to work. These are the companies who have established a good business model and just need that extra push to reach the next level of success.

This is the bottom line -- the Bridge Act gives small businesses the opportunity to access capital, create jobs, reinvest in themselves and continue to grow at little or no long term cost to the federal government. This is a win for small businesses and it is a win for the taxpayer.

I hope we will continue to hold hearings like these to stress the importance of small business needs and the impact these companies will have on our country as a whole.

Chairman KERRY. Fine. Thank you very much.

Jim, thanks very much for being with us. Thanks for your help.

**STATEMENT OF THE HONORABLE JIM DeMINT, A REPRESENTATIVE IN CONGRESS FROM SOUTH CAROLINA**

Mr. DEMINT. Thank you, Senator and all the folks on the Senate side who have shown a lot of vision in this. I think we tend to go to the traditional fixes when looking at stimuli and this is a new idea. It is something that, Doug, you have found, takes a lot of cultivation on the government side, but the fact that it has come this far is very encouraging to me.

I was a small businessman for years and it was amazing that every year, we would sit down and figure out how to disperse what little capital we had into bonuses or whatever to avoid taxes, so we really did not accumulate the capital we needed to grow like we should.

A better example is even yesterday in a hearing for the Small Business Administration with a veteran who started a business in his home after 20 years in the service. He talked about the process of starting a business with $600. He went out and got 17 credit cards to get their lines of credit and he had so much money borrowed on those cards, paying 20 percent, he was not paying himself any money and the sad fact was, he was actually showing a profit because he was not paying himself any money or paying rent and he had to pay taxes. So the tax code was actually taking his capital while he was trying to grow. He now has 100 employees, but it was not because we helped him.

I think the next Microsoft, the next Apple Computer, is in someone's home right now. The fact that it is very difficult to get capital is something we need to look at, not to give them money, but this bill, the BRIDGE Act, basically allows them to borrow from their own tax liability, to use that as collateral to leverage the collateral they have to grow their business.

Many of our traditional fixes for taking a tax load off business can apply to large companies, generally do, companies that can be downsizing, laying off people, and still get the benefit of some of our approaches to reducing tax liability. But this bill is targeted at the companies that are creating jobs today, the ones that are growing. It actually qualifies them based on whether they are growing or not and have been growing.

So this targets a relatively small amount of Federal revenue. By just allowing these companies to defer their tax obligation, use it as collateral, they can leverage even a small amount of money, $10,000 or $20,000 to $50,000, they can leverage $50,000 in tax liability probably to $100,000 or more, keep their own money and grow their business, and then pay their tax liability. We are not giving them money. We are allowing them to keep their own money and manage their own cash to grow their businesses.

This is a novel idea and I think one that can be expanded in a number of different directions once we prove it out. The bill is very limited in the sense that it does not apply to a broad spectrum of businesses, but it does apply to several hundred thousand companies in this country that are providing almost all of the net new jobs, and to push this through the Senate, to have an example over here, it would be a pleasure to help you, Senator, because we think that this is an idea that may be our best tax idea in a long time. Thank you so much for your initiative on this.

Chairman KERRY. Thanks so much. Thank you for your expertise and thanks for being here.

We have three presenters who are going to start off the conversation, the aforementioned Doug Tatum, and thank you, Doug, for being here, Patrick Von Bargen and Mark Heesen. Why do you not start off, Doug, and then we will go to Patrick and then Mark.

**STATEMENT OF DOUGLASS TATUM, CHIEF EXECUTIVE OFFICER, TATUM CFO PARTNERS, ATLANTA, GEORGIA**

Mr. TATUM. Thank you, Senator, and Congressmen Baird and DeMint. I will not repeat what has been said earlier about the BRIDGE Act. I did, however, I believe, have some materials that you might find interesting. There are four businesses: Les Walker, CEO of DocuSource, California, you will find that in your package; Eliot Weinman, who is a CEO and entrepreneur up in Massachusetts, up in the Boston area; Ed Rankin, who is the CEO of PeopleSolutions and one of the "Inc. 500 Fastest Growing Businesses in the United States;" and then Harden Wiedemann, CEO of Assurance Medical in Dallas.[1]

I think you will find that interesting, because these are little vignettes of CEOs who, effectively, fell into no man's land and into the capital gaps and their comments on what would have happened had they been able to defer their tax liabilities and retain that capital in their businesses, and I think you will find that fascinating if you get a chance to look at that.

But I would summarize my comments by saying we are blessed with an entrepreneurial culture which is the single most important economic competitive advantage that we have as an economy. Senator, I have spoken to over 1,000 CEOs in the last 90 days on no man's land, by the invitation of various associations, and I point out in every one of those speeches that your name change in this Committee is hugely significant, because if you get 100 CEOs in a room, small business people, men and women, every one of them had aspirations to grow. Every one of them believed they had that opportunity or they would not be in the business.

We know statistically that a very small number of those will break out of being small and become emerging growth entrepreneurial businesses. Those businesses are entirely different than small businesses, and so your name change is hugely instrumental in describing the difference, both in this city particularly, but is recognized out around the country as being a significant understanding of the issues.

Those businesses that grow and grow rapidly, by virtue of their growth are negative cash flow, but they are economically profitable. What we have, I think, is in summary in terms of tax policy, is that we need a world class farm league. You cannot build a great major league baseball team without a farm league, and these emerging growth companies are the farm leagues for the venture capitalists, my friend over here, Mark Heesen. These are the future

[1] Statements located on pages 18-34 in Mr. Tatum's prepared testimony.

large companies. Those four CEOs whose stories we provided you in written form generated several hundred employee jobs, several hundred high-quality jobs in a matter of 24 months in their businesses and every one of them indicated they had to slow down, stop, or sell as a result of the cash flow constraints.

So I almost summarize the BRIDGE Act as a correction in an error in the tax code. I am not so sure that the policymakers really understood the consequences of growth on a microeconomic basis to rapidly growing companies. The interesting thing, back in—I forgot the date, 30 years ago, when the SBA—the Federal Reserve, who we had an opportunity to brief on this, did a study indicating there was a capital gap for these companies. Well, that capital gap is still here today and it is exacerbated by a lot of issues that we can get into.

So it is very, very important that if the research of Patrick and his group is as significant as we believe it is, which is that a very small number of companies have generated all the jobs, and I am suggesting to you that the jobs are not going to be created by large corporations in the future, and I think there is research to indicate that, that this group of companies is our most precious national asset. Tax policy that allows them to retain capital or tax policy that allows investors to invest in these companies and defer capital gains is the single most important thing we can do to creating a great farm league in the next 20 years.

So I will rest with that and turn it over to my colleagues here and look forward to some questions.

[The prepared statement of Mr. Douglass Tatum follows:]

16

**Presentation by Douglass M. Tatum, CEO, Tatum CFO, LLP**

**Before the**

**Senate Committee on Small Business and Entrepreneurship Roundtable**

**"Unleashing the Power of Entrepreneurship: Stimulating Investment in America's Small Businesses"**

**May 22, 2002**

**Introduction**

Mr. Chairman, Ranking Member, and other Members of the Senate Committee on Small Business and Entrepreneurship, thank you for the opportunity to appear today before the committee and discuss issues relating to financing investment in America's growing small businesses. My name is Douglass Tatum, and I am CEO of Tatum CFO, a national partnership providing chief financial officers for growing businesses across the United States. The firm is headquartered in Atlanta, Georgia, and has offices in 24 cities. I previously participated in a roundtable by this committee on March 1, 2001.

Today, I am discussing a proposed solution to the critical capital funding needs of rapidly growing small businesses, or "emerging growth businesses," that do not have access to adequate capital to finance the continued growth of the business at a reasonable cost. The proposal is called the "BRIDGE Act" ("Business Retained Income During Growth and Expansion"), and it was introduced in the Senate (S. 1903) on January 28, 2002, by Chairman Kerry and Senators Snowe, Lieberman, Bennett, and Bingaman. The proposal was introduced in the House (H.R. 3062) on October 9, 2001, by Representatives DeMint, Baird, Manzullo, Velazquez, Crane, Matsui, and others. As noted, both the House and the Senate bills have received bipartisan support, and I thank each of you for your support of the proposal that will benefit thousands of emerging growth businesses in every state and region of the United States. For state-by-state information on rapidly growing businesses, see the July 2001 publication by the National Commission on Entrepreneurship, High-Growth Companies: Mapping America's Entrepreneurial Landscape.

I will summarize the BRIDGE Act proposal and its potential benefits, and discuss some background on the "capital funding gap" for emerging growth businesses that Tatum CFO has identified and presented to the Congress and the Administration. I have provided handouts on the BRIDGE Act: a one-page background, a summary, and a power point presentation on the proposal. In addition, I have attached four short summary statements from CEOs in multiple states who have experienced problems with the "capital funding gap." These statements illustrate how the BRIDGE Act would have helped to overcome some of these problems and enabled these businesses to grow and prosper.

TATUM CFO PARTNERS, LLP

## THE BRIDGE ACT: TAX DEFERRAL FOR ENTREPRENEURIAL BUSINESSES

### The Entrepreneurial Process and Need for Capital

- **Entrepreneurs, jobs and economic growth.** – The U.S. economic expansion of the past decade was a period of substantial growth in business revenues, assets, and employment. According to recent studies by the Kauffman Center for Entrepreneurial Leadership (Global Entrepreneurship Monitor, 1999, 2000) and Cognetics, Inc., the greatest growth in employment has been among small and mid-size entrepreneurial firms (principally, under 100 employees). For example, Cognetics data indicate that 85% of net, new job growth for 1994-1998 was in firms with under 100 employees (Whose Creating Jobs? 1999). The Kauffman research indicates a close association of entrepreneurship opportunities and economic growth among the G-7 countries.
- **Emerging growth firms and "No Man's Land."** – Even rapidly growing and profitable firms may face a transitional cash flow shortage (or negative cash flow) due to the need for increasing investment in working assets and new personnel as sales expand. Tatum CFO Partners, LLP ("Tatum CFO") has characterized this expanding business transition as "No Man's Land." (See Tatum CFO publication, No Man's Land – Where Growing Companies Fail©.) Most expanding businesses go through this "No Man's Land," which is an economic transition period during which a company can lose its economic momentum due to a lack of management, human resources, infra-structural systems, and/or capital. These firms are "too big to be small and too small to be big."
- **Entrepreneurial capital needs.** – From Tatum CFO's experience in providing financial counsel to emerging growth firms, the greatest financial need is for capital funding between about $250,000 to $1 million, when the capital needs exceed the entrepreneur's personal credit. External financing in this range is extraordinarily difficult for companies to obtain during their early growth years. Even profitable, emerging growth firms may not generate sufficient cash flow to finance needed assets to support the firm's continued growth. Attracting outside capital is difficult not only because of uncertainties related to emerging growth firms, but also because the costs of financing relatively small amounts make it uneconomic and unattractive to traditional capital sources.

### Entrepreneurial Tax Deferral Proposal

- **Tax policy to encourage emerging growth firms.** – Consistent with the need to continue the growth of the U.S. economy, Tatum CFO believes that Federal income tax policy should encourage emerging growth firms by providing a limited tax deferral to bridge the "capital funding gap" – to help these companies through the financial "No Man's Land." A tax deferral would provide a critical source of additional capital to reinvest and help these companies to keep "going and growing" -- resulting in expanding employment for the economy and tax revenues for the government. This would help to revitalize the economy, without long-term revenue loss.
- **Tax deferral proposal (H.R. 3062/S. 1903).** – In order to provide emerging growth firms needed capital funds as they expand sales revenue, the "Bridge Act" (introduced with bipartisan cosponsors in the House and Senate) would allow a temporary, optional deferral of a portion of Federal income tax liability where the firm's gross receipts for the year are 10% or more above the average for the prior 2 years. The deferral would be for 2 years and would be limited to $250,000 of tax, which would be payable with interest (Federal tax underpayment rate) over a 4-year period. The tax-deferred amount would be deposited in a trust account at a bank or other approved financial intermediary, and the firm could use the deferred amount as collateral for a business loan.

  An eligible "small business" would be an "active trade or business" using accrual accounting for tax purposes with annual gross receipts of $10 million or less. Upon sale, merger, or cessation of the business, any remaining tax deferral would be payable at that time. The deferral would sunset (expire) after 2005, with a GAO study.

Tatum CFO Partners, LLP, 4501 Circle 75 Parkway, Suite A-1164, Atlanta, GA 30339, 800-TATUMCFO (800-828-8623)

TATUM CFO PARTNERS, LLP

**The BRIDGE Act (H.R. 3062/S. 1903):**
**A Bipartisan Solution to Help Solve Capital Funding Gap for Small, Rapidly Growing Entrepreneurial Businesses and to Help These Companies Create New Jobs**

**The BRIDGE Act: Summary**

The BRIDGE Act ("Business Retained Income During Growth and Expansion") would allow a growing business to *defer*, not deduct, up to $250,000 in Federal income tax for two years, with payment over the following four years and with interest paid during the entire deferral period at the Federal tax underpayment rate. Businesses that grow at least 10% in gross receipts above the prior 2-year average would be eligible if they are on accrual accounting for tax purposes and have $10 million or less in gross receipts. The deferred tax amount would be placed in a trust account at a bank, to be used as collateral for a business loan. The tax deferral would sunset (expire) after 2005 (unless extended), with a General Accounting Office study and report to the Congress.

**Background on the BRIDGE Act**

The BRIDGE Act was introduced in the House on October 9, 2001 (H.R. 3062) by Representatives Jim DeMint (R-SC), Brian Baird (D-WA), Phil Crane (R-IL), Robert Matsui (D-CA), Donald Manzullo (R-IL, Chairman of the House Small Business Committee), Nydia Velazquez (D-NY), Patrick Toomey (R-PA), William Pascrell, Jr. (D-NJ), Ron Lewis (R-KY), and Melissa Hart (R-PA). A companion bill (S. 1903) was introduced in the Senate on January 28, 2002 by Senators John Kerry (D-MA, Chairman, Senate Small Business and Entrepreneurship Committee), Snowe (R-ME), Lieberman (D-CT), Bennett (R-UT), and Bingaman (D-NM).

The BRIDGE Act is the result of extensive discussions with Members and staff, business trade groups, and Administration officials, two hearings before the House Small Business Committee, as well as the input of Tatum CFO Partners, LLP ("Tatum CFO"), a national financial services firm headquartered in Atlanta, GA. Tatum CFO initiated the proposal, based on its extensive experience in providing chief financial officers for emerging growth businesses. Currently, four business trade groups are supporting the BRIDGE Act: Council of Growing Companies, National Association of Small Business Investment Companies, Small Business Survival Committee, and Small Business Legislative Council. These groups represent thousands of small and emerging growth businesses and their employees.

**Benefits of the BRIDGE Act**

The BRIDGE Act is designed to address two significant financial problems for fast-growing, entrepreneurial businesses on accrual accounting. First, fast-growing companies quickly outstrip capital financing based on the personal credit of the entrepreneur and face a "capital funding gap" for business financing needs (identified by Tatum CFO as between about $250,000 and $1 million in funding). At about $10 million in sales, a company can more readily attract external financing at a more reasonable cost, based on the business assets, to support a $1 million or more credit line. Second, fast-growing companies on accrual accounting may be profitable for tax purposes but face an increasing negative cash flow as the company expends its cash to keep up with growth. The faster the rate of sales growth, the more the company faces a negative cash flow under accrual accounting.

The BRIDGE Act would benefit the vital entrepreneurial sector of the economy, which has provided most of the net new job growth during the past decade, and is providing most of any new job growth in the current economy (as larger firms are downsizing). (See *Who's Creating the Jobs?* 1999, published by Cognetics, Inc.)

The BRIDGE Act would allow growing, entrepreneurial businesses to retain a portion of their Federal income tax liability for a limited period, payable with interest, during a critical time when outside financing is extremely difficult and costly to obtain. The bill would provide additional needed capital to be reinvested in the firm's continued growth. This added capital source would help to create up to 641,000 new jobs during the first three years, thus, helping to reinvigorate the economy. (Projections are based on a sample database of firms from the Kauffman Center for Entrepreneurial Leadership, Kansas City, MO.)

The Congressional Joint Tax Committee staff estimates that the bill with the 2005 sunset would result in temporary revenue "losses" during the first four years, followed by revenue pick-up during the next six years--for a net revenue *gain* of +$1.1 billion for the 10-year period. Thus, there would be no net long-term revenue cost under the bill, since it involves a tax deferral, with interest, rather than a tax forgiveness.

The BRIDGE Act is a bipartisan proposal that would "bridge" the capital funding gap for entrepreneurial businesses and would have a significant economic/job/tax revenue multiplier effect, which is needed in the current economic situation. The bill would provide critically needed cash for continued business operations. The bill would help to offset some of the recent decline in business investment activity. Moreover, the bill would help to offset some of the recent and continuing employment losses in the economy. In getting needed capital to fast-growing, small companies, the BRIDGE Act has the benefit of being highly efficient. George Gendron, Editor-in-Chief of *Inc* magazine, stated that "[t]he BRIDGE Act is an ingenious, fiscally sound mechanism for keeping billions in the hands of a group that makes the most efficient use of capital." (Dec. 2001 issue)

The tax deferral is self-executing, with no bureaucratic, time-consuming application process in deciding who benefits. If the business meets the growth and size tests, the tax deferral would be obtained by simply filing a tax form. The BRIDGE Act will benefit a wide spectrum of businesses with $10 million or less in sales, whether capital-intensive or service businesses. It will benefit thousands of businesses across the country, as there are high-growth companies in every State and region of the country. (See *High-Growth Companies: Mapping America's Entrepreneurial Landscape*, July 2001, by the National Commission on Entrepreneurship.)

*For further information or questions on the BRIDGE Act, contact Chuck Royal of Cong. DeMint's staff, (202) 225-6030; Ryan McCormick of Sen. Kerry's staff, (202) 224-7054; or Richard Trotter, Tatum CFO Partner for Government Affairs and Services, (619) 921-0119.*

TATUM CFO PARTNERS, LLP

**The BRIDGE Act**
**Will Benefit Thousands of Entrepreneurial Businesses and Help Create Over 600,000 New Jobs**

1. **Bipartisan:** House bill (H.R. 3062) – DeMint (R-SC), Baird (D-WA), Crane (R-IL), Matsui (D-CA), Manzullo (R-IL), Velazquez (D-NY), Toomey (R-PA), Pascrell (D-NJ), Ron Lewis (R-KY), Hart (R-PA). Senate bill (S. 1903) – Kerry (D-MA), Snowe (R-ME), Lieberman (D-CT), Bingaman (D-NM), and Bennett (R-UT).
2. **Tax Deferral, Not a Tax Cut or Forgiveness**: Provides up to $250,000 income tax *deferral* for two years, with payback over the following 4-year period (all with interest at the Federal underpayment rate).
3. **Alleviates Capital Funding Gap for Growing, Entrepreneurial Businesses**: Helps to "bridge" the capital gap for funding needs of growing, small businesses (very difficult and costly to get loans or investments in the range of about $250,000 to $1 million) by retaining a portion of tax liability in a trust account, for use as bank collateral to finance continued business expansion and create new jobs. In the December 2001 *Inc* magazine, Editor-in-Chief George Gendron states that "The BRDIGE Act is an ingenious, fiscally sound mechanism for keeping billions in the hands of a group that makes the most efficient use of capital."
4. **Helps Create Over 600,000 New Jobs in First 3 Years**: Added retained capital is projected to help create up to 641,000 new jobs, based on data from the Kaufman Center for Entrepreneurial Leadership.
5. **Aligns Timing of Payment of Tax Liability with Ability to Pay**: Helps to alleviate negative cash clow during high-growth phase when profits are accruing, but with little cash to pay the tax.
6. **Nationwide, Broad-Based Benefits for Thousands of Growing Small Businesses:** Estimated 79,000 to 95,000 small businesses to benefit in FY 2003, with $10 million or less in sales on accrual accounting and growing by 10% or more above average sales for the prior 2 years. It is not targeted to specific industries. High-growth companies are in every State and region of the country.
7. **Self-Executing Provision**: There is no bureaucratic, time-consuming process in deciding who benefits. If the business qualifies, the tax deferral is obtained by filing a tax form.
8. **Temporary Revenue Cost**: With sunset after 2005, Joint Tax Committee estimates a "loss" of $-2.4 billion for 2002, -6.3 billion for 2003, -8.2 billion for 2004, and –6.0 billion for 2005 (-22.9 billion for 2002-2005), and a positive (+) revenue gain of $24.1 billion for 2006-2011 – for a net total *gain* of $+1.1 billion (rounded) for the 10-year period. Thus, there is no long-term revenue loss.
9. **Significant Economic Multiplier Effect**: Would help to reinvigorate the economy through continued growth of entrepreneurial businesses, which have created most of the net new jobs in the past decade and are the ones most likely to add new jobs in the current economic situation.
10. **Business Trade Group Support**: Supported by the Council of Growing Companies (CEOs of rapidly growing companies of $3 million or more in sales and double digit annual growth), National Association of Small Business Investment Companies (SBICs), Small Business Survival Committee (70,000+ business members), and Small Business Legislative Council (80 trade and professional groups with thousands of members).

***–IS THERE ANY OTHER TAX PROPOSAL THAT WILL HELP STIMULATE ECONOMIC AND JOB GROWTH MORE THAN THE BRIDGE ACT, WITHOUT LONG-TERM REVENUE LOSS?***

Tatum CFO Partners, LLP (March 2002)

fyi

# Bridging the Capital Gap

**The BRIDGE Act is an ingenious, fiscally sound mechanism for keeping billions in the hands of a group that makes the most efficient use of capital BY GEORGE GENDRON, EDITOR-IN-CHIEF**

IN AN ECONOMY LIKE OURS, there is always debate about government intervention in the marketplace. But there's no denying that today at least some business groups need help urgently.

In lower Manhattan we have an entire population of 5,000 to 7,000 companies whose future is very much in doubt as a direct result of the terrorist attacks on the World Trade Center.

Meanwhile, down in Washington, just about every business interest group imaginable has lined up on the steps of the Capitol looking for a handout. Whenever a tax bill comes before Congress, the special interests have a free-for-all. But there's something particularly tawdry about the spectacle this time around.

Somewhere between the special-interest groups and the companies in dire need lies another group of businesses that don't fall into either category. I'm referring to the hundreds of thousands of small private growth companies that play a critical role in generating new jobs—particularly during recessions. As we note in this month's special report on the state of the entrepreneurial economy (see "Cloudy With a Chance of Monsoons," page 86), there are signs that this time around, growth businesses may not be able to serve as the economic shock absorbers they've been in the past.

Part of the problem has to do with what Douglass Tatum calls the "capital gap." Tatum is the founder and CEO of Atlanta-based Tatum CFO Partners LLP, which contracts out financial executives on a part-time basis to early-stage growth companies. He says that a while back he started noticing patterns of failure among small, profitable growth companies, as an increasing number of them began experiencing negative cash flow at an accelerating rate.

Like most start-ups, those companies had been launched with personal savings and credit-card borrowing, but the most successful of them needed a level of financing that institutions in the capital markets weren't able to provide. As a result, many emerging companies found themselves in a kind of no-man's-land when it came to financing their future growth.

Tatum took his concerns to Washington, D.C., where he worked with Representatives Jim DeMint (R-SC) and Brian Baird (D-WA) to come up with a solution: a limited tax deferral that would bridge the capital gap. Under the so-called BRIDGE Act, a company would be allowed to defer up to $250,000 of federal corporate income-tax liability when its revenues exceeded its average revenues for the two prior years by 10% or more. The amount deferred would have to be repaid, with interest, over a four-year period beginning two years after the deferral. To be eligible, a company would have to do its accounting on an accrual basis and have total annual revenues of no more than $10 million.

The BRIDGE Act, if passed, would reduce tax revenues by $2.4 billion in the first year but wouldn't cost taxpayers a dime over the long term. In fact, it's estimated that the government would wind up making $1 billion on the deal over 10 years—and that's before factoring in any of the benefits that would flow from the hundreds of thousands of additional jobs that would be created. It is an ingenious, fiscally sound way to keep billions of dollars in the hands of a group that makes more efficient use of capital than any other group on the face of the earth.

*George Gendron (george.gendron@inc.com) is the editor-in-chief of Inc.*

TATUM CFO PARTNERS, LLP

**Tatum CFO Partners, LLP**

# *THE BRIDGE ACT*

**HR 3062**

**S 1903**

***"Business Retained Income During Growth and Expansion"***

**A Bipartisan Approach to Growing the Economy and Jobs**

-1-

## Concept of the BRIDGE Act

Small, rapidly growing, profitable businesses would be allowed to defer the payment of part of their Federal income tax, temporarily retaining part of the capital that they have created by their profitability.

**This would result in:**

- Needed capital for continued growth of the business
- More jobs created
- Ultimately, sufficient growth to attract funds from traditional sources at a reasonable cost

TATUM CFO PARTNERS, LLP

-2-

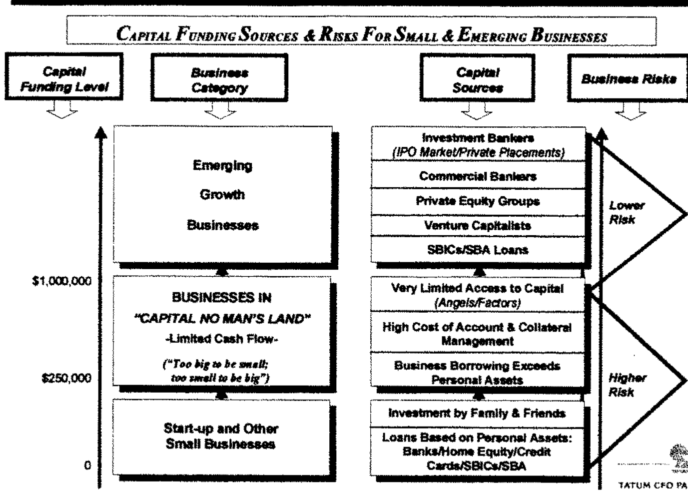
# Fundamental Reasons for Supporting the BRIDGE Act

- Business growth (in sales) is the engine of job growth
- In small and rapidly growing businesses, the lack of adequate capital is the primary limit to achieving their full potential
- Businesses using accrual accounting for taxes, even while profitable, are cash flow negative if their annual percentage growth rate exceeds their percentage return on capital
- Businesses having capital funding needs of about $250,000 to $1 million are in a "capital funding gap" -- in which their need for capital is too large to be met by personal savings or personal loans but too small to be met profitably at affordable costs from traditional sources of credit such as banks

TATUM CFO PARTNERS, LLP

-3-

# Illustration of "Capital Funding Gap"

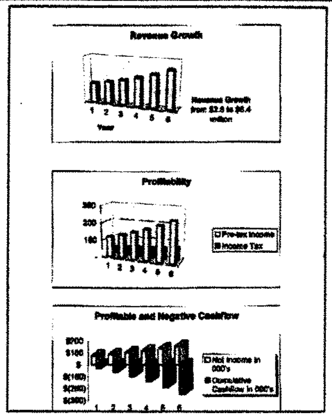



TATUM CFO PARTNERS, LLP

-4-

## Microeconomics of Growth

The following illustrations were built from an economic model that accounts for the typical asset growth characteristics of a rapidly expanding business on accrual accounting and transitioning through "No Man's Land."




TATUM CFO PARTNERS, LLP



## What the BRIDGE Act Would Do

- Allow qualifying, small, and profitable businesses to defer the payment of up to $250,000 of their Federal income tax liability
- Assuming the retained funds are used for business growth, up to 600,000 new jobs could be created in the first three fiscal years under the Act

TATUM CFO PARTNERS, LLP

## How the BRIDGE Act Would Work

- **The deferral, if elected by a business, would require:**
  - The payment of interest on the deferred amount at the Federal tax "underpayment" rate
  - The payment of the deferred tax in four years (minimum of 25% per year), starting two years after the year of deferment
  - Deposit of deferred tax amount in a bank to be used as collateral for a business loan

TATUM CFO PARTNERS, LLP

-7-

## Who Would Qualify for the BRIDGE Act?

- **Qualifying businesses:**
  - Have annual sales revenues up to $10 million
  - Have sales growth of 10% or more above the average sales of the past two years
  - Use accrual accounting for taxes
  - Have a cumulative maximum of not more than $250,000 of tax liabilities deferred

TATUM CFO PARTNERS, LLP

-8-

## Who Would Qualify for the BRIDGE Act? (continued)

- **Qualifying businesses are found in:**
  - Every state and region of the country
  - All 394 U.S. Labor Market Areas

**An estimated 79,000 to 123,000 businesses are projected to use the BRIDGE Act in each of the first two years following enactment**

**The BRIDGE Act is non-discriminatory with respect to geography, ownership style, or market (i.e., whether manufacturing, wholesale, retail, or service industry)**

TATUM CFO PARTNERS, LLP

-9-

## What is the Long-Term Cost of the BRIDGE Act?

### NOTHING!

In fact, with a five-year sunset, the Congressional Joint Committee on Taxation estimates that the **BRIDGE** Act, over a 10-year period, will generate positive revenue ($1.1 billion) due to interest income (not counting the tax revenues that would come from the inevitable growth in business, investments, and jobs).

TATUM CFO PARTNERS, LLP

-10-

# Congressional Support for the BRIDGE Act

- **Bipartisan support in the House (HR 3062) and the Senate (S 1903):**
  - Co-sponsors in the House Ways and Means Committee and the Small Business Committee
  - Co-sponsors in the Senate Finance Committee and the Small Business and Entrepreneurship Committee

TATUM CFO PARTNERS, LLP

-11-

# Editorial and Business Comments

- "The **BRIDGE** Act is an ingenious, fiscally sound mechanism for keeping billions in the hands of a group that makes the most efficient use of capital." *George Gendron, Editor-in-Chief, Inc magazine, December 2001.*
- In getting capital to the most deserving recipients, the **BRIDGE** Act has the benefit of "being self-selective and 100% efficient". The **BRIDGE** Act would get capital in the hands of growing, profitable, small businesses "with no government involvement other than record-keeping and no expenditure of scarce time in an application process by the intended recipients." *Lee Mercer, President of NASBIC, testimony before the House Committee on Small Business, June 26, 2001.*

TATUM CFO PARTNERS, LLP

-12-

# Economic Assumptions and Analysis

- **Dr. Michael Camp,** Vice President of Research, Kauffman Center for Entrepreneurial Leadership (Economic data and analysis)
- **Dr. David Birch,** Cognetics, Inc. (co-author of Who's Creating the Jobs? 1999), (Economic data)
- **Patrick von Bargen,** Executive Director, National Commission on Entrepreneurship (High-Growth Companies: Mapping America's Entrepreneurial Landscape, July 2001)
- **Sam Norwood,** Partner, Tatum CFO Partners, LLP (Micro- and macro-economic models)

TATUM CFO PARTNERS, LLP

-13-

# House and Senate Congressional Staff Contacts

### *House of Representatives:*

- Chuck Royal - Office of Representative Jim DeMint (R-SC)
  - Telephone: 202.225.6030 / E-mail: Chuck.Royal@mail.house.gov
- Joel Rubin - Office of Representative Brian Baird (D-WA)
  - Telephone: 202.225.3536 / E-mail: Joel.Rubin@mail.house.gov

### *United States Senate:*

- Ryan McCormick - Majority Staff, Senate Small Business and Entrepreneurship Committee, Senator John Kerry, Chairman (D-MA)
  - Telephone: 202.224.5175/E-mail: Ryan_McCormick@small-bus.senate.gov

-14-

## Conclusion

**THE BRIDGE ACT**

is

**SOUND POLICY**

and

**GOOD LEGISLATION**

for

**CONGRESS TO ENACT!**

TATUM CFO PARTNERS, LLP

-15-

TATUM CFO PARTNERS, LLP

**Tatum CFO Partners, LLP**

# *THE BRIDGE ACT*

**CONTACT:**

***TATUM CFO PARTNERS, LLP***

**Richard Trotter - 619.921.0119**

**Sam Norwood - 404.352.9536**

-16-

**Summary Statement of Les Walker, CEO, DocuSource, California**

If capitalization weren't a problem, Les Walker, CEO of DocuSource, would be building his sales organization and aggressively seeking sales throughout Southern California, not just in Los Angeles and Orange counties. "We would be placing sales branches in new marketplaces, signing more customers, hiring more service and field technicians, and even adding administrative support," Walker explained.

Instead, DocuSource has trimmed its staff from more than 100 to only 70 employees, kept its focus largely on LA and Orange counties -- and is even considering the sale of the company.

"We're in a vice where there is a tremendous market opportunity, but we're not in a position from a capital standpoint," Walker said. "Instead of increasing revenue and employment, we're reducing our workforce so we can work within the realities."

DocuSource should be on top of the world.

Consider: The fast-growth office equipment company has grown 700 percent over the past eight or nine years, to more than 100 employees and $21 million in sales in 2001. It was ranked 159 in 1995 on Inc magazine's annual list of 500 fastest growing companies. The LA Business Journal has counted it among the fastest growing private companies in Los Angeles for six consecutive years. Although clients are primarily from Southern California, its national accounts include the prestigious CB Richard Ellis.

"We are a good example of an emerging-growth company that has the ability to compete and provide alternative solutions to the largest players in our industry," Walker said. "Our challenge is capitalization in order to sustain our level of growth."

Walker indicated that the BRIDGE Act would have been helpful to his company and others like it that are profitable but cash-poor. "If we had had $250,000 in deferred income taxes that could be treated as capital from the bank's perspective, it would have cut our debt to equity ratio in half. We would suddenly have become a very bankable company. That would have had a tremendous impact on our ability to continue to grow the company and provide jobs."

Instead, Walker said, the company's current bank increasingly is cutting back on the firm's borrowing power. "We're in a cash stranglehold with the current lender." Efforts to negotiate a line of credit from a replacement bank have been unsuccessful. "Banks have tightened up their underwriting criteria," he said.

DocuSource has been equally unsuccessful in its efforts to raise $1 million in subordinated debt. "We offered a 20 percent annual interest rate, and at this point have only raised about 40 percent of what we need, with half of that total coming from the owners."

Incorporated in 1990, the company ran into trouble in 1998, when it expanded its product line and its marketplace. From a one-product company in the Los Angeles County marketplace, it began to offer three product lines in a territory that included seven Southern California counties.

The catalyst was Ricoh Corp.'s development of the first digital copier, which it sold through authorized dealers such as DocuSource. DocuSource seized the opportunity to sell the latest and best technology to a broad range of customers. The drawback: "It took a tremendous amount of investment to bring it on. We had to train the sales staff, train or hire field service technicians, and expend capital to inventory the equipment, parts and supplies.

"There's no question. If we had additional capital, we would build our sales organization and become aggressive with the other Southern California counties; we would be placing sales branches in those marketplaces," Walker said.

Instead, DocuSource is reluctantly considering the sale of the company, which would undoubtedly lead to layoffs. "The acquiring company probably does not need all the infrastructure that we have – which means that the economy would be better off with us as an independent company than if we're acquired and duplicate personnel are laid off."

# # #

**Summary Statement of Eliot Weinman, entrepreneur, Masssachusetts**

Eliot Weinman has started two fast-growth companies in the past 12 years, ramped them up to several million dollars in revenue – then was forced to sell both of them when capital needs outstripped cash flow.

Weinman established the first company, Software Productivity Group, in 1989, working from his home. "We produced magazines, ran conferences and performed analyst consulting services," he said. "Our clients were large companies that were buying enterprise software and software development tools."

In 1990, the company's revenues totaled about $100,000. By 1993, the total had grown to $2 million and, by 1995, $3.8 million. By the time the company was sold in March 1996, it numbered about 25 employees.

"It all sounds great," Weinman concedes. "The problem is that, when you're growing, you've got to pay your payables. You can't push them more than 60 days." And Software Productivity Group's payables – primarily for printing and postage – were substantial. By contrast, cash receipts from accounts receivables were taking three to six months to come in.

"Then there are taxes," said Weinman. "We were in the 40 percent tax bracket after the third year."

If the BRIDGE Act had been in force at that point, Weinman could have put the deferred taxes to good use. "When a business is growing, you've got critical cash-flow needs. I wouldn't have minded paying taxes later – I would definitely have been able to hire more people, have grown more and, in the end, generated more revenue and profits, and thus, would have ended up paying more taxes to the IRS."

By the end of 1995, Software Productivity Group had grown to 25 employees, had moved into a new office in June 1995, and was generating almost $4 million in revenue. "We were on track to do almost $6 million in 1996."

It wasn't to be. "I needed to increase magazine circulation at a cost of over $400,000, expand and move the office again, and hire more people. The tax bill was going to be more than $300,000, and we needed working capital of at least $200,000. Since January and February are typically slow months in our business, we also had to fund about $150,000 in overhead through March 1996. Athough I had set up a $100,000 revolving line of credit, I couldn't successfully grow my company on what was left," Weinman said.

At that point, Software Productivity Group was approached by Ullo International, a privately held rollup company. "Ullo was prepared to cash us out and invest $1 million in the company," said Weinman, who accepted the deal, albeit reluctantly. "If we had been better capitalized, I would have kept the business," he said.

Weinman founded another company in late 1997, with Intermedia Group, a high-tech conference and consulting business. This time he accepted $300,000 in venture financing from META Group, a publicly held company (Nasdaq: METG). On reflection today, Weinman said he might not have gone that route if the BRIDGE Act had been on the books as a potential option once his company achieved a measurable fast-growth position.

One again, the company grew rapidly. It did $450,000 million in revenue in 1998, $1.9 million in 1999, and $6.2 million in 2000.

"We were a nice-sized company, doing business across the country. We had about $1.3 million in cash by the end of 2000."

However, this was barely enough to fund the fast-growing company's needs. Intermedia paid $750,000 in taxes and $300,000 in expenses during the slow months of December through February. It also had to begin funding the marketing expenses for the March and April conferences. With no conferences planned early in the year, income was minimal the first quarter. Weinman was left with about $250,000 in the once-hefty bank account. "A quarter of a million in deferred taxes would have given us an important buffer," Weinman said. He added, "Half a million dollars would have been even better."

"If you have a quarter million, you can hire up to three or four people and begin funding the marketing expenses needed. That carries the growth you had in 2000 into 2001 and accelerates your business a great deal."

Again, with cash needs of at least $250,000-$500,000, Intermedia Group was a target for a takeover. "When you are growing quickly in the $1 million-to-$10 million range, you start to compete with larger companies very quickly. Our competitors on the low end were $30 million to $40 million conference companies. On the high end, we were also competing with large, traditional information technology publishing companies whose annual revenue was greater than $1 billion.

Instead of continuing to grow as an undercapitalized business, Weinman accepted an offer from Internet.com (now INT Media Group, Inc., Nasdaq: INTM) to buy Intermedia.

Weinman adds, "Another benefit to the Bridge Act would be, as an entrepreneur, you could pay yourself a little more. I was pulling a salary of $30,000 at Software Productivity Group for several years. Some would-be entrepreneurs can't afford to do that. If an entrepreneur could pay himself or herself $60,000, it would provide more incentive to go into business, and then stick with it."

"I believe it's better for a small company to grow big and succeed than to get sold. I would rather have a business. I think most entrepreneurs would."

# # #

**Summary Statement of Ed Rankin, CEO, PeopleSolutions, Inc., Texas**

If the BRIDGE Act had been in force when Ed Rankin's human management resource company began its rapid growth in 1996, things might have been different.

"If we had been given an extra $250,000 at several points in our growth, that would have meant the difference between night and day," said Rankin, founder and CEO of PeopleSolutions®, Inc.

"When you're a new business, you haven't earned the right to have people pay in advance. They pay once you've billed them for the work. I might have to pay my people two, three or even four times before receiving the first payment from the client. We were always behind in cash flow."

The first cash crisis occurred as PeopleSolutions, Inc. entered its third year of operation, a period of unprecedented growth. "Our clients, predominately large, U.S.-based multinational corporations, were asking us for more and more services. We were profitable. We were ranked among the 25 fastest growing companies in the Dallas-Ft. Worth area.

"And we had no cash."

Undercapitalized and delinquent on taxes, Rankin was forced to sell its receivables, at a discount, to an unregulated lender at high rates. "I had no choice. I sold my receivables, collected my cash, paid the IRS, and stayed in business.

By 1997, things were looking up. "We had very strong gross profit margins and a backlog of receivables from a growing list of blue-chip, Global 1000 clients." A newly opened office in Austin became profitable in 90 days. The company was again ranked among the 25 fastest growing privately held companies and among the 100 fastest-growing owner-managed businesses in the Dallas-Ft. Worth area. Revenues totaled $3.8 million.

"A large regional bank extended us a credit line to finance our receivables and a working capital loan, which was used to pay off some equipment leases and release us from the factoring agreement."

In 1999, Inc. magazine ranked PeopleSolutions among the 500 fastest-growing companies in the United States. But cash flow was once again a problem, and Rankin began to consider selling the business. The newly merged bank complicated matters by rejecting a request to increase the company's credit line, and then forcing PeopleSolutions into the bank's factoring division, saddling the firm with an onerous repayment schedule. "We had no cash to grow. It was all going back to the bank," Rankin said.

PeopleSolutions was rescued later that year by a Small Business Investment Company lender. PeopleSolutions accepted a deal for $1 million in subordinated debt, which allowed it to grow from $4 million in 1999 to $6.5 million the following year.

Rankin is convinced that the BRIDGE Act not only would have lessened his woes considerably – it would also have accelerated PeopleSolutions' growth.

"If we had been able to take advantage of the tax deferral provisions of the proposed Bridge Act, I believe that the company would be at least twice as large as we are today," Rankin said. "We would have added more people, who would be paying more employment taxes. And there's no question we would have created more jobs."

# # #

**Summary Statement of Harden Wiedemann, CEO, Assurance Medical, Inc., Texas**

In 1998, Harden Wiedemann's Assurance Medical, Inc., a company that outsourced drug-testing services, was on the fast-growth track with clients such as Frito-Lay and Southwest Airlines.

By January 2001, unable to keep up with the capital requirements, Wiedemann was forced to sell Dallas-based Assurance Medical to First Hospital Corporation, based in Norfolk, Va.

Today, Wiedemann shakes his head at the irony of the situation. "It wasn't that the company went out of business. The problem was that we had too much business to service with the resources we had! We had more contracts and demands for services than we could fund out of cash flow.

"We needed several million dollars in working capital to take on AT&T and several other large companies as clients," Wiedemann said. "We had to ramp up the telephone service center, hire more employees – lots of things that required upfront cash.

"I tried everything," he said. "I even looked at factoring. I could not get funding." The company had entered territory known as "No Man's Land," the transitional period when a company is too big to be small, and too small to be big.

"We needed $2 million to $3 million. That was too much for early-stage investors and incubators, and not enough for the venture capitalists," Wiedemann said. "We really beat the bushes. For a full year, that was pretty much all I was spending my time on."

Wiedemann laments that lost year. "It takes you away from the operational aspects of the businesss. Customer service is the reason we got those companies – that started to slide when I couldn't keep my eye on the ball because I was spending all my time trying to find funding."

Wiedemann believes that legislation such as the proposed BRIDGE Act, which would allow entrepreneurial, rapidly growing companies to defer up to $250,000 in federal taxes, might have saved his business if it were in force at the time. "It would have allowed me to ramp up my operation enough to bring those contracts on line, so we could have continued to grow out of internal cash flow. We could have closed the deal with AT&T and several other pending contracts."

He considers the BRIDGE Act solution superior to alternatives such as obtaining a loan through the Small Business Investment Company program. He found that process slow, exasperating and ultimately unsuccessful. "It's unfathomably complicated and bureaucratic," he said.

Frustrated at every turn, Wiedemann decided to re-create the company and transform Assurance Medical into a Web-based application service provider, rather than an outsourcing partner. "We actually had a commitment from a venture capital group. If the migration had panned out, we had a commitment to merge with two other companies and get $5 million. Then the e-commerce market started to erode, the venture capital company pulled out -- and I went into high gear trying to sell the business."

The sale cost 20 employees their jobs. But more than that, Assurance Medical lost the opportunity to hire more workers and continue growing. "We could have been as big as 50 to 100 employees and $20 million in sales if we had been able to get interim financing. We were on track to do that," Wiedemann said.

"When times are tough, small business creates the jobs," he concluded. "When you cut off their air supply, it has an economic impact.

"The BRIDGE Act could help businesses survive so they can continue to create jobs."

# # #

Chairman KERRY. Thank you, Doug.
Patrick.

**STATEMENT OF PATRICK VON BARGEN, EXECUTIVE DIRECTOR, NATIONAL COMMISSION ON ENTREPRENEURSHIP, WASHINGTON, D.C.**

Mr. VON BARGEN. Senator, thank you for this opportunity to speak. I am Executive Director of the National Commission on Entrepreneurship. I am delighted to say that most of the points I was going to cover here have already been covered by Members of Congress, which is a truly delightful situation to have. But let me highlight a few points that have been made and maybe add one or two.

In this report we did of high-growth companies, we found several things. First of all, when we gathered the research to find out whether these companies were important to the economy, we came up with a number of roughly two-thirds. That is, about two-thirds of the new jobs in the economy are created by these companies. Well over two-thirds of the innovation in the economy are created by the companies, and somewhere between one-third and two-thirds of economic growth can be accounted for through various correlations by these companies.

We also found that these companies are across all industries. They are not just all high-technology companies. And we found that there are these companies in every single one of the 394 different labor market areas that we studied in the United States.

Now, in another study we did, which is called "Five Myths About Entrepreneurs," we really, for purposes of this roundtable, focused on two big important needs of these entrepreneurs. One, of course, is securing enough capital to grow a company, to hire new employees, to purchase or lease equipment, to make the investments that need to be made in order to grow the company and capture more market share.

And, of course, the second biggest challenge was convincing very talented, creative people to leave larger, more secure companies and join in what is a risky venture, and that is usually done with stock options and stock issuances.

But the first challenge, this need to raise capital, of course, is the discussion point for this roundtable, and just to frame it, it has been done in different ways here, but first of all, it is not a venture capital problem. We know that even though the average venture capital deal size has dropped considerably over the last year-and-a-half or 2 years, certainly venture capitalists do not invest at levels roughly below $3 million on a general basis, and there seems to be enough venture capital in the system still to meet the needs of companies desiring, and at a level of growth where they can use venture capital.

On the other end, it is not a bootstrap capital problem yet. That is, entrepreneurs seem to have access and are very good at convincing friends and families to invest in their companies. They are very good at applying for credit cards. They can do second mortgages on their homes. They can apply savings. That can get them up to somewhere between $100,000 and $300,000. So it is not that problem that is the issue.

The issue is really what we call early stage capital, which is in the range of if a company needs somewhere between $100,000 and $3 million, what does that company do? And when you think about the lending behavior of banks, you are really reduced to two possible pots of money to fund that growth. One is to take the profits, the retained earnings in the company, and reinvest those in the growth needs of the company, and the other is to convince wealthy investors, angel investors, to purchase stock in the company and fund this next stage of growth.

So we have those two pots, and right now, we have obstacles in the way of both of them. I think, as Doug pointed out, he cannot believe that the tax system really meant to do what it did in terms of creating this obstacle for companies to use the profits that they are generating on their growth path to continue the growth. We know on the basis of what was attempted in 1993 with Section 1202 of the Internal Revenue Code, this targeted capital gains system, that we have gummed that up enough that that is not being used by wealthy investors.

So we are here today to discuss the BRIDGE Act, which deals with that first problem of retained earnings used for investment and growth, and then also the Affordable Small Business Stimulus Act, which would deal with the wealthy individual investor issue.

[The prepared statement of Mr. Von Bargen follows:]

2.21

Statement of

**Patrick Von Bargen**
**Executive Director**
**National Commission on Entrepreneurship**

before the

Senate Committee on Small Business and Entrepreneurship
Roundtable on
Unleashing the Power of Entrepreneurship:
Stimulating Investment in America's Small Businesses

May 22, 2002

Mr. Chairman and Members of the Committee:

Thank you for inviting me to open this roundtable this morning. I am Patrick Von Bargen, Executive Director of the National Commission on Entrepreneurship, a non-profit organization that focuses on public policy that supports entrepreneurship and entrepreneurs. The National Commission on Entrepreneurship is funded by the Kauffman Center for Entrepreneurial Leadership at the Ewing Marion Kauffman Foundation. Our mission is really quite simple: We bring information to federal, state, and local policymakers that makes the case for the importance of entrepreneurship to today's economy; research and describe the characteristics of entrepreneurial companies and highlight those policies are important to them; and design "toolkits" for policymakers at all levels that shows what they can do to provide continued support for entrepreneurs and entrepreneurial companies

While there is no shortage of research and discussion about the importance of small businesses in the United States, relatively little attention has been paid to entrepreneurial companies – those innovative companies that intend to grow large and to grow fast. Here are some things we do know.

Entrepreneurs use innovations to improve our quality of life; small entrepreneurs lead the way in developing ideas; they are responsible for more than half of all innovations – 67 percent of inventions and 95 percent of radical innovations since World War II.

Small entrepreneurial companies create jobs – about 5% of small businesses – those growing at least 15 percent for 5 years created about two-thirds of the news jobs between 1993 and 1996.

Entrepreneurs improve our position in global economic competition. Entrepreneurs have pushed U.S. companies in dominant positions in critical global industries such as biotechnology, pharmaceutical and the Internet. For example, the US biotechnology industry is about five times larger than all the biotechnology industries in Europe and U.S. companies are expected to account for 80 percent of the worlds top-selling pharmaceutical products by 2002.

Finally, entrepreneurs create economic growth and new wealth for reinvestment in our country. The Global Entrepreneurship Monitor (also funded by the Kauffman Foundation and conducted by scholars at Babson University and the London School of Business) has made the connection between entrepreneurship and economic growth, finding that about one-third of the difference in economic growth rates is due to the impact of entrepreneurial activity. And, the economic growth generated by entrepreneurial companies is reinvested in other entrepreneurial companies, in distributions to their employees (Cisco systems employs 19,000 people, 7,000 of whom are millionaires), and in philanthropic ventures.

The benefits of entrepreneurial companies are enormous and we believe that public policymakers must continue to insure that public policy encourages the startup and growth of entrepreneurial companies. But in order to understand the kinds of public policies that are most useful to entrepreneurial companies, we need to look at what separates them from other kinds of businesses.

Entrepreneurial growth companies are indistinguishable from all small businesses when they start out; they both start small with the same limited means and require tremendous energy and adventurousness on the part of their founders. They serve important economic functions – stimulating the economy and creating new jobs to replace those lost by downsizing in other areas.

But the key departure point that allows some small businesses to change into entrepreneurial growth companies is usually in productivity gains in their company's product, service, or distribution scheme. This productivity gain makes fast growth possible but not inevitable. For many business owners the goal is not to see how big and how fast their company can grow but rather to provide prosperity themselves and their employees. But for entrepreneurial growth companies, the extent and rate of growth is the most important goal and that is what separates them from their more traditional counterparts.

This difference results in many characteristics that entrepreneurial growth companies and small businesses don't share. Appreciating the difference between a small business before its growth period and once it has become entrepreneurial is perhaps the most important step towards creating effective support for growth companies.

Entrepreneurial growth companies are often clustered around newly deregulated and emerging industry sectors such as telecommunications, financial services and information technology. Entrepreneurial ventures are particularly uncertain and extremely vulnerable to falling flat because their growth is often in industries with no proven business models and no established network of support. They do, however, have the potential for tremendous returns.

An examination of some key differences between entrepreneurial growth companies and other companies explains why these companies need different kinds of support than traditional small or even large businesses. Some examples include:

One, unlike the popular myth, entrepreneurs do not accept all the risk themselves; they are notorious for sharing both the risks and rewards of success. They excel in convincing employees, customers, suppliers, and lawyers to share in the risk. They depend on a system that turns out high quality workers, from entry level employees to the technically skilled; an immigration system that helps them tap into skilled workers from around the globe; a bankruptcy system that does not forever stigmatize them for a failure or even two; and the commitment of community leaders to help create a culture that makes entrepreneurship an honored profession.

Two, entrepreneurial growth companies depend on public policy that strikes the correct balance between protecting intellectual property and putting into the marketplace ideas that be modified and commercialized.

Three, a vibrant entrepreneurial economy depends on a continuous supply of entrepreneurs to use new ideas to form new industries. While some would argue, that entrepreneurs are born not made, a sound entrepreneurship education helps equip many people with ideas – including scientists and engineers -- to get into the marketplace.

Four, the willingness of entrepreneurs to stop on a dime and go a different direction to adapt to changes in the marketplace, must be supported by a regulatory system that is equally flexible and responsive. Overly onerous regulatory agencies (especially at the local level) that are ponderously slow can quickly kill an entrepreneurial venture.

Five, all entrepreneurial growth companies experience one thing in common – the need for growth capital. Entrepreneurial growth companies require an abundance of capital that is usually not available from banks or other private lenders or public finance programs. Traditional debt financing is hard for entrepreneurs – they usually don't have a long enough business history or collateral that attracts traditional debt financing. With traditional financing not an option, entrepreneurial growth companies have to rely on other avenues to fund their growth. These avenues include equity investments from informal investors –angels—or formal investors -- venture capitalists -- and most often from bootstrapping i.e., self-financing and reinvesting in their businesses everything they earn as they earn it.

I believe that this brief excursion through the entrepreneurial landscape underscores the importance of the roundtable being held today. While adequate financing for entrepreneurial growth companies is dependent upon a whole, supportive financial infrastructure such as an overall favorable tax policy and stock options that allow capital starved companies to attract the best and brightest employees and experts, the legislation under discussion here makes some very important adjustments that can make a big difference to rapidly accelerating businesses. While many of the participants at this roundtable will discuss the specific provisions of the BRIDGE Act and the Affordable Small Business Stimulus Act, I want to highlight why these two bills are so important. In very broad terms, they provide the exact right kind of capital to entrepreneurial growth companies when they need it the most.

The Business Retained Income During Growth and Expansion (BRIDGE) Act recognizes the need of entrepreneurs to reinvest all their profits into the growth of their companies. As stated above, companies that are eligible for the BRIDGE Act provisions often have very limited options in securing additional financing. These companies often do not have sufficient collateral, even though they have some demonstrated cash flow, that will allow them to obtain debt financing. And, the amount of money these firms need is too small for traditional venture capital firms whose average investment is about $13 million dollars. Another complicating factor for many fast growing companies is that they are not located in regions that offer many formal or informal investors. According to the National Venture Capital Association, 79 percent of all venture fund investments are made in only five states. And while there is not similar hard data as to where angel investors are located, logic dictates that many of them are located in the same areas. While the risks and costs of the BRIDGE Act is minimal to the treasury, the impact on those businesses that can avail themselves of the legislation could be enormous.

Similarly, the Affordable Small Business Stimulus Act will help those business that do seek investment capital to find it. By providing additional capital gains incentives to investors in qualified small businesses, the bill will serve to increase the size of the pool of potential investors. By creating a more favorable climate for individual investors who are willing to hold onto their investments for more than five years, entrepreneurial growth companies will be able to attract non-traditional investors to their businesses.

Thank you for this opportunity to participate in this round table. I look forward to the discussion and appreciate the opportunity to provide input from our experience with entrepreneurial growth companies.

Ms. FORBES [Presiding]. Thank you.
Mark.

**STATEMENT OF MARK HEESEN, PRESIDENT, NATIONAL VENTURE CAPITAL ASSOCIATION, ARLINGTON, VIRGINIA**

Mr. HEESEN. Thank you very much. I am Mark Heesen, President of the National Venture Capital Association. I agree with what has been said so far, that venture capitalists basically need a farm league. Without a farm league, there is no investment in emerging growth companies down the line.

Venture capitalists in the year 2000, venture-backed companies made up 11 percent of U.S. GDP. That is an incredible number when you think that there are only several thousand venture capitalists in the entire country, and yet those venture-backed companies made up 11 percent of U.S. GDP, 12.5 million jobs, and $1.1 trillion in revenue. So there are a very few emerging growth companies, gazelles, out there that we invest in that become super stars. There are a lot of failures, as well, and venture capitalists do not like to talk about their failures, but it is an important part of the process.

But we cannot even get to those companies unless there are basically programs put together that encourage entrepreneurship, and unfortunately, things are countercyclical. When times are good, basically, entrepreneurs do not need government as much and you always hear entrepreneurs say the best government is no government at all. The reality is that entrepreneurs need government—it is a very important element about how they grow, particularly when it comes to capital gains.

People will not invest in what is very often a speculative venture, a high-tech company or another type of an emerging growth company, if he or she does not believe at the end of the day that they will get some sort of financial gain out of it. They can put the money in a bank, they can put it in a mattress and it will do better at the end of the day very often than putting that money into a small company that could become an emerging growth company. You have to give them some incentive to put money there and capital gains differentials do that.

Section 1202 is a perfect example of a very good intention that has not, frankly, worked because of bureaucrats at the Treasury. Congress tried to fix that problem back in 1998 and we are still working with Treasury to try to get Section 1045 fixed. This bill, S. 1676, would make marked improvements in Section 1202.

Those are absolutely imperative if we are going to see emerging growth companies move through the process. Venture-backed investors, by and large, are not tax sensitive because they are pension funds, they are colleges and endowments, they are banks and insurance companies. Most of them are not tax sensitive. However, the high net worth individuals and the entrepreneurs themselves who are not high net worth are extremely tax sensitive, and so it is important that we look at that early stage so that we have a very good crop of candidates in which to invest.

What we have found in the last year is a dramatic downturn in the amount of venture capital investing in this country and that will likely continue through this year. However, what we have seen over the last couple of quarters is an increasing interest in early-stage companies again, which I think is very good news. But it is just a small portion of all the companies that need financing in this country. Venture capital has been given kind of rock star status lately and the reality is that it is a small portion of companies that we fund. Many of them, as I said, become very important companies, but it is a small portion of those companies in which we invest and there are a lot of others that need things like the BRIDGE Act so that we can look at them down the line.

Another important element, I think, just to address is something that is coming down the pike effective January 1 of 2003 and that is the taxation of ISOs and ESPPs, incentive stock options and employee stock purchase plans. This has nothing to do with the other stock option issue that everyone is hearing about.

But employers, small employers, and employees who are making under the Social Security limit of $85,000 are going to be paying an extra tax come January 1 of 2003, a combined tax of 15 percent on their ISOs and ESPPs. That is a major hit on small companies and it is something that the Treasury has reversed a 30-year policy on. The House has actually passed as part of the pension bill a provision that would not allow Treasury to do this. The Senate has not yet acted upon this, but it is a very important issue to small businesses. Thank you.

[The prepared statement of Mr. Mark Heesen follows:]

3.26

NVCA
National Venture Capital Association

**SENATE COMMITTEE ON**
**SMALL BUSINESS & ENTREPRENEURSHIP**

Roundtable on

***Unleashing the Power of Entrepreneurship:***
***Stimulating Investment in America's Small Businesses***
May 22, 2002

Written Comments of Mark G. Heesen, President
National Venture Capital Association

**Introduction/Summary:**
Access to adequate capital resources has been and will continue to be the key enabler to the success of our country's entrepreneurial small businesses. These firms add vibrancy, innovation and growth to our economy. Venture-backed companies, in particular, have demonstrated a remarkable ability to leverage the equity capital resources and guidance they receive from venture capitalists to generate high levels of job growth and revenues. Investments by venture capitalists over the past 30 years have built companies that are responsible for nearly 11 percent of the U.S. gross domestic product, have created 12.5 million jobs and have generated $1.1 trillion in revenue in the year 2000 alone. Assuring that this model of economic growth continues and thrives should be a priority.

As president of the National Venture Capital Association, I am pleased and honored to participate in this roundtable program. This discussion comes at a critical time since history has shown that small, entrepreneurial firms are the companies that most efficiently and aggressively add jobs to the economy during an economic downturn, thereby helping to restore growth.

The Committee is to be commended for having identified three important areas for discussion: barriers to capital formation; tax considerations; and legislative proposals to stimulate small business investment. NVCA has been focused on three long-standing tax considerations that continue to pose barriers to capital formation as well as an immediate concern posed by an IRS proposal regarding the tax treatment of statutory stock options. Specifically, these issues are:

- the erosion of beneficial tax treatment of gains on the disposition of "qualified small business stock" (QSBS) under section 1202 of the Internal Revenue Code (IRC);
- problems associated with IRC section 1045, regarding how the capital gains "rollover" provisions of that section apply when a partnership disposes of QSBS and reinvests the proceeds in other qualified small businesses;
- difficulties posed to entrepreneurs by the individual Alternative Minimum Tax; and
- the threat to the use of qualified stock options, including Incentive Stock Options, posed by a current IRS proposal that would mandate the imposition of withholding taxes on the exercise of these options.

Importantly, legislation introduced last year by Chairman Kerry and Senator Max Cleland (The Affordable Small Business Stimulus Act of 2002, S. 1676) would do much to restore the effectiveness of IRC section 1202 as a capital formation tool and would enhance the "rollover" provisions found in section 1045. Chairman Kerry also is to be commended for his work on the Finance Committee addressing the

1655 North Fort Myer Drive • Suite 850 • Arlington, Virginia 22209 • 703.524.2549 • Fax 703.524.3940 • www.nvca.org

problems posed by the IRS proposal regarding the imposition of withholding taxes on statutory stock options. NVCA is pleased with the Chairman's work in these areas and looks forward to working with him and the Committee in finding ways to stimulate investment in America's small businesses.

**Recommended Policies to Stimulate Capital Formation and Entrepreneurial Activity:**

- ***Targeted capital gains relief:***

Congress can enhance small business access to capital by concentrating on targeted capital gains relief. Focusing on two specific areas under the Internal Revenue Code (having to do with qualified small business stock) would not only increase the amount of capital available to small businesses, but it would also restore Congress' original intent of several years ago to provide incentives for investors to fund small, growing firms.

  - ***Enhancing IRC Section 1202:***

  Congress should eliminate Internal Revenue Code Section 57(a)(7), which treats a percentage of capital gains excluded from "regular" taxable income under IRC Section 1202 attributable to the disposition of qualified small business stock (QSBS) as a tax preference item for alternative minimum tax (AMT) purposes. This will ensure that a significant differential exists between overall capital gains rates and the rates applicable to gains realized on dispositions of QSBS and thereby restore the incentive to invest in such stock that Congress intended to create when it enacted Section 1202 in 1993.

  As mentioned above, Chairman Kerry and Sen. Cleland have introduced legislation, S. 1676, which would expand on section 1202 of the tax code by significantly increasing the capital gains exclusion of gains on qualified small business stock; shorten the required holding period from five years to three years; and raise the size of eligible businesses to those with gross assets of $100 million, indexed for inflation. These provisions of S. 1676 would greatly enhance the effectiveness of section 1202 and would stimulate significant equity investment in these small businesses.

  - ***Issue regulations under IRC Section 1045 regarding capital gains "rollover":***

  Congress should direct the Treasury Department to issue regulations under IRC Section 1045 addressing how the capital gains "rollover" provisions of that section apply when a partnership disposes of QSBS and reinvests the proceeds in other QSBS.

  Section 1045 allows taxpayers other than corporations that dispose of QSBS (as defined in section 1202) held more than six months to defer tax on the sale of those assets if they invest the proceeds in other QSBS within 60 days of that disposition. In 1998, Congress amended Section 1045 to make clear that taxpayers holding stock through a partnership could qualify for the benefits of that provision.

  Unfortunately, Section 1045 is silent (and the Treasury Department has issued no guidance) regarding how partners can obtain rollover benefits in the context of a variety of very common transactions involving partnerships. For example, virtually all venture managers and most venture investors hold partnership interests in a number of venture capital partnerships. No guidance is available, however, with regard to how a partner's share of gains attributable to one partnership's disposition of QSBS can be rolled over if another partnership, to which that partner has contributed capital, makes a timely investment in other QSBS.

This problem and others could be easily corrected if Congress were to instruct the Treasury Department to issue regulations governing the application of Section 1045 to partnerships. Issuing regulations will fulfill Congress' legislative intent and increase access to capital by our high growth companies.

S. 1676 also would be very helpful in this area by extending the rollover period from 60 days to 180 days. This extension would allow investors added flexibility in investing proceeds in additional promising start-ups.

- ***Alternative Minimum Tax (AMT) Repeal:***

The 30-year-old alternative minimum tax (AMT) system exists separate from, but parallel to, the regular tax system. Under the AMT scheme, taxable income is modified by an intricate series of "adjustments" and by "preference items" to arrive at alternative minimum taxable income. The application of the AMT frequently results in a higher tax payment than required by the regular income tax system.

The AMT is particularly cruel to entrepreneurs. Many of our leading high-tech regions are in high tax states or jurisdictions. As such, many taxpayers are falling into the AMT because the high cost of property taxes and income taxes in these areas, which are not allowed as AMT deductions. Employees who are not reimbursed for their business expenses are injured as well, because these types of miscellaneous deductions are not allowed for AMT. Perhaps worst of all is the fact that incentive stock options are an AMT-tax-preference item. With the dramatic decline in technology stocks, entrepreneurs who exercised these options when the market was at a healthier level are now finding themselves paying taxes on phantom income.

Due to the fact that AMT is not indexed for inflation, last year's tax cut of some $1.35 trillion from the regular tax system will cause an estimated 1.5 million more taxpayers to be affected by AMT in 2002, for a total of 4.5 million, according to a Joint Committee on Taxation report. In 2010, the total number subject to the tax is estimated to be 26.9 million, of whom 12.2 million will have been placed into the system by the tax plan.

Past research by the prominent economic analysis firm DRI/McGraw-Hill concludes that the repeal of the AMT would, among other things, increase fixed investment, expand the capital stock in the economy, increase labor productivity, and reduce the cost of capital by a significant amount.

- ***Halting IRS Proposal to Require the Imposition of Withholding Taxes on ISOs:***

Longstanding Treasury policy held that statutory stock options, including incentive stock options (ISOs), were not subject to employment tax withholding. The Treasury and IRS reversed this policy in 2001 by issuing proposed rules that would impose employment tax withholding on the exercise of these options beginning in January 2003.

These options are not taxed as income when they are exercised. Instead, the employee pays a tax on the capital gain at the disposition of the stock. As such, a tax deduction is not available to the employer as is the case with non-qualified options.

ISOs are widely used by both entrepreneurial and established U.S. companies. A recent survey by the National Center for Employee Ownership (NCEO) revealed that 82% of venture-backed companies offer ISOs and 62% provide only ISOs. A separate NCEO survey indicated that 44% of all surveyed companies offered ISOs to all employees.

Small, high growth companies use ISOs to attract, retain, and incentivize their employees. These employee equity participation plans are particularly useful to small, entrepreneurial firms since these options offer beneficial tax treatment and since many of these small companies cannot utilize the tax deduction that comes with non-qualified options.

In 2002, workers will pay 6.2% in Social Security taxes on the first $84,900 they earn. There is no cap on Medicare, which taxes 1.45% of all wages. Companies pay an equal amount on their workers' behalf, bringing the total up to 15.3%. In addition to the direct costs in taxes, which, because of the Social Security wage base will hit rank-and-file workers the hardest, employers will face new and heavy administrative costs in implementing the proposed IRS policy.

If this regressive tax increase is allowed to go forward small, entrepreneurial firms will be overwhelmed by the costs associated with administering the tax collection. This will have the effect of either diverting significant capital resources away from the core business to funding a new tax administration plan or it will discourage these companies from offering this important benefit to their employees in the first place.

Legislation preventing implementation of the IRS proposal (H.R. 2695) was included in the Pension Security Act of 2002 (H.R. 3762), which was recently passed by the House. The Senate Finance Committee is expected to take up its own pension proposal later this spring. Whether the Finance Committee includes a similar provision in this bill remains to be seen.

Importantly, Sen. Kerry and nine of his Finance Committee colleagues recently wrote to Treasury Secretary Paul O'Neill urging the Administration to "reconsider the issuance of these proposed rules and, at a minimum, extend these new withholding requirements beyond 2003 to provide Congress adequate time to review the issue."

**Conclusion:**
America's small, entrepreneurial firms have been the catalyst to our economy's growth in the past and will continue to be a key determinant to our future prosperity. It is widely recognized that the lynchpin to their success is access to adequate capital resources. Congress can provide no better service that to create policies that facilitate this capital formation.

BARRIERS TO ACCESS TO CAPITAL

Ms. FORBES. Thank you very much.

Before we get too far into our discussion with all of you who have come so far, we appreciate your being here, as everyone has said.

I would like to introduce Mark Warren, who is Senator Bond's tax counsel, and Ryan McCormick, who is Senator Kerry's tax staffer. If we have detailed tax knowledge, I am going to be turning to them because I am not a tax expert.

If you look in your packets, there should be an agenda in there. Some of you have been to our roundtables before, but if you have not, when you would like to speak, you just take your nameplate and put it up on end like this and I will try to recognize you in the order that you put them up, but sometimes I do not get it quite right, so we will get to you eventually. We do kind of move the conversation along, so you will see there are sort of estimated times next to some of these topics.

We will do the best we can to get everyone's views in, but please be assured that if you have written comments, the entirety of your written comments will be placed in the record. This is transcribed, so if you could please say your name and the group you are with, that will help our court reporters.

Mark, did you want to say anything? No?

Congressman DeMint, did you want to say any more? No? Okay.

All right. So looking at our agenda, the first thing we would like to talk about is we would like to hear your views on what you see as the barriers of access to capital. We have touched on this a little bit, but we have sort of three points here and you are welcome to address any of the three.

Mr. WARREN. One point that I think the presenters have focused on a lot is a segment of the small business community that is very rapidly growing and very significant. But I look at it in terms of the progression of a small business, and what has not really been touched on, and I know a whole lot of groups here represent, are the very small businesses, those that are just getting started, those that are not corporations with stock that would benefit in terms of capital gains trades. And that, I think, is a constituency that we have to keep in mind, as well, because if they do not have the opportunity to grow, then you are never going to reach that high growth stage. So I would appreciate hearing from you all if there are ideas that we can do either outside of the tax code or through the tax code that would also benefit that constituency, as well.

Mr. DEMINT. Could I make just a comment?

Ms. FORBES. Yes, sure.

Mr. DEMINT. Just as a note on the BRIDGE Act, as I understand the way it is written, this could be a one-person company that is growing. When you have a very small base to start with, it is easy to meet our growth requirements, so it is not necessarily between $300,000 and $1 million. A person who can defer a few thousand dollars the way the BRIDGE Act is structured, and for a one-person company starting, the ability to have a few thousand capital, leverage it into ten, you can add an employee, can rent space.

So this is something that is designed to help not only the gazelle emerging growth companies, but applies just as easily and probably more often to a tiny little company that went from $10,000 in sales to $20,000. They have doubled their revenue, and if they do that over a few years, they have met our criteria. There are obviously other needs of small business, but this is what we hope to fit in that slot, too.

Ms. FORBES. Does anyone have some comments or views on any of these barriers? One of the questions that we have had is at what point do companies turn the corner, and prior to that, how can you identify that point and how can you get them to turn the corner faster.

Mr. Esparza.

Mr. ESPARZA. Yes. My name is Moctesuma Esparza and I am here representing the New America Alliance, a Latino business leaders' initiative. Our organization is made up of very successful Latino business leaders and would generally fall outside of the goals of support that this legislation contemplates.

However, I would like to bring attention to the fact that this legislation, as has been discussed, does not really take into account that there are historical structural inequities in the access to capital for Latinos in particular and for other minorities in the country. The equity that most entrepreneurs use as bootstrap, which comes from friends and relatives, comes from the accumulated equity in home ownership that has been generated over generations.

Particularly in our communities, it is not that long ago, certainly in our memory, that restrictive covenants restricted the ability of Latinos to purchase land in particularly desirable, upscale possible areas or in areas that equity could be increased in, and certainly redlining in regards to home loans has historically restricted this generation of equity, and the equity that is available in our communities is far below the national average as a consequence of these historical structural inequities.

So certainly I think that it must be acknowledged that in our communities, the access to bootstrap capital is greatly restricted by the lack of accumulated equity in home ownership or access to credit cards.

And further, in regards to the early stage, the availability of access, even social contact with venture capitalists or banking institutions is greatly restricted. I am a fairly successful business person and the only support that I was able to find in terms of being able to go and acquire capital came from an African American-run SBIC and private equity fund, which is represented here by Mr. Duane McKnight, and had it not been for their particular focus on seeking out a company like mine, I would not be at this table today.

I have now launched a new company and I have gone out to the capital markets, to the private equity firms, the venture capital firms, and I have found nary a Latino anywhere in the ranks of these companies and I have found that the educational effort that I must expend to introduce them to the tremendous profit opportunity available in the Latino community is a tremendous time consumption of energy and that, generally, they only want to do what they know and they only want to work with the people that they know.

And new areas, particularly considering that the future workforce and the future vitality of this great Nation, is dependent on empowering the Latino community, which will quickly become 1-in-4 Americans in the next 30 years, is of vital importance to the future health of this country and that providing capital flow to this community and of easing the problems of bootstrap, of early stage, and of access to venture capital must be considered in any legislative effort to attempt to help these problems that entrepreneurs face.

And so far, I have not heard, nor have I read, that any consideration is given to this or any dialogue has been addressed to this. Thank you.

Ms. FORBES. Thank you.

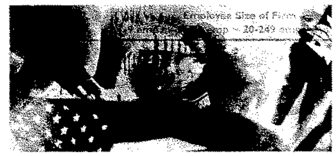
Bruce Phillips.

Mr. PHILLIPS. Thank you. My name is Bruce Phillips. I am with the National Federation of Independent Businesses. I would like to speak a little bit to Mr. Warren's comments about established small businesses.

We represent about 600,000 small firms, of which the average size is about seven. But I would like to call your attention also to the fact that we publish research, and there is a copy if you would like to pick one up on the way out, a national small business poll where we asked—this is Dun & Bradstreet-weighted information, so it is representative of the country as a whole—we asked 750 companies how many wanted to grow and which ways they wanted to grow.

[The poll submitted follows:]

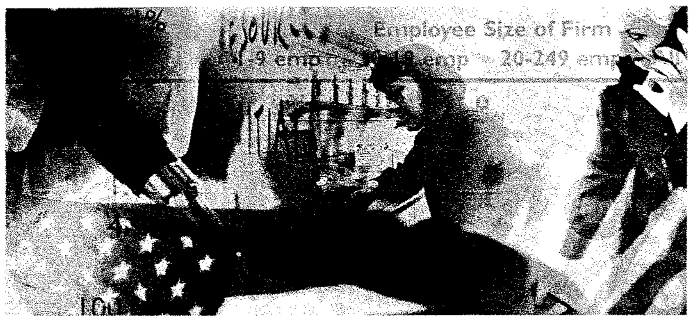
NFIB National
Small Business
Poll



# *Success, Satisfaction and Growth*

Volume 1, Issue 6
2001
ISSN - 1534-8326

William J. Dennis, Jr.
NFIB Research Foundation
Series Editor




# *Success, Satisfaction and Growth*

## Table of Contents

# Executive Summary

- Small-business owners generally feel that their current businesses are successful. On a scale of "1" to "10" with "10" meaning "extreme success" and "1" meaning "total failure," owners evaluate their firms as 7.3. Twenty-one (21) percent assess their ventures as a "9" or "10." Only 17 percent rate theirs below the scale's mid-point.

- Small-businessmen and women who feel that their businesses are highly successful identify "quality of products and/or services" and "treatment of employees, customers, and business associates" as the two factors that most influenced their evaluations. Those who feel their businesses are not successful most often cite "financial performance" as the factor most influencing theirs. "Personal satisfaction" and "growth performance" are comparatively infrequent bases on which owners rate their firms' success.

- The personal satisfaction small employers realize from owning their businesses is 8.0 on a scale of "1" to "10" with "10" meaning "extremely satisfied" and "1" "extremely dissatisfied." While personal satisfaction is positively related to business success, more satisfaction is achieved by small-business owners than success. Forty (40) percent rate their personal satisfaction from business ownership as a "9" or "10."

- Forty-two (42) percent of small-businessmen and women spend the most time on a typical day in operations/making the product or service. Sales and marketing consume the most time for 22 percent while 15 percent volunteer that they just hop from task to task. Comparatively few typically spend most of their time in planning and strategy (10 percent), finance (6 percent) or personnel (3 percent).

- One likely reason that so many small employers receive so much personal satisfaction from business ownership is that a majority (51 percent) spend most of their time doing what they like to do best. The most popular type of activity is operations/making goods or services (35 percent) and marketing and sales (32 percent). The two areas where small-business owners as a group would like to spend more time and apparently cannot are sales and marketing (32 percent) and planning and strategy (17 percent).

- Small-businessmen and women are indifferent to the term used to describe them. More prefer "small-business owner" (47 percent) than "business owner" (26 percent) or "entrepreneur" (20 percent). But, comparatively few object to any one of the three. "Entrepreneur" draws the most objections (12 percent).

- Fifty-one (51) percent of small employers want to grow. However, most who want to grow have modest aspirations. Eight to 9 percent of all owners would like to become "growth" firms.

- Forty-three (43) percent of small employers prefer to remain the size that they are now. The most frequent reason for their preference is that they feel comfortable with the business as it is (44 percent). The lack of financial and/or human resources (22 percent), the risks expansion implies (14 percent), and a limited market (13 percent) are other frequent reasons. Three percent would like to contract.

- Terminating a business large enough to employ people is usually not a "spur-of-the-moment" decision. Twenty-three (23) percent of current owners say that they plan to get out in the next few years. Fifty-nine (59) percent of that group plan to sell. One-quarter intend to form another business.

# Success, Satisfaction and Growth

**Success in business is a subjective judgement. While rapid growth, market domination, and the owner's personal satisfaction are likely aspects of it, no measures or ratios or checklists provide an objective determination. Success is a perception rooted in an individual's value structure. As a result, individuals can reach different judgments about a venture's success using identical criteria. When the criteria vary, as they usually do, their judgements vary even more. One business owner, for example, may judge a business highly successful because it provides him or her employment doing what the owner likes to do; another business owner may consider a $100 million venture a bust because it failed to live up to its potential; an economic development administrator may determine both have failed because neither created employment in a particular political jurisdiction. Two properties often associated with success are business growth and owner satisfaction. Yet, neither may define or even help define success for the owner. Despite its mercurial properties, the perceived success of an owner's business is important because it influences owner decisions. It causes some owners to carry on when they otherwise might not. It causes other owners to get out, perhaps avoiding a greater loss than might otherwise occur. It often causes non-owners to try to form their own business when alternative investment opportunities and employment are available. In effect, business success is a flexible yardstick against which the owner can judge his or her enterprise and subsequently adjust plans, operations and procedures. This issue of the *National Small Business Poll* is devoted to the business success of small employers and some of its varying aspects.**

## Success

Small-business owners generally feel that their current businesses are successful. On a scale of "1" to "10" with "10" meaning "extreme success" and "1" meaning "total failure," owners rate their success on average as 7.3 (Q#3). Eleven (11) percent believe that their firms have been extremely successful (a "10") and another 10 percent evaluate their enterprises as a "9." Almost half rate theirs in the "7" to "8" range. In contrast, just 17 percent place their businesses below the mid-point on the success scale, i.e., <6. Almost no one evaluates theirs as a "2" or a "1." The most likely reason for the absence of cases at the bottom of the scale is that an extreme lack of success has forced them to the market's sidelines already.

Success can be based on many reasonable criteria. As a result, the survey asked small employers to identify the two factors that most influenced their evaluations of their businesses' success. Significantly, the most frequent reasons involve the firm's contribution to others rather than its contribution directly to the owner. Forty-two (42) percent say that one of the two primary factors in their evaluation is the quality of products or services offered (Q#3a). The second most frequently cited reason is the treatment of employees, customers, and business associates (37 percent). Sixty-one (61) percent of all owners mention at least one of them.

The factor influencing evaluation of the firm's success cited with third greatest frequency (32 percent) is the firm's financial performance. Owners mention personal satisfaction fourth most often (25 percent). The least likely factors cited of those listed are growth performance (13 percent) and variance from initial expectations (5 percent). Note that while half would like to grow (Q#1), just 13 percent say that growth is one of the two most influential factors in evaluating the current success of their business.

Small-business owners who rate their success most highly ("9" or "10") are also the most likely (56 percent) to mention the quality of products and services offered as one of the two most important factors in their evaluation. They also are more likely than those less successful to mention the treatment of employees, customers, and business associates (44 percent). In fact, both reasons are directly related to success, the more often cited the higher rated on the success scale. The comparable figures for those rating themselves as "4" or less are 8 percent and 11 percent respectively.

Success is also directly tied to financial performance, but in the opposite direction. Forty-five (45) percent evaluating their firms with a "6" or lower choose financial performance as one of the two most important factors compared to 23 percent of those giving themselves a "9" or "10." Owners of less successful firms are also more likely to offer only one reason for evaluation instead of the two requested.

Personal satisfaction, growth performance, and variation from initial expectation do not appear closely related to owner evaluation of success. Comparatively few cite them as one of the more important reasons in their evaluations. Thus, the primary bases for assessing success would appear to differ between business owners themselves and outside observers such as newspaper reporters, public officials, academics and even the general public.

Care must be taken to avoid the obvious, but incorrect interpretation of the reasons for the evaluation of success. These data do not suggest that those small-business owners who feel successful are primarily interested in "doing good" while those who feel less successful are primarily interested in financial performance. They suggest something more subtle. They suggest that there is a financial (and perhaps growth) minimum required to be successful. The minimum can vary notably depending on the owner. But once that threshold has been passed, less tangible factors take on new significance. Many firms that are rated by their owners as successful are not and will never be financial dynamos. But, they provide enough to allow the owner to operate and judge the firm's success on a variety of other criteria.

## Personal Satisfaction

Personal satisfaction from something as time-consuming and economically relevant as owning and operating a business is obviously important to the individual. The difficulties inevitably encountered are much easier to tackle when the owner obtains personal gratification from efforts put forward. Most small-business owners, in fact, get a great deal of personal satisfaction from their businesses. On a scale of "1" to "10" with "10" meaning "extreme satisfaction" and "1" meaning "extreme dissatisfaction," 28 percent rate their personal satisfaction from the business as a "10" (Q#4). Two-thirds (67 percent) feel their personal satisfaction rates an "8" or higher compared to just 12 percent who rank it below the scale's mid-point.

There is a direct relationship between personal satisfaction from owning a business and the firm's success. People who tend to have more successful ventures (by their own evaluations) also tend to feel greater personal satisfaction from owning their firms. However, perceived business success cannot be equated with personal satisfaction. The personal satisfaction achieved from business ownership is more highly rated on average than business success, 8.0 on a ten point scale for satisfaction compared to 7.3 for success. This difference helps explain why many owners who operate financially marginal enterprises remain in business.

*A Satisfying Job*

While most small-business owners receive considerable personal satisfaction from owning their businesses, not every aspect of the business is equally gratifying or even gratifying at all. Some parts of the job are simply more pleasant than others.

A plurality of small-business owners (42 percent) spend most of their time on a typical day working on operations or making goods and services (Q#5). A chef cooking in his restaurant, a teacher working with children in her day-care center, or a carpenter swinging a hammer in his home improvement business are examples. Though all have employees and run the business, their primary activity on a typical day is production. The second most frequent prevalent activity is sales and marketing. Twenty-two (22) percent report that they constitute the day's primary activity. Sales and marketing can include anything from waiting on customers to working on a radio ad.

Fifteen (15) percent volunteer that they do a little bit of everything; they do not spend most of their time on anything in particular. This is the "jack-of-all-trades" response that stereotypes, with a large element of truth, small-business owner activity. Another 10 percent say that they spend most of their time planning and developing strategy. While the percentage is surprisingly high, the minimal variation by firm size is more so. One would expect owners of larger, small firms to focus more on planning while those in the smallest firms would spend more time hopping from area to area. That does appear to happen. The two areas where small-business owners are least likely to spend the largest part of their day is in finance (6 percent) and personnel (3 percent).

One likely reason that so many receive so much personal satisfaction from business ownership is that a majority appear to spend most of their time doing the kinds of things they like to do. Just over half (51 percent) say that they spend the largest part of their daily activity in the functional area they like most (data not shown). In fact, the proportions among the kind of tasks small-business owners actually perform and the kind of things that they like to perform are similar. Thirty-five (35) percent prefer making goods or services (doing), seven points short of those actually spending most of their time on it (Q#5b). The two areas where small employers as a group would like to spend more time than they are able are sales and marketing (32 percent) and planning and strategy (17 percent). In each, roughly 50 percent more would like to spend most of their time in the area than they actually do. Only five percent each most like to spend their time in finance and personnel. Relatively few (3 percent) volunteer that they prefer doing a little bit of everything.

The functional areas where small-business owners least like to spend their time are generally the opposite of the areas where they most like to spend their time. The two most dreaded functional areas are finance (34 percent) and personnel (20 percent) (Q#5a). The former helps explain the high incidence of professionals doing accounting and finance work in small businesses both as consultants and paid-employees. Sales and marketing, though highly desirable for many, is most disliked by 14 percent of owners and making goods and services by 12 percent. Curiously, 7 percent complain that the activity they like least is hopping from area to area. Of the 11 percent who say that they work most in the area they like least, over a third note that they spend most of their time doing a little bit of everything and like it least. They prefer more focused activity.

*What's in a Name?*

Poll after poll shows that small-business owners are a highly respected and admired category of Americans. But in an era of delicate sensibilities, the language used to refer to an individual is sometimes taken as a symbol of respect (or lack thereof). Efforts are therefore made to call groups of people what they wish to be called. Terms for people who own smaller businesses are no exception.

People who own and operate small businesses usually wish to be called small-business owners, though it is doubtful that they really care. If given a choice, 47 percent prefer the term "small-business owner;" 26 percent prefer "business owner;" and, 20 percent prefer "entrepreneur" (Q#6). Six percent volunteer that they do not care or are indifferent.

More interesting is the reverse approach, asking these people what they do not want to be termed. Comparatively few object to being called any of the most common terms. Six percent object to being called a "small-business" owner (Q#6aA). Owners of enterprises employing more than 20 people are most likely to disdain the name. Five percent don't want to be called a "business owner," though it not clear why they do (Q#6aB). Finally, 12 percent object to the term "entrepreneur" (Q#6aC). Owners of larger firms, those who presumably would be most sympathetic to the term, are in fact the most likely to hold an unfavorable opinion of it. Two percent object to all three terms; 16 percent object to at least one, but 82 percent feel nothing is wrong with any of them.

## Growth Dynamics

Business growth is another popular measure of business success. However, this measure is more common among outside observers than small-business owners themselves. Many in the public appear to assume that most small-business owners want to grow their businesses, and grow them substantially if only the opportunity and resources were available; only the aberrant small-business owner is not interested in growth. The data show that assumption is generally wrong. Many small employers are content with the current size of their businesses. Even those who want to grow more often than not would like to grow modestly. The owner who wants to grow aggressively, let alone possessing the ability and opportunity to do so, is the one who is aberrant.

Just 14 percent offer business growth as one of the two most influential factors in assessing their venture's success. That is not surprising. Relatively few firms grow substantially once they have leveled from the growth spurt that often occurs almost immediately following birth. The data in the survey show that 18 percent increased sales over the last two years by 30 percent or more (15 percent annually) (Q#D2). Another 17 percent increased theirs by 20 to 29 percent. The real volume sales of 31 percent appear to have at best stayed about even with inflation and many have not done that.

Still, business growth is an objective for about half of current small employers. Fifty-one (51) percent indicate that they want to grow their businesses (Q#1). In contrast, 46 percent do not. Forty-three (43) percent want to keep their firms approximately the same size and three percent would actually like to contract them. Owners of different size firms exhibit virtually no difference in the basic growth objective. However, those who have owned the firm comparatively few years are much more likely to possess the desire to grow than are those who have owned their firms for many years (data not shown).

The growth envisioned by most small-business owners wishing it is modest. Fourteen (14) percent say that they would like to grow sales, but their growth objective is a level that remains under one million dollars (Q#1a). Another 23 percent would like their sales to ultimately rise to between one and five million. In contrast, 9 percent want them to grow to over $100 million and 6 percent say they want to grow sales as much as possible. Thus, about 8 to 9 percent of the entire population clearly want to own a "growth" firm. The large number (12 to 13 percent of all owners) who cannot or will not give a sales growth target are assumed to have modest growth objectives since they appear not to have focused on the growth issue. Since no more than 5 percent of all businesses can be called "growth firms," the number intending to grow and the number actually growing differ. That raises questions about why those who want to grow do not. Is it a lack of skills, resources or market opportunity, or is it the lack of an intense desire to become larger?

There is no special reason why small-business owners choose their desired growth level. Fifty-five (55) percent who express interest in growing say that they just want the business to grow and they have arbitrarily chosen a growth target (perhaps only because they were asked to do so). In contrast, 20 percent say that they chose a particular sales level because the level is necessary to provide the desired amount of personal income. A small construction business, for example, may not provide enough income with $100,000 in sales; the owner therefore targets $750,000 in sales so that it does. Eight percent say that they chose a growth level because a business has to be at least a specified size for it to survive. Reasons involving eventual disposal of the business are less frequently offered.

A firm may become so promising or so strong that it reaches the public stock exchanges. Sixteen (16) percent of those who want to grow also claim that they would eventually like to have their firms publicly traded (Q#1c). That is approximately the same number who would like their firms to eventually reach at least $100 million in sales. Nothing like that number will ever be listed. Yet, the number expressing an interest shows that many small-business owners have big ideas.

The owners of many firms with the potential to "go public" choose to remain private. The reasons vary. Most are personal, but usually involve retaining control of the business. While the data do not tell us whether the owners who say they want to "go public" are actually more attractive candidates for the exchanges than those who do not, the overwhelming majority intending to grow want their firms to remain in private hands.

*Unchanging by Choice*

Over two in five small-business owners say that they are happy with the current size of their businesses. Probing further, 44 percent of this group or 19 percent of all respondents indicate that they are comfortable with their business as it is (Q#1e). They do not want its size to change. Another 14 percent feel that expansion requires risks that they are not willing to assume. Thirteen (13) percent more claim that the market is limited; they may have a nice business, but there is no room for a larger one. Still, 22 percent express no desire to grow because the financial or people resources are not available. These latter owners are probably not candidates for growth despite the reason provided. While they may be open to growth if the additional resources become available, their response suggests a passive approach that is probably not conducive for growth.

The proportion of small employers who want to get smaller is minuscule. As a result, it is not possible to quantify the reasons for their outlook (Q#1d).

*Leaving the Business*

A tiny fraction of operating businesses will go bankrupt. Only a few more will close their firms owing debts to a creditor. At the same time, business turnover is considerable and business owner turnover is even higher. Small-business owners are constantly in the process of leaving businesses that they have formed, though not necessarily due to the lack of success.

Twenty-three (23) percent of small employers indicate that they plan to get out of their current business within the next few years (Q#2). Of that group, almost 59 percent intend to sell the firm as their way of leaving (Q#2a). Sixteen (16) percent plan to pass their enterprise to an heir and 15 percent will shut theirs down. While sale is preferred to closure or abandonment, many owners intent on selling their businesses are likely to be disappointed. The Wells Fargo/NFIB *Series on Business Starts and Stops* indicates that only three of every eight employers sell or transfer their firms while five of every eight either close or abandon them.

The sizeable number intending to exit their businesses also suggests that many, if not most, termination decisions are well-considered rather than "spur-of-the-moment." (A general rule of thumb is that somewhat more than one in 10 employers leave in any year even though exit is "front-loaded.") That means many business owners plan to leave well before the time they actually do. Perhaps the reason for the time interval is that finding a buyer for the business takes time. Perhaps the reason is that hope springs eternal and it still might be possible to reverse adverse trends. An important factor is that most do not seem pressured into leaving. Those intending to leave soon rate their businesses as 7.0 on the success scale compared to 7.4 among those having no such plans. Whatever the reason for leaving, many expect to get out long before they actually do.

One reason to leave a current business is to start another business. About one in four (25 percent) of those who intend to get out in the next few years plan to start another business after they leave their current endeavor (Q#2b).

## Final Comments

Small-business owners do not have to own a large or rapidly growing business to feel that theirs is successful. In fact, four times as many believe that they have a highly successful venture as can be considered a "growth" firm. Moreover, financial reward does not necessarily determine the owner's evaluation of success. While some financial minimum, albeit an arbitrary minimum, is necessary to continue operating, many factors besides financial performance contribute to the success of their enterprises. Certainly, the very high level of personal satisfaction associated with owning a firm and the fact that a majority spend most of their time doing what they like to do helps create a positive feeling about their ventures. So is the idea that their firms produce quality products or services, and treat people "right." Someone once observed that a good business is about makin' a little money, havin' a little fun, and doin' a little good. Small-business owners as a group appear to subscribe to that philosophy in a big way.

# Success, Satisfaction and Growth

*(Please review notes at the table's end.)*

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |

**1. Over the next few years, do you intend to grow your business, to make it smaller, or to keep it about the same size as it is now?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Grow | 50.4% | 51.9% | 57.5% | 51.3% |
| 2. Make smaller (contract) | 3.2 | 2.5 | 1.4 | 2.9 |
| 3. Stay about the same | 43.0 | 42.0 | 39.7 | 42.5 |
| 4. (DK/Refuse) | 3.5 | 3.7 | 1.4 | 3.3 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

**1a. In terms of annual sales, how large would you eventually like your firm to be? A broad estimate is fine. (If "grow" in Q#1.)**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. < $1 million | 16.2% | 7.8% | 6.6% | 14.2% |
| 2. $1 - $4.9 million | 22.9 | 38.9 | 8.4 | 23.1 |
| 3. $5 - $24.9 million | 16.5 | 19.8 | 23.3 | 17.6 |
| 4. $25 - $99.9 million | 3.9 | 2.4 | 13.0 | 4.3 |
| 5. $100 million or more | 9.2 | 9.6 | 14.6 | 9.8 |
| 6. As large as possible | 6.0 | 1.8 | 6.4 | 5.6 |
| 7. (DK/Refuse) | 25.3 | 19.8 | 31.6 | 25.4 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 173 | 99 | 115 | 387 |

**1b. Why do you want to see your business grow to that size? Does it have to be that size to: (If not "DK/Refuse" in Q#1a.)**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Survive | 7.7% | 3.9% | 9.1% | 8.0% |
| 2. Provide the desired level of personal income | 23.9 | 26.3 | 13.0 | 20.4 |
| 3. Be able to divide the business among possible heirs | 4.3 | 5.3 | 3.9 | 3.9 |
| 4. Sell it for a reasonable return, OR | 5.1 | 5.3 | 5.2 | 3.9 |
| 5. You just want the business to grow and that is your size objective | 52.1 | 53.9 | 61.0 | 55.4 |
| 6. (Other) | 5.1 | 3.9 | 7.8 | 4.6 |
| 7. (DK/Refuse) | 1.7 | 1.3 | — | 3.9 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 126 | 76 | 77 | 279 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |

**1c. Would you eventually like to have your firm "go public," i.e., have its stock traded on one of the public exchanges?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Yes | 15.8% | 14.3% | 20.9% | 16.2% |
| 2. No | 81.3 | 78.6 | 74.4 | 80.2 |
| 3. (DK/Refuse) | 3.0 | 7.1 | 4.7 | 3.6 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 173 | 99 | 115 | 387 |

**1d. Why do you want your business to get smaller? Is it because: (If "make smaller" in Q#1.)**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. There are too many headaches managing current-sized business | | | | |
| 2. You can't now spend time doing the things you want to do | | | | |
| 3. There is too much fat in the current operation and it needs retrenchment | | | | |
| 4. You are phasing down so you can get out of this business | | | | |
| 5. (Other) | | | | |
| 6. (DK/Refuse) | | | | |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 12 | 7 | 3 | 22 |

**1e. Why do you want to keep your business about the same size? Is it because: (If "stay same" in Q#1.)**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. The market is limited | 12.5% | 14.7% | 10.7% | 12.5% |
| 2. You are comfortable with your business as it is | 44.4 | 41.2 | 42.9 | 43.9 |
| 3. Expansion requires risks that you do not want to take | 13.2 | 14.7 | 14.3 | 13.5 |
| 4. The financial and/or people resources for expansion are not available | 21.8 | 23.5 | 25.0 | 22.3 |
| 5. (Other) | 6.3 | 2.9 | 3.6 | 5.6 |
| 6. (DK/Refuse) | 1.9 | 2.9 | 3.6 | 2.2 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 154 | 88 | 80 | 322 |

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| | Employee Size of Firm | | | |
| **2. Do you intend to get out of your business within the next few years?** | | | | |
| 1. Yes | 23.3% | 23.5% | 15.1% | 22.6% |
| 2. No | 72.4 | 74.1 | 79.5 | 73.2 |
| 3. (DK/Refuse) | 4.3 | 2.5 | 5.5 | 4.2 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **2a. Do you intend to get out by: (If "phasing down" in Q#1d or "yes" in Q#2.)** | | | | |
| 1. Selling it | 58.9% | | | 58.7% |
| 2. Shutting it down | 17.0 | | | 15.1 |
| 3. Passing it to an heir | 14.9 | | | 16.3 |
| 4. (DK/Refuse) | 9.2 | | | 9.9 |
| Total | 100.0% | | | 100.0% |
| N | 82 | | | 158 |
| **2b. Do you plan to start another business after you leave this one?** | | | | |
| 1. Yes | 28.4% | | | 25.1% |
| 2. No | 66.7 | | | 70.2 |
| 3. (DK/Refuse) | 5.0 | | | 4.7 |
| Total | 100.0% | | | 100.0% |
| N | 82 | | | 158 |
| **3. On a scale of one-to-ten where "10" means extreme success and "1" means total failure, how successful is your business?** | | | | |
| 1. Ten | 11.1% | 9.9% | 13.5% | 11.2% |
| 2. Nine | 9.0 | 11.1 | 14.9 | 9.8 |
| 3. Eight | 26.5 | 33.3 | 37.8 | 28.4 |
| 4. Seven | 22.9 | 23.5 | 20.3 | 22.7 |
| 5. Six | 9.3 | 9.9 | 5.4 | 9.0 |
| 6. Five | 11.6 | 8.6 | 2.7 | 10.4 |
| 7. Four to one | 7.9 | 3.7 | 4.0 | 7.1 |
| 8. (DK/Refuse) | 1.7 | — | 1.4 | 1.5 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| Average | 7.2 | 7.5 | 7.9 | 7.3 |
| N | 351 | 201 | 200 | 752 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |

**3a. What are the TWO most important factors influencing the rating you just made of your firm's success? (If response given in Q#3.)**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Financial performance | 31.5% | 36.2% | 29.2% | 31.8% |
| 2. Growth performance | 12.6 | 20.0 | 18.1 | 13.9 |
| 3. Quality of products or services offered | 41.6 | 41.3 | 41.7 | 41.6 |
| 4. Treatment of employees, customers, business associates | 35.5 | 38.8 | 48.6 | 37.1 |
| 5. Personal satisfaction | 26.4 | 22.5 | 15.3 | 24.9 |
| 6. Variance from initial expectation | 5.4 | 3.8 | 4.2 | 5.1 |
| 7. (Other) | 7.7 | 3.8 | 8.3 | 7.4 |
| 8. (No second reason) | 36.7 | 32.6 | 33.3 | 35.9 |
| 9. (DK/Refuse) | 2.5 | 1.3 | 1.4 | 2.3 |
| Total | 200.0% | 200.0% | 200.0% | 200.0% |
| N | 345 | 200 | 197 | 742 |

**4. On a scale of one-to-ten where "10" means extreme satisfaction and "1" means extreme dissatisfaction, how much personal satisfaction have you received from owning this business?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Ten | 28.6% | 19.0% | 27.0% | 27.5% |
| 2. Nine | 10.8 | 16.5 | 18.9 | 12.2 |
| 3. Eight | 26.5 | 32.9 | 28.4 | 27.3 |
| 4. Seven | 12.6 | 10.1 | 6.8 | 11.8 |
| 5. Six | 5.5 | 3.8 | 6.8 | 5.4 |
| 6. Five | 7.8 | 6.3 | 2.7 | 7.2 |
| 7. Four to one | 4.7 | 5.1 | 2.7 | 4.6 |
| 8. (DK/Refuse) | 3.5 | 6.3 | 6.8 | 4.1 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| Average | 8.0 | 7.8 | 8.3 | 8.0 |
| N | 351 | 201 | 200 | 752 |

**5. During a typical day, in what area of the business do you spend most of your time?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Sales and marketing | 22.7% | 22.5% | 15.1% | 22.0% |
| 2. Personnel | 3.2 | 3.8 | 5.5 | 3.4 |
| 3. Finance | 5.3 | 8.8 | 12.3 | 6.3 |
| 4. Operations or making goods and services | 43.0 | 40.0 | 38.4 | 42.2 |
| 5. Planning and strategy | 10.0 | 8.8 | 15.1 | 10.3 |
| 6. (Little of everything; no special area) | 14.8 | 15.0 | 13.7 | 14.7 |
| 7. (DK/Refuse) | 1.1 | 1.2 | — | 1.0 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
| **5a. In what area of the business do you LEAST like to spend your time?** | | | | |
| 1. Sales and marketing | 13.2% | 18.8% | 13.7% | 13.9% |
| 2. Personnel | 17.2 | 28.8 | 34.2 | 20.1 |
| 3. Finance | 36.3 | 25.0 | 23.3 | 33.8 |
| 4. Operations or making goods and services | 12.1 | 12.5 | 8.2 | 11.8 |
| 5. Planning and strategy | 6.5 | 3.7 | 5.5 | 6.1 |
| 6. (Little of everything; no special area) | 7.3 | 8.8 | 6.8 | 7.4 |
| 7. (DK/Refuse) | 7.4 | 2.5 | 8.2 | 7.0 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **5b. In what area of the business do you MOST like to spend your time?** | | | | |
| 1. Sales and marketing | 31.5% | 35.0% | 27.4% | 31.5% |
| 2. Personnel | 4.8 | 7.5 | 5.5 | 5.2 |
| 3. Finance | 3.6 | 11.3 | 12.3 | 5.3 |
| 4. Operations or making goods and services | 37.0 | 26.3 | 30.1 | 35.2 |
| 5. Planning and strategy | 16.7 | 15.0 | 20.5 | 16.9 |
| 6. (Little of everything; no special area) | 3.3 | 2.5 | 2.7 | 3.2 |
| 7. (DK/Refuse) | 3.0 | 2.5 | 1.4 | 2.8 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **6. Several terms are used to describe people who own and operate smaller businesses. As one of those people, which of the following terms do you prefer?** | | | | |
| 1. Small-business owner | 49.2% | 44.4% | 32.4% | 47.0% |
| 2. Business owner | 23.8 | 29.6 | 35.1 | 25.5 |
| 3. Entrepreneur | 20.1 | 21.0 | 20.3 | 20.2 |
| 4. (Indifferent; Don't care) | 6.1 | 3.7 | 5.4 | 5.8 |
| 5. (DK/Refuse) | 0.8 | 1.2 | 6.8 | 2.4 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
| **6a. Do you object to being called:** | | | | |
| **A. A small-business owner** | | | | |
| 1. Yes | 5.5% | 4.9% | 10.8% | 5.9% |
| 2. No | 94.2 | 92.7 | 85.1 | 93.1 |
| 3. (DK/Refuse) | 0.3 | 2.4 | 4.1 | 0.9 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **B. A business owner** | | | | |
| 1. Yes | 5.1% | 1.2% | 5.5% | 4.7% |
| 2. No | 94.5 | 96.3 | 91.8 | 94.5 |
| 3. (DK/Refuse) | 0.3 | 2.4 | 2.8 | 0.8 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **C. An entrepreneur** | | | | |
| 1. Yes | 11.3% | 11.1% | 13.7% | 11.5% |
| 2. No | 86.7 | 86.4 | 82.2 | 86.3 |
| 3. (DK/Refuse) | 2.0 | 2.4 | 4.1 | 2.2 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |

## Demographics

**D1. Is your primary business activity:**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Construction | 9.6% | 11.3% | 10.8% | 9.9% |
| 2. Manufacturing | 7.8 | 16.3 | 13.5 | 9.2 |
| 3. Wholesale | 5.8 | 6.3 | 5.4 | 5.8 |
| 4. Retail | 21.1 | 23.8 | 25.7 | 21.8 |
| 5. Transportation | 4.3 | 2.5 | 5.4 | 4.2 |
| 6. Communication | 3.5 | 1.2 | 2.7 | 3.2 |
| 7. Financial Services | 6.8 | 3.8 | 2.7 | 6.1 |
| 8. Services | 35.2 | 30.0 | 28.4 | 33.9 |
| A. Non-professional, e.g., lodging, auto repair, garages, recreation | (19.2) | (33.3) | (27.3) | (21.2) |
| B. Professional, e.g., health, legal, education, engineering | (36.4) | (29.2) | (31.8) | (35.4) |
| C. Business, e.g., advertising, mail, employment agencies, computer services, security, equipment rental | (28.0) | (25.0) | (22.7) | (27.3) |
| D. Personal, e.g., laundries, beauty shop, photography, funeral services, child care | (16.4) | (12.5) | (18.2) | (16.2) |
| 9. Agriculture, forestry, fishing | 4.3 | 2.5 | 2.7 | 4.0 |
| 10. (Other) | 1.0 | 1.2 | 1.3 | 1.1 |
| 11. (DK/Refuse) | 0.7 | 1.2 | 1.3 | 0.8 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

**D2. Over the last two years, have your real volume sales:**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Increased by 30 percent or more? | 16.7% | 17.3% | 26.0% | 17.7% |
| 2. Increased by 20 to 29 percent? | 17.6 | 14.8 | 17.8 | 17.3 |
| 3. Increased by 10 to 19 percent? | 27.9 | 28.4 | 21.9 | 27.3 |
| 4. Changed less than 10 percent one way or the other? | 18.9 | 21.0 | 17.8 | 19.0 |
| 5. Decreased by 10 percent or more? | 13.1 | 12.3 | 6.8 | 12.4 |
| 6. (DK/Refuse) | 5.8 | 6.2 | 9.6 | 6.2 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |

**D3. Is this business operated primarily from the home, including any associated structures such as a garage or a barn?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Yes | 26.4% | 4.9% | 2.7% | 21.8% |
| 2. No | 72.0 | 92.6 | 94.5 | 76.4 |
| 3. (DK/Refuse) | 1.7 | 2.5 | 2.7 | 1.8 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

**D4. How long have you owned or operated this business?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. < 6 years | 32.0% | 22.2% | 21.9% | 29.9% |
| 2. 6-10 years | 18.2 | 16.0 | 17.8 | 17.9 |
| 3. 11-20 years | 30.0 | 29.7 | 20.5 | 29.0 |
| 4. 21-30 years | 8.3 | 14.8 | 24.7 | 10.6 |
| 5. 31 years+ | 9.4 | 12.3 | 11.0 | 9.9 |
| 6. (DK/Refuse) | 2.2 | 4.9 | 4.1 | 2.6 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

**D5. What is your highest level of formal education?**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. Did not complete high school | 2.7% | 3.7% | 2.7% | 2.8% |
| 2. High school diploma/GED | 22.7 | 14.8 | 16.2 | 21.2 |
| 3. Some college or an associates degree | 20.1 | 23.5 | 21.6 | 20.6 |
| 4. Vocational or technical school degree | 3.3 | 3.7 | 2.7 | 3.3 |
| 5. College Diploma | 33.8 | 39.5 | 39.2 | 35.0 |
| 6. Advanced or professional degree | 15.8 | 11.1 | 14.9 | 15.2 |
| 7. (DK/Refuse) | 1.7 | 3.7 | 2.7 | 1.9 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

**D6. Please tell me your age.**

| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
|---|---|---|---|---|
| 1. <25 | 1.2% | 2.5% | 1.4% | 1.3% |
| 2. 25-34 | 11.3 | 14.8 | 11.1 | 11.7 |
| 3. 35-44 | 24.6 | 25.9 | 33.3 | 25.6 |
| 4. 45-54 | 31.7 | 27.2 | 26.4 | 30.7 |
| 5. 55-64 | 18.4 | 14.8 | 18.1 | 18.0 |
| 6. 65+ | 9.6 | 8.6 | 5.6 | 9.1 |
| 7. (DK/Refuse) | 3.2 | 6.2 | 4.2 | 3.6 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

| | Employee Size of Firm | | | |
|---|---|---|---|---|
| | 1-9 emp | 10-19 emp | 20-249 emp | All Firms |
| **D7. What is the zip code of your business?** | | | | |
| 1. East (zips 010-219) | 7.3% | 12.3% | 9.5% | 8.0% |
| 2. South (zips 220-427) | 25.0 | 18.5 | 17.6 | 23.6 |
| 3. Mid-West (zips 430-567, 600-658) | 26.0 | 30.9 | 24.3 | 26.4 |
| 4. Central (zips 570-599, 600-898) | 25.0 | 22.2 | 28.4 | 25.0 |
| 5. West (zips 900-999) | 16.7 | 16.0 | 20.3 | 17.0 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **D8. What were your gross sales in the most recent calendar or fiscal year?** | | | | |
| 1. <$100,000 | 15.2% | 1.2% | 1.4% | 12.4% |
| 2. $100,000 - $249,999 | 15.4 | 3.8 | 2.7 | 12.9 |
| 3. $250,000 - $499,999 | 13.1 | 5.0 | 5.4 | 11.5 |
| 4. $500,000 - $999,999 | 7.1 | 16.3 | 2.7 | 7.7 |
| 5. $1 million - $4.9 million | 14.9 | 38.8 | 37.8 | 19.7 |
| 6. $5 million - $9.9 million | 1.7 | 2.5 | 12.2 | 2.8 |
| 7. $10 million or more | 0.3 | 1.2 | 8.1 | 1.1 |
| 8. (DK/Refuse) | 32.3 | 31.3 | 29.8 | 32.0 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |
| **D9. Sex** | | | | |
| Male | 75.7% | 76.5% | 74.3% | 75.6% |
| Female | 24.3 | 23.5 | 25.7 | 24.4 |
| Total | 100.0% | 100.0% | 100.0% | 100.0% |
| N | 351 | 201 | 200 | 752 |

## Table Notes

1. All percentages appearing are based on **weighted** data.
2. All "Ns" appearing are based on **unweighted** data.
3. Data are not presented where there are fewer than 50 unweighted cases.
4. ( )s around an answer indicate a volunteered response.

WARNING — When reviewing the table, care should be taken to distinguish between the percentage of the population and the percentage of those asked a particular question. Not every respondent was asked every question. All percentages appearing on the table use the number asked the question as the denominator.

# Data Collection Methods

The data for this survey report were collected for the NFIB Research Foundation by the executive interviewing group of The Gallup Organization. The interviews for this edition of the Poll were conducted between September 7 and October 11, 2001 from a sample of small employers. "Small employer" was defined for purposes of this survey as a business owner employing no fewer than one individual in addition to the owner(s) and no more than 249.

The sampling frame used for the survey was drawn at the Foundation's direction from the files of the Dun & Bradstreet Corporation, an imperfect file but the best currently available for public use. A random stratified sample design was employed to compensate for the highly skewed distribution of small-business owners by employee size of firm (Table A1). Almost 60 percent of employers in the United States employ just one to four people meaning that a random sample would yield comparatively few larger small employers to interview. Since size within the small-business population is often an important differentiating variable, it is important that an adequate number of interviews be conducted among those employing more than 10 people. The interview quotas established to achieve these added interviews from larger, small-business owners were arbitrary but adequate to allow independent examination of the 10-19 and 20-249 employee size classes as well as the 1-9 employee size group.

**Table A1**

## Sample Composition Under Varying Scenarios

| | Expected from Random Sample* | | Obtained from Stratified Random Sample | | | |
|---|---|---|---|---|---|---|
| Employee Size of Firm | Interviews Expected | Percent Distri-bution | Interview Quotas | Percent Distri-bution | Completed Interviews | Percent Distri-bution |
| 1-9 | 593 | 79 | 350 | 47 | 351 | 47 |
| 10-19 | 82 | 11 | 200 | 27 | 201 | 27 |
| 20-249 | 75 | 10 | 200 | 27 | 200 | 27 |
| All Firms | 750 | 100 | 750 | 101 | 752 | 101 |

**Sample universe developed from special runs supplied to the NFIB Research Foundation by the Bureau of the Census (1997 data).*

Obviously, keeping tax rates lower, permanently lower, is a number one issue for many of these companies. When we asked the question, how many of you would like to be able to have $100 million in sales within the next 5 years, of the half that said they wanted to grow—half of the firms in the survey said, in fact, they were content with their present size—about 8 to 9 percent of the companies said they would like to be doing $100 million in sales within 5 years. Well, if you take about 9 percent, give or take, of $3 million, you are in the $300,000-$400,000 company range, and that is the target, I think, that this group is concerned with.

One of the questions that really struck me, when business owners were asked what they liked to do best, the thing that came out increasingly was they were most interested in operations and serving customers and providing the best possible product. When asked what they liked to do least, the answer was to raise money, finance, which led me to believe, how do we make this leap between the people who clearly need the money and would like to grow and the people who do not have time because they are wearing four hats at once, trying to make payroll, trying to meet suppliers, trying to meet customers, et cetera, et cetera?

I guess I concluded that it is education, that we need more linking, more networks, more groups like what the Kaufman Foundation has done. Many small firm owners will take a few hours occasionally to go out and listen to some people, even bankers, people who have gone through this process and have obtained a fair amount of money in the angel capital stage. But it is, frankly, a very, very difficult process.

We know that there are at least 300,000 or 400,000 people in the farm leagues, as the gentleman said. The problem is, how do we get these people who are so busy with their 6-, 7-, 8-employee companies and who need the money and many of whom would like to get the money to, in fact, to apply for it, to sit in the seminars, et cetera, et cetera? And I think that is one of the two problems of very small firms and continues to be, by the way.

Ms. FORBES. Thank you.

Mr. Hughes.

Mr. HUGHES. Thank you. My name is Robert Hughes. I am a self-employed CPA from Dallas, Texas. I am also the President of the National Association for the Self-Employed, a microbusiness trade association that has about 200,000 members around the country. Our typical member has fewer than 5 employees.

In concert with what our colleague was saying across the table about bootstrap capital for small business, it is my belief that that is one of the most important issues that we should address when we begin talking about working capital for business. It is at this level, microbusiness, that jobs are created, innovations are made, and the economy is stimulated.

Right now, we know that 34 percent of microbusinesses use credit cards to purchase inventory. We know that 64 percent of those same businesses use credit cards to purchase their capital acquisitions for equipment and business machines. We know also that one of the detractors of growth in entrepreneur business is access to working capital.

So we think while we like some of the provisions of the proposals that are on the table, we think that they should be expanded to include microbusiness, as well, in the areas of zero to $300,000 of working capital.

Another provision of the bill that seems to be an oxymoron to me is that as a tax professional, we spend a tremendous amount of time endeavoring to reduce the tax liability of the businesses with whom we work. As you know, that is a significant consideration in terms of the future growth and cash flow of the organization.

In order to take advantage of these provisions, it is necessary, of course, to have tax and it is then contradictory to say that we can increase our working capital because we want to generate a tax liability. If we could find some method that would enable us to provide working capital through tax deferral that would not somehow conflict with what we are trying to do from a profit perspective, would enable us to still minimize our tax liabilities and provide some working capital requirements, it would be useful, as well.

In addition, while the bill may—I am not sure that it does—should extend to sole proprietors as well as corporations, S corporations, and partnerships.

Ms. FORBES. Thank you.

Mr. Carroll, I am sorry I missed you earlier. I know your nameplate was up.

Mr. CARROLL. Thank you very much, and good morning, ladies and gentlemen, Senator Kerry, and all staff from all the various Members of Congress as well as my colleagues from the small business community.

My name is Frank Carroll. I am Chairman and Founder of Small Business Service Bureau, which is a national small business organization of over 50,000 small companies. I am delighted to be here with Small Business Service Bureau's Angie Doye, co-founder and CFO of Gwathmey, who, with the CEO, Judith Gwathmey, has built an innovative, highly successful small business in Cambridge, Massachusetts.

The fast-growing, creative firm is exactly the type of company that will benefit enormously from S. 1903 and S. 1676 and my congratulations to all of you Members of Congress and small business people who have worked on it. We all realize that bills have to be tweaked, and in some cases, certainly S. 1676 needs a little tweaking.

But in the interest of time, I would like to introduce and to call on Angie and let her tell us how these bills affect her company. I know how it affects our other members, but let us hear from another small business person who could tell us about her company, with your permission.

Ms. FORBES. Sure.

Ms. DOYE. My name is Angelia Doye. I am the CFO of Gwathmey, Incorporated, located in Cambridge, Massachusetts. We are a small biotechnology company that was founded on an SBIR grant back in 1996. We now have 9 employees. We have been awarded seven SBIR grants since 1996, and with those SBIR grants we have been able to build the technology and to acquire the equipment that we needed to service the biomedical industry.

One of the problems that we are facing especially, even right now, is we are trying to get a bridge loan from the bank in order to be able to expand the business. As we have developed the technology in-house, we have also had to acquire personnel, and in looking to do that, we have found that we have to build our contract basis with the industry and that is what we are in the process of doing now.

It takes about 2 to 3 months just to secure a contract from a biotech or pharmaceutical company if you move quickly. So we have asked for a bridge loan from a couple of different banks, and one of the problems that we come up with is the cash flow issue. Of course, because we have basically been founded and operated from SBIR grants, the cash flow is small because you do not make profits off of grants. But the industry contracts have started to build up.

We have got equipment, and every time we purchase equipment, understand that because we are a biotech company, a piece of equipment is anywhere from $40,000 to $70,000. As we acquire the equipment we need to service the industry at the end of the year, it becomes a tax problem—well, a tax problem to me. It is a tax liability.

The money we do get at the end of the year that we call profits, we wind up paying out in taxes. So it is a vicious cycle for us in that we acquire the equipment, we get the personnel, but at the end of the year, we are taxed, so we do not have the money we need to go forward into the next quarter. So we have months now where we have enough money and other months where we do not. So the bridge loan, we figured, would get us to the point where we have the bigger contracts coming in toward the end of the year, but we have been denied due to the cash flow.

And the equipment that we have, the banks are telling us that it is too specialized for them in case we default on our loan based on what our cash flow indicates. So I think that the BRIDGE Act is something that would be very useful for us. We have been encountering this about 3 years now.

Ms. FORBES. Thank you very much.

Giovanni Coratolo.

Mr. CORATOLO. I am Giovanni Coratolo with the U.S. Chamber of Commerce and I think, certainly from my members, what I have heard, I think it is important to address this when you address the issues of access to capital and its barriers, is certainly focusing in on some of the traditional lending institutions and, in specific, the 7(a) program in which we have seen subsidy rate miscalculations that have provided the government with the hidden tax on business and capital of up to $1 billion over the last decade.

Certainly, we see this as something that needs fixing. We see our members that have struggled in the access to capital and institutions that have matriculated out of that process. That is important. Certainly, this is something that we applaud the efforts of Senator Kerry and Senator Bond both, who have been on record to provide the fixes or encourage fixes to this area so that this is an area that we see that does need attention and needs focus.

And also, the level of funding in this year's 7(a) program is something that we are very concerned about, so that, I think, is important to have on the record.

Ms. FORBES. Thank you very much.

Jerry Feigen.

Mr. FEIGEN. Thank you, Patty. My name is Jerry Feigen. I am Director of the Macklin Center for Entrepreneurship at Montgomery College in Rockville, Maryland. I have been in this arena for quite a while.

In fact, in the early 1970s when I was with SBA, I tried to use the word "entrepreneurship" in a document we were going to publish and I was shot down because they thought nobody would understand it or pronounce it. Thank goodness we are here at a day where it is more than SBA, as the Senator said. It is an educational career alternative in high schools and colleges and universities and has much deeper roots.

I think the BRIDGE Act is a great first step for a limited number of companies and I support it. I think the issues of costs are always there, banking costs. What are they going to add on to the piece of the pie and what is Treasury going to add on in terms of the processing and paperwork and those kinds of things? But I think it is a great first step.

I would like to go to the other end of the spectrum. We are at a point in this country where VCs always talk about pipeline. The pipeline for entrepreneurship has never been greater at all levels. Demographics in the immigration area and in the minority area are just ballooning and the career alternative for entrepreneurship is at its greatest height.

We just did a program with the NIH last April, April 18, 2002, 500 scientists from the bench to business showed up, 87 percent of whom want to have an entrepreneurial career, want to take their science someplace. These are people without a great deal of money, but a lot of intellectual knowledge. They do not know how to put a business plan together. And importantly, there are not sources, except some of the VCs are now—of the activity in the venture area, bio-focused venture funds are still maintaining some growth.

So I think there is an issue there. How do we mine those entrepreneurs that are not only bio, but IT, science, engineering? They are coming out of the woodwork and out of the school systems and they are feeding off of themselves and the access to their capital means has to be taken care of.

[The prepared statement of Mr. Feigen follows:]

**Jerry Feigen**

**Director,**
**Macklin Center for Entrepreneurship**
**at Montgomery College**
**Rockville, Maryland**

**before**

**U.S. Senate Small Business and**
**Entrepreneurship Committee**

**May 22, 2002**

**Contact Information**
**Phone: 301 738-1702**
**Fax: 301 279-5149**
**Email: jfeigen@mc.cc.md.us**
**Website: www.macklin.org**

The comments and opinions provided herein are solely those of Jerry Feigen and do not necessarily reflect the position of Montgomery College.

Senator Kerry and Members of the Committee: It is indeed a great privilege and pleasure to participate in the Committee's Roundtable on issues impacting cost and access to capital for Small Business and New Enterprises.

The fact that the Committee on Small Business has in recent years expanded its title to include "Entrepreneurship" is a major illustration of how our country has evolved from a "Small Business" conscienceness to a new century of "Entrepreneurship" reflecting a greater universal acceptance of that term in our growing economic and education sector.

I recall vividly that when I was working at the SBA in the 1970's, I had just finished a report for the public in which I chose to use the word "entrepreneurship" in the title. I was shot down by a higher authority who didn't think the word would be readily understood or pronounced. Of course, today we know that entrepreneurship has begun to achieve deep meaning and understanding within every level of education, public policy, and private sector markets. Many, if not most, of the countries around the globe are evaluating and choosing to emulate our country's new enterprise process.

If you forgive me for "looking backward" in order to look forward, I'd like to touch briefly on where we have come from in this country relative to Small Business and the "Entrepreneurship Evolution."

In the early 1960's, I worked for the Securities and Exchange Commission (SEC) to help participate in the "clean up" of the after affects of the stock market's volatility and its impact on small investors. Smoke screens, "salted" mines, "unsavory bootstrapping" and "Ponzi" schemes were in full bloom with their aroma beguiling the naive as well as some very sophisticated investors. It was the time of the first special study of the stock market undertaken by the SEC. A study that would have profound effects on financial markets, specialists, etc.

At that time, it was clear that from a regulator's standpoint "small business" meant "high risk." Something more than "caveat emptor" was felt necessary to protect the "widows and orphans" by regulators. That meant costly documentation and reviews to assure compliance and confidence.

We are now in another risk averse era where regulatory transgressions and the great need for clear transparency still prevail. We have large companies globally who have consolidated with support from large financial institutions (no longer bound by Glass Steagall), and thereby losing core focus and accountability as far as small and large investors.

Given these circumstances, I believe we need to make certain that whatever regulatory restrictions are imposed to "assure" complete compliance (corporate and personal), "noncollusion," and "fairness" to all investors, we must be careful to not indirectly punish new enterprise development and "Small Business" owners and their stakeholders.

During the past four decades of Small Business and Entrepreneurship development in the U.S., that vital economic sector really did not receive any public policy or private sector respect. Small Business public policy had not distinguished between "life style" businesses and "growth" businesses with outside investor interest. During these 40 years, new growth companies had to compete with the consequences of those large companies who had sufficient resources and clout to work the regulatory and economic system in its favor. Early stage companies had scarcely enough "growth capital" to maintain payrolls, let alone deal with the costs of attracting outside investor capital. "Life style" businesses relied on traditional local banks (with or without SBA guarantees) for debt support which depended on the credit criteria established by the current economic cycle.

The 1960's and 1970's ushered in the development of the Small Business Investment Companies (SBICs) under the Small Business Investment Act of 1958. It was to be a public/private partnership to create an institutional source of long term growth capital for "pioneering" or "growth" firms. The SBICs and their portfolio companies survived, achieved double-digit returns and risk management know how. A national new enterprise private sector equity and management "process" evolved all across the U.S. despite the often "shunned" status it received within the government decision making hierarchy and the private financial sector skepticism. These privately managed venture funds called SBICs were to pilot an experiment in deal making and business development which was considered too risky by the private sector. At that time it would be a new kind of private financial serves fund that would soon lead to the creation of our venture capital industry with billions of dollars under professional management.

The late 1970's and 1980's issued in an era of successful SBICs to meet the economic needs of the times. The emerging private venture capital industry grew in status as the private financial markets accepted precedent setting SBIC portfolio returns and portfolio companies. Such companies as Intel, Genentech, Apple Computer, Federal Express, etc. hit their stride in the marketplace. The NASDAQ Stock Market was created as the right "liquidity" mechanism at the right cyclical moment so that these venture backed companies were able to a find home on Wall Street where the New York Stock Exchange had historically kept the barriers too high to reward the patient investors backing the venture capital industry. More than $2 billion dollars were under professional venture capital management and that was to grow to $50-$75 billion in the 1980's.

The 1980 White House Conference on Small Business created a "sea change" with regard to securities legal precedents and private vs. public investing equity requirements, "growth" vs. "life style" businesses. Regulatory standards that were limiting Small Business capital raising were significantly changed to define investors deemed not necessary to need public protection as well as those investors who could "fend" for themselves. In effect, "private" placement and venture capital investment as well as reporting requirements became codified for the "small" company sector. During this period other changes in law, (1) capital gains tax reductions for institutions and individuals, (2) even exceptions to ERISA were made where pension fund allocations accommodated "professional" venture capital transactions, and (3) technology grants for small business technology prototype development were also mandated throughout the major federal government's agencies with large extramural research budgets. Again, the government provided funds for feasibility assessments and commercialization wherein such investing would be considered too risky for the private sector to undertake. In effect, it took more than 40 years for the "risk averse" legal and private sector barriers to come down slightly and provide acknowledgement and acceptance of our truly American venture capital process based on calculated risk taking, value added growth, and long term support for people with innovative ideas.

Generally, our markets flourished in the 1980's and leaped out of sight in the mid 1990's and so did our economy and the stakeholders that lived off of the longest economic boom cycle ever. Unfortunately, greed, smoke and mirrors, uncontrolled bootstrapping, and "Ponzi" type schemes once again raised their ugly heads in various sophisticated new incarnations. Short-term greed based on false value creation has unleashed the regulatory and investor psychological morass we read about today. The question once again is who do you trust and how do you know?

Should we have known the cycle would end? Yes. Should we have known that financial bottom line numbers not based on true historic economic values and products and services (active "trade and businesses"), but on "plugged" return expectations would once again entice even the most sophisticated of investors and stakeholders? Yes. Will it happen again? Probably.

However, in our efforts to "clean house" and to bring basic values and transparency in sync with the realities of "profitable" real growth for our future enterprises, let's not turn the clock back and make Small Business and Entrepreneurship lose the public and private market share it has so rightfully gained for the past 20 years. Any public policy effort to enforce unbalanced regulatory restrictions to bring perceived investor trust back to our markets should be measured in terms of the greater relative negative and deleterious impact on the "access" and "cost" of capital for today's "growth" and emerging innovative "pioneering" companies.

Today, the entrepreneurship pipeline is flowing beyond everyone's expectation and hopes. Universities, colleges, and even high schools are providing well structured courses in entrepreneurship either as a career alternative or as development of general business survival skills. We are just beginning to have viable regional incubator/science park "ecosystems" encouraging entrepreneurs and generating commercial technology transfer with skilled human capital support. Do we really want to discourage our young people from thinking or dreaming of new business ideas?

With regard to the two proposals being reviewed, the following might be helpful.

S. 1903, the BRIDGE Act

The Business Retained Income During Growth and Expansion (BRIDGE) Act is intended to provide aid to entrepreneurial firms financing their own growth and expansion. It is designed to help companies which lack the size or long track record to tap into capital markets. The proposal would allow "small" businesses to temporarily defer a portion of their federal income tax liability. The two-year deferral would be limited to $250,000 of tax which would be repayable with interest over a four-year period. The tax-deferred amount would be deposited in a separate trust account – a BRDIGE account –at a bank or other approved intermediary, and the firm could borrow against the deferred amount, as collateral, for business purposes. I have previously called such companies "life style" companies that maintain a steady institutional or public economic position of growth but not sufficient growth to warrant investor return requirements. They are more dependent on debt financing and positive cash flow servicing. While this is a first step, it is hard to know what the administrative ease and costs of such proposal might bring to this business. Frankly, I believe it is the ability of banks, particularly local banks using realistic risk assessment standards based on sound judgment (and not static formulas) that will make the most difference for this sector's economic well being.

Also, I believe that Section 1244 ordinary loss treatment standards should be raised to meet today's realistic business size profiles. We have a great pipeline of potential entrepreneurial wannabees – should we share some of their risk on the downside?

S. 1676, the Affordable Small Business Stimulus Act

Among other provisions, S. 1676 would provide capital gains incentives for equity investments in small businesses. The bill expands on Section 1202 of the tax code which provides an exclusion of 50 percent for capital gains from qualified small business stock held by individuals for more than five years. To me this is very significant piece of legislation. The need at his time is to unleash "equity" for new entrepreneurs and their concepts. The venture capital process is one of long term patient investing and support. There are a number of sophisticated angel investor clubs where individual investors would benefit from such legislative tax incentives to support their interest in a new enterprise. To me, with a steady adequate source of private equity flows to small concerns, debt requirements become much easier to manage.

It is interesting that historically, SBA, SEC, ERISA, and Treasury/IRS have had different definitions of "Small Business." These two pieces of legislation seem to continue the variety of public policy definitions. However, this is a great first step. But if you will permit me, we are certainly on our entrepreneurial growth cusp. We really need a blue print that will maintain this sector's growth at each stage of growth – from seed to pre-IPO. I am <u>not</u> speaking of government funding increases rather better government management of existing resources and budgets.

What else could be done to assure that the Small Business and Entrepreneurship baby (now adolescent) is not thrown out with the proverbial "bath water." Even though the water is not clean but murky during this pendulum swing to more oversight, transparency, and personal accountability should we not save our future economic seeds? How can we keep the private "equity" capital flows and management support systems moving in a positive direction during this economic and regulatory "risk averse" cycle?

Some suggestions might be:

- Assure Small Business and Entrepreneurship has a clear and strong voice in the public policy changes that will be undertaken over the next few years. Perhaps a nonprofit, bipartisan commission whose mandate supports new enterprise public policy issues. The regulatory aftermath of Enron will hit the small business pocketbook in two years. We should be concerned now.

- Recognize that the very large financial institutions, from an economy of scale standpoint, can't service "smaller" business transactions and achieve the profits they need. Smaller regional, calculated risk oriented banks and non-banks will be the institutional support for new and life style/growth companies.

- Understand that more debt and government guarantees will not keep financial institutions accountable. More private equity will serve to balance appropriate debt/equity ratios and business.

- Take another look at SBICs, originally created to be local and national private financial equity funds. Legislative history and public policy saw envisioned SBICs to be a counter cyclical institutional long term capital source to keep young businesses and their entrepreneurs sustained during cyclical downturns when private sector risk investing shuts off. The mechanism is currently in place, operating with small government overhead, but may need some management streamlining. SBIC portfolios are represented in most of the states and their transactions are smaller and more industry diverse than larger venture capital limited partnerships.

- Be clear that we are just at the very beginning of a biotechnology and information technology revolution, and therefore, support for new enterprise technology transfer and commercialization should be encouraged through existing research grant programs and investing sources such as industry focused venture capital firms, investment angel clubs, and corporate strategic alliances.

- Encourage technology incubators that are affiliated with colleges and universities to help to generate ideas, clarify those with true market potential, and provide an eco-system where students, faculty, and the private sector can interact in a "living" science-business laboratory situation. Incubators are now developing in inner city landscapes for similar purposes.

  As an example, Montgomery College has a 2005 initiative to develop such a Bioscience-Technology Park at its Germantown campus off of I-270 (DNA Alley) in Montgomery County. It will have incubator space for early stage and next stage companies. Montgomery College has over 20,000 credit students and 26,000 workforce development students representing 170 countries. What a great entrepreneurial "eco-system" for innovation and growth where all kinds of symbiotic networking and support can be found in a global milieu.

As another specific example of the very high science interest in entrepreneurship, on April 18, 2002 a half-day program was presented at NIH in Bethesda sponsored by NIH and the Macklin Center for Entrepreneurship. It was entitled "Moving from the Bench to Business: Entrepreneurship in Science." Nearly 500 NIH scientist showed up. An evaluation of the program afterward indicated that 87% of those attending are interested in pursuing an entrepreneurship career. The question is where will the equity and professional management support come from to assure a reasonable chance for success. A success that might bring cures for society's diseases and pains.

Finally, given the great demographic changes throughout our country. There are genuine interests in new enterprise development and it is surfacing in every region of the U.S. Minority, women and immigrant owned businesses are proliferating in accordance with their general population growth factor. We must assure them that business and wealth creation are still alive and well in the U.S.

Thank you very much. As a citizen who has followed the "Small Business" odyssey over the last four decades, I really appreciate the Committee's intent in keeping this key economic sector in a survival mode.

**Jerry Feigen**
**Adjunct Professor**

**Georgetown University Law Center**

**U.S. SMALL BUSINESS FINANCING**
**A 300 YEAR CHRONOLOGY**

**COLONIAL PERIOD - 1600'S - 1700'S**

- EAST INDIAN COMPANIES - ENGLAND, DENMARK, FRANCE
- PRIVATE CHARTERS WITH GOVERNMENTS
- **HUDSON BAY COMPANY - 1670 - NORTH AMERICA – FIRST PRIVATE PLACEMENT DEAL**
    * "ADVENTURERS OF ENGLAND"
    * JOINT STOCK COMPANY - LEGAL ENTITY - 19 "ACCREDITED" INVESTORS
    * TAKING LOSSES WITH "APPROPRIATE PHLEGM IN ADVERSITY"
    * TWO FRENCH ENTREPRENEURS
    * RETURNS - TWO ELKES AND TWO BLACK BEAVER
    * EXPANSION STAGE - SELLING ICE TO CALIFORNIA TERRITORY
- INSURANCE INDUSTRY BEGINS
- LACK OF FORMAL SYSTEM OF BANK AND CREDIT
- CAPITAL FROM FEW MERCHANTS WITH SURPLUS - WIDOWS
- LONDON PROVIDES MAJOR SOURCE OF CAPITAL
- DEVELOPMENT OF SHIP BUILDING AND FISHING INDUSTRIES
- **NEW YOUR STOCK EXCHANGE - INFORMAL LIQUIDITY – 1780**
- ELI WHITNEY - MACHINE INTERCHANGEABLE PARTS - 1798
- **WASHINGTON'S ADDRESS – PUBLIC POLICY AND NEW ENTERPRISE**

**INDUSTRIAL REVOLUTION - 1800'S**

- HAMILTON'S FIRST BANK OF U.S.
- **SUPREME COURT ESTABLISHES DOCTRINE OF VESTED INTERESTS - "UPHOLDS PRIVATE PROPERTY EVEN ABOVE GENERAL GOOD OF THE WHOLE COMMUNITY" (PRIVITIZATION)**
- JOHN MARSHALL - 1819 - FORMULATES NATURE OF CORPORATIONS

ANALOGOUS TO THE NATURE OF INDIVIDUALS

- NEW YORK PASSES FIRST GENERAL CORPORATION LAW - 1811
- STATES CLEARED TO ENACT BANKRUPTCY LAWS
- **STATES ACT AS LENDERS AND INVESTORS - 1820'S PROJECTS-LARGE (ERIE CANALS) AND SMALL**
- BANK OF U.S. TAKES ACTIVE ROLE IN MANAGING ECONOMY THEN REVERTS TO STATES
- DEVELOPING INDUSTRIES AND ENTREPRENEURS - RAILROAD, STEEL, OIL
- "SMALL BUSINESSES" - INFORMAL NETWORK OF WHOLESALERS, BROKERS, JOBBERS, FACTORS AND AGENTS
- INSURANCE INDUSTRY DEVELOPED FURTHER
- **ENTREPRENEURS**
    * AUGUST **BRENTANO** - 1853 - NEWSSTAND IN NEW YORK
    * ROWLAND HASSEY **MACY** - 1858 - DRY GOODS - FIRST DAY'S SALE $11
    * GEORGE HUNTINGTON HARTFORD - 1859 - **A & P** TEA COMPANY TO SELL DIRECT TO CUSTOMERS

**<u>WORLD WAR I AND SPECULATION AGE</u>**

- **ANTI-TRUST LEGISLATION** - CLAYTON - SHERMAN ACTS
- **INCOME TAX OF 1913**
- POST WAR BOOM
- AMERICA - AN INTERNATIONAL POWER
- "LOST GENERATION" - **ERA OF RISK**

**<u>DEPRESSION YEARS</u> - 1930'S - <u>RISK AVERSE INVESTING PERIOD</u> - <u>BEGINS</u> - <u>4 DECADES</u>**

- **STOCK MARKET CRASH - 1929**
- "MACMILLAN REPORT" - ENGLAND - CAPITAL GAP - FIRST REVIEW - **EQUITY LIQUIDITY SOURCES NEEDED**
- **<u>RECONSTRUCTION FINANCE CORP. ACT OF 1934 – Legal Precedents</u>**
    * SECTION 5(D) - A NEW BUSINESS LOAN PROGRAM
    * DIRECT LENDING OR WITH PRIVATE FINANCIAL INSTITUTIONS
    * BUSINESS OF ANY SIZE - UNABLE TO RECEIVE CREDIT PRIVATELY ON <u>REASONABLE</u> TERMS
- <u>FEDERAL RESERVE BANKS</u> - EMERGENCY LEGISLATION 1934 SECTION 13B OF FEDERAL RESERVE ACT: AUTHORIZED FEDERAL RESERVE BANKS TO:
    * MAKE DIRECT LOANS
    * PARTICIPATE WITH FINANCIAL INSTITUTIONS TO <u>LARGE</u> OR <u>SMALL</u> BUSINESS NEEDING WORKING CAPITAL - BUT <u>UNABLE</u> TO OBTAIN FINANCIAL ASSISTANCE ELSEWHERE
    * AUTHORITY ONLY TO BE USED IN EXCEPTIONAL CIRCUMSTANCES

**<u>FEDERAL SECURITIES ACTS</u> - 1933 - 1940**

* **SECURITIES ACT OF 1933** - PROTECTION - DISCLOSURE
* **SECURITIES EXCHANGE ACT OF 1934** - MONITORING
* **INVESTMENT COMPANY ACT OF 1940 AND INVESTMENT ADVISERS ACT OF 1940**
    ** INVESTING AND REINVESTING FOR THE PUBLIC
    ** MANAGING OTHER PEOPLE'S MONEY

**<u>BANKING LEGISLATION</u>**

- **GLASS-STEAGALL ACT OF 1934 - INVESTMENT BANKING RESTRICTIONS** - ONLY LOANS AND CHECKING
- MCFADDEN ACT AMENDMENTS - BRANCHING RESTRICTIONS
- FDIC - 1933 BANKING ACT - $2,400 DEPOSITS INSURED INCREASE TO $100,000
- HOME LOAN BANK BOARD - 1932 - EVERY FAMILY A HOME

**<u>WORLD WAR II AND SMALL BUSINESS ACT OF 1942</u>**

- SMALLER WAR PLANTS CORPORATION (SWPC) CREATED TEMPORARILY TO HELP WAR PRODUCTION
- POWERS INCLUDE: DIRECT AND PARTICIPATING LOAN PROGRAMS, ENCOURAGING PRIVATE CREDIT AVAILABILITY, UNDERTOOK FEDERAL PRIME CONTRACTS TO BE SUBCONTRACTED, EMPOWERED TO DISPOSE OF WAR SURPLUS THROUGH SMALL FIRMS, ADVOCATED SMALL BUSINESS INTERESTS TO FEDERAL PROCUREMENT AGENCIES AND BIG BUSINESS AND ALSO TO MAKE STUDIES.

**<u>AMERICAN RESEARCH AND DEVELOPMENT (ARD)</u> - 1946**

- PUBLIC INVESTMENT COMPANY FOR CREATIVITY, INNOVATION, AND ENTREPRENEURSHIP - GENERAL DORIOT - PEOPLE OVER IDEAS
- $70,000 = KEN OLSEN (DEC) DIGITAL EQUIPMENT CORP.

**<u>FEDERAL RESERVE STUDY "FINANCING NEEDS OF SMALL BUSINESS"</u> - MAY 29, 1953**

- LONG-TERM AND EQUITY NEEDS OF SMALL FIRMS
- PERIODS OF CREDIT CONTRACTION WHERE SMALL FIRMS HURT THE MOST - SMALL FIRMS GET HIT HARDER THAN LARGER FIRMS
- NEED FOR MANAGEMENT AND TECHNICAL ASSISTANCE

**<u>SMALL BUSINESS ADMINISTRATION CREATED</u> - JULY 20, 1953** = RFC + SWPC

- MAKE LOANS
- ENTER PROCUREMENT CONTRACTS TO SUBLET
- CERTIFY TO PROCUREMENT OFFICERS OF CAPACITY AND CREDIT OF SUBCONTRACTORS
- PROVIDE TECHNICAL AND MANAGERIAL AIDS
- DISASTER LOAN PROGRAM
- RFC AND SWPC TERMINATED
- SINGLE AGENCY IN FEDERAL GOVERNMENT TO <u>ASSIST</u>, <u>PROTECT</u>, AND <u>PROMOTE INTEREST</u> OF <u>SMALL BUSINESS</u>

**<u>FEDERAL RESERVE BOARD STUDY OF 1957/1958 - "FINANCING SMALL BUSINESS"</u>**

- LONG-TERM OR EQUITY NEEDED - NOT SHORT-TERM
- SPECIFIC NEEDS INCLUDE:
    * NEW FIRMS OR FIRMS WITH NEW LINES OR PROCESSES - "PIONEERING FIRMS" - INNOVATION AND INVENTION
    * CAPITAL FOR GROWTH OF ESTABLISHED BUSINESS - EXPANSION SURVIVAL
    * BUSINESS CONTINUITY - OWNERSHIP TRANSFER
    * MANUFACTURING FIRMS NEED HELP IN PARTICULAR
    * EXISTING INSTITUTIONS - ONLY SHORT-TERM PROVIDES
    * "CAPITAL GAP" - WILLIAM McCHESNEY MARTIN - THERE IS A GAP IN EXISTING STRUCTURE OF FINANCING INSTITUTIONS WHICH LIES IN THE LONG-TERM DEBT AND EQUITY CAPITAL AREA..AND THERE IS ROOM FOR A GOVERNMENT PROGRAM TO FOSTER THE FLOW OF <u>PRIVATE</u> INVESTMENT FUNDS TO SMALL BUSINESS."

**<u>SMALL BUSINESS INVESTMENT COMPANY ACT OF 1958</u> - AUGUST 21, 1958**

- CREATION OF SMALL BUSINESS INVESTMENT COMPANIES (SBICS)
  - **EQUITY AND LONG TERM CAPITAL**
  - **PRIVATE MANAGEMENT AND CAPITAL**
  - **GOVERNMENT PARTNERSHIP - CAPITAL LEVERAGE**
- CREATION OF STATE DEVELOPMENT COMPANIES (SBC) AND LOCAL DEVELOPMENT COMPANIES (LDC)
- JOB CREATION AND ECONOMIC GROWTH TO COMBAT RECESSION

**<u>RISE AND FALL OF NEW ISSUES AND "GOING PUBLIC"</u> - 1960'S**

**- SPECIAL STUDY OF THE SECURITIES MARKET – SEC - CHANGING U.S. FINANCIAL MARKETS - 1963**

<u>- BANK HOLDING COMPANY ACTS OF 1965 AND 1970</u>

<u>- DLJ IS FIRST BIG BOARD MEMBER TO GO PUBLIC</u>

**<u>- NASD CREATES NASDAQ IN 1971- GORDON MACKLIN – LIQUIDITY ALTERNATIVE to NYSE FOR VC PORTFOLIO COMPANIES</u>**

**<u>-DEVELOPING PRIVATE VENTURE COMMUNITY IN 1970'S</u>**

- **SBA TASK FORCE AND VENTURE CAPITAL - 1977**
- LIFE CYCLE OF A GROWTH BUSINESS
- REGULATORY IMPACT ON VENTURE INVESTING

<u>CORPORATE VENTURING IN PRIVATE POOLS</u> - 1970'S

**<u>ERISA - 1974 - PENSION PROTECTION U.S. RISK "PRUDENT MAN" (1974) AND "PLAN ASSETS" (1979)</u>**

**<u>FIXED COMMISSIONS ABOLISHED (1975)</u>**

**<u>CAPITAL GAINS TAX REDUCTION</u> - 1978 - 48 - 26%**

**<u>FIRST WHITE HOUSE CONFERENCE ON SMALL BUSINESS</u> - JANUARY 1980**

- CAPITAL FORMATION AND RETENTION
- INNOVATION AND TECHNOLOGY (SBIR)

**<u>DEBT VS. EQUITY - SECTION 385 TAX POLICY DILEMMA</u> - WHAT IS DEBT?, WHAT IS EQUITY?, WHAT IS DIVIDEND?, WHAT IS INTEREST EXPENSE? - 1980**

**<u>SMALL BUSINESS INVESTMENT INCENTIVE ACT OF 1980</u>**

- **BDCS EMERGE - PUBLIC INVESTING IN VENTURE FUNDS**
- **ACCREDITED INVESTORS (SOPHISTICATED INVESTOR QUANTIFIED)**
- GOVERNMENT WIDE FORUM - STATE AND FEDERAL SECURITIES REQUIREMENTS
    * CHANGES NEEDED FOR GROWTH CAPITAL IN SMALL BUSINESS

<u>DEPOSITORY INSTITUTIONS DEREGULATION AND MONETARY CONTROL ACT OF 1980</u>

- ELIMINATION OF REGULATIONS Q
- FEES FOR SERVICE PERMITTED
- BROADER LOAN MAKING AUTHORITY

<u>REGULATORY FLEXIBILITY ACT OF 1980 - P.L. 96-354</u>

<u>SMALL BUSINESS BUDGET RECONCILIATION ACT OF 1981</u>

- NO LOAN ELSEWHERE TEST
- SO SOUND AND SECURE
- 90% - 70% GUARANTEES
- CONSOLIDATION OF PROGRAMS

**<u>ERTA TAX ACT OF 1981</u>**

- **CAPITAL GAINS REDUCTION - 26% - 20%**
- R&D TAX CREDITS - 25%
- R&D PARTNERSHIPS

TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

**SMALL BUSINESS INNOVATION ACT OF 1982**

- **SBIR**
- R&D SUBCONTRACTING

SEC'S FIRST GOVERNMENT WIDE FORUM ON SMALL BUSINESS CAPITAL FORMATION - 1982

TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

- IDB - ELIMINATION
- PENSION PLAN CHANGES
- MERGER AND ACQUISITIONS

SUBCHAPTER S REVISION ACT OF 1982 - INCREASED BENEFITS

THE DEPOSITORY INSTITUTIONS ACT OF 1982

- S&LS - COMMERCIAL LOANS
- MONEY MARKET INSURED ACCOUNTS

SEC/NASAA - SMALL BUSINESS HEARINGS - SEPTEMBER 1983

**VENTURE CAPITAL INDUSTRY - 1983**

- **DISBURSES $2.8 BILLION IN 1983 VS. $400 MILLION IN 1977**

DEFICIT REDUCTION ACT OF 1984

- DISC VS. FSC
- CAPITAL GAINS HOLDING PERIOD - 6 MONTHS
- PAPERWORK BURDENS
- ESOPS
- SUBCHAPTER S EXTENDED
- SECTION "1244" STOCK EXTENDED TO PREFERRED STOCK

SMALL BUSINESS SECONDARY MARKET IMPROVEMENT ACT OF 1984 - LIQUIDITY FOR SECONDARY LOAN PROGRAM BACKED BY SBA GUARANTEES

**ENTREPRENEURS OF THE 1970'S/1980'S**

- **BOB NOYCE - INTEL "CHIP"**
- **GENE AMDAHL - AMDAHL COMPUTERS - TRILOGY INVESTMENTS**
- **STEVE JOBS - APPLE COMPUTER**
- **SEYMOUR CRAY - CRAY RESEARCH**

**FRED SMITH - FEDERAL EXPRESS**

**TAX REFORM ACT OF 1986**

- LOWER RATES - INDIVIDUALS AND CORPORATIONS
- NO CAPITAL GAINS DIFFERENTIAL
- ELIMINATION OF SHELTERS

**STOCK MARKET CRASH OF 1987**

- **SHIFT TO RISK AVERSION**

REUTERS BUYS INSTINET CORP. (1987)

COSBI LEGISLATION - OCTOBER 1987

- FIRST PRIVATIZATION OF SBICS LEGISLATION
- WHITHER VENTURE CAPITAL INSTITUTIONS?

**THE DECADE OF THE ENTREPRENEUR ENDS? - 1989**

- "VELDA SUE" - A NEW VENTURE CAPITAL AGENCY?
- CAPITAL GAINS TAX DIFFERENTIAL RETURNS FOR INDIVIDUAL INVESTORS
- RESOLUTION TRUST CORPORATION - S&L BAILOUT
-
-
-
-
-

- **<u>THE 1990'S</u>**
- **<u>DECADE OPENS WITH SERIOUS QUESTIONS</u>**
    * **VENTURE CAPITAL INDUSTRY IN RETREAT**
    * SBIC'S UNDER SIEGE - REVISITED AND RESTRUCTURED
    * NEW TAX AND SEC PROPOSALS FOR SMALL FIRMS???
    * CAPITAL GAINS
    * R&D
    * HEALTH CARE
    * REG A/ REG D/ REPORTING, BROKER DEALER, S-18
- <u>STATE OF THE UNION - 1992</u> - NEW POLICIES FOR ENTREPRENEURS?
    * ECONOMIC DEVELOPMENT
    * JOBS
    * TECHNOLOGY AND INNOVATION
- **<u>ADVANCED TECHNOLOGY PROGRAM</u> (P.L. 100-418, P.L. 102-245),** NATIONAL INSTITUTE OF STANDARDS AND TECHNOLOGY, ACCELERATE U.S. GROWTH THROUGH PRE-COMPETITIVE GENERIC TECHNOLOGIES, FIRST FUNDING GRANTS 1991.
- ENTERPRISE CAPITAL FORMATION ACT - TARGETED CAPITAL GAINS FOR SMALL BUSINESS - SEN. BUMPERS, JANUARY 1992
- **<u>SBICS & VENTURE CAPITAL INDUSTRY RESURRECTED?</u> - 1992**
    * **SBA'S INVESTMENT ADVISORY COUNCIL REPORT - FEB. 1992**
    * H.R. 5191 - SMALL BUSINESS EQUITY ENHANCEMENT ACT OF 1992 - CONG. LA FALCE & IRELAND - JUNE 1992
    * **SMALL BUSINESS CREDIT AND BUSINESS OPPORTUNITY ACT OF 1992 - TITLE IV - SBICS - ENACTED AUGUST 1992 - SIGNED BY PRESIDENT BUSH**

-

**<u>SEC CHAIRMAN BREEDEN SMALL BUSINESS & VENTURE CAPITAL PROPOSALS - FEBRUARY 1992</u>**

- * 1933 ACT CHANGES TO MAKE IT EASIER TO RAISE EQUITY
- * 1940 ACT CHANGES TO ALLOW EASIER FORMATION OF VENTURE CAPITAL FUNDS & POOLING OF SHORT TERM DEBT

- <u>CRITICAL TECHNOLOGIES DEVELOPMENT PROGRAM</u> - TITLE III(E), COMMITTEE ON SCIENCE, SPACE, AND TECHNOLOGY MODELS SBIC PROGRAM FOR CRITICAL TECHNOLOGIES, CONG. BROWN - SBA VS. COMMERCE, JUNE 1992
- <u>U.S. COMMISSION ON MINORITY BUSINESS DEVELOPMENT REPORT</u>, CHANGES FOR SMALL <u>AND</u> MINORITY BUSINESS, J. SMITH, CHAIR - SEPTEMBER 1992
- <u>SMALL BUSINESS RESEARCH AND DEVELOPMENT ENHANCEMENT ACT</u>, P.L. 102-564, OCTOBER 28, 1992 - INCREASE % AND $ AMOUNTS OF AWARDS AND PILOTS SMALL BUSINESS TECHNOLOGY TRANSFER PROGRAM
- <u>DEFENSE ADVANCED RESEARCH PROJECTS AGENCY</u> - DARPA - SHIFTING $BILLIONS TO CIVILIAN TECHNOLOGY IN CRITICAL AREAS,

**<u>1992</u>**

- <u>PRESIDENT-ELECT CLINTON</u> - SMALL AND EMERGING BUSINESS FOCUS WITHIN GLOBAL ECONOMIC, TECHNOLOGY DEVELOPMENT AND DOMESTIC JOB GENERATION POLICIES???. NOVEMBER 1992
- <u>KAUFFMAN FOUNDATION</u> CENTER FOR ENTREPRENURIAL LEADERSHIP - LAUNCHED.

**<u>1993</u>**

- <u>OMNIBUS BUDGET RECONCILIATION ACT OF 1993 (ORBA)</u>, INCLUDES CAPITAL GAINS PROVISION TARGETED TO INDIVIDUAL INVESTORS INVESTING IN ORIGINAL ISSUE STOCK OF QUALIFIED SMALL BUSINESS

("C" CORPORATION WITH LESS THAN $50 MM OF AGGREGATE CAPITAL)

- 50% OF GAINS EXCLUDED IF HELD 5 OR MORE YEARS
- SEC'S FINAL RULES FOR SMALL BUSINESS INITIATIVES PUBLISHED, THE SMALL BUSINESS INCENTIVE ACT OF 1993 PASSES SENATE (S.479) PROPOSING EXPANDING SEC SMALL BUSINESS INCENTIVES,
- FINANCIAL ACCOUNTING STANDARDS BOARD (FASB) PROPOSES REVISING ACCOUNTING RULES FOR INCENTIVE STOCK OPTIONS (ISOS), REQUIRES REPORTING OF STOCK OPTION GRANTS AS A CHARGE AGAINST EARNINGS AND DISCLOSURE OF IMPACT ON NET INCOME.

**1994**

- SBICS AND VENTURE CAPITAL REJUVENATED
- IMPLEMENTING, LICENSING & FUNDING OF REVITALIZED SBIC PROGRAM UNDER SBA'S $500MM TO $1BIL. IN PRIVATE INVESTMENT, INCREASE IN SIZE STANDARD FOR GROWTH COMPANIES (<$18MM NET WORTH $2MM PROFITS)

**1995**

- NEW REPUBLICAN CONGRESS - **WITHER SMALL BUSINESS**, HILL COMMITTEES, SBA AND SBICS' APPROPRIATIONS???
- **WHITE HOUSE CONFERENCE ON SMALL BUSINESS - JUNE, 1995 -** BACKS GROWTH ENTREPRENEURS AND SBIC'S PRIVATIZATION
    - TARGETED GROWTH COMPANY CAPITAL GAINS REDUCTION
    - CHANGES IN SBIR/STTR LEGISLATION
- SEC CAPITAL FORMATION FORUM - SEPTEMBER, 1995 - BACKS SBICS PRIVATIZATION AND TARGETED CAPITAL GAINS FOR "QUALIFIED" SMALL BUSINESS INVESTMENTS HELD OVER A LONG TERM
- NEW CAPITAL GAINS - TARGETED GROWTH

- NEARLY $700MM OF PRIVATE CAPITAL UNDER NEW SBIC LICENSING PROGRAM OF SBA - MORE THAN THE CUMULATIVE TOTAL FOR THE LAST 10 YEARS.

<u>**1996**</u>

- **FIRST "INVESTMENT" RETURN TO SBA AS A LIMITED PARTNER** (AFTER LESS THAN 12 MONTHS) UNDER NEW SBIC PROGRAM - $35,000
- WHITHER FUNDING PRIVATIZATION AND SURVIVAL OF SBICS???
- WHITHER INVESTMENT FOR US GROWTH COMPANIES???
- RISE OF COALITION OF GROWTH COMPANIES FOR NEXT CENTURY - ENTREPRENURS COALITION
- **JANUARY 1996 STAFF STUDY OF FEDERAL RESERVE BOARD - SIGNIFICANCE OF PRIVATE EQUITY, VENTURE CAPITAL AND SBIC MARKET IN U.S. FINANCIAL FLOWS OF CAPITAL.**
- **SECURITIES INVESTMENT IMPROVEMENT ACT OF 1996 - S. 1815 CHANGES TO IMPROVE AND EXPAND PRIVATE EQUITY**
- **QUALIFIED PURCHASER POOLS - UNLIMITED NUMBER OF "QUALIFIED INVESTORS"**
- SMALL BUSINESS INCENTIVE ACT
    * 1940 ACT EXEMPTION STATE CHARTERED ECONOMIC DEVELOPMENT COMPANIES
    * EXEMPTIONS FOR INTRASTATE, CLOSED-END FUNDS UP TO $10 MILLION (UP FROM $100,000) OR SEC DISCRETION
    - BUSINESS DEVELOPMENT COMPANIES
        * NEW CLASS AND TYPES PORTFOLIO COMPANIES ELIGIBLE FOR INVESTMENT - LIQUIDITY
        * BDCS PERMITTED TO ISSUE WARRANTS, OPTIONS, RIGHTS EXPIRING WITHIN TEN YEARS

- <u>**RELEASE OF VENTURE CAPITAL FLOW DATA FOR 1995**</u>
  * **1995 - $3.859 BILLION** - 1,485 FINANCINGS - 1,128 COMPANIES
  * **1994 - $2.741 BILLION** - 1,433 FINANCINGS
  * UP 40% 1995 VS. 1994
  * **AVERAGE DEAL SIZE $2.6 MILLION IN 1995 VS. $1.9 MILLION IN 1994**

- <u>FUNDRAISING BY VENTURE CAPITALISTS IN 1996</u>
  * 1996 - SIX MONTHS - $2.032 BILLION TOTAL FOR YEAR END = ?
  * 1995 - SIX MONTHS - $1.553 BILLION - TOTAL FOR YEAR END = $4.4 BILLION
  * UP 31%
- <u>NEW PARTICIPATING SECURITIES SBICS MID 1996 UPDATE</u>
  - 35 NEW SBICS SINCE 1994
  - 28 NEW SBICS HAD > $350 MILLION OF PARTICIPATING SECURITIES
    - $700,000 IN PROFITS TO SBA
    - $7.5 MILLION REPAYMENT OF PRINCIPAL AND PRIORITY PAYMENTS
    - FY 1995 - 166 REPORTING SBICS
    - SBIC TOTAL PRIVATE CAPITAL IN MID 1996 WAS $900 MILLION UP FROM $32 MILLION (1988 - 1992)
    - $1 BILLION OF ADDITIONAL PRIVATE CAPITAL BEING REVIEWED FOR LICENSES BY SBA
    - TOTAL FINANCING IN FY 1995 TO SMALL BUSINESSES WAS $1 BILLION UP FROM $500 MILLION (1988-1992)
    - 88% OF FY 1995 FINANCING WERE “EQUITY-TYPE”

- **<u>NOVEMBER 1996 - DEFEAT OF CALIFORNIA PROPOSITION 212 - FRIVOLOUS SECURITIES FRAUD LAWSUITS</u>**

<u>1997</u>

- CHARTER CLASS KAUFFMAN FELLOW'S PROGRAM - JUNE 1997
- CHANGE IN CAPITAL GAINS TAX - FROM 28 TO 20%???
- **NASDAQ ORDER-HANDLING RULES TAKE EFFECT; EIGHT ECNs LATER REGISTER**

<u>1998</u>

- **SEC FOCUS ON ONLINE TRANSACTIONS**
- **CORPORATE VENTURING RETURNS – TELECOM AND IT ***
- FORMER CHAIRMAN OF NYSE AND FEDERAL RESERVE, WILLIAM MCCHESNEY MARTIN, DIES
- TAX FREE ROLL OVER OF QUALIFIED SMALL BUSINESS STOCK (IRC SECTION 1045)
- **NASD BUYS AMERICAN STOCK EXCHANGE**

<u>1999</u>

- **SEC ALLOWS ELECTRONIC CAPITAL NETWORKS (ECNs) TO BECOME STOCK EXCHANGES; NYSE, NASDAQ PROPOSE TO BECOME FOR-PROFIT – LISTING SHARES?**
- **FINANCIAL DEREGULATION AND THE END OF GLASS STEAGAL ***
- **MEGA FINANCIAL MERGERS SURGES GLOBALLY**
- **DOW JONES INDEX REFLECT EARLY VENTURE START-UPS – "COMING OF AGE OF VC BACKED COMPANIES"**
- **VENTURE CAPITAL INVESTMENTS HIT NEW HIGHS**
- **NASDAQ GOES GLOBAL**

- AN ENTREPRENEURIAL ECONOMY LEADS U.S. ECONOMIC GROWTH

**1999 VENTURE BACKED INVESTMENTS**

- 1ST HALF '99 VENTURE INVESTMENTS $11.4 BILLION (1,168 DEALS - 60% IT, 15% HEALTH, 25% RETAIL / SERVICES).
- NEARLY MATCHES TOTAL OF ALL OF 1998 $12.5 BILLION (1,824 DEALS) VS. $4.0 BILLION IN ALL OF 1993 (400 DEALS).
- VENTURE BACKED IPOS – '99 ($6.6 BILLION) 1ST HALF OF '99 VS. 77 ($4.2 BILLION) TOTAL 1998.
- 199 SBICS – PARTICIPATING SECURITIES – INVESTMENTS

**2000**

- IPO/DOT COM BUBBLE BURST
- VCs FREEZE INVESTING – LIMITEDS SHIFT ASSET ALLOCATION TO SAFETY
- VCs NURSE WOUNDED AND BECOME ECONOMIC BELL WEATHER
- U.S. AND GLOBAL ECONOMY IN RETREAT

**2001**

- NEW U.S. GOVERNMENT ELECTED – BARELY — GEORGE W. BUSH
- VC ACTIVITY IN EARLY STAGE DEALS STALLED IN U.S. BUT SOME CONTINUE INTERNATIONALLY
  FIRST ROUND VENTURE FUNDING DURING SECOND QUARTER DOWN TO $1.04 BILLION OR 87% FROM SAME PERIOD IN 2000
- HOWEVER ANGEL FUNDS GROW REGIONALLY GETTING BETTER VALUATIONS
- TERRORISTS HIT WORLD TRADE CENTER AND PENTAGON
- U. S. GOES ON WAR FOOTING - GLOBAL ALLIANCES
- IMPACT ON STOCK MARKETS SIGNIFICANT - DOW JONES DOWN 20%
- "RECESSION" HITS U.S. – UNEMPLOYMENT UP

## WHAT'S NEXT???

Ms. FORBES. Thank you.

Todd McCracken.

Mr. MCCRACKEN. Good morning. I am Todd McCracken. I am President of National Small Business United. I will try to be very brief.

As I think we have already seen this morning, and I think only half the folks have spoken, the credit and capital picture for small business is incredibly complex and there is no silver bullet, there is no one fix for small business at large. I mean, we are trying to have a conversation at one table where we are talking about SBICs and venture capitalists and bank loans and credit card borrowing and the start-up dry cleaner and biotech firms, all in the same conversation. It is a pretty difficult thread to try to maintain.

But it is clear that small businesses often have great difficulty obtaining capital, although the difficulty seems to have been less in the last few years than it was for a great many years. But it is cyclical in nature and I would like to try to raise one issue that I think relates to the issue that the BRIDGE Act is trying to get at, and it is an issue that comes back over time with the economy, and that is basically the problem of the banking regulators.

We hear anecdotally from members now who are in a growing stage. They may or may not be in the BRIDGE Act's definitions of a fast-growing company, but they are certainly successful companies but, nevertheless, have cash flow problems that in years past, in most times, they are able to get a bank loan to get them past these times. In the last year or so, that has become much more difficult for them and the reasons that appear to be for this are that the banking regulators are changing the rules of the game, basically, for the banks, in particular, for how they judge the creditworthiness, how they rate the value of inventory and other assets, for instance, of the businesses' assets.

I want to raise the issue because we think it is critically important, because the way the bank regulators function now is in times of great economic boom, they have almost an "anything goes" attitude sometimes, and then when the economy starts to go south, they exacerbate it by changing their standards and there ought to be some level of uniformity in what constitutes a good loan and it should not be different in July of 1998 than it is in August of 2001.

I do not know if anyone who knows more about this and is smarter on these issues than I am has any particular ideas on how we can achieve some of that uniformity from the regulators, but I think it is crucially important.

Ms. FORBES. Okay, thank you.

Darrell McKigney.

Mr. MCKIGNEY. Thank you. I am Darrell McKigney. I am President of the Small Business Survival Committee. We have been supporting the BRIDGE Act for some time, testifying for it on behalf of the House. We appreciate Senator Kerry's effort on that.

But one of the things that kind of gets me thinking about the BRIDGE Act is it really highlights to me how much taxes make the difference between success or failures of businesses. We heard from Angelia this morning about how all the profit goes to taxes, and it strikes me that one of the simplest things we could do to provide capital for small businesses is continue to cut taxes, to make the tax cuts that were passed last year permanent. That is a big help for small businesses.

The biggest angel investors out there a lot of times are parents and people who give money or gift money to take care of an estate. The estate tax is going out of business or is phasing out and then it is going to rear its head back up. We ought to make that permanent. We ought to make it easier for people to gift money to friends and family. Those are the people who often know those businesses and those people the best. That is a good opportunity.

Mark, I think, brought up self-employed people. The fastest-growing part of the workforce right now are self-employed people. I think they have increased something like 30 percent over the last decade, and with technology, that is only going to increase and it is a great opportunity. The thing is, they run into, I think, a couple of specific issues.

One, they immediately run into payroll taxes, and that gets into the issue of Social Security reform. There ought to be a way that people can invest their money privately so there is more capital out there for the rest of us to access and get a better rate of return when they retire and, at the same time, lower rates so they do not have to pay so much.

The other issue I think they run into is so many times if they are using a home office or they are using a car or a vehicle, it is very hard to deduct those things and a lot of times their personal expenses are mingled in with their business expenses, and those are, in addition to a lot of the other areas that were brought up here, I mean, those are some things that I think we could look at that would have an immediate consequence for people.

[The prepared statement of Mr. McKigney follows:]

Small Business SURVIVAL Committee

4-45

**WRITTEN COMMENTS OF**
**DARRELL MCKIGNEY**
**PRESIDENT, SMALL BUSINESS SURVIVAL COMMITTEE**
**May 22, 2002**

Chairman Kerry and members of the Committee, I am Darrell McKigney, President of the Small Business Survival Committee (SBSC) a national nonpartisan, nonprofit small business advocacy organization with 70,000 members throughout the country.

The topic of today's discussion, "Investing in Small Businesses", couldn't be more important and timely. With our economy working towards a rebound from a slow and often difficult period, the nation is looking to America's small businesses – which are responsible for creating 75% of all new jobs - to spark recovery and return to good economic times.

As we look to small businesses to spark growth and create jobs, we need to keep in mind that even in good times, about half of all small businesses fail within four years. In slow times, layoffs and tight personal budgets sometimes force people into starting small businesses which go on to succeed, but a tough economy often spells the end of the dreams of many small business owners. Whether growing or struggling to survive, access to capital and investment can be the difference between success or failure.

For many fast growing and new small businesses, one of the greatest challenges is overcoming the period where high growth necessitates more capital, but a short business track record discourages needed investment. One piece of legislation we're discussing today, S. 1903, the BRIDGE Act, would allow some these emerging small businesses defer up to $250,000 of federal tax liability for two years and allow them to pay that tax burden off over four years with interest while allowing them to use the deferred money to secure a business loan. The BRIDGE Act is an innovative idea that would provide crucial resources for many fast-growing businesses facing investment shortages, and allow them to keep growing and creating jobs.

SBSC has been and continues to be a strong supporter of the BRIDGE Act and we applaud Chairman Kerry and other supporters of the legislation for their efforts on behalf of this bill.

The BRIDGE Act also illustrates how the tax burden can make the difference between success or failure for small businesses, and how small businesses can have a better chance of surviving if they are simply allowed to have use of their own money.

This is particularly true of the smallest small businesses. For many of these, the first and most important sources of investment are the people who know them best: themselves, their families, friends and business associates. With some 90% of small business owners paying personal income rather than corporate taxes, the difference between having adequate capital or not can be the income tax burden. Similarly, the amount of discretionary money available for investment by individuals is highly determined by their tax burden.

- continued -

1920 L Street, N.W. Suite 200 • Washington, D.C. 20036
Phone (202) 785-0238 • Fax (202) 822-8118
www.sbsc.org

SBSC applauds Congress for giving a tremendous boost to small businesses last year in passing income tax cuts. SBSC supports increasing those benefits by speeding up its full enactment and making them permanent.

Likewise, Congress did much to help opportunities for investment by moving to phase out the death tax. By removing a tremendous disincentive for investment by retirees and opening the door to new sources of capital, the elimination of the death is a key investment initiative. Congress now must make elimination of the death tax permanent so people can plan for investing that money beyond the next ten years.

Also, of all the tax measures that impact investment, one of the most important would be to once again reduce or even eliminate capital gains taxes. There is no greater disincentive to investment than the capital gains tax.

Finally, I want to highlight the special needs of the smallest small businesses, the self-employed. This is one of the fastest growing sections of the work force, and for many, being able to invest their own earnings in their business is particularly challenging. In addition to income taxes, high social security and other payroll taxes are a tremendous burden. Congress needs to look at ways to reform social security so citizens can make more money available for investment in the private sector, receive higher returns on that investment, and still be able to lower social security taxes.

And for many, who work at home or use their personal vehicles or computers, confusion and difficulty in deducting those expenses can deny them a full return on their investment.

In conclusion, I want to thank the Chairman and the Committee for this important discussion. We appreciate the work the Senate has done during this Congress to lower the tax burden. By allowing small business owners to keep and invest more of their own money, we can immediately begin to reduce problems with cash flow while making small businesses more profitable and attractive to outside investment. With that goal in mind, we urge support for initiatives such as the BRIDGE Act and making last year's tax relief permanent to provide even more opportunities.

# # #

Ms. FORBES. Okay, thank you.

Amy Millman.

Ms. MILLMAN. Thank you, Patty, for inviting us to join this roundtable and for pulling all of these great folks together. I wanted to mention one theme that comes up from the women entrepreneurs that we talk about. They want to say thank you for making the distinction between the small business, the world of small business, the world of entrepreneurship. There are some very significant differences in the way these companies start, grow, and then there are some very similar aspects.

I think the issue that we have faced in small business development and in entrepreneurial development is the difference between large and small, and the government makes no distinctions, for the most part, between large and small. When you are a fast-growth company, those distinctions begin to blur, and so what is happening to many of the entrepreneurs that I run across, very much like Angie, are that they have grown to a point now where the large corporate tax regulations, requirements, are kicking in before they really have reached profitability.

They asked if there would be some recognition of this phenomenon which other small businesses have experienced over the years, but at a slower pace. They are experiencing it very quickly and it has meant the difference between staying in business and not. So there are lists and lists that they are giving me of rules, regulations, some State, some Federal, that have caused them all of a sudden to put the skids on their enterprises, much to the consternation of Mark Heesen's members.

But, in general, that is basically it. As the input comes in, I would like to have the opportunity to be able to forward their thoughts to you.

Ms. FORBES. Please do.

Jeremy Wiesen.

Mr. WIESEN. Thank you. I come at entrepreneurship in three different ways. I am a business school professor at New York University, but I have been at UCLA, Berkeley, Stanford, Wharton, Columbia, so I may have been in your neck of the woods.

In the 1980s, I started, with others, Financial News Network, which was the complete start-up acquired by CNBC later on, started in a garage, basically, in Los Angeles. After that started, something called Tofutti Company, which maybe you have some Tofutti Cuties in your icebox here, or your kids do. It is still around and going strong.

Thirdly, aside from teaching entrepreneurship, I have started something called the Global Goals Institute with Dr. Christian Kling, who is here today, and we have developed several ideas and one of them that we focused on in a group meeting was to amend Section 1244 of the Internal Revenue Code. I have always been a big fan of Section 1244. I remember in law school, they told us, "if you do not remember Section 1244, you may be sued for negligence." And then when I went to the Wharton School, they said, "by the way, if you do not remember Section 1244, you may be sued for negligence." So I have always remembered Section 1244 and I have actually taken advantage of Section 1244.

It was enacted in 1954. It focuses on losses. The amendment to Section 1202 focuses on gains. Section 1244 says to the angel investor, you can deduct up to $50,000 a year as a person, $100,000 as a couple, from losses in small businesses that you have invested in. It was amended in 1978. Prior to that, it was $25,000 and $50,000. As of 1978, prior to that, the size of the company had to be $500,000 in capital. It was raised in 1978 to $1 million in capital. That is the capital limit at the time that you invest.

At the Global Goals Institute with Dr. Kling, we have held meetings and we have not found anybody who is opposed to raising those limits. We think it is appropriate. Just on an inflation basis, they ought to be doubled.

So from a tax point of view, and I have been speaking to folks on the Committee to try to push this forward. I would be very interested in your ideas, because I think as an investor, you not only think what happens if it works out, can I save some money on gains—I can see Douglas is enthusiastic about this——

[Laughter.]

Mr. WIESEN. But what about those losses? If you can write off the losses against ordinary income and not just against capital gains, I think it is a tremendous incentive.

In this paper that I have prepared today, I have a bunch of other ideas and most of them go to how to link into infrastructures. I know that at Financial News Network, if I had not brought Merrill Lynch, a firm of very great repute 20 years ago, anyway——

[Laughter.]

Mr. WIESEN. ——If I had not brought Merrill Lynch in as an early investor to Financial News Network, we would not have had our studios, our advertising, and many things. And at Tofutti, if I had not been able to do a national distribution deal with Häagen-Dazs, you would not see any Cuties in the supermarkets. So these were two complete start-ups that depended upon linking into existing business infrastructures, and I think that at another hearing at another time, we ought to think about how—and I have ideas here of how to encourage small businesses to be able to link into existing business infrastructures.

[The prepared statement of Mr. Wiesen follows:]

5.49.

Presentation of
Professor Jeremy Wiesen
Stern School of Business
New York University

"ENTREPRENEURSHIP TO THE RESCUE!"

at the
Roundtable Program on
"Unleashing the Power of Entrepreneurship:
Stimulating Investment in America's Small Businesses"

Small Business and Entrepreneurship Committee
United States Senate
May 22, 2002

Contact: Prof. Jeremy Wiesen
Stern School of Business
New York University
40 West 4th Street
New York, NY 10012
212-998-0052
jwiesen@stern.nyu.edu

## ENTREPRENEURSHIP TO THE RESCUE

### INTRODUCTION:

1. Decline in venture capital. The Senate Committee on Small Business and Entrepreneurship has a propitious concern for the decline in capital available for new businesses and a desire to seek innovative solutions. New businesses have created a preponderance of the new jobs since 1980 and are needed to counteract today's bad economic news--unemployment at 6%, budget deficits in New York City and California of $6 billion and $20 billion respectively, and over 1,000,000 new college graduates who may not find employment. It is appropriate to consider: "Entrepreneurship to the rescue!"

2. "Hyper-tech" era. The new businesses with the greatest potential to make a significant difference to the national and world economies are developing innovative products and services, often based on new technologies. In a "hyper-tech" era, one that experiences a great velocity of scientific change, it is difficult for investors to perform definitive "due diligence" on investment opportunities because technologies are leap-frogging each other, making businesses obsolete at a rapid pace. In these circumstances it is more important than ever to assist venture capital investors by helping them to diversify their investments, to tax their successes while cushioning their failures, and to find ways to provide entrepreneurial infrastructure to young companies.

### REASONS FOR CAPITAL SCARCITY:

Venture capitalists are balking at making seed investments in small businesses for the following reasons:

1. Exiting angels. Angel investors, hurt by investing in failed high-tech companies, are not anxious to invest in new businesses. The pendulum has swung from investing in anything without wanting to see a business plan, to disinterest in funding start-ups regardless of their documented merit.

2. Venture capital firms act like LBO firms. Professional venture capital firms, also hurt in the internet bubble bust, are more than ever spurning seed money investments and looking to invest in mature companies, acting more like leveraged buy-out firms.

3. Less capital to venture firms. Many venture capital firms are returning investor's money for lack of companies that meet their investment criteria. Concurrently, institutional investors have reduced investing in new venture partnerships because of their recent poor returns.

4. Bad IPO market diminishes expectations. The bad public offering market reduces the prospects of exiting a private investment through an IPO.

5. Disillusion with start-ups. The internet bubble bust has had an impact on many elements of start-up activity. For example, a New York City monthly networking breakfast for budding entrepreneurs and service providers that grew quickly from 40 attendees at $40/person to 400 persons at $100/person has been cancelled indefinitely.

**PROPOSED SOLUTIONS:**

1. Increase limits on IRC Section 1244. Section 1244 of the Internal Revenue Code permits individuals to deduct losses of $50,000 ($100,000 for a couple) per year from ordinary income from investments in small companies that had raised no more than $1,000,000 in capital. These limits should be increased, perhaps significantly, after a study of the tax revenue impact. Section 1244, adopted in 1954 at half the present limitations, was last amended in 1978, so an immediate doubling of the limits would not only be below inflation but also in keeping with prior congressional action.

2. Publicly held venture funds. "Business development company" legislation passed in 1980 promotes the creation of publicly traded vehicles that make venture capital investments. Through this means angel and smaller investors can participate in the hyper-tech era on a diversified, professional and liquid basis. BDC's have not proliferated and need further encouragement.

3. Stimulate IPO market. Venture capital needs to have a new-issues market for smaller companies as an exit for their investments. This requires the return of small and medium-sized underwriters along with investor confidence. Reducing the capital requirements for firm-commitment underwritings might be a solution.

4. Expand government funding. It is difficult to get SBA loans. For example, at President Bush's town meeting in Orlando in December several people in attendance were very critical of the paperwork needed to get an SBA loan. New "mini," and larger "maxi," loan programs should be initiated. It should not be harder to find institutional seed money in the U.S. than it is in Bangladesh and South Africa, two countries that have focused on getting capital to people who want to start new businesses.

5. Focus on franchising. Uniform state franchising laws could be aimed at reducing the delays in selling franchises in states such as California and New York. Franchising is very helpful to entrepreneurship because it provides almost every kind of infrastructure for the new enterprise, from education to financing.

6. Tap pension funds for corporate venturing. ERISA regulations could permit pension funds to invest in corporate venturing programs, creating the ultimate value-added investor. Big companies have what entrepreneurs need--knowledge, contacts and facilities for marketing, manufacturing and distribution.

7. Incubation and mentoring. Promote incubation and mentoring of new businesses by harnessing the resources of colleges and national mentoring organizations. High schools and colleges should offer entrepreneurship courses. Find ways to foster strategic alliances with established companies.

8. Eliminate additional barriers to entrepreneurship. Coordinate governmental activities that relate to entrepreneurship: Federal Reserve Board processes that can hamper economic growth; assistance to the development of technology--the subject of many of the most innovative and important new businesses; and, exemptions from any rules that discourage the issuance of stock options when assembling an experienced team in a young company.

**CONCLUSION**

Entrepreneurship is an egalitarian and empowering activity which is important to the United States--indeed the world. Building new businesses has proven its importance to the U.S. economy and is now recognized as an important part of our foreign policy.

Empirical results show that anyone can be a successful entrepreneur if the task matches their capabilities and they acquire the necessary assistance.

The Committee's efforts at finding ways to bring more capital to small businesses is particularly important at this time to counter the business negativity that lingers from the internet bubble bust, exacerbated by the corporate governance and disclosure problems of the past year.

***JEREMY WIESEN*** *is Associate Professor of Business Law and Accounting, Stern School, New York University and held permanent professorships at Columbia and Wharton and visiting positions at Stanford, UCLA, Berkeley, Monash University in Australia and the Cyprus International Institute of Management. He was Counsel to the Commission on Auditors' Responsibilities ("the Cohen Commission"), a member of the staff of the U.S. Securities and Exchange Commission and the AICPA's Committee on the Perpetration and Detection of Fraud. Professor Wiesen was Chairman and Co-CEO of the Financial News Network (acquired by CNBC), a founder of Tofutti Brands Inc., and with Dr. Christian Kling a co-founder of The Global Goals Institute which attempts to find innovative solutions to unaddressed world problems. He is a graduate of The Wharton School and Harvard Law School.*

Ms. FORBES. Thank you.

Richard Newpher.

Mr. NEWPHER. Thank you very much, Patty. I appreciate the Senator putting together this meeting and giving us an opportunity to speak.

I am Dick Newpher with the American Farm Bureau Federation, and I am not part of the farm team that has been mentioned here a couple of times. I wish I were. It would at least represent that I was a lot younger than I am.

[Laughter.]

Mr. NEWPHER. But I am with the American Farm Bureau and we have 5 million member families across the country, not all of whom are farmers. There are not 5 million farm families in America. There is probably somewhere around 2 million. We do appreciate very much the concern that is expressed with regard to capital and the concern that is also expressed with regard to taxes and capital gains taxes and estate taxes especially.

You know, agriculture has traditionally lived off the value of its property, the equity in its land and the holdings to raise capital. Most of my life and most of the history of American agriculture, bankers were quite willing to que up with money because they knew that there was a piece of land out there that had the ability to be sold and recover the loan and so on.

We are rapidly finding in agriculture that that is changing. Our margins are getting smaller. Our debt loads are getting sufficient that the bankers, especially given the fact that about every 10 to 20 years you have a break in the land prices in agriculture, the bankers are not quite so eager to lend us money as they had been, and so we have a great interest in the capital as an existing business. We do not fit the description exactly for new and emerging and things of that nature, but we are a very critical business to rural America.

The bills, and I would like to echo a little bit about what Robert Hughes said in the one specific bill, to make sure that any legislation like this is available to sole proprietorships. We are, by and large, partnerships, sole proprietorships, Subchapter S corporations. We do have agriculture corporations, which you read about in the paper as being the nasty people in agriculture and taking over the world, which is another myth that needs to be dispelled. But we need to make sure that when we look at these things, we look at all the business structures that might be about in our land and especially in agriculture, which are predominated by those types of structures.

We have, I think, many needs, especially with regards to tax legislation. We have numerous examples of strong agricultural businesses that, because of the death of the principals in the business, had to be highly mortgaged and/or partially sold in an effort to keep it going for the next generation. It was mentioned earlier, for a country to do damage through its tax code to existing viable businesses is probably worse than not passing new legislation to help us in the future.

In the capital gains area, we very often are stopped from restructuring, changing our businesses in ways that would make sense for us in rural America and in agriculture because the changing of selling of assets, when our assets are principally land, causes us to have capital gains liability and so we resist change as a result of having tax liability, and that is another, I think, travesty of the tax policy that should be changed and should be eliminated.

If you go into the specific legislation, S. 1903, we have a request for, in agriculture, and we have a couple of bills in agriculture that could very easily be merged with these bills that would enable agriculture to set aside 20 percent of its net income per year in an account that could be taken back into the cash stream anytime in the next 5 years, and you could do that for 5 successive years, and then at that time it would become subject to tax automatically.

Those kinds of things to help us to help ourselves and not, when we have a good year, take the tax off the top, and when we have a bad year, there is nothing there to income average and help with our tax responsibility, is another area that we could very easily, I think, help, either by amending into S. 1903 or passing individual legislation.

In addition and in closing, I would encourage, as was encouraged earlier by Darrell McKigney, that we need, and we have had significant tax policy change. We need to make sure that that tax policy remains in place and that we make especially the estate portion of that tax policy permanent so that we can rely on our businesses being passed from generation to generation.

I thank you for the hearing and we will be here the rest of the afternoon.

Ms. FORBES. Thank you very much.

We have been joined by the Committee's Ranking Member, Senator Bond. Thank you.

**OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, RANKING MEMBER, COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP, AND A UNITED STATES SENATOR FROM MISSOURI**

Senator BOND. Patty, thank you very much, and thanks to all of you for coming out for this very important discussion.

I have to apologize, because as so often happens in the Senate, this is the "Perfect Storm" day for me. I was looking forward to being here, but the Smithsonian this morning had its initial kickoff of the major effort to collect all the artifacts from September 11 and bring together the pictures, the clothes worn by heroes who rescued living survivors from the Pentagon, a tremendous array of information and memorabilia and information that is already coming in, and I had sponsored last winter the legislation designating the Smithsonian as the central repository. I felt that I had to be there for that, and I have two other things going on.

I am relying on Mark and Patty and the others to keep us up to speed on what happens here, but I am going to have to express my sincere thanks, tell you a few brief things, and then excuse myself. I think it is extremely important that we have this discussion for all of us, through our staffs, to learn about how we can increase the access to capital for the entrepreneurs who keep this country growing.

I think last summer we made great progress in easing the capital drain by reducing tax rates. Some 20 million small businesses are taxed on personal rates through proprietorships, partnerships, and Subchapter S corporations, and that means that individual rate reductions do directly affect and help small business. That means that small business will be able to put that money back into purchasing new equipment. That means hiring new people, providing better benefits for those who are there.

The tax bill also addressed another capital drain by dramatically reducing the death tax, putting it out of its misery in 2010, meaning that we save in small businesses, in very many instances, hundreds of thousands of dollars in estate planning costs currently incurred to try to figure out how to keep the business or the farm going when the owner dies.

Now, as a lawyer—actually, I am a recovering lawyer. I am in the 12-step process——

[Laughter.]

Senator BOND. I know that lawyers and accountants benefit greatly from estate planning, but we can find something else for them to do if small businesses and farms do not have to spend that much money trying to avoid this estate tax.

With all of the strengths of the United States Senate, however, we do have a procedural problem. We did not get to the 60 votes that we needed to extend the effective date of that tax bill and I would hate to see, like some Frankenstein monster, the tax rates rise from the grave in 2011 and penalize anybody who did not have the decency to die in 2010. It seems to me a rather macabre tax impact.

But also, let me point out one other thing that will, we think, bring money into the entrepreneurship of small business. The Small Business Investment Company Capital Access Act of 2000 will permit and encourage tax-exempt investors like pensions and endowment funds to invest in small business investment companies. Currently, the tax law imposes a special tax on investment earnings by tax-exempt institutions and that puts about 60 percent of the private capital potentially available for starting up small businesses off the table.

There has been a significant contraction in the amount of money available, namely, the capital available in the private-equity market, and during the time this SBIC program has taken on a significant role. We think that this change in the tax code to permit tax-exempt entities without penalty to participate in the SBDCs would pave the way for much more investment capital to be invested and to be made available for small businesses.

In closing, I urge you to look outside the tax system to stimulate investment in small business. We need to make the tax code simpler and the least burdensome possible, but we also need to be sure that we do not impose other burdens on small businesses and farm enterprises through regulatory efforts or activities that make small businesses and farming unprofitable.

So with that, I leave you with thanks and my best wishes for a continued productive discussion, because these roundtables do help us refine and define the issues that we are going to pursue on the floor of the Senate. With that, again, I am going to have to beg your indulgence as I go on to the third of my four responsibilities this morning, so thank you very much.

[The prepared statement of Senator Bond follows:]

**SENATOR CHRISTOPHER S. BOND**
**RANKING MEMBER**
**COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP**
**OPENING STATEMENT**
**"UNLEASHING THE POWER OF ENTREPRENEURSHIP:**
**STIMULATING INVESTMENT IN AMERICA'S SMALL BUSINESSES"**
**MAY 22, 2002**

Good morning and welcome to the Committee's roundtable on access-to-capital issues affecting small businesses. It is a pleasure to have such a broad cross section of the small business community represented today as the Committee continues its tradition of exploring the needs and concerns of small businesses in the area of capital access.

I am also pleased that the discussion this morning is focusing on how access to capital can be improved through the Federal income tax laws. Last summer we made extraordinary progress in easing the "capital drain" on most small firms simply by reducing the tax rates. According to the Internal Revenue Service, more than 90% of small businesses with gross receipts of less than $1 million are pass-through entities – in other words, businesses that are taxed only at the individual owner level. Consequently, the individual-rate reductions included in the President's tax bill are cutting the taxes paid by sole proprietors, partners, and S corporation shareholders.

So what does this have to do with access to capital? Simply put, with more of their tax dollars in hand, these small business owners will be able to reinvest in their businesses – purchase new and more efficient equipment. They will be able to expand their product lines and the services they render. And – most importantly – they will be able to continue creating more jobs in our home towns!

The President's tax bill also addressed another major capital drain by dramatically changing the death tax and putting it on the road to extinction by 2010. Too often we have heard about the family-owned company that has had to be sold just to pay the death taxes. According to the Small Business Administration (SBA), more than 70% of all family businesses do not survive through the second generation and fully 87% do not make it to a third generation. That is an absurd result of the tax code.

But we are forgetting an even greater problem caused by the estate tax. Thousands of small businesses in this country waste millions of dollars each year on estate planning and insurance costs just to keep the doors open if the owner should die. Again, these are dollars that could be used to expand the business and create more jobs in our communities.

With all of its strengths, however, the tax bill has one major flaw – procedural rules in the Senate forced it to be limited to a ten-year life. So, while America's entrepreneurs can enjoy the benefits of the tax bill today and over the next several years, our work is not finished. We must make the tax cuts, and in particular the repeal of the estate tax, permanent! Otherwise, our success in reducing the tax burden will turn into the largest tax increase in American history come 2011. That is a result I hope never to see and will devote my best efforts to avoid.

Access to capital for small businesses can also be significantly improved through a simple change in the tax laws. Earlier this year, I introduced the "Small Business Investment Company Capital Access Act of 2002," with the goal of increasing the amount of venture capital available to small businesses through the Small Business Investment Company (SBIC) program administered by the Small Business Administration (SBA).

SBICs are government-licensed, government-regulated, privately managed venture capital firms created to invest only in original issue debt or equity securities of American small businesses that meet size standards set by law. In 1958, Congress created the SBIC program to assist small business owners in obtaining investment capital. Forty years later, small businesses continue to experience difficulty in obtaining investment capital from banks and traditional investment sources.

Although investment capital is readily available to large businesses from traditional Wall Street investment firms, small businesses seeking investments in the range of $500,000 to $3 million have to look elsewhere. SBICs are frequently the only sources of investment capital for growing small businesses.

During the past two years, there has been a significant contraction of the private-equity market. During this same period, the SBIC program has taken on a significant role in providing venture capital to small businesses seeking investments in that $500,000 to $3 million range.

So what is the problem? While Debenture SBICs qualify for SBA-guaranteed borrowed capital, the government guarantee forces a number of potential investors, namely pension funds and university endowment funds, to avoid investing in SBICs because they would be subject to tax liability for unrelated business taxable income (UBTI). More often than not, tax-exempt investors generally opt to invest in venture capital funds that do not create UBTI. As a result, 60% of the private capital potentially available to these SBICs is effectively "off limits."

The "Small Business Investment Company Capital Access Act of 2002" would correct this problem by excluding government-guaranteed capital borrowed by Debenture SBICs from debt for purposes of the UBTI rules. This change would permit tax-exempt organizations to invest in SBICs without the burdens of UBTI record keeping or tax liability.

This legislation is important for one simple reason: once enacted it paves the way for more investment capital to be available for more small businesses that are seeking to grow and hire new employees. According to the National Association of Small Business Investment Companies (NASBIC), a conservative estimate of the effect of this bill would be to increase investments in Debenture SBICs by $200 million from tax-exempt investors in the first year and $400 million in the second year. Government-guaranteed SBIC leverage commitments equal to $400 million in year one and $800 million in year two would be added to the private capital. Thus, total year one capital available for investment would equal $600 million and total year two capital would equal $1.2 billion.

Moreover, data developed by Venture Economics for the period 1970-1999 indicates that one job is created for every $22,600 invested in a small company. At that rate, this bill could be responsible for the creation or support of as many as 62,000 jobs within the next two years, whether within companies receiving investments directly or within those firms benefitting indirectly through increased sales of goods and services to the former companies.

And the cost? Industry experts estimate that if the change were effective now, there would be less than a $1 million in lost tax revenues. About $1.5 billion in private capital is invested in Debenture SBICs. A NASBIC poll of Debenture SBICs indicates $30.3 million of that amount is from tax-exempt investors. For the previous 10 years, Debenture SBIC returns have averaged 7.78%. Applied to the $30.3 million, that would result in lost taxable income of $2.36 million per year. If all of that were taxed at the top 39% rate, the tax revenue loss would be $922,000 per year.

The "Small Business Investment Company Capital Access Act of 2002" will provide sorely needed capital for the sector of our economy that provides about 75% of the net new jobs small businesses. And it will allow the SBIC program to continue its extraordinary record of providing critical financing to Main Street America small businesses. Many one-time small companies like Federal Express, Intel, Outback Steakhouse, America Online, and Callaway Golf have benefitted from the program. But it also benefits thousands of companies we know from home towns all over the United States, like Steelweld Equipment Company, in St. Clair, Missouri. These Main Street companies provide both stability and growth in our local business communities.

Today, the SBIC Program is expanding rapidly in an effort to meet the growing demands of small business owners for debt and equity investment capital. And it is important to focus on the significant role that is played by the SBIC program in support of these growing small businesses. When Fortune Small Business compiled its list of 100 fastest growing small companies in 2000, 6 of the top 12 businesses on the list received SBIC financing during their critical growth year. These firms will be the beneficiaries of the "Small Business Investment Company Capital Access Act of 2002."

In closing, let me leave you with an important issue to consider. Increasing access to capital is critical for the survival of America's small businesses today and those that will follow in the days and years to come. But if we use the tax code to accomplish that goal, we run the risk of adding even more complexity to the nearly incomprehensible tax system that exists today.

Accordingly, I urge you to look outside the tax system for ways to stimulate investment in small businesses. At the very least, if the tax code must be involved, look for the simplest and least burdensome approach possible. It makes no sense to provide capital with one hand and simply take it away with the other through higher taxes and compliance costs.

Again, thank you for participating today and for providing the Committee with your invaluable insight into this matter and its effects on the small business community.

Ms. FORBES. Thank you, Senator Bond.

Duane McKnight.

Mr. MCKNIGHT. Good morning. I am sort of wearing two hats here today. I am general partner with Syncom, which is a venture fund that has been around since 1977, and also as Vice Chairman of the National Association of Investment Companies, which is a private equity organization that has about 35 members, about $1.2 billion in capital currently in its membership, and these firms focus primarily on underserved markets in venture capital, primarily minority entrepreneurs, women, and similar opportunities.

Just listening here, I just wanted to also follow up on Mr. Esparza's comments. The capital access issue is not an equal opportunity problem in many respects, not only from a minority standpoint, but also from a gender standpoint and, to some degree, a geographical standpoint, as well. We even heard that there are some issues with respect to the type of corporate structure you may have. There are some people with different corporate structures who also do not have capital access because of that structure.

I say that to suggest that any legislation that is put in place, a blanket legislation that is put in place to try to address some of these intricate issues that we have, needs to address some of the things that are particular to certain groups in the capital access scenario.

Also, we have talked mainly about small business growing organically, and as you know, small businesses can also grow from an acquisition standpoint, and I think tax legislation with respect to giving access to opportunity plays a large part in the drawing capital to small business, because many times, the opportunity to grow that is not there that restricts the capital from flowing. That could be primarily in the form of if a small business wants to acquire another company, where that company would receive some sort of capital gains deferment upon selling, would rather sell to a small business, give a small business an opportunity to buy that company as opposed to a large business.

As you know, the small business that would probably buy that company would probably maintain those employees. A large company buying that same company would probably RIF most of the employees under that scenario. So if there was some ability to allow small business to acquire a company, the acquiring company's shareholders are able to defer tax or even have a tax reduction would go to a large extent of allowing small businesses to grow in that fashion, as well.

Ms. FORBES. Okay. Thank you very much.

I am going to call on Lee Mercer, Kathy Freeland, and Dean Garritson, and then we will sort of close out this first section and move on to the second, so if you want to be looking ahead a little bit and seeing if you have any particular comments you would like on the record having to do with tax considerations affecting capital and labor investment decisions. I think some of you have touched on this, but that is where we are going next.

So with that, Lee.

Mr. MERCER. Thank you, Patty. I am Lee Mercer with the National Association of Small Business Investment Companies. I would like to thank Senator Kerry and Senator Bond for all that they do to help our program and in so doing to help small businesses. Regarding Senator Bond's statement, I should note that Senator Kerry and Senator Bond both have introduced separate pieces of legislation that actually do the same thing, which would make it easier for debenture SBICs to raise money from tax-exempt investors by declaring that debenture indebtedness is not acquisition indebtedness, which automatically creates UBTI for a tax-exempt investor.

Why is this important? I want to kind of go back to something that Mr. Von Bargen stated. He said, most VCs do not invest below $3 million. The SBIC program does. That is, in fiscal year 2001, SBIC investments actually represented 55 percent of all venture capital transactions in this country and the average investment size was $1 million and the median investment size was about $300,000. Now, that is 55 percent of transactions. It is probably only about 15 percent of the money, but it is a large number of transactions.

Does it solve the problem? No, it does not solve the problem, which is why the BRIDGE Act, I think, is an interesting proposal and why we were one of the first, I think Mr. Tatum would say, we were one of the first to sign on as supporters of it. If you look at what it does, (A) it is a very efficient way to get capital to fast-growing companies if the government decides that they want to support that group, requiring no costly infrastructure to do it.

It is, in essence, if you look at the deal flow problem from both the venture capitalists' point of view, and from the small business's point of view that is trying to raise money, the venture capital professional may be able to look at 200 deals in a year, but only 30 or 40 of those that they get interested in, and maybe only 15 or 20 of those would they actually do significant due diligence on, and that one professional would then make perhaps three, at most four, investments in a year.

So what that tells you is that if you just get down to the 15 or 20 where the venture capital professional is doing serious due diligence, those companies merited some support, probably, some level of support. They were growing fast enough so that the venture capitalist was willing to spend a significant amount of time investigating them and did not choose to—only chose to invest in three out of the 15, but those other 12, if they were growing fast enough, the BRIDGE Act would be a substantial help, and I know I am kind of blending between A and B.

The other thing that I would like to say is in the 6-plus years that I have been at NASBIC, and I was a practicing lawyer for many years a long time ago—I guess I am a recovering lawyer, too.

[Laughter.]

Mr. MERCER. The thing that strikes me as a hurdle for small businesses is that I am continually amazed at how few small businesses that actually have good stories to tell do not have a business plan that is in a format that will allow venture capital professionals to digest it quickly so that they can put it into this 200 down to three formula that they use. I mean, that is a true hurdle. I get business plans, what people purport to say are business plans, at my office all the time asking me to forward them to SBICs and they are just not—you cannot do it. So that is a real hurdle, and

I do not know the answer to the question other than the fact that I have always suggested that SBA needs to do as much as they can to solve that problem.

Ms. FORBES. Okay, thank you.

Mr. MERCER. One more thing. I would note that People Solutions, which was one of the stories, is last year's SBIC and NASBIC Portfolio Company of the Year, and a great success story for everybody concerned.

Ms. FORBES. Thank you for making that additional point.

Kathryn Freeland.

Ms. FREELAND. Good morning. My name is Kathryn Freeland. I am a CEO and sole shareholder of RGII Technologies. We are an information technology solution provider primarily to the Federal Government marketplace.

My journey to entrepreneurship was much like many of the stories that have been told today, especially with the one that Mr. DeMint mentioned earlier this morning, as well. RGII started out bootstrapping $3,000 and a lot of credit card debt, and I must say that that is the way many small businesses begin, especially those small businesses that happen to be minority small businesses, the Latino community, the African American community, the women-owned business community. We tend to have to start that way.

But I must say that without the SBA, and many of us do turn to the SBA because maybe we do not have all the information that we need or the access to the venture capitalists or we may not want to give up the ownership in our small businesses that we are trying to grow from ground zero at that time, we end up going to SBA for assistance, and I must say, without SBA's assistance, RGII would not be where we would be today.

RGII is a $30 million company now, almost 350 employees, but the challenges along the way to get us there mostly centered around access to capital. And so even though we had access to the marketplace, the government contracts and what have you, financing those government contracts was a challenge. We could win them, but how could we support them?

And so, again, the BRIDGE Act, and as Mr. Warren mentioned, how do you help those microsmall businesses that they may not need hundreds of thousands of dollars, they may just need $10,000 to $15,000 to $25,000 just to get them started.

So I would implore looking at the BRIDGE Act and making certain that we are including those microsmall businesses in the mix. Is it really centered around helping all levels of small businesses and not just those who have reached the peak where that $250,000 tax relief may be of assistance.

So in the midst of all of that, again, the banking community is not taking the risks. They were not 12 years ago when RGII started and they still are not today, and so we do need the additional assistance to help those small businesses that are trying to get from point A to point B to really make their dreams a reality and what their business plans, as Mr. Mercer said, are stating.

So I thank you for the opportunity to come and talk to you today.

Ms. FORBES. Thank you very much.

Dean Garritson, you have been very patient. Thank you.

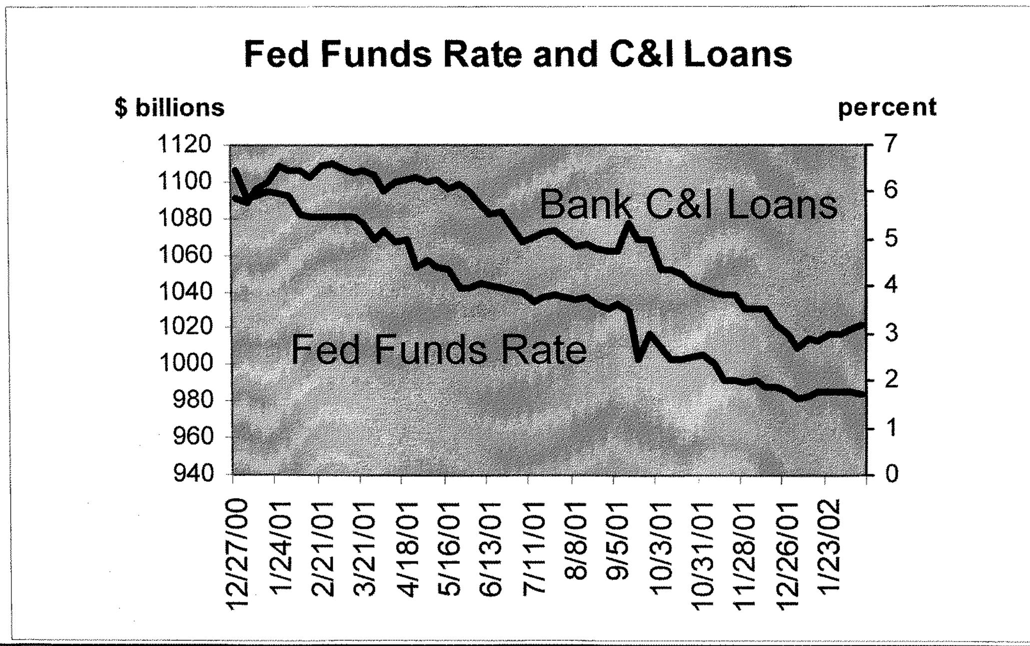
Mr. GARRITSON. Hi. I am with the National Association of Manufacturers, and while most folks might know that we represent some 85 percent of industrial output, fewer people know that the NAM represents, or 80 percent of the NAM's members, almost 85 percent, are small manufacturers, and the average small manufacturer at the NAM is about 80 employees.

What we have found is a different problem with access to capital than some of the issues raised today, but some have hinted at it, Todd and others, and that is that the access to capital from the current lending community and the traditional lending community, banking, is significantly restricted.

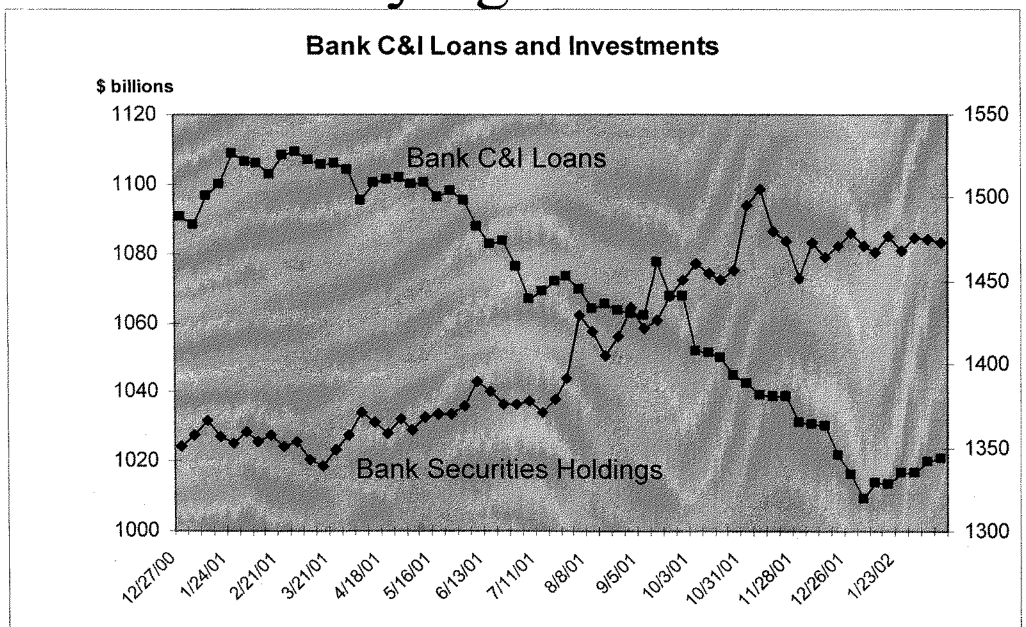
I have got just one chart. I will pass it forward. You can see the first number is the Federal funds rate and the second line going the same direction is actually the nature of commercial and industrial loans. So while the rates for money are getting cheaper, the loans are not getting through.

[The charts submitted follow:]

# Cheap Credit Not Getting Through



# Banks Switch From Lending to Buying Securities



There are three numbers that kind of explain that. One is during the last calendar year, $70 billion was taken in by the banking community, and I am sorry the banking community is not here because they are going to hear me not beat up on them at the end of this. But of that $70 billion that they took in, what did they do with the money? As it turns out, $70 billion was restricted or reducing commercial industrial loans and $140 billion went into Treasury. That is not good for the entrepreneurial and manufacturing community, which is a very highly capital-intense community.

But what we have found, that despite the decreasing interest rate, the dollars are not flowing, but we are not beating up on bankers. We have heard enough from the banking CEOs of small and medium-sized banks, regional banks that service more than 80 percent of our members, is that the regulators have come to them with a rather broad swath and told them in no uncertain terms to reduce lending to certain SIC codes. We find that to be way too broad a sweep. In fact, we described it, or some of our partners in this fight have described that as while the Comptroller at Treasury has gone out witch hunting, they have just got a couple of folks sweeping the front porch with a broom, and it is entirely true.

The regulating community, from the Comptroller at Treasury, is a little too harsh and a little too broad and a little too bureaucratic to be able to provide individual lending to individual enterprise levels, and we find that regulatory structure to be overly reactive in a down-cycled economy.

It will not surprise anybody to tell you that we have got some thoughts on taxes, but I am going to hold on to those for the second half of this.

Ms. FORBES. Thank you very much.

## TAX CONSIDERATIONS AFFECTING CAPITAL AND LABOR INVESTMENT DECISIONS

Ms. FORBES. Let us move ahead to the second portion. We are not exactly sticking to the time, so we may have to cut this a little bit short because I know that the Chairman wants to hear your views on the two bills that he has introduced, especially if you have recommendations on broadening them, some of you have mentioned that. So why do we not turn to the tax considerations affecting capital and labor investment.

There were some questions that we would like to hear from you, especially those of you that are representing large groups. What are the primary tax considerations that small business must make when determining to make capital or labor investment decisions and how do these differ, and you have the manufacturers, you have those self-employed, you have other groups that might—we are sort of trying to figure out if there is like a one-size-fits-all solution.

Mark.

Mr. WARREN. Let me just add one other kind of question to the mix. We heard from a lot of the groups here at the end of last year and the beginning of this year that there was a lot of progress made with Treasury's announcement of the new $10 million threshold for cash accounting. I think that that change, especially for the microsmall business starting out, is a significant improvement in terms of reducing complexity and burden.

I wonder, given some of the proposals out here that would require accrual accounting, is that going to be a significant hurdle imposed by the tax system?

Ms. FORBES. Mr. Culpepper.

Mr. CULPEPPER. I am Lee Culpepper with the National Restaurant Association and I just want to make a quick point under topic two: Tax Treatment of Capital Investments.

Restaurant buildings are currently depreciated over 39-and-a-half years, which is an absurd schedule. The average restaurant is renovated every 6 to 8 years, and that is just one example, I think of the depreciation schedule overall that is really not well thought out. It is based more on politics and it is based more on needs in terms of the budget than it really is on the useful life of property.

So in terms of something that would help restaurants, and perhaps small businesses in the country at large, an update of the depreciation schedule to comport more with what is accurately going on in the economy would be very helpful.

Ms. FORBES. Thank you.

Ben Cooper.

Mr. COOPER. Thank you, Patty. I am Ben Cooper with the Printing Industries of America. It is interesting to be here with high-growth companies. Printing is a little bit different situation. We are a roughly 500-year-old industry and continue to do reasonably well, but kind of reaching for the first time in that 500-year-period a bit of a downturn. One of the issues that we think about with this is to what degree does the government become a partner or an impediment?

I recall back in the early 1980s when one of our industry's favored tax themes, the investment tax credit, was eliminated. One reason it was eliminated was because companies, including companies in our industry, were making equipment purchase decisions not based on growth, but based on the tax code.

We have some similar kinds of problems now, only in reverse, and that is that the tax code has become an impediment and it has almost no bearing on reality, similar to Lee's situation. I think one aspect of the tax code that borders on comical is that we are still carrying a 5-year depreciation schedule on computers while we allow software, and this is even absurd, to be depreciated over 3 years. I am not sure how many of you could justify that. And when we say computer, it is entertaining to look at the tax code because among the things the tax code actually classifies as computers are calculators and similar office machines. What means is they really have not reexamined the term "computer" since the late 1970s.

But to carry a computer on your book or any kind of computer system for 5 years, it is comical. That tends to benefit larger companies, who tend to lease and can turn the equipment over. As you move down the scale of companies, they are not leasing, they are buying, and most of our members are maybe of a nature and generation where they do not tend to throw things away, so because they do not dispose of it in a rational way, even though they may have it in the closet, it may be holding plants or what else, it is still carried on the books.

We have been working on this issue, I think, for—I think this is the seventh year. We were pleased to see the 30 percent bonus depreciation because that helped a great deal.

One of the things, and I know NAM shares our views on this, it is a little frustrating because the emphasis, not in this group, but the emphasis you hear in the economy on the high-tech sector, somebody is buying that high-tech stuff and it is manufacturing companies. If we do not buy, they do not sell, and if the tax code is an impediment to buying, they are not going to sell. So I think we have to start looking at this thing as a bit more of a partnership.

We were very disappointed and have been disappointed for several years that the Congress has not been able to take a look at depreciation schedules. I am actually at the point now where I would go back maybe several decades and say that we probably should do away with the corporate income tax altogether and make things a lot simpler, but at the very least, what we ought to be doing is looking at more innovative ways to use depreciation, and maybe first and foremost to allow companies to take a schedule that makes sense for their business, not based on a schedule that the Federal Government sets out that seems to purport to some universe that is no longer rational.

Ms. FORBES. Thank you.

I am just going to ask Ryan McCormick to respond a little bit to your comments because I know that Senator Kerry and Senator Bond have a bill that addresses some of—or two bills.

Mr. COOPER. And there are many bills, yes.

Mr. MCCORMICK. I just wanted to say, I think Senator Kerry shares your concerns about depreciation schedules. I think that having accurate depreciation schedules greatly enhances the ability to encourage business investment and he was a strong advocate of the 30 percent bonus depreciation provision in the economic stimulus act.

We have included in S. 1676 a proposal to shorten the depreciation schedule for computers from 5 years to 3 years and for computer software from 3 years to 2 years. That is a start. I know there are a number of other items which also deserve consideration, but at least in terms of the high-tech equipment, we wanted to get started on that as soon as possible.

Mr. COOPER. Not to overstay my welcome here, but one thing to keep in mind, we are talking about computers, and I know you are aware of this, but we are not talking about PCs. In our industry, computer systems for relatively small companies, we find companies with 10 and 15 employees are spending hundreds of thousands of dollars in computer purchases and it is the type of equipment where our industry is going, and this is not unique in printing, it is true throughout manufacturing, where the computer technology, it pervades the manufacturing field now and it is that equipment that is in this 5-year category.

Ms. FORBES. So you are saying the definition needs to be looked at, not just the number of years?

Mr. COOPER. The definition is comical. You could not even identify a computer based on the definition that is used in the code now. You would not be able to recognize what you were dealing with. We have been working with Treasury, and I think that as a result of one of Mr. Archer's recommendations several years ago, there was a study done by Treasury on depreciation schedules, and to tell you the level to which this thing has come, they said that there was—this is almost a direct quote—anecdotal evidence that computers are depreciated faster than 5 years, but no empirical evidence.

I do not know what they were looking at, but to say that there is only anecdotal evidence that computers are turning over faster than 5 years is laughable. I do not blame them so much for that, it is just part of the system that we are in now that we cannot move these things quicker than we do.

Ms. FORBES. Okay.

Yes, Mark.

Mr. WARREN. Let me just add to one point that Ben raised. I think this is a classic example of the partnership issue, where you are buying technology. If Congress were able to both look at the definition and make the useful lives a little more reasonable, which is one of the things that Senator Bond set out to do at the beginning of this Congress with the 5-year reduction in the class life to 3 years for computer equipment, as well as to allow software to be depreciated quicker and also expensed, you get that partnership. In addition, you encourage better productivity and efficiency within the businesses and that spreads, as well, because then your customers are more likely to be buying from you, whether or not it is the IT community.

I think that is what Chairman Greenspan has said over and over again, that the productivity and efficiency of our manufacturing and our overall economy is the key to getting us back to a more robust economy, so that is a very good point.

Ms. FORBES. Thank you.

Doug Tatum.

Mr. TATUM. I was going to talk to you about the cash basis issue. I have a briefing here prepared by one of my partners, but that rule generally does not apply to manufacturers, wholesalers, retailers, publishers, and a variety of people that are around the table.

One other part, as I read it, indicates that it provides that the taxable income must be determined under the method of accounting on the basis for which the taxpayer regularly keeps income in keeping its books, and that might be a misinterpretation of that.

Mr. WARREN. The consistency requirement was removed in the final rule.

Mr. TATUM. Okay, because I was going to say, it is important that businesses look at their financial status under accrual and the banks and the capital markets require that, regardless of whether you are reporting on tax basis.

The other thing, back to your comment earlier, the BRIDGE Act, Angelia and Kathryn, would have applied to you probably your second year in business. So one of the case studies indicates that the opening second year of business, the company was at $100,000 in revenue. So it is the accumulation of a quarter-million dollars up to $10 million, but it allows you to retain that capital even when you are small and growing, and that capital is extraordinarily precious in those early days, and so those are two issues that I wanted to comment on.

Mr. HUGHES. Just one third method, and that is percentage completion for contractors may need to be included, too.

Ms. FORBES. Okay.

Dean Garritson.

Mr. GARRITSON. Trying to find one-size-fits-all in a tax issue, good luck.

[Laughter.]

Ms. FORBES. I was not saying that that was the right approach. I was just trying to get you to identify the different approaches.

Mr. GARRITSON. Agreed. I was just thinking, to get 30 people around the table from different industries to agree that there is only one ox that should be fattened, umm. It is a difficult bill to try to fit, but I am wondering if we do not get there by some of the modifications of depreciation. We heard it from Lee and from Benjamin with their organizations. Depreciation, we all use similar schedules, despite the nature of the assets.

If you buy the notion that capital equipment spurs productivity and that productivity, given that labor growth can only grow at 1 percent per year for as far as the eye can see, so that productivity is the only way you are going to be able to get non-inflationary economic growth, then you are kind of straddled with the notion that you have got to be able to reduce the costs of capital assets over time, and that means in our tax code either access to capital at better rates or, more importantly when you look at the tax code and specifically this section of the discussion, depreciation. It just is not any more complicated than that.

And then broad-based depreciation that you supported, particularly the bonus depreciation, was extraordinarily helpful to a number of businesses. The capital equipment sectors of the manufacturers, we do not expect to expand much more in the way of capital equipment. Actually, we expect to spend a lot less than we did last year and last year was a bad year. So that sort of bonus depreciation that you were able to pass, very effective.

To continue that sort of depreciation discussion would be very much appreciated, at least in the small, medium, and the large manufacturing sector of the economy, but for our purposes as a small manufacturer that has no other place to go than either cash flow or the banks, we would like to see some help in the Comptroller of the Currency, and then the second half of that is the depreciation with respect to cash flow by virtue of lower taxation.

Ms. FORBES. Thank you very much.

Giovanni Coratolo.

Mr. CORATOLO. Thank you, Patty. Several things that come to mind when discussing investment decisions affecting capital and labor driven by the tax code, number one, certainty about tax code, and certainly we see the problems with the tax legislation that has been recently passed and its expiration within 10 years, and I think that has been mentioned. In order to make proper investment decisions, a lot of investors need to have certainty of those decisions over length of time or else it really undermines that investment and certainly induces a lot of risk in that decision making process, so that may scare away some of the capital.

We certainly proffer, which has been mentioned, the elimination of the estate tax, making that permanent after 2010, and also accelerating the Economic Growth and Tax Relief Reconciliation Act of 2001, trying to make that permanent, also. But also, making decisions, investment decisions on capital and labor, we really should address AMT.

The AMT unfairly penalizes businesses that invest heavily in plant and equipment and machinery. The AMT significantly increases the cost of that capital, discourages investment and productivity enhancing assets by negating many of the capital formation incentives provided under the regular tax code. So this is something that we do not normally look at, but still, it does add a layer of complexity in making those investment decisions that those investors have to take into account, and certainly we have to be careful of when we look at capital formation and those decisions that are spurred by the tax code.

Thank you, Patty.

Ms. FORBES. Thank you.

Susan Eckerly.

Ms. ECKERLY. I am Susan Eckerly. I am with NFIB. I work with Bruce.

I thought Dean raised a good point, particularly when Giovanni added a new tax item with respect to AMT. I think we probably have a pretty healthy list of tax cuts that all of our organizations would like, and one thing I think that would be good to look at is the calendar. We only have about, what, after the recess last week, there is June, July, and basically September, three legislative work periods, and I doubt much will happen in September other than the funding end game, in which to close out some of the tax legislative items that are already pending now for this Congress.

One thing that has already passed the Senate is the expensing limits that have been raised that are in Senator Bond and Senator Kerry's bills, and anything that both Kerry and Bond can do as leaders of the small business in the Senate to push those would be great because there is an opportunity, I think, to advance those before the end of the year, and there is already a lot of momentum behind those. I know particularly the Senate had a great vote on those.

And also, I mean, other folks have mentioned obviously the tax permanency. We have, hopefully, a vote coming up before the end of June on the death tax and those are things that already have momentum, already have been acted on this year that we can advance on, and although there are other items that are mentioned here that are good, hopefully, there are a lot of members represented by all our organizations and hopefully we can stir the grassroots to help sort of finish what we have already started so far this Congress.

Ms. FORBES. Okay. Go ahead.

Mr. WARREN. Just to keep us grounded with what Susan and Giovanni and others have said, a number of these tax provisions, while in and of themselves, they are discrete, they all do flow together into the whole access to capital notion. Going back, a number of people have said it before, I think Senator Bond, as well: the more that we do not demand that a business pay in taxes, the more capital that they have in hand to reinvest in equipment and grow their business and create jobs and keep jobs in this environment, especially for the microbusiness, the very small. That, I think, is a significant issue that warrants some discussion and for us to keep in mind.

Ms. FORBES. Mark Heesen.

Mr. HEESEN. I thank you. I just wanted to echo what Susan said in the respect that we have to look at this realistically about what can be done over the next 6-7 months, frankly, and a lot can be done at Treasury, and that is the Senate putting Treasury to do things that they have, frankly, not done for the last number of years, and when you look at Section 1045 on the qualified small business stock, that is something that the Senate certainly can put its foot on the ground and say, Treasury, you have been trying to work on regulations, or you have been saying you are going to be working on regulations for years. Depreciation is another example. Come January 1, 2003, like I said, without Treasury doing something or without pressure being put on the Congress, we are going to see another major tax increase on smaller companies.

These are things that can be done without legislation being passed and when you are looking at literally 40 legislative days between now and any legislation being passed probably in March of next year at the earliest, let us look at things that really can work in the very near term, and there are some very concrete things that can be done for the smaller companies and emerging growth companies by some little pressure on Treasury. Thank you.

Ms. FORBES. Okay. Thank you.

## POLICY PROPOSALS TO STIMULATE SMALL BUSINESS INVESTMENT AND CAPITAL FORMATION

Ms. FORBES. If there are no more comments on this particular section, I think we need to move on to the last section. Go ahead.

Mr. WARREN. What about the UBTI bills?

Ms. FORBES. Sure. Absolutely.

Mr. WARREN. The floor is also open for the change in the unrelated business income rules to allow greater investment by tax-exempt organizations into SBICs, since they are a significant funder of investment capital.

Ms. FORBES. And let me just say, we are very aware of how few weeks are left. It sounds like a long time, but we are trying to get—I mean, one thing about the BRIDGE Act, it does have bipartisan support in both Houses. So assuming—and Senator Kerry is on Finance, and Senator Snowe, who is the cosponsor here. So, hopefully, that will have a vehicle to go on. Obviously, it is probably not going to go by itself. I mean, it could theoretically, but it is pretty unlikely.

Similarly, on this UBTI piece of legislation, or there are different versions of it, but if we can get momentum on the House side, then maybe we can get—it is not that controversial, it is just complicated and that makes it a little bit tricky in terms of getting the Finance Committee people to include it in something, especially—in that case, it does not cost any money, but if a bill costs money, then you have got to overcome that hurdle, as well.

So we welcome your comments on the BRIDGE Act, the UBTI proposal, the Affordable Small Business Stimulus Act, particularly the capital gains incentives part of that.

Okay, Ben.

Mr. COOPER. Well, certainly, as we mentioned before, we support the provisions in the Small Business Incentive Act. Those are things we have been looking for for a long time.

One point about the expensing provisions which are in the legislation, which Susan also referenced, the levels right now are, frankly, so low that if you are in anything other than service or retail, you really cannot take advantage of it. There is a sense that that may be what it was intended for, but even moving up to the modest levels that it is moving up in the proposed legislation will allow small companies in our industry, and over half of our companies have fewer than 10 employees, it will allow those companies in certain years to be able to take advantage of expensing and I think that is very important, particularly in light of the difficulty in getting the depreciation schedules resolved.

So I do think that that is an important piece of legislation, and we really do not have a—I do not think the BRIDGE Act applies to our industry particularly well. I think that most of our folks would welcome an opportunity to have that sort of tax problem, to have that kind of profit. It does not exist in our industry. In fact, I think the goal in most of our smaller companies in our industry is to have even enough income to be taxed. We have almost the reverse problem. However, if these companies succeed and have to advertise, that would be a good thing. We would like that.

Ms. FORBES. Thank you.

Robert Hughes.

Mr. HUGHES. We, too, like the Act a lot. We think it will do a lot to stimulate microbusiness. We do have some concerns about the capital gain exclusion provisions on the sale of the stock, not so much from the way it looks on paper, because who could deny that that would be good. However, I think in actual utilization out in the field, the provision will have very limited usage and acceptance for these reasons.

The first is that when small businesses are sold, the professional is probably going to use a stock sale as the last choice. Typically, there may be an asset sale as opposed to a stock sale, and if so, this provision probably would not apply.

The second part of it is that the formation, the entity formation has changed significantly in the last 10 years. The entity of choice, in my opinion, today is the limited liability company as opposed to some other flow-through entity, like an S Corporation. In fact, few S Corporations are formed these days compared to limited liability companies, and it is not clear—I think it does not apply, but it is not clear that it applies to limited liability companies that operate as corporations but are certainly not taxed the same way corporations are taxed.

So if an entity was formed, the business was successful, operated 3 to 5 years, whatever the criterion ends up being, and then the business were sold, this provision would have no effect, and so in some way, that provision needs to be structured so that it will allow for the transaction to escape some portion of tax, not just a corporate entity.

Ms. FORBES. Everybody else just loves these bills and does not have anything else to recommend? Okay.

[Laughter.]

Ms. ECKERLY. Patty, just to give you a response with respect to the BRIDGE Act, our members sort of suffer the same fate as Ben's, and unfortunately, I do not think they would be able to take advantage of it at this point.

But certainly with respect to, I think it is S. 1676, there are several provisions in there that we support. I know Senator Bond has got some of those same provisions——

Ms. FORBES. Similar.

Ms. ECKERLY. ——And we would love to see—hope that that could proceed this year. I mean, particularly with respect to expensing, the depreciation schedules, to echo what Ben said, are complex. Our members generally expense and need to see those expensing limits raised to really—that would benefit them probably the most.

Ms. FORBES. Okay. Mark, do you have anything?

Well, thank you all for coming. You have raised some really interesting points and some really helpful points.

Jerry, did you want to say something?

Mr. FEIGEN. Just one quick thing. I know we are all going to be feeling the aftermath of Enron and the regulatory and the pendulum, which should occur and will affect all of us deeply when the pendulum swings the other way. I just think we really have to be on top of what changes the SEC and the Treasury Department. We worked 20 years to get certain exemptions in focus and respect and we need to live with the aftermath, but it should be based on what we say we can live with.

Ms. FORBES. Okay, and Giovanni wanted to comment?

Mr. CORATOLO. I certainly want to thank Senator Kerry for having this and Senator Bond. It is a terrific way to present our views and our thoughts and certainly the format is terrific, so we applaud your effort in this respect.

Ms. FORBES. Thank you very much. Thank you. Thanks everyone.

I will remind you, if you have written comments or if something occurs to you, we leave the record open for about a week after today, so let us say until the end of next week, if you have additional things you would want to submit. Thank you very much.

[Whereupon, at 11:36 a.m., the roundtable was adjourned.]

# LEGISLATION

United States Senate
COMMITTEE ON SMALL BUSINESS & ENTREPRENEURSHIP
WASHINGTON, DC 20510–6350

**Unleashing the Power of Entrepreneurship:**
**Stimulating Investment in America's Small Businesses**

Attracting sufficient capital to finance business growth and expansion is a constant concern of entrepreneurs and small businesses. The ways in which small and large firms obtain financing differ significantly, with small businesses heavily reliant on personal savings, private equity investors, bank lending, and venture capital. Public policy, including tax policy, can play an important role in ensuring that rapidly expanding, entrepreneurial businesses have access to the capital they need to continue creating jobs and stimulating the economy. Senator John Kerry, Chairman of the Senate Committee on Small Business and Entrepreneurship, has introduced two pieces of legislation which provide incentives for small business investment and growth.

**S. 1903, the BRIDGE Act**

The Business Retained Income During Growth and Expansion (BRIDGE) Act will provide aid to entrepreneurial firms financing their own growth and expansion. It is designed to help companies which lack the size or long track record to tap into capital markets. The proposal would allow small, fast-growing businesses to temporarily defer a portion of their federal income tax liability. The two-year deferral would be limited to $250,000 of tax, which would be repayable with interest over a four-year period. The tax-deferred amount would be deposited in a separate trust account — a BRIDGE account — at a bank or other approved intermediary, and the firm could borrow against the deferred amount, as collateral, for business purposes. Eligible firms' gross receipts may not exceed $10 million and the firm must have gross receipts that are at least 10 percent greater than the firm's average receipts for the prior two years. Amounts in the BRIDGE account could only be used as security for a loan to the business, for repayment of such a loan, or to pay installments of the unpaid taxes.

**S. 1676, the Affordable Small Business Stimulus Act**

Among other provisions, S. 1676 would provide capital gains incentives for equity investments in small businesses. The bill expands on Section 1202 of the tax code which provides an exclusion of 50 percent for capital gains from qualified small business stock held by individuals for more than five years. A qualified small business is a corporation engaged in an active trade or business whose gross assets do not exceed $50 million as of the date of issuance of the stock. The Taxpayer Relief Act of 1997 added a provision allowing taxpayers to roll over the gain from the sale of small business stock if it's used to purchase other small business stock within 60 days. S. 1676 would increase the capital gains exclusion percentage to 75 percent generally or 100 percent for investments in critical technologies, including transportation security, environmental, and antiterrorism technologies. The bill would shorten the required holding period from five years to three years and raise the size of eligible businesses to those with gross assets of $100 million, indexed to inflation. In addition, the bill extends the rollover period to 180 days.

II

107TH CONGRESS
2D SESSION

# S. 1903

To amend the Internal Revenue Code of 1986 to allow certain small businesses to defer payment of tax.

---

IN THE SENATE OF THE UNITED STATES

JANUARY 28, 2002

Mr. KERRY (for himself, Ms. SNOWE, Mr. LIEBERMAN, Mr. BENNETT, and Mr. BINGAMAN) introduced the following bill; which was read twice and referred to the Committee on Finance

---

# A BILL

To amend the Internal Revenue Code of 1986 to allow certain small businesses to defer payment of tax.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Business Retained Income During Growth and Expansion Act of 2002" or the "BRIDGE Act of 2002".

**SEC. 2. DEFERRED PAYMENT OF TAX BY CERTAIN SMALL BUSINESSES.**

(a) IN GENERAL.—Subchapter B of chapter 62 of the Internal Revenue Code of 1986 (relating to extensions of time for payment of tax) is amended by adding at the end the following new section:

**"SEC. 6168. EXTENSION OF TIME FOR PAYMENT OF TAX FOR CERTAIN SMALL BUSINESSES.**

"(a) IN GENERAL.—An eligible small business may elect to pay the tax imposed by chapter 1 in 4 equal installments.

"(b) LIMITATION.—The maximum amount of tax which may be paid in installments under this section for any taxable year shall not exceed whichever of the following is the least:

"(1) The tax imposed by chapter 1 for the taxable year.

"(2) The amount contributed by the taxpayer into a BRIDGE Account during such year.

"(3) The excess of $250,000 over the aggregate amount of tax for which an election under this section was made by the taxpayer (or any predecessor) for all prior taxable years.

"(c) ELIGIBLE SMALL BUSINESS.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible small business' means, with respect to any taxable year, any person if—

"(A) such person meets the active business requirements of section 1202(e) throughout such taxable year,

"(B) the taxpayer has gross receipts of $10,000,000 or less for the taxable year,

"(C) the gross receipts of the taxpayer for such taxable year are at least 10 percent greater than the average annual gross receipts of the taxpayer (or any predecessor) for the 2 prior taxable years, and

"(D) the taxpayer uses an accrual method of accounting.

"(2) CERTAIN RULES TO APPLY.—Rules similar to the rules of paragraphs (2) and (3) of section 448(c) shall apply for purposes of this subsection.

"(d) DATE FOR PAYMENT OF INSTALLMENTS; TIME FOR PAYMENT OF INTEREST.—

"(1) DATE FOR PAYMENT OF INSTALLMENTS.—

"(A) IN GENERAL.—If an election is made under this section for any taxable year, the first installment shall be paid on or before the due date for such installment and each succeeding installment shall be paid on or before the date which is 1 year after the date prescribed by this paragraph for payment of the preceding installment.

"(B) DUE DATE FOR FIRST INSTALLMENT.—The due date for the first installment for a taxable year shall be whichever of the following is the earliest:

"(i) The date selected by the taxpayer.

"(ii) The date which is 2 years after the date prescribed by section 6151(a) for payment of the tax for such taxable year.

"(2) TIME FOR PAYMENT OF INTEREST.—If the time for payment of any amount of tax has been extended under this section—

"(A) INTEREST FOR PERIOD BEFORE DUE DATE OF FIRST INSTALLMENT.—Interest payable under section 6601 on any unpaid portion of such amount attributable to the period before the due date for the first installment shall be paid annually.

"(B) INTEREST DURING INSTALLMENT PERIOD.—Interest payable under section 6601 on any unpaid portion of such amount attributable to any period after such period shall be paid at the same time as, and as a part of, each installment payment of the tax.

"(C) INTEREST IN THE CASE OF CERTAIN DEFICIENCIES.—In the case of a deficiency to which subsection (e)(3) applies for a taxable year which is assessed after the due date for the first installment for such year, interest attributable to the period before such due date, and interest assigned under subparagraph (B) to any installment the date for payment of which has arrived on or before the date of the assessment of the deficiency, shall be paid upon notice and demand from the Secretary.

"(e) SPECIAL RULES.—

"(1) APPLICATION OF LIMITATION TO PARTNERS AND S CORPORATION SHAREHOLDERS.—

"(A) IN GENERAL.—In applying this section to a partnership which is an eligible small business—

"(i) the election under subsection (a) shall be made by the partnership,

"(ii) the amount referred to in subsection (b)(1) shall be the sum of each partner's tax which is attributable to items of the partnership and assuming the highest marginal rate under section 1, and

"(iii) the partnership shall be treated as the taxpayer referred to in paragraphs (2) and (3) of subsection (b).

"(B) OVERALL LIMITATION ALSO APPLIED AT PARTNER LEVEL.—In the case of a partner in a partnership, the limitation under subsection (b)(3) shall be applied at the partnership and partner levels.

"(C) SIMILAR RULES FOR S CORPORATIONS.—Rules similar to the rules of subparagraphs (A) and (B) shall apply to shareholders in an S corporation.

"(2) ACCELERATION OF PAYMENT IN CERTAIN CASES.—

"(A) IN GENERAL.—If—

"(i) the taxpayer ceases to meet the requirement of subsection (c)(1)(A), or

"(ii) there is an ownership change with respect to the taxpayer,

then the extension of time for payment of tax provided in subsection (a) shall cease to apply, and the unpaid portion of the tax payable in installments shall be paid on or before the due date for filing the return of tax imposed by chapter 1 for the first taxable year following such cessation.

"(B) OWNERSHIP CHANGE.—For purposes of subparagraph, in the case of a corporation, the term 'ownership change' has the meaning given to such term by section 382. Rules similar to the rules applicable under the preceding sentence shall apply to a partnership.

"(3) PRORATION OF DEFICIENCY TO INSTALLMENTS.—Rules similar to the rules of section 6166(e) shall apply for purposes of this section.

"(f) BRIDGE ACCOUNT.—For purposes of this section—

"(1) IN GENERAL.—The term 'BRIDGE Account' means a trust created or organized in the United States for the exclusive benefit of an eligible small business, but only if the written governing instrument creating the trust meets the following requirements:

"(A) No contribution will be accepted for any taxable year in excess of the amount allowed as a deferral under subsection (b) for such year.

"(B) The trustee is a bank (as defined in section 408(n)) or another person who demonstrates to the satisfaction of the Secretary that the manner in which such person will administer the trust will be consistent with the requirements of this section.

"(C) The assets of the trust consist entirely of cash or of obligations which have adequate stated interest (as defined in section 1274(c)(2)) and which pay such interest not less often than annually.

"(D) The assets of the trust will not be commingled with other property except in a common trust fund or common investment fund.

"(E) Amounts in the trust may be used only—

"(i) as security for a loan to the business or for repayment of such loan, or

"(ii) to pay the installments under this section.

"(2) ACCOUNT TAXED AS GRANTOR TRUST.—The grantor of a BRIDGE Account shall be treated for purposes of this title as the owner of such Account and shall be subject to tax thereon in accordance with subpart E of part I of subchapter J of this chapter (relating to grantors and others treated as substantial owners).

"(3) TIME WHEN PAYMENTS DEEMED MADE.—For purposes of this section, a taxpayer shall be deemed to have made a payment to a BRIDGE Account on the last day of a taxable year if such payment is made on account of such taxable year and is made within 3½ months after the close of such taxable year.

"(g) REPORTS.—The Secretary may require such reporting as the Secretary determines to be appropriate to carry out this section.

"(h) APPLICATION OF SECTION.—This section shall apply to taxes imposed for taxable years beginning after December 31, 2001, and before January 1, 2006.".

(b) PRIORITY OF LENDER.—Subsection (b) of section 6323 of the Internal Revenue Code of 1986 (relating to protection for certain interests even though notice filed) is amended by adding at the end the following new paragraph:

"(11) LOANS SECURED BY BRIDGE ACCOUNTS.—With respect to a BRIDGE account (as defined in section 6168(f)) with any bank (as defined in section 408(n)), to the extent of any loan made by such bank without actual notice or knowledge of the existence of such lien, as against such bank, if such loan is secured by such account.".

(c) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 62 of the Internal Revenue Code of 1986 is amended by adding at the end the following new item:

"Sec. 6168. Extension of time for payment of tax for certain small businesses.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

(e) STUDY BY GENERAL ACCOUNTING OFFICE.—

(1) STUDY.—In consultation with the Secretary of the Treasury, the Comptroller General of the United States shall undertake a study to evaluate the applicability (including administrative aspects) and impact of the BRIDGE Act of 2001, including how it affects the capital funding needs of businesses under the Act and number of businesses benefiting.

(2) REPORT.—Not later than March 31, 2005, the Comptroller General shall transmit to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate a written report presenting the results of the

study conducted pursuant to this subsection, together with such recommendations for legislative or administrative changes as the Comptroller General determines are appropriate.

○

II

107TH CONGRESS
1ST SESSION

# S. 1676

To amend the Internal Revenue Code of 1986 to provide tax relief for small businesses, and for other purposes.

---

IN THE SENATE OF THE UNITED STATES

NOVEMBER 13, 2001

Mr. KERRY introduced the following bill; which was read twice and referred to the Committee on Finance

---

# A BILL

To amend the Internal Revenue Code of 1986 to provide tax relief for small businesses, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE.**

(a) SHORT TITLE.—This Act may be cited as the "Affordable Small Business Stimulus Act of 2001".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

**SEC. 2. INCREASE IN EXPENSE TREATMENT FOR SMALL BUSINESSES.**

(a) IN GENERAL.—Section 179(b)(1) (relating to dollar limitation) is amended to read as follows:

"(1) DOLLAR LIMITATION.—

"(A) IN GENERAL.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $35,000 ($25,000 in the case of taxable years beginning in 2001).

"(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2002, the $35,000 amount contained in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 2001' for 'calendar year 1992' in subparagraph (B) thereof.

If any amount as adjusted under this subparagraph is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000."

(b) EXPANSION OF PHASE-OUT OF LIMITATION.—Section 179(b)(2) is amended to read as follows:

"(2) REDUCTION IN LIMITATION.—

"(A) IN GENERAL.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property for which a deduction is allowable (without regard to this subsection) under subsection (a) for such taxable year exceeds $350,000 ($250,000 in the case of taxable years beginning in 2001).

"(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2002, the $350,000 amount contained in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting 'calendar year 2001' for 'calendar year 1992' in subparagraph (B) thereof.

If any amount as adjusted under this subparagraph is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000."

(c) TIME OF DEDUCTION.—The second sentence of section 179(a) (relating to election to expense certain depreciable business assets) is amended by inserting "(or, if the taxpayer elects, the preceding taxable year if the property was purchased in such preceding year)" after "service".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

**SEC. 3. MODIFICATIONS OF EXCLUSIONS AND ROLLOVERS OF GAIN ON QUALIFIED SMALL BUSINESS STOCK.**

(a) EXCLUSION OF GAIN ON QUALIFIED SMALL BUSINESS STOCK.—

(1) INCREASE IN EXCLUSION PERCENTAGE.—

(A) IN GENERAL.—Section 1202(a)(1) (relating to exclusion for gain from certain small business stock) is amended by striking "50 percent" and inserting "75 percent".

(B) 100-PERCENT EXCLUSION FOR CRITICAL TECHNOLOGY AND SPECIALIZED SMALL BUSINESS INVESTMENT BUSINESSES.—Section 1202(a) is amended by adding at the end the following new paragraph:

"(3) CRITICAL TECHNOLOGY AND SPECIALIZED SMALL BUSINESS INVESTMENT BUSINESSES.—

"(A) IN GENERAL.—In the case of qualified small business stock acquired after the date of the enactment of this paragraph which is stock in—

"(i) a critical technology corporation, or

"(ii) a corporation which is a specialized small business investment company (as defined in subsection (c)(2)(B)(ii)),

paragraph (1) shall be applied by substituting '100 percent' for '75 percent'.

"(B) CRITICAL TECHNOLOGY CORPORATION.—The term 'critical technology corporation' means a corporation substantially all of the active business activities of which during substantially all of a taxpayer's holding period of stock in the corporation are in connection with critical technologies (as defined in section

2500(6) of title 10, United States Code), transportation security technologies, antiterrorism technologies, technologies enhancing security by improving methods of personal identification (including biometrics), or environmental technologies for pollution minimization, remediation, or waste management."

(C) EMPOWERMENT ZONE CONFORMING AMENDMENT.—Section 1202(a)(2)(A) is amended—

(i) by striking "60 percent" and inserting "100 percent", and

(ii) by striking "50 percent" and inserting "75 percent".

(2) DECREASE IN HOLDING PERIOD.—

(A) IN GENERAL.—Section 1202(a)(1) is amended by striking "5 years" and inserting "3 years".

(B) CONFORMING AMENDMENT.—Section 1202(j)(1)(A) is amended by striking "5 years" and inserting "3 years".

(3) EXCLUSION AVAILABLE TO CORPORATIONS.—

(A) IN GENERAL.—Subsection (a) of section 1202 (relating to partial exclusion for gains from certain small business stock) is amended by striking "other than a corporation".

(B) TECHNICAL AMENDMENT.—Subsection (c) of section 1202 is amended by adding at the end the following new paragraph:

"(4) STOCK HELD AMONG MEMBERS OF CONTROLLED GROUP NOT ELIGIBLE.—Stock of a member of a parent-subsidiary controlled group (as defined in subsection (d)(3)) shall not be treated as qualified small business stock while held by another member of such group."

(4) STOCK OF LARGER BUSINESSES ELIGIBLE FOR EXCLUSION.—

(A) IN GENERAL.—Paragraph (1) of section 1202(d) (defining qualified small business) is amended by striking "$50,000,000" each place it appears and inserting "$100,000,000".

(B) INFLATION ADJUSTMENT.—Section 1202(d) (defining qualified small business) is amended by adding at the end the following:

"(5) INFLATION ADJUSTMENT OF ASSET LIMITATION.—In the case of stock issued in any calendar year after 2002, the $100,000,000 amount contained in paragraph (1) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year, determined by substituting 'calendar year 2001' for 'calendar year 1992' in subparagraph (B) thereof.

If any amount as adjusted under the preceding sentence is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000."

(b) INCREASE IN PERIOD TO PURCHASE REPLACEMENT STOCK AND QUALIFY FOR ROLLOVER.—

(1) IN GENERAL.—Section 1045(a)(2) (relating to nonrecognition of gain) is amended by striking "60-day" and inserting "180-day".

(2) CONFORMING AMENDMENT.—Section 1045(b)(2) is amended by striking "60-day" and inserting "180-day".

(c) EFFECTIVE DATES.—

(1) EXCLUSION.—The amendments made by subsection (a) shall apply to stock issued after the date of the enactment of this Act.

(2) ROLLOVER.—The amendment made by subsection (b) shall apply to sales after the date of the enactment of this Act.

**SEC. 4. RECOVERY PERIOD FOR DEPRECIATION OF COMPUTERS AND PERIPHERAL EQUIPMENT AND COMPUTER SOFTWARE.**

(a) RECOVERY PERIOD FOR COMPUTERS.—

(1) 3-YEAR PERIOD.—

(A) IN GENERAL.—Subparagraph (A) of section 168(e)(3) (relating to 3-year property) is amended by striking "and" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", and", and by adding at the end the following new clause:

"(iv) any computers or peripheral equipment (as defined in subsection (i)(2)(B))."

(B) CONFORMING AMENDMENT.—Clause (iv) of section 168(e)(3)(B) (relating to 5-year property) is amended by inserting "(except computers or peripheral equipment)" before the comma.

(2) 3-YEAR RECOVERY PERIOD UNDER ALTERNATIVE DEPRECIATION SYSTEM FOR TAX-EXEMPT USE PROPERTY, ETC.—Subparagraph (C) of section

168(g)(3) (relating to alternative depreciation system for certain property) is amended to read as follows:

"(C) QUALIFIED TECHNOLOGICAL EQUIPMENT.—

"(i) IN GENERAL.—Except as provided in clause (ii), in the case of any qualified technological equipment, the recovery period used for purposes of paragraph (2) shall be 5 years.

"(ii) COMPUTERS OR PERIPHERAL EQUIPMENT.—In the case of any computer or peripheral equipment, the recovery period used for purposes of paragraph (2) shall be 3 years."

(b) 24-MONTH USEFUL LIFE FOR DEPRECIATION OF COMPUTER SOFTWARE.—Subparagraph (A) of section 167(f)(1) (relating to computer software) is amended by striking "36 months" and inserting "24 months".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after the date of the enactment of this Act.

**SEC. 5. DEDUCTION FOR 100 PERCENT OF HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS.**

(a) IN GENERAL.—Paragraph (1) of section 162(l) is amended to read as follows:

"(1) ALLOWANCE OF DEDUCTION.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to 100 percent of the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer and the taxpayer's spouse and dependents."

(b) CLARIFICATION OF LIMITATIONS ON OTHER COVERAGE.—The first sentence of section 162(l)(2)(B) is amended to read as follows: "Paragraph (1) shall not apply to any taxpayer for any calendar month for which the taxpayer participates in any subsidized health plan maintained by any employer (other than an employer described in section 401(c)(4)) of the taxpayer or the spouse of the taxpayer."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

**SEC. 6. DISCLOSURE OF TAX INFORMATION TO FACILITATE COMBINED EMPLOYMENT TAX REPORTING.**

Section 6103(d)(5) is amended to read as follows:

"(5) DISCLOSURE FOR COMBINED EMPLOYMENT TAX REPORTING.—The Secretary may disclose taxpayer identity information and signatures to any agency, body, or commission of any State for the purpose of carrying out with such agency, body, or commission a combined Federal and State employment tax reporting program approved by the Secretary. Subsections (a)(2) and (p)(4) and sections 7213 and 7213A shall not apply with respect to disclosures or inspections made pursuant to this paragraph."

**SEC. 7. INCOME AVERAGING FOR FARMERS AND FISHERMEN NOT TO INCREASE ALTERNATIVE MINIMUM TAX LIABILITY.**

(a) IN GENERAL.—Section 55(c) (defining regular tax) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following new paragraph:

"(2) COORDINATION WITH INCOME AVERAGING FOR FARMERS AND FISHERMEN.—Solely for purposes of this section, section 1301 (relating to averaging of farm and fishing income) shall not apply in computing the regular tax."

(b) ALLOWING INCOME AVERAGING FOR FISHERMEN.—

(1) IN GENERAL.—Section 1301(a) is amended by striking "farming business" and inserting "farming business or fishing business".

(2) DEFINITION OF ELECTED FARM INCOME.—

(A) IN GENERAL.—Clause (i) of section 1301(b)(1)(A) is amended by inserting "or fishing business" before the semicolon.

(B) CONFORMING AMENDMENT.—Subparagraph (B) of section 1301(b)(1) is amended by inserting "or fishing business" after "farming business" both places it occurs.

(3) DEFINITION OF FISHING BUSINESS.—Section 1301(b) is amended by adding at the end the following new paragraph:

"(4) FISHING BUSINESS.—The term 'fishing business' means the conduct of commercial fishing as defined in section 3 of the Magnuson-Stevens Fishery Conservation and Management Act (16 U.S.C. 1802)."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

**SEC. 8. MODIFICATION OF UNRELATED BUSINESS INCOME LIMITATION ON INVESTMENT IN CERTAIN DEBT-FINANCED PROPERTIES.**

(a) IN GENERAL.—Section 514(c)(6) (relating to acquisition indebtedness) is amended—

(1) by striking "include an obligation" and inserting "include—

"(A) an obligation",

(2) by striking the period at the end and inserting ", or", and

(3) by adding at the end the following:

"(B) indebtedness incurred by a small business investment company licensed under the Small Business Investment Act of 1958 which is evidenced by a debenture—

"(i) issued by such company under section 303(a) such Act, or

"(ii) held or guaranteed by the Small Business Administration."

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to acquisitions made on or after the date of the enactment of this Act.

○

II

107TH CONGRESS
1ST SESSION

# S. 189

To amend the Internal Revenue Code of 1986 to provide tax relief for small businesses, and for other purposes.

---

IN THE SENATE OF THE UNITED STATES

JANUARY 25, 2001

Mr. BOND (for himself and Mr. ENZI) introduced the following bill; which was read twice and referred to the Committee on Finance

---

# A BILL

To amend the Internal Revenue Code of 1986 to provide tax relief for small businesses, and for other purposes.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE; AMENDMENT OF 1986 CODE; TABLE OF CONTENTS.**

(a) SHORT TITLE.—This Act may be cited as the "Small Business Works Act of 2001".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents is as follows:



# TITLE I—TAX RELIEF

## SEC. 101. DEDUCTION FOR HEALTH INSURANCE COSTS OF SELF-EMPLOYED INDIVIDUALS INCREASED.

(a) IN GENERAL.—Section 162(l)(1) (relating to special rules for health insurance costs of self-employed individuals) is amended to read as follows:

"(1) ALLOWANCE OF DEDUCTION.—In the case of an individual who is an employee within the meaning of section 401(c)(1), there shall be allowed as a deduction under this section an amount equal to the amount paid during the taxable year for insurance which constitutes medical care for the taxpayer, the taxpayer's spouse, and dependents.".

(b) CLARIFICATION OF LIMITATIONS ON OTHER COVERAGE.—The first sentence of section 162(l)(2)(B) is amended to read as follows: "Paragraph (1) shall not apply to any taxpayer for any calendar month for which the taxpayer participates in any subsidized health plan maintained by any employer (other than an employer described in section 401(c)(4)) of the taxpayer or the spouse of the taxpayer.".

(c) DEDUCTION TAKEN INTO ACCOUNT FOR SELF-EMPLOYMENT TAX PURPOSES.—Section 162(l) is amended by striking paragraph (4) and redesignating paragraph (5) as paragraph (4).

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

**SEC. 102. ALTERNATIVE MINIMUM TAX.**

(a) REPEAL OF ALTERNATIVE MINIMUM TAX ON INDIVIDUALS.—

(1) IN GENERAL.—Section 55(a) (relating to alternative minimum tax) is amended by adding at the end the following new flush sentence:

"For purposes of this title, the tentative minimum tax on any taxpayer other than a corporation for any taxable year beginning after December 31, 2004, shall be zero.".

(2) REDUCTION OF TAX ON INDIVIDUALS PRIOR TO REPEAL.—Section 55 is amended by adding at the end the following new subsection:

"(f) PHASEOUT OF TAX ON INDIVIDUALS.—

"(1) IN GENERAL.—The tax imposed by this section on a taxpayer other than a corporation for any taxable year beginning after December 31, 2000, and before January 1, 2005, shall be the applicable percentage of the tax which would be imposed but for this subsection.

"(2) APPLICABLE PERCENTAGE.—For purposes of paragraph (1), the applicable percentage shall be determined in accordance with the following table:

| "For taxable years beginning in calendar year— | The applicable percentage is— |
|---|---|
| 2001 | 80 |
| 2002 | 60 |
| 2003 | 40 |
| 2004 | 20.". |

(3) NONREFUNDABLE PERSONAL CREDITS FULLY ALLOWED AGAINST REGULAR TAX LIABILITY.—

(A) IN GENERAL.—Section 26(a) (relating to limitation based on amount of tax) is amended to read as follows:

"(a) LIMITATION BASED ON AMOUNT OF TAX.—The aggregate amount of credits allowed by this subpart for the taxable year shall not exceed the taxpayer's regular tax liability for the taxable year.".

(B) CHILD CREDIT.—Section 24(d) is amended by striking paragraph (2) and by redesignating paragraph (3) as paragraph (2).

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 2000.

(b) INCOME AVERAGING NOT TO INCREASE ALTERNATIVE MINIMUM TAX LIABILITY.—

(1) IN GENERAL.—Section 55(c) (relating to regular tax) is amended by redesignating paragraph (2) as paragraph (3) and by inserting after paragraph (1) the following:

"(2) COORDINATION WITH INCOME AVERAGING FOR FARMERS.—Solely for purposes of this section, section 1301 (relating to averaging of farm income) shall not apply in computing the regular tax.".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to taxable years beginning after December 31, 2000.

(c) EXPANSION OF THE EXEMPTION FROM THE ALTERNATIVE MINIMUM TAX FOR SMALL CORPORATIONS.—

(1) IN GENERAL.—Section 55(e)(1)(A) (relating to exemption for small corporations) is amended to read as follows:

"(A) $10,000,000 GROSS RECEIPTS TEST.—The tentative minimum tax of a corporation shall be zero for any taxable year if the corporation's average annual gross receipts for all 3-taxable-year periods ending before such taxable year does not exceed $10,000,000. For purposes of the preceding sentence, only taxable years beginning after December 31, 1997, shall be taken into account.".

(2) GROSS RECEIPTS TEST FOR FIRST 3-YEAR PERIOD.—Section 55(e)(1)(B) is amended to read as follows:

"(B) $7,500,000 GROSS RECEIPTS TEST FOR FIRST 3-YEAR PERIOD.—Subparagraph (A) shall be applied by substituting '$7,500,000' for '$10,000,000' for the first 3-taxable-year period (or portion thereof) of the corporation which is taken into account under subparagraph (A).".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years beginning after December 31, 2000.

**SEC. 103. REPEAL OF FEDERAL UNEMPLOYMENT SURTAX.**

(a) IN GENERAL.—Section 3301 (relating to rate of Federal unemployment tax) is amended—

(1) by striking "2007" and inserting "2000", and

(2) by striking "2008" and inserting "2001".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to calendar years beginning after December 31, 2000.

**SEC. 104. PERMANENT EXTENSION OF RESEARCH CREDIT.**

(a) IN GENERAL.—Section 41 of the Internal Revenue Code of 1986 (relating to credit for increasing research activities) is amended by striking subsection (h).

(b) CONFORMING AMENDMENT.—Section 45C(b)(1) of such Code is amended by striking subparagraph (D).

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to amounts paid or incurred after the date of the enactment of this Act.

**SEC. 105. INCREASED DEDUCTION FOR BUSINESS MEAL EXPENSES.**

(a) IN GENERAL.—Section 274(n)(1) (relating to only 50 percent of meal and entertainment expenses allowed as deduction) is amended by striking "50 percent" in the text and inserting "the allowable percentage".

(b) ALLOWABLE PERCENTAGE.—Section 274(n) is amended by redesignating paragraphs (2) and (3) as paragraphs (3) and (4), respectively, and by inserting after paragraph (1) the following new paragraph:

"(2) ALLOWABLE PERCENTAGE.—For purposes of paragraph (1), the allowable percentage is—

"(A) in the case of amounts for items described in paragraph (1)(B), 50 percent, and

"(B) in the case of expenses for food or beverages, 80 percent.".

(c) CLARIFICATION OF SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.—Section 274(n)(4) (relating to limited percentages of meal and entertainment expenses allowed as deduction), as redesignated by subsection (b), is amended to read as follows:

"(4) SPECIAL RULE FOR INDIVIDUALS SUBJECT TO FEDERAL HOURS OF SERVICE.—In the case of any expenses for food or beverages consumed while away from home (within the meaning of section 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, paragraph (2)(B) shall apply to such expenses.".

(d) CONFORMING AMENDMENT.—The heading for subsection (n) of section 274 is amended by striking "50 PERCENT" and inserting "LIMITED PERCENTAGES".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

# TITLE II—TAX SIMPLIFICATION

## SEC. 201. CLARIFICATION OF CASH ACCOUNTING RULES FOR SMALL BUSINESS.

(a) CASH ACCOUNTING PERMITTED.—Section 446 (relating to general rule for methods of accounting) is amended by adding at the end the following new subsection:

"(g) SMALL BUSINESS TAXPAYERS PERMITTED TO USE CASH ACCOUNTING METHOD WITHOUT LIMITATION.—

"(1) IN GENERAL.—Notwithstanding any other provision of this title, an eligible taxpayer shall not be required to use an accrual method of accounting for any taxable year.

"(2) ELIGIBLE TAXPAYER.—For purposes of this subsection—

"(A) IN GENERAL.—A taxpayer is an eligible taxpayer with respect to any taxable year if—

"(i) for all prior taxable years beginning after December 31, 1999, the taxpayer (or any predecessor) met the gross receipts test of subparagraph (B), and

"(ii) the taxpayer is not a tax shelter (as defined in section 448(d)(3)).

"(B) GROSS RECEIPTS TEST.—A taxpayer meets the gross receipts test of this subparagraph for any prior taxable year if the average annual gross receipts of the taxpayer (or any predecessor) for the 3-taxable-year period ending with such prior taxable year does not exceed $5,000,000. The rules of paragraphs (2) and (3) of section 448(c) shall apply for purposes of the preceding sentence.

"(C) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2001, the dollar amount contained in subparagraph (B) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 2000" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under this subparagraph is not a multiple of $100,000, such amount shall be rounded to the nearest multiple of $100,000.".

(b) CLARIFICATION OF INVENTORY RULES FOR SMALL BUSINESS.—Section 471 (relating to general rule for inventories) is amended by redesignating subsection (c) as subsection (d) and by inserting after subsection (b) the following new subsection:

"(c) SMALL BUSINESS TAXPAYERS NOT REQUIRED TO USE INVENTORIES.—

"(1) IN GENERAL.—An eligible taxpayer shall not be required to use inventories under this section for a taxable year.

"(2) TREATMENT OF TAXPAYERS NOT USING INVENTORIES.—If an eligible taxpayer elects not to use inventories with respect to any property for any taxable year beginning after December 31, 2000, such property shall be treated as a material or supply which is not incidental.

"(3) ELIGIBLE TAXPAYER.—For purposes of this subsection, the term 'eligible taxpayer' has the meaning given such term by section 446(g)(2).".

(c) INDEXING OF GROSS RECEIPTS TEST.—Section 448(c) (relating to $5,000,000 gross receipts test) is amended by adding at the end the following new paragraph:

"(4) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2001, the dollar amount contained in paragraph (1) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 2000" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under this paragraph is not a multiple of $100,000, such amount shall be rounded to the nearest multiple of $100,000.".

(d) EFFECTIVE DATE AND SPECIAL RULES.—

(1) IN GENERAL.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) CHANGE IN METHOD OF ACCOUNTING.—In the case of any taxpayer changing the taxpayer's method of accounting for any taxable year under the amendments made by this section—

(A) such change shall be treated as initiated by the taxpayer;

(B) such change shall be treated as made with the consent of the Secretary of the Treasury; and

(C) the net amount of the adjustments required to be taken into account by the taxpayer under section 481 of the Internal Revenue Code of 1986 shall be taken into account over a period (not greater than 4 taxable years) beginning with such taxable year.

**SEC. 202. INCREASE IN EXPENSE TREATMENT FOR SMALL BUSINESSES.**

(a) IN GENERAL.—Section 179(b)(1) (relating to dollar limitation) is amended to read as follows:

"(1) DOLLAR LIMITATION.—

"(A) IN GENERAL.—The aggregate cost which may be taken into account under subsection (a) for any taxable year shall not exceed $50,000.

"(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2001, the dollar amount contained in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 2000" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under this subparagraph is not a multiple of $1,000, such amount shall be rounded to the nearest multiple of $1,000.".

(b) EXPANSION OF PHASE-OUT OF LIMITATION.—Section 179(b)(2) is amended to read as follows:

"(2) REDUCTION IN LIMITATION.—

"(A) IN GENERAL.—The limitation under paragraph (1) for any taxable year shall be reduced (but not below zero) by the amount by which the cost of section 179 property for which a deduction is allowable (without regard to this subsection) under subsection (a) for such taxable year exceeds $400,000."

"(B) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2001, the dollar amount contained in subparagraph (A) shall be increased by an amount equal to—

"(i) such dollar amount, multiplied by

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, by substituting "calendar year 2000" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as adjusted under this subparagraph is not a multiple of $10,000, such amount shall be rounded to the nearest multiple of $10,000.".

(c) TIME OF DEDUCTION.—The second sentence of section 179(a) (relating to election to expense certain depreciable business assets) is amended by inserting "(or, if the taxpayer elects, the preceding taxable year if the property was purchased in such preceding year)" after "service".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

**SEC. 203. DEPRECIATION MODIFICATIONS.**

(a) COMPUTER SOFTWARE ELIGIBLE FOR EXPENSING.—

(1) IN GENERAL.—The heading and first sentence of section 179(d)(1) (relating to section 179 property) are amended to read as follows:

"(1) SECTION 179 PROPERTY.—For purposes of this section, the term 'section 179 property' means property—

"(A) which is—

"(i) tangible property to which section 168 applies, or

"(ii) computer software (as defined in section 197(e)(3)(B)) to which section 167 applies,

"(B) which is section 1245 property (as defined in section 1245(a)(3)), and

"(C) which is acquired by purchase for use in the active conduct of a trade or business.".

(2) NO COMPUTER SOFTWARE INCLUDED AS SECTION 197 INTANGIBLE.—

(A) IN GENERAL.—Section 197(e)(3)(A) is amended to read as follows:

"(A) IN GENERAL.—Any computer software.".

(B) CONFORMING AMENDMENT.—Section 167(f)(1)(B) is amended by striking "; except that such term shall not include any such software which is an amortizable section 197 intangible".

(b) 2-YEAR APPLICABLE RECOVERY PERIOD FOR DEPRECIATION OF COMPUTERS AND PERIPHERAL EQUIPMENT.—

(1) IN GENERAL.—Section 168(c) (relating to applicable recovery period) is amended by adding at the end the following flush sentence:

"In the case of 5-year property which is a computer or peripheral equipment, the applicable recovery period shall be 2 years.".

(2) CONFORMING AMENDMENTS.—

(A) Section 168(g)(3)(C) (relating to alternative depreciation system for certain property) is amended to read as follows:

"(C) QUALIFIED TECHNOLOGICAL EQUIPMENT.—

"(i) IN GENERAL.—Except as provided in clause (ii), in the case of any qualified technological equipment, the recovery period used for purposes of paragraph (2) shall be 5 years.

"(ii) COMPUTERS OR PERIPHERAL EQUIPMENT.—In the case of any computer or peripheral equipment, the recovery period used for purposes of paragraph (2) shall be 2 years.".

(B) Section 168(j)(2) (relating to depreciation of property on Indian reservations) is amended by adding at the end the following flush sentence:

"In the case of 5-year property which is a computer or peripheral equipment, the applicable recovery period shall be 1 year.".

(C) Section 467(e)(3)(A) (relating to certain payments for the use of property or services) is amended by adding at the end the following flush sentence:

"In the case of 5-year property which is a computer or peripheral equipment, the applicable recovery period shall be 2 years.".

(c) 2-YEAR DEPRECIATION PERIOD FOR COMPUTER SOFTWARE.—Section 167(f)(1)(A) of the Internal Revenue Code of 1986 is amended by striking "36 months" and inserting "24 months".

(d) ADJUSTMENTS ON DEPRECIATION LIMITS FOR LUXURY AUTOMOBILES.—

(1) IN GENERAL.—Section 280F(a)(1)(A) (relating to limitation on amount of depreciation for luxury automobiles) is amended—

(A) by striking "$2,560" in clause (i) and inserting "$5,400";

(B) by striking "$4,100" in clause (ii) and inserting "$8,500";

(C) by striking "$2,450" in clause (iii) and inserting "$5,100"; and

(D) by striking "$1,475" in clause (iv) and inserting "$3,000".

(2) CONFORMING AMENDMENT.—Section 280F(a)(1)(B)(ii) (relating to disallowed deductions allowed for years after recovery period) is amended by striking "$1,475" each place that it appears and inserting "$3,000".

(e) EFFECTIVE DATE.—The amendments made by this section shall apply to property placed in service after December 31, 2000.

**SEC. 204. SIMPLIFICATION OF ESTIMATED TAX RULES.**

(a) IN GENERAL.—Section 6654(d)(1) (relating to failure by an individual to pay estimated income tax) is amended by striking subparagraph (C).

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

**SEC. 205. EXCLUSION FROM PARTNERSHIP FILING REQUIREMENTS FOR MARRIED COUPLES AS BUSINESS CO-OWNERS.**

(a) IN GENERAL.—Section 6031 (relating to return of partnership income) is amended by adding the following the new subsection:

"(f) EXCEPTION FOR A MARRIED INDIVIDUALS AS PARTNERSHIP CO-OWNERS.—This section shall not apply to a partnership for any taxable year if—

"(1) all of the capital or profits interests in the partnership are owned by 2 individuals who are a married couple (as determined under section 7703),

"(2) such individuals elect the application of this subsection for such taxable year, and

"(3) such individuals file a joint return for all taxable years of such individuals which include items from such taxable year of the partnership.

The Secretary shall prescribe regulations for the retention of such records as may be necessary for the administration of this chapter in any case where an election is made under this subchapter.".

(b) MARRIED COUPLES AS BUSINESS CO-OWNERS PERMITTED TO FILE SEPARATE SELF-EMPLOYMENT TAX SCHEDULES.—Section 6017 (relating to self-employment tax returns) is amended by adding the following new sentence: "The preceding sentence shall apply even if the husband and wife elect, under section 6031(f), to be excluded from the filing requirements of section 6031.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after the date of the enactment of this Act.

# TITLE III—TAXPAYER PROTECTIONS

## SEC. 301. TAXPAYER'S RIGHT TO HAVE AN IRS EXAMINATION TAKE PLACE AT ANOTHER SITE.

(a) IN GENERAL.—Section 7605(a) (relating to time and place of examination) is amended to read as follows:

"(a) TIME AND PLACE.—

"(1) IN GENERAL.—The time and place of examination pursuant to the provisions of section 6420(e)(2), 6421(g)(2), 6427(j)(2), or 7602 shall be such time and place as may be fixed by the Secretary and as are reasonable under the circumstances. In the case of a summons under authority of paragraph (2) of section 7602, or under the corresponding authority of section 6420(e)(2), 6421(g)(2), or 6427(j)(2), the date fixed for appearance before the Secretary shall not be less than 10 days from the date of the summons.

"(2) LIMITATION.—Upon request of a taxpayer, the Secretary shall conduct any examination described in paragraph (1) at a location other than the taxpayer's residence or place of business, if such location is reasonably accessible to the Secretary and the taxpayer's original books and records pertinent to the examination are available at such location.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to examinations occurring after the date of the enactment of this Act.

**SEC. 302. CLARIFICATION OF ELECTRONIC FILING.**

(a) IN GENERAL.—Section 2001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998 (relating to electronic filing of tax and information returns) is amended by—

(1) striking "and" at the end of paragraph (2);

(2) redesignating paragraph (3) as paragraph (4); and

(3) inserting after paragraph (2) the following new paragraph:

"(3) electronic filing shall be a voluntary option for taxpayers; and".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years after the date of the enactment of this Act.

## SEC. 303. TAXPAYER'S ELECTION WITH RESPECT TO RECOVERY OF COSTS AND CERTAIN FEES.

(a) IN GENERAL.—

(1) Section 504(f) of title 5, United States Code, is amended to read as follows:

"(f) A party may elect to recover costs, fees, or other expenses under this section or under section 7430 of the Internal Revenue Code of 1986.".

(2) Section 2412(e) of title 28, United States Code, is amended to read as follows:

"(e) A party may elect to recover costs, fees, or other expenses under this section or under section 7430 of the Internal Revenue Code of 1986.".

(b) COORDINATION.—Section 7430 (relating to awarding of costs and certain fees) is amended by adding at the end the following new subsection:

"(h) COORDINATION WITH EQUAL ACCESS TO JUSTICE ACT.—This section shall not apply to any administrative or judicial proceeding with respect to which a taxpayer elects to recover costs, fees, or other expenses under section 504 of title 5, United States Code, or section 2412 of title 28, United States Code.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to proceedings initiated after the date of the enactment of this Act.

**SEC. 304. REPEAL OF THE FAILURE-TO-PAY PENALTY.**

(a) IN GENERAL.—Section 6651(a) is amended by striking paragraphs (2) and (3).

(b) CONFORMING AMENDMENTS.—

(1) Section 6651(a) is amended—

(A) by striking "In the case of failure—

"(1) to" and inserting "In the case of failure to", and

(B) by striking the semicolon at the end of paragraph (1) and inserting a period.

(2) Section 6651(b) is amended—

(A) by striking "For purposes of—

"(1) subsection (a)(1)" and inserting "For purposes of subsection (a)",

(B) by striking the comma at the end of paragraph (1) and inserting a period, and

(C) by striking paragraphs (2) and (3).

(3) Section 6651 is amended by striking subsections (c), (d), and (e).

(4) Section 6651(f) is amended by striking "paragraph (1) of".

(5) Section 6651(g) is amended to read as follows:

"(g) TREATMENT OF RETURNS PREPARED BY SECRETARY UNDER SECTION 6020(b).—In the case of any return made by the Secretary under section 6020(b), such return shall be disregarded for purposes of determining the amount of the addition under subsection (a).".

(6) Section 6651, as amended by paragraphs (3) and (4), is amended by redesignating subsections (f) and (g) as subsections (c) and (d), respectively.

(7) The heading of section 6651 is amended to read as follows:

**"SEC. 6651. FAILURE TO FILE TAX RETURN.".**

(8) The table of sections for subchapter A of chapter 68 is amended by striking the item relating to section 6651 and inserting the following new item:

"Sec. 6651. Failure to file tax return.".

(9) Section 5684(c)(2) is amended by striking "or pay tax".

(10) Section 6601(e)(2)(A) is amended by striking "section 6651(a)(1)" and inserting "section 6651(a)".

(c) EFFECTIVE DATE.—The amendments made by this section shall be effective for failures to pay occurring after the date of the enactment of this Act.

**SEC. 305. REPEAL OF INTEREST ON PENALTIES.**

(a) IN GENERAL.—Section 6601(e)(2), as amended by section 304, is amended by striking subparagraph (A) and inserting the following new subparagraph:

"(A) IN GENERAL.—No interest shall be imposed under subsection (1) in respect of any assessable penalty, additional amount, or addition to the tax applied under chapter 68.".

(b) EFFECTIVE DATE.—The amendment made by this section shall be effective for assessable penalties, additional amounts, or additions to tax imposed after the date of the enactment of this Act.

○

# S. 189
# "SMALL BUSINESS WORKS ACT OF 2001"

DESCRIPTION OF PROVISIONS

## TITLE I – SMALL BUSINESS TAX RELIEF

### ***Self-Employed Health Insurance Deductibility***

The bill amends section 162(*l*)(1) of the Internal Revenue Code to increase the deduction for health-insurance costs for self-employed individuals to 100% beginning on January 1, 2001. Currently the self-employed can only deduct 60% of these costs. The deduction is not scheduled to reach 100% until 2003, under the provisions signed into law in October 1998. The bill is designed to place self-employed individuals on an equal footing with large businesses, which can currently deduct 100% of the health-insurance costs for all of their employees.

In addition, the bill corrects a disparity under current law that bars a self-employed individual from deducting *any* of his or her health-insurance costs if the individual is *eligible* to participate in another health-insurance plan. This provision affects self-employed individuals who are eligible for, but do not participate in, a health-insurance plan offered through a second job or through a spouse's employer. That insurance plan may not be adequate for the self-employed business owner, and this provision prevents the self-employed from deducting the costs of insurance policies that do meet the specific needs of their families. In addition, this provision provides a significant disincentive for self-employed business owners to provide group health insurance for their employees. The bill ends this disparity by clarifying that a self-employed person loses the deduction only if he or she *actually participates* in another health-insurance plan.

The bill also levels the playing field by permitting self-employed individuals to deduct the cost of their health insurance against their self-employment taxes. This change will put the self-employed on an equal footing with owners and employees of corporations whose health-insurance benefits are not subject to employment taxes.

### ***Alternative Minimum Tax Relief***

The bill repeals the individual Alternative Minimum Tax (AMT) by 2006. For individual taxpayers, the individual AMT has become an increasingly burdensome tax. For the sole proprietors, partners, and S corporation shareholders, the individual AMT increases their tax liability by, among other things, limiting depreciation and depletion deductions, net operating loss treatment, the deductibility of state and local taxes, and expensing of research and experimentation costs. In addition, because of its complexity, this tax forces small business owners to waste precious funds on tax professionals to determine whether the AMT even applies.

The bill addresses these issues by eliminating 20% of the individual AMT each year until complete repeal is achieved in 2006. During the phase-out period, the bill extends the current exclusion of personal tax credits from the AMT, and it coordinates the farm income-averaging rules with the AMT to ensure that farmers and ranchers do not lose the benefits of income averaging.

For small corporate taxpayers, the bill increases the current exemption from the corporate AMT, under section 55(e) of the Internal Revenue Code. Under the bill, a small corporation will initially qualify for the exemption if its average gross receipts are $7.5 million or less (up from the current $5 million) during its first three taxable years. Thereafter, a small corporation will continue to qualify for the AMT exemption for so long as its average gross receipts for the prior three-year period do not exceed $10 million (up from the current $7.5 million). The increased limits for the small-corporation exemption from the corporate AMT will be effective for taxable years beginning after December 31, 2000.

***Repeal of Federal Unemployment Surtax***

In 1976, a surtax of 0.2% was added to the Federal Unemployment Tax to repay loans from the Federal unemployment fund made during the 1974 recession. Those loans were fully repaid in 1987. Accordingly, the bill repeals the 0.2% surtax beginning in taxable year 2001.

***Extend Research and Experimentation Tax Credit Permanently***

The bill permanently extends the research and experimentation (R&E) tax credit, which has been a valuable resource for businesses developing new products. Under current law, the R&E tax credit is set to expire on June 30, 2004.

***Increased Deduction for Business Meal Expenses***

The bill increases the limitation on the deductibility of business meals from the current 50% to 80% beginning in 2001. Unlike their large competitors, small enterprises often sell their products and services by word of mouth and close many business transactions on the road or in a local diner. In addition, individuals who are subject to the Federal hours-of-service limitations of the Department of Transportation (such as truck drivers) are currently able to deduct 60% of their business meals and are on schedule to deduct up to 80% in coming years. Accordingly, the bill corrects this significant lack of parity for small-business owners by putting them on par with individuals subject to hours-of-service limitations and their large competitors.

## TITLE II – SMALL BUSINESS TAX SIMPLIFICATION

***Clarification of Cash Accounting Rules for Small Businesses***

The bill amends section 446 of the Internal Revenue Code to provide a clear threshold for small businesses to use the cash receipts and disbursements method of accounting, instead of accrual accounting. To qualify, the business must have $5 million or less in average annual gross receipts based on the preceding three years. Thus, even if the production, purchase, or sale of merchandise is an income-producing factor in the taxpayer's business, the taxpayer will not be required to use an accrual method of accounting if the taxpayer meets the average annual gross receipts test.

In addition, the bill provides that a taxpayer meeting the average annual gross receipts test is not required to account for inventories under section 471. The taxpayer will be required to treat such inventory in the same manner as materials or supplies that are not incidental. Accordingly, the taxpayer may deduct the expenses for such inventory that are actually consumed and used in the operation of the business during that particular taxable year.

The bill indexes the $5 million average annual gross receipts threshold for inflation. The cash-accounting safe harbor will be effective for taxable years beginning after December 31, 2000.

***Increase in Expense Treatment for Small Businesses***

The bill amends section 179 of the Internal Revenue Code to increase the amount of equipment purchases that small businesses may expense each year from the current $24,000 to $50,000. This change will eliminate the burdensome recordkeeping involved in depreciating such equipment and free up capital for small businesses to grow and create jobs.

The bill also increases the phase-out limitation for equipment expensing from the current $200,000 to $400,000, thereby expanding the type of equipment that can qualify for expensing treatment. This limitation along with the annual expensing amount will be indexed for inflation under the bill.

Following the recommendation of the National Taxpayer Advocate, the bill also amends section 179 to permit expensing in the year that the property is purchased or the year that the property is placed in service, whichever is earlier. This will eliminate the difficulty that many small firms have encountered when investing in new equipment in one tax year (*e.g.*, 2000) that cannot be placed in service until the following year (*e.g.*, 2001). The bill also expands section 179 to permit the expensing of computer software up to the new $50,000 limit.

The equipment-expensing provisions will be effective for taxable years beginning after December 31, 2000.

***Modification of Depreciation Rules***

The bill modifies the outdated depreciation rules to permit taxpayers to depreciate computer equipment and software over a two-year period. Under present law, computer equipment is generally depreciated over a five-year period and software is usually depreciated over three years. With the rapid advancements in technology, these depreciation periods are sorely out of date and can result in small businesses having to exhaust their depreciation deductions well after the equipment or software is obsolete. The bill makes the tax code in this area more consistent with the technological reality of the business world.

The bill also amends section 280F of the Internal Revenue Code, which limits the amount of depreciation that a business may claim with respect to a vehicle used for business purposes. Under the current thresholds, a business loses a portion of its depreciation deduction if the vehicle placed in service in 2000 costs more than $14,400. Although these limitations have been subject to inflation adjustments, they have not kept pace with the actual cost of new cars and vans in most cases. For many small businesses, the use of a car or van is an essential asset for transporting personnel to sales and service appointments and for delivering their products. Accordingly, the bill adjusts the thresholds so that a business will not lose any of its depreciation deduction for automobiles costing less than $25,000, which will continue to be indexed for inflation.

***Simplification of Estimated Tax Rules***

The bill simplifies the current rules for calculating the level of estimated taxes necessary to avoid the interest penalty for underpayment of estimated taxes. Currently, small business owners can avoid the interest penalty if they pay estimated taxes equal to at least 90% of their tax liability for the current year. Alternatively, for taxable year 2001, small business owners who earned more than $150,000 in taxable year 2000 can avoid the interest penalty if they pay estimated taxes equal to 112% of their 2000 tax liability. For taxable years 2002 and beyond, the threshold will be 110%. In contrast, taxpayers earning $150,000 or less, can avoid the penalty by paying estimated taxes equal to 100% of their prior year's tax liability.

The bill simplifies the estimated-tax rules by providing a consistent test for avoiding the interest penalty: taxpayers must deposit estimated taxes equal to 90% of the current year's or 100% of the prior year's tax liability. This change will eliminate complex calculations currently required of small business owners and ease strains on the business' cashflow. These changes will be effective for tax years beginning after the date of enactment.

***Exemption from Partnership Rules for Sole Proprietorships Jointly Owned by Spouses***

The Internal Revenue Service (IRS) National Taxpayer Advocate's Annual Report to Congress for 2001 identified a problem facing married couples operating a small business. Although these couples file a joint tax return, they are currently required to comply with the onerous partnership rules instead of being permitted to treat the business as a sole proprietorship. According to IRS estimates, the additional burden of the partnership rules can add more than 200 hours to the time required to prepare the business' tax return than would be necessary if it were treated as a sole proprietorship.

The bill amends the Internal Revenue Code to permit married couples who file joint tax returns to opt out of the partnership rules and treat their jointly owned business as a sole proprietorship. It also amends the self-employment tax rules to allow such married couples to receive Social Security credits on an individual basis, which they currently receive when filing a partnership return.

**TITLE III – SMALL BUSINESS TAXPAYER PROTECTIONS**

***Taxpayer's right to have an IRS examination take place at another site***

The bill provides that the IRS must accept a taxpayer's request that an audit be moved away from his or her home or business premises if the off-site location (*e.g.*, an accountant's office) is accessible to the auditor and the taxpayer's books and records are available at such a location. This provision will enable the IRS to conduct an audit but without the fear and disruption resulting from the auditor being present in a family home and among a business' employees and customers for days or weeks.

***Clarification that Electronic Filing is a Goal, not a Mandate***

The bill amends the IRS Restructuring and Reform Act of 1998 (Public Law 105-206) to clarify that the IRS should set as a goal, but not a mandate, that paperless filing should be the preferred and most convenient means of filing tax and information returns in 80% of cases by the year 2007. Concerns have been raised that in order to reach this goal, the IRS may have to require certain taxpayers to file electronically. The bill makes clear that electronic filing should be a voluntary option for taxpayers, not a new government mandate.

***Taxpayer's election with respect to recovery of costs and certain fees***

Under the Internal Revenue Code, a taxpayer may recover costs and fees, including attorney's fees, against the IRS if he or she prevails and the IRS' litigation position was not substantially justified. The Equal Access to Justice Act (EAJA) permits a small business to recover such costs when an unreasonable agency demand for fines or civil penalties is not sustained in court or in an administrative proceeding. In addition, a small business may also recover such costs and fees under the EAJA when it is the prevailing party and the agency enforcement action is not substantially justified. Currently, the EAJA prohibits a taxpayer seeking to recover costs and fees in an IRS enforcement action from doing so under the EAJA if the fees and costs can be recovered under the Internal Revenue Code.

The bill permits taxpayers to elect whether to pursue recovery of attorney's fees and expenses under the EAJA or the Internal Revenue Code.

***Repeal of the failure-to-pay penalty***

The failure-to-pay penalty was originally enacted in the 1960s to compensate for the low rate of interest applied to an individual's tax liability, and for the fact that such interest was not compounded. Today, with interest compounded daily and adjusted for changes in the interest rate, this penalty is no longer needed and serves only as another hidden, second penalty. In addition, this penalty is often applied on top of accuracy-related penalties, resulting in total punishment of as much as 45% in non-criminal cases. To simplify the tax rules and reduce the multiplicity of punishment on taxpayers, the bill repeals the failure-to-pay penalty.

***Limit Compounded Interest to Underlying Tax***

Under current law, when a taxpayer fails to pay the correct amount of taxes, interest is applied and compounded not only on the underlying tax liability, but also on any penalties assessed. As a result, compound interest becomes an additional penalty. In many cases the interest on penalties can substantially increase the total amount of tax due and jeopardize the small business taxpayer's ability to pay its tax debt. In addition, calculating the interest on penalties adds an additional layer of complexity and compliance costs for small businesses. The bill alleviates this situation by limiting the application of interest to only the underlying tax assessment.

## S. 2022
## "SMALL BUSINESS INVESTMENT COMPANY CAPITAL ACCESS ACT OF 2002"

### DESCRIPTION OF PROVISIONS

The bill amends section 514 of the Internal Revenue Code to exclude government-guaranteed capital borrowed by Debenture Small Business Investment Companies (SBICs) from debt for purposes of the Unrelated Business Taxable Income (UBTI) rules. This change would permit tax-exempt organizations to invest in SBICs without the burdens of UBTI record keeping or tax liability.

Currently, while Debenture SBICs qualify for borrowed capital guaranteed by the Small Business Administration, the government guarantee forces a number of potential investors, namely pension funds and university endowment funds, to avoid investing in SBICs because they would be subject to tax liability for UBTI. Frequently, tax-exempt investors generally opt to invest in venture capital funds that do not create UBTI. As a result, 60% of the private-capital potentially available to these SBICs is effectively "off limits."

II

107TH CONGRESS
2D SESSION

# S. 2022

To amend the Internal Revenue Code of 1986 to modify the unrelated business income limitation on investment in certain debt-financed properties.

IN THE SENATE OF THE UNITED STATES

MARCH 15, 2002

Mr. BOND (for himself and Mr. GRASSLEY) introduced the following bill; which was read twice and referred to the Committee on Finance

# A BILL

To amend the Internal Revenue Code of 1986 to modify the unrelated business income limitation on investment in certain debt-financed properties.

*Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*

**SECTION 1. SHORT TITLE.**

This Act may be cited as the "Small Business Investment Company Capital Access Act of 2002".

**SEC. 2. MODIFICATION OF UNRELATED BUSINESS INCOME LIMITATION ON INVESTMENT IN CERTAIN DEBT-FINANCED PROPERTIES.**

(a) IN GENERAL.—Section 514(c)(6) of the Internal Revenue Code of 1986 (relating to acquisition indebtedness) is amended—

(1) by striking "include an obligation" and inserting "include—

"(A) an obligation",

(2) by striking the period at the end and inserting ", or", and

(3) by adding at the end the following:

"(B) indebtedness incurred by a small business investment company licensed under the Small Business Investment Act of 1958 which is evidenced by a debenture—

"(i) issued by such company under section 303(a) of such Act, or

"(ii) held or guaranteed by the Small Business Administration.".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to acquisitions made on or after the date of the enactment of this Act.

○

# COMMENTS FOR THE RECORD

MAX CLELAND
GEORGIA
Telephone: (202) 224-3521
TDD/TTY: (202) 224-3203
www.senate.gov/~cleland

COMMITTEES:
ARMED SERVICES
COMMERCE
GOVERNMENTAL AFFAIRS
SMALL BUSINESS

# United States Senate

WASHINGTON, DC 20510–1005

**May 22, 2002**

**STATEMENT BY SENATOR MAX CLELAND**

**U.S. Senate Small Business and Entrepreneurship Committee Roundtable: "Unleashing the Power of Entrepreneurship: Stimulating Investment in America's Small Businesses."**

Mr. Chairman, I appreciate this opportunity to be here today to discuss small business access to capital. In the wake of last year's economic downturn, we must look to incentives to help stimulate investments in small businesses. I also want to thank the small businesses who are represented today for providing constructive guidance on these important issues.

First of all, let me say that I am disappointed that the final economic stimulus package passed earlier this year did not include more small business tax relief. The President's tax cut package did not address many small business tax cuts that I support, and I believe that by not reaching a compromise earlier in the stimulus debate, we missed a good opportunity to help small businesses get back on their feet.

I have supported several tax incentives to promote small businesse investments including cosponsoring Senator Collins' bill, the *Encouraging Investment in Small Business Act* (S. 455). By increasing the numbers of small businesses eligible to take tax credits under a provision in the Internal Revenue Code and by decreasing the holding period for investors, this bill would assist small businesses in obtaining the long-term investment capital which is essential to the survival of so many small businesses, especially high tech and e-commerce businesses.

I am also a co-sponsor of Chairman Kerry's *Affordable Small Business Stimulus Act* (S. 1676), which will be further discussed today.

I also support efforts to reduce the capital gains rate. During the Senate debate on the President's tax cut, I voted for the Gregg amendment which would have reduced the 20% capital gains rate to 15% from June 1, 1001 until January 1, 2004. Unfortunately, this measure failed by a vote of 47-51 and the final Senate bill did not include a reduction in capital gains taxes.

Finally, let me say that I think that any small business investment incentives will be insufficient unless Congress completely eliminates estate taxes for small business owners. I have heard from many constituents that they are concerned about growing their small business if their children will have to sell all or part of it just to pay taxes.

I look forward to a productive discussion today in this roundtable and I hope that we will be able to follow-up on constructive recommendations provided by the small businesses present.

Small Business
Service Bureau, Inc.

National Operations
Service Center
554 Main Street
P.O. Box 15014
Worcester, MA 01615-0014
Phone
(508) 756-3513
Toll Free
1-800-343-0939
Fax
(508) 770-0528
www.sbsb.com

**Francis R. Carroll**
Founder and CEO

Small Business Service Bureau, Inc.
554 Main Street
Worcester, Massachusetts

Roundtable Session Remarks
On

**S.1903 and S.1676**

United States Senate Committee on
Small Business and Entrepreneurship

May 22, 2002

Chairman Kerry, Senator Bond, members of the Senate and House Small Business Committees, it is a great pleasure and honor to be here today to discuss the difficulties facing small businesses in obtaining critical financing to help them survive and grow in an economy which is just beginning to show signs of recovering.

I am Francis R. Carroll, Founder and CEO of the Small Business Service Bureau, Inc., (SBSB), a small business membership organization, headquartered in Worcester, Massachusetts, which represents more than 50,000 small businesses nationwide.

On behalf of our members, I want to thank the Committee, and particularly Senator John Kerry for his dedication to the success of small businesses, which are the backbone of the U.S. economy. I am here to enthusiastically support innovative funding proposals like **Sen. Kerry's "BRIDGE Act," S.1903**, and business-friendly tax treatments included in **"The Affordable Small Business Stimulus Act of 2001," S.1676.**

I also am delighted to be here today with Small Business Service Bureau member Angie Doye, co-founder and CFO of Gwathmey, Inc. who with CEO Dr. Judith Gwathmey has built an innovative, highly successful small business in Cambridge, Massachusetts. This fast-growing, creative firm, Gwathmey, Inc., is exactly the type of company that will benefit enormously from **S.1903** and **S.1676.**

When I think back 34 years ago to when I founded Small Business Service Bureau and signed up my first small business member for health care benefits, I realize that while many things have changed, the key elements that make small business successful have not-- integrity, dedication and determination.

What clearly has changed is the environment that small businesses must operate and compete in. Indeed, the world in which we live, and work, has changed forever, particularly in the past couple of years.

This new environment requires all businesses, and particularly small businesses, to better analyze competition and identify new market niches and opportunities, to harness technology and the power of the Internet to enhance sales, and to be more resourceful and innovative about attracting capital.

This new environment *demands* entrepreneurs to better leverage the dwindling resources that are available. It requires new tools like the "BRIDGE" Account, and new tax rules that promote growth by permanently increasing depreciation allowances. What's needed are new, business-friendly policies that *Encourage*, rather than *Discourage* small business success which is why Congress needs to pass **S.1903 and S.1676--** bills that benefit small businesses' bottom lines.

Savvy companies like Gwathmey, Inc. have utilized to the fullest, current funding mechanisms including the highly-competitive Small Business Innovation Research (SBIR) grant program, which delivered $1.1 billion to small firms in 2000 (the latest full-year data is available). Meanwhile, other firms have utilized the Small Business Technology Transfer Program (STTR), which in 2000 doled out $60 million dollars to hundreds of firms and the Small Business Investment Company program which delivered $4.5 billion to 4,277 small business owners that year.

These are successful programs that the Small Business Service Bureau has supported for many years, and programs that I had supported while I served on SBA's National Advisory Council.

Small businesses and SBSB members have used a range of methods to fund their endeavors. Some have even leveraged their entire life savings to chase their dream of owning and operating their own business.

*Business StartUps Online* reports that start-ups today are moving to more traditional financing-- 72 percent are tapping personal savings, 45 percent get funding through banks and other financing companies, 10 percent are going directly to individual investors, 7 percent are accessing government-guaranteed loans and 1 percent are working with venture capitalists.

As you know, the dot-com boom, and subsequent demise of many of those companies during the past couple of years, have venture capitalists a bit tight fisted. The National Venture Capital Association of Arlington, Va., says the number of companies receiving venture money fell to 3,736 in 2001 from 6,245 in 2000.

At the same time, banks also have tightened the purse strings. In February 2002, the National Association of Manufacturers, a Washington, D.C., trade group, reported that more than a third of small and medium-size manufacturers said it was harder to get credit from their banks as compared to last year.

This lending crunch has had ripple effects through small business capital markets. Today, many of the smallest businesses have turned to credit cards to fund operations and are accumulating significant debt. [The 2001 Federal Reserve Survey of Small Business Finances found the use of business credit cards by small businesses was growing. About one-third of all small businesses--and more than 50 percent of firms with 20 or more employees--had business credit cards in 1998, according to the study].

SBSB surveys indicate that 46 percent of small businesses are now borrowing at rates above the prime rate (and 75 percent at prime or above). SBSB sees this as a potential disaster in the making.

At the same time, taxes and a tight capital market have led to many small businesses leasing rather than buying equipment--everything from point-of-sale computer systems and storage devices to vehicles. While this solution works for some firms, a better alternative would be for Congress to amend outdated tax policy and pass legislation that makes purchasing equipment and technology a better alternative.

Unfortunately, SBSB surveys indicate that small business purchasing through the first quarter of 2002 has remained flat, and that is unlikely to change over the next six months. The increased business equipment depreciation allowance in **S.1676** would greatly benefit small businesses over the long-term and needs to be supported and passed by Congress.

While all of the tax incentives contained in **S.1676** promote small business success, SBSB members see increased depreciation as key. Current IRS business equipment depreciation rules are outdated, and the 30 percent bonus depreciation included in the Economic Stimulus Bill, which sunset in 2004, hasn't provided enough incentive to jump start purchasing in the short-term as had hoped. A better solution, which is contained in **S.1676,** would be to increase permanently depreciation amounts for new equipment from $24,000 to $35,000, or more, and increase the phase-out level, above which expensing is not allowed to $350,000, which truly would provide a long-term bottom-line benefit to small business.

SBSB surveys also have revealed that about 30 percent of small businesses nationwide have consistently indicated that taxes are the top problem facing small businesses today, followed by insurance costs at 22 percent and finding qualified staff at 14 percent. Quickly moving up the list of top problems is the amount of "paperwork" required to operate. Increased paperwork has been identified as the top problem for about 14 percent of small businesses during the past couple of years in SBSB surveys, and the cost of compliance with federal regulations are astronomical.
Small firms with less than 20 employees spend an average of nearly $7,000 per employee annually to comply with federal regulations enforced by more than 60 federal agencies, according to the SBA Office of Advocacy.

SBSB strongly supports the Single Tax Filing provision in **S.1676** that would simplify the tax filing process for small businesses by allowing the IRS and state agencies to combine on one form, both State and Federal employment tax returns.

SBSB also fully supports accelerating full deductibility of health insurance expenses for the self employed, currently at 70 percent (and scheduled to increase to 100 percent in 2003).

If there is a silver lining to this weaker economy, it is that we are seeing more entrepreneurs testing the small business market and starting their own small businesses. Small businesses are an incredible source of new ideas and products and the innovations in the fields such as software, computer technology, aerospace, and pharmaceuticals are very impressive. According to the U.S. Small Business Administration (SBA), small businesses account for a little more than half of all the innovations in our economy. They provide services and inputs to the production process, train workers, and are a primary marketing and distribution engine for retail products and services.

But make no mistake, small businesses right now are still struggling.
Legislation being considered today can very well make or break small businesses. I hope Congress will choose to help improve the economic outlook for small businesses by passing **S.1903, S.1676** and other innovative legislation that supports small businesses.

Thank you for the opportunity to appear before the Committee today to support these important bills on behalf of small businesses around the country.

Gwathmey, Inc.
From Molecule to Whole Animal

Pre-Clinical Research

Cardiovascular Disease

Oncology

CNS Disease

Infectious Disease

Arthritis

Services

Animal Models and Studies

Gene Therapy

Pharmacokinetic Studies

Toxicology

Physiology

Molecular Biology

**Angelia A. Doye**
Co-founder and CFO

Gwathmey, Inc.
763 Concord Ave., Building E
Cambridge, Massachusetts

Roundtable Session Remarks
On

**S.1903 and S.1676**

United States Senate Committee on
Small Business and Entrepreneurship

May 22, 2002

Chairman Kerry, Senator Bond, members of the Senate and House Small Business Committees, it is a pleasure to be here today to examine the barriers and obstacles to obtaining capital that are facing small businesses.

I am Angelia A. Doye, one of the Founders and CFO of Gwathmey, Inc., a small minority owned biotechnology company located in Cambridge, MA and a member of Small Business Service Bureau. I am here to support the **"Bridge Act" S.1903**, and the **"Affordable Small Business Stimulus Act of 2001" S.1676**.

I would like to share some of Gwathmey, Inc.'s experiences in trying to obtain working capital and pay taxes.

Gwathmey, Inc. has been primarily supported by SBIR grants since 1996. We were one of the recipients of the 2001 Roland Tibbetts Award. We have been able to develop the technology and equipment we have in house through SBIR grants. We are now transitioning more into the contract research testing business as we were originally established to do.

We have tried over the last two years to obtain working capital as we began our transition toward obtaining industry contracts. We approached banks and were denied. We have tried minority groups and have not been considered because we did not fit into the standard portfolio of restaurants, hairdressers, etc. One of the biggest problems we faced is *Cashflow*.

Because we've functioned primarily through grants, we don't have money flowing in and out. Grants are drawn upon by their categorized expenses at the time of spending. The money cannot sit in the bank more than 30 days. Industry contracts were few and of small amounts. At one point, we applied for a loan and were denied although we had $182,000 in the bank. In that instance *Cashflow* was the determining factor.

Assets are another issue. One of the assets we utilize is equipment. The bank said the equipment we have was too specialized for their use should we default on the loan.

Although the equipment is of little or no help to us now, taxes on the equipment hurts us. Keep in mind much of the equipment is purchased through grants and was used for grant work. Equipment is taxed, but grants don't pay taxes. Therefore, the more equipment we acquired, the bigger the expense became through taxes.

Any contract money that we are able to acquire that could be used to roll over into the next year to help with upcoming expenses ends up a tax payment. It is a vicious circle that is difficult to break. If taxes could be deferred for a year or two to help us get established and show a decent cashflow, we could get a bank loan. In our case, the "BRIDGE Act" is just what the Doctor ordered. This is why Dr. Judith Gwathmey and I so enthusiastically support the **"BRIDGE Act," S.1093**.

In addition, we are considering leasing equipment instead of purchasing it because of the tax associated with it until we become more stable. In that regard, the tax incentives provided in **S.1676** would directly benefit Gwathmey, Inc and many small business like ours around the country.

Gwathmey, Inc. has now reached the point where we need to expand by adding the Business Development component and a few additional personnel to operate efficiently. However, this will be difficult and may not happen if we don't secure a (Bridge) Loan. Collateral provided by deferring tax into a BRIDGE Account certainly would help. Until then, we remain stretched thin and hope to land a big contract that can get us through the next quarter.

Thank you for the opportunity to appear before the Committee today to talk with you about Gwathmey, Inc. and our support for these important bills.

Respectfully submitted,

Angelia A. Doye, Co-founder and CFO
Dr. Judith Gwathmey, Co-founder and CEO
Gwathmey, Inc.

Springboard ENTERPRISES
Women • Capital • Connections

---

**MEMORANDUM**:
To: Senate Committee on Small Business and Entrepreneurship
**From**: Amy Millman, President, Springboard Enterprises
**RE**: Additions to the Record of the Roundtable on "Unleashing the Power of Entrepreneurship: Stimulating Investment in America's Small Businesses"
**Date**: Friday, May 24, 2002

Springboard Enterprises is a not for profit entity that provides education, coaching and networking opportunities for women entrepreneurs who lead high growth enterprises. We canvassed the companies who have participated in our program and they provided the following input. We would appreciate having these comments added to the record.

**Christina Lomasney, CEO Isotron Corporation, Kenner Louisiana**
I run a company that is currently funded by SBIR and other grants from the US government. I believe that today, this has become a viable source of funding for start-up companies, especially in the area of Nanotechnology.

I do have some question about the taxing practices on these funds. For example, when I hire people under an SBIR contract, my employees are still required to pay Federal and State (where applicable) income tax. This seems to be "taking money out of one pocket of the government and putting it in another" as a result, we are not able to ramp up hiring as quickly and the net effect is slower growth under the SBIR program than could otherwise be achieved. Because these contracts are administered by Federal agencies, and audits are generally required, it would not be a stretch to eliminate the federal tax obligation for the funds received under these grant programs.

The net result would be positive for the Government. The US government's objective with these programs like SBIR, DARPA, ATP, etc. is to give a "jump start" to high-risk ventures. The ROI for the government is in the form of taxes that the company will pay down the road when the venture becomes profitable. By recouping taxes in the near term, the effect is an added level of cash-flow risk for the venture. There could be a grace period during the term of government funding to maximize this investment by eliminating taxpayer obligation on the government-invested funds. Note also that in my experience, the SBIR budget projection process does not take into account taxes and so the complete program is not always achievable.

I also would encourage the committee to support the legislation proposed that would increase the NSFs Nanotechnology Spending by $17 million. The bill is called "Investing in America's Future Act."

**Julie Hamrick, CEO Ignite Sales. Dallas Texas**
1) How about some relief from unemployment taxes - or a lower earnings threshold for them?
2) Anything that would reduce the amount of paperwork such as less frequent payroll tax filings.
3) Measures to stimulate corporate investments directly in small businesses, or stimulate corporate involvement in groups/programs that help small businesses.

**Lucy McQuilken, CEO Chaoticom, Boston Mass**
1) Tax considerations - the litmus tests for defining "Key Employees" and "Highly compensated Employees" don't make sense in the context of a smaller than 10 person startup. For example, Key employees are defined as the "10 employees with the highest ownership interest in the company" since most startups offer stock options, this makes all of the employees "Key" which means none of them are eligible for Sec. 25A Cafeteria benefits. Also, they should specify that "options" do not constitute "ownership" for this purpose.

**Lu Cordova, Chair of CTEK Angels and President of CTEK Incubator**
I'm the chair of CTEK Angels, the largest group of angel investors in Colorado. I also am President of CTEK incubator that is a business catalyst for entrepreneurial ventures. The government needs to support individual investment, not with a cap gain credit, but with a 1-1 full cap loss credit. Individual investors need incentives on the downside, not upside, to stimulate seed investment.

We, at Springboard, appreciate the opportunity to participate in the Committee's roundtable and look forward to working with you on the passage of legislation that will provide incentives for small business/entrepreneurial investment and growth.

Jaime, please make sure these get in the record.
-----Original Message-----
From: Amy Millman
Sent: Thursday, May 30, 2002 12:54 AM
To: McCormick, Ryan (Small-Business)
Cc: Forbes, Patty (Small-Business)
Subject: FW: Senate roundtable input - ADDITIONS FOR RECORD
Importance: High

Here are our recommendations.

1. SBA's Export Express program. The SBA has a program for early stage companies that have found an export market for their products called Export Express. Based on a Business Plan, a company should be able to secure 85% of funding up to $150,000 for export sales. Our first customer is offshore, but todate we have not been successful at getting our bank, Fleet, or other banks in the Boston area, to actually process an application under this program even through they have delegated lending authority. We are told by the bank that it is not an effective program so they do not support it. We disagree. We think that if the SBA gives delegated authority, they should require delegated lenders to participate in all programs. Alternatively, the SBA needs to figure out the issues and address them so that this program is viable.

2. PCT patents. The changes in the patent law two years ago that brought U.S. practices into line with those of other countries, means that small business PCT patents are published prior to their issuance. This change in patent law is adverse to high tech companies that rely on patents very early because the patent office is so slow in processing patents. Rep. Barney Frank's office tells us that revenue from the patent office is being put into general funds and they agree that the patent office is underfunded. There is a need for higher funding of the patent process that fast tracks early stage high growth company PCT patent applications so that these patents are awarded prior to them being published worldwide.

3. Tax issues. Founders of early stage technology companies should be able to withdraw funds from 401Ks without the tax penalty to fund their ventures during this difficult funding environment.

THE COMPANY
e-Vantage today is focused on raising our funding through business partnerships. We have a formal LOI from one partner, and are talking with three other major banking and technology companies. We develop, support and sell enterprise software for the banking industry. Our product, in the alpha stage of development, is e-FX ADVISOR. This Internet services platform enables banks to cost effectively help small to-mid-sized enterprises (SMEs) grow their exports by selling in the currency of their customers and managing the associated risk. At the same time this platform opens up significant new revenue streams for banks by harnessing the power of diversification across the bank's entire SME customer base. With the growth in world trade topping $ 5 trillion - an estimated 30% of which comes from smaller businesses - and the rise of the euro challenging marketing strategies, e-FX ADVISOR is addressing a large, growing and underserved market.

FOR THE RECORD

Community Wealth Ventures, Inc.

**Senate Small Business Committee – May 22, 2002**
**Bill Shore Testimony for the Record**

Chairman Kerry, Ranking Member Bond and members of the Senate Small Business Committee, I would like to share some information about one of the fastest growing but least recognized areas of small business -- the increasingly successful business entrepreneurship of America's nonprofit sector.

There are many great success stories in the small business world, and many would not have been possible without the U.S. Small Business Administration (SBA). I want to address not past success, but future opportunities. A sector exists that remains untapped with untold potential to create revenues, jobs, taxes, and repair the social fabric of our country.

It may surprise you to learn that I am speaking of the NONprofit sector. But it is precisely this sector that is capitalizing on business opportunities to create a new kind of wealth. We call it community wealth – nonprofit organizations generating profit to help them reduce or eliminate their dependence on government and foundation funding. It is perhaps the best untapped market for new revenues, jobs, and economic growth – everything the SBA seeks to develop.

The responsibilities of nonprofit organizations have increased dramatically at the same time that growth in government funding for social services has decreased. In countless communities across the country, individual citizens, responding to evident need and the call of service have developed private sector solutions to feeding the hungry, after-school programs, health care, etc. Heavily dependent on charity for their survival, such efforts, while not only worthy, but critical, are not sustainable or scalable. They simply don't reach everyone they are designed to serve. Nonprofits have come to realize, as government has in recent years, that redistributing wealth, by itself, cannot solve our social and economic problems. Only creating new wealth can.

Society relies on nonprofits to address some of the nation's greatest challenges. But America's problems are far out-pacing the public and philanthropic dollars available to solve them. Traditionally, nonprofit organizations dependent upon government funds, charitable solicitations and foundation grants compete for philanthropic dollars; at best, they can only hope to get a bigger piece of the pie. But with rising expectations and diminishing resources, a piece of the pie is not enough: more and more, innovative nonprofit executives are expanding the pie itself.

Most community nonprofits are woefully undercapitalized. I don't just mean that they do not have enough money to do all of the things they wish to do. I mean that they lack the access to capital available to for-profits. Given the universe of financial instruments available to build great ideas, they tend to use only one: the charitable gift. Nonprofits also are under tremendous pressure to externalize all of their resources, to pass them straight through to the community, rather than to invest on themselves, in recruiting and retaining great staff, and in building a sustainable institution. Ironically, such honorable intentions often result in less efficient use of donors gifts than would otherwise be the case.

Dr. Benjamin Spock, the pediatrician and best-selling author, enabled generations of parents to raise strong and healthy children by reassuring them that "You know more than you think you do." If he were alive to craft a similar philosophy for strong and healthy nonprofit organizations, it might be built on the conviction that "You're worth more than you think you are." Non-profits and community based organizations have assets that they typically deploy to achieve their mission, but almost always under-appreciate in terms of leveraging those assets to generate revenues.

In growing numbers, nonprofit organizations such as rehabilitation centers, homeless shelters, youth groups, and community development corporations are addressing this challenge by creating community wealth enterprises. They are starting small businesses such as auto repair shops, catering businesses, printing and packaging operations, and website development firms. In addition to competing in the for profit marketplace, these mission-driven businesses are providing job training.

One of these enterprising nonprofit organizations is Seattle-based Pioneer Human Services. Each year, Pioneer helps more than 5,000 ex-convicts, homeless, and drug-addicted individuals find jobs and rebuild their lives. Pioneer employs nearly seven hundred people in several for profit business ventures. Pioneer's businesses support 95% of the organization's $55 million annual operating budget. Its largest business is a precision light-metal fabricator that has become the sole supplier to Boeing of sheet metal liners for the cargo bays of aircraft. In 1996, Pioneer's plant became the first nonprofit in the U.S. to win ISO-9002 certification, a benchmark for quality in the private sector.

In Jamaica Plain, Massachusetts, the COMPASS School offers high-risk, inner-city children and families clinical, educational, violence prevention, and social services. The school's leadership in successfully working with adjudicated youth led it to create a consulting service that helps public school systems design and implement programs to work with at-risk and kids with special needs. The consulting business has successfully grown and will generate over $800,000 in revenue this year, and serve as a significant contributor to the schools annual budget.

The nonprofit sector is large and oftentimes difficult to define. Each year, more than 700,000 501(c)(3) and 501(c)(4) organizations deliver critical services to communities across the United States.[1] Many of these organizations rely heavily on federal funding

[1] Internal Revenue Service, Data Book, various years

for ongoing sustainability. The 1999 Form 990 data show a total of almost $30 billion reported as received from government under program service revenue. But in recent estimates demonstrate that between 1997 and 2002, government funding has declined 9 percent. Nonprofit organizations will have lost $50 billion after inflation when compared to 1995 support levels.[2]

In 1984 I started Share Our Strength, an anti-hunger organization. Our objective was to be a grantmaker but not a re-granter. We adopted a policy that we would not pursue foundation grants or government funding. We did not want to simply redistribute wealth, we wanted to create our own wealth. We methodically organized the restaurant and food service community across the United States. We became a market aggregator and now work with 8,000 chefs and restaurateurs around the country. We create food and wine benefits, called Taste of the Nation, in over 90 cities around the country and have generated over $100 million to fight hunger and poverty. Key to our success has been developing corporate partnerships with American Express, Evian, Calphalon, Tyson Foods, and others corporations. These are not philanthropic relationships, these are business partnerships. We are a key part of our corporate partners marketing success and, in helping them achieve their business objectives, help fight the war on hunger in the this country.

Community-based nonprofit organizations ranging from maternal and child health clinics and charter schools to job-training and environmental organizations approached us and asked if we could teach them how to do this. They too wanted to be more self sufficient. In response, we launched Community Wealth Ventures (CVW) four years ago to provide nonprofit organizations with entrepreneurial wealth creation strategies they need. Community Wealth Ventures helps entrepreneurial nonprofits improve their bottom line through the design and implementation of business ventures and nonprofit/corporate partnerships.

Over the past few years, Community Wealth Ventures has become the leader in the field, helping dozens of nonprofit organizations leverage their assets into businesses or partnerships. And Community Wealth Ventures practices what it preaches: it is a for-profit subsidiary of Share Our Strength, with its profits going to fund the anti-hunger organization.

We have recently completed a project in Washington D.C. for the Fannie Mae Foundation and Meyer Foundation in which we worked with eight of their grant recipients to help them develop business plans to launch enterprises. One of the groups, the Latin American Youth Organization recently took over the Ben & Jerry's shop around the corner in Eastern Market. We helped them develop the capacity and business understanding to successfully run this venture. They will gain both a chance to provide job training for the young people in their center, and importantly, the profits from the ice cream shop will help fund their mission.

[2] "The Nonprofit Sector and the Federal Budget: Updates as of September 1997", Alan J. Abramson and Lester M. Salamon

Another organization in this project, the largest provider of day care to underserved families in D.C. is the National Child Day Care Association, led by Travis Hardman. They operate 25 day care sites for low income and at-risk children in D.C. with 350 staff, serving 1600 children and their families every day (98% of their funding comes from Headstart.) As part of caring for several thousand children every day, they produced 600,000 meals annually in their commercial kitchen. We identified that they had the capacity to produce 1.2 million meals. After working with them, they have not only formalized their institutional catering service with a business plan, but have landed seven contracts providing food services to assisted living facilities and other child care centers, generating over $300,000 of new revenue.

Travis recently told an audience of foundation and non-profit executives that the process of creating community wealth "was a transformational experience for our organization. We now have a senior management team that owns the organization's success, instead of just a collection of individual department heads. We know that we must generate our own revenues." When they started the process they had 3 outside food service contracts. Today they have seven. They eventually hope to generate $5 million annually

A recent study by the Yale School of Management and The Goldman Sachs Foundation found a number of illuminating lessons that show that this movement is vital but needs support:

1. On average, nonprofit organizations operating enterprises say that their enterprises generate 12 percent of their annual net revenue. These enterprises are a critical way for nonprofits to diversify their reliance on outside funding.
2. 66 percent of the organizations currently operating ventures say that generating income and surplus for their programs is a top reason for operating the enterprise. 52 percent say that moving toward self-sufficiency is a top reason.

As a secondary benefit, we have seen how a for-profit business can dramatically impact a nonprofit that goes beyond the bottom line. It also has a positive impact on an organization's service and program delivery, entrepreneurial culture, self-sufficiency, and its ability to attract and retain donors and staff. Organizations that run a business start to impart "business thinking" in their organization, with an affect on accountability and results of all work that the organization is engaged in.

One of the key challenges that nonprofits face when trying to gain greater self-sufficiency through creating a venture is the need for effective business planning. Community Wealth Ventures has worked with a number of groups that have the entrepreneurial spirit, but need assistance with business planning, marketing and structuring of their venture. The Yale Study found that effective business planning is one of the key differentiators between ventures that succeed or fail.

The government's commitment to control federal spending depends in part on the ability of community-based nonprofit organizations to deliver services effectively and efficiently. But some of the nonprofit organizations we rely on most heavily have the least capacity to be sustainable or get to scale. The best way to ensure both their long-term success and their independence is to support their efforts to create their own wealth, rather than relying on redistributed wealth from private donors or the government.

We are proposing that Congress authorize the SBA to create a pilot demonstration program to provide technical assistance and consulting to nonprofit organizations that receive federal funding to help them establish for-profit small businesses in a manner that they can succeed.

- Funding would be for technical assistance to work with nonprofits to develop business plans. Nonprofits will submit applications for the technical assistance and must match the value of the assistance with 30% funding.

- The program would also establish a revolving start-up capital loan fund for organizations that successfully complete business plans in this program.

If the SBA can do for nonprofit small businesses what it has done for for-profit small businesses, the leverage on government dollars and long-term savings to the federal government can be significant.

There are a number of benefits such a program could provide: nonprofits that become more self-sufficient lessen their dependence on federal funding. In effect this "teaching a man to fish" approach will end up saving the federal government many multiples of this amount over the long term.

Secondly, nonprofits who run businesses gain the benefit of "business thinking" -- being more efficient, using measures and outcomes of performance, and becoming "bottom line oriented."

In summary, this committee and the SBA can make a dramatic impact in creating new businesses throughout the country:

1. Nonprofits can be a vital part of the small business community—as such they would provide employment, increase the tax base, and contribute to the growth of the country's economy.
2. Effective technical assistance can help nonprofits learn how to build and run businesses so that they succeed.
3. Successful nonprofit businesses will, in the long term, lessen nonprofit dependence on government grants and could save the government billions of dollars.

I'd like to submit for the record a list of examples of some of the work that Community Wealth Ventures has done both locally and nationally, as well as two essays that indicate the power of this concept and how it can transform a nonprofit organization. One of the essays is from the CEO of an organization that serves people with AIDS in New York City. The other is from the CEO of a bakery that provides job training and also supplies all the brownies used in Ben & Jerry's ice cream.

Thank you once again, Mr. Chairman. Those of us at CWV look forward to working with you to extend that growth into the non-profit sector where it will not only help the economy, but also enable community organizations to more effectively meet local needs.

FOR THE RECORD

Community
Wealth
Ventures, Inc.

## Examples of CWV Helping Our Clients Leverage Their Assets into Revenue Generating Opportunities

- **Davis Memorial Goodwill Industries** - CWV worked with this international nonprofit that delivers employment and training services to people with special needs to evaluate its ability to generate community wealth. Goodwill had a large government contracting custodial service practice and an under-producing commercial practice. CWV worked with the organization to assess existing capacity of this commercial entity, evaluate its market growth potential and create business and implementation plans to support the growth objectives. As a result, this client has signed a new six-figure contract with a commercial property.

- **Neighborhood Reinvestment Corporation** – CWV assisted this national community development corporation in negotiating its first corporate partnership with Washington Mutual Bank. CWV developed a full management account strategy for the organization and assisted in implementing the strategy during all phases of the negotiation process. With CWV's assistance, the Corporation has successfully grown the partnership which generated over $3 million in revenues and support for the organization by the second year of the relationship.

- **Chesapeake Bay Foundation Bay Schools Project** - CWV worked with the Chesapeake Bay Foundation to assess the school reform marketplace and to determine the potential for generating revenues from the sale and delivery of an innovative program to integrate education about the Chesapeake Bay into the curriculum for elementary, middle school and high school students. The program had been funded by third party donations and is now undergoing a transition to capture a large percentage of its costs from direct payment for services. As a result, the program sustainability and capacity for expansion has increased dramatically.

- **Prichard Committee** – CWV worked with this education advocacy organization to identify opportunities based on its existing assets. After extensive feasibility assessments of potential opportunities, CWV helped the Committee to develop and launch a consulting business that leveraged its expertise in establishing parent training institutes focused around school involvement. As a result of CWV's work and recommendations, the Committee already has obtained several revenue-generating contracts for its consulting services.

- **Welfare to Work Partnership** – CWV worked with the Partnership to evaluate potential business opportunities that would leverage the organization's expertise on welfare-to-work issues. With CWV's help, the Partnership launched Aptus Consulting, a new subsidiary that offers recruitment and retention services for businesses looking to hire new entry-level staff and to reduce entry-level staff turnover. The Partnership staff has already entered into pilot project relationships with two major clients – a large national discount grocery chain and a dominant national home improvement supply company – to test and refine their products and services.

- **Share Our Strength** – CWV worked with this national anti-hunger organization to develop and launch a high-end catering business targeting private corporations in the Washington DC metro area. CWV conducted in-depth market research to identify key market trends and competitors and assisted SOS in developing the staffing and business model for the catering venture. Following the recommendation in the business plan developed by CWV, SOS generated over $400,000 in revenues from high-end corporate catering contracts in the first year.

- **Local Initiative Support Cooperation (LISC)**– CWV worked with this national financial intermediary organization to develop a comprehensive marketing strategy aimed at attracting corporate partners. CWV assessed the internal assets and structure of the organization while interviewing key corporate donors to design a strategy specific to the Cooperation's position and ability. The organization has hired a new staff member to oversee its corporate partnerships and is currently implementing recommendations from the CWV plan regarding internal structure and marketing issues.

- **Boys and Girls Clubs of Newark** - CWV worked with this local chapter of a national youth services organization to identify possible business opportunities. Although the organization had a strong national brand, the local chapters' most powerful asset was its close relationship with the African-American and Latino community. Based on the huge demand among corporations to target this population, CWV worked with the client to design a focus group business that would generate revenue by providing companies with access to do market research with youth at the clubs. The clubs were able to incorporate this revenue-generating activity as part of a broader program to help youth understand business principles, marketing, and their own value as consumers. As a result, the client signed several revenue-generating contracts with corporations to host focus groups with club youth. There are plans to roll this focus group business out nationwide in partnership with the organization's local affiliates.

- **MHRA** - CWV worked with this health care services provider and discovered that their IT division, while focusing on providing AIDS assistance, was actually providing a broad range of technical and computer related assistance. CWV helped the organization formalize these activities and offer them as for-fee specialized IT consulting and training services for all area nonprofits. As a result, this client has numerous revenue-generating contracts with area organizations to provide specialized IT support.

- **Technology Works** - CWV worked with this DC-based nonprofit start-up to evaluate their initial business strategies, develop a business plan to support the final product/service decisions, and coach/mentor the president through the business start-up process. As a result of this collaborative effort, CWV helped refocus the primary planning efforts on building a sustainable revenue generating strategy that supports the organization's mission-focused objectives. As a result the client, has signed up over 50 fee-for-service members for its services

- **WBUR** - This National Public Radio affiliate engaged CWV to identify revenue generating opportunities for the station. Given the station's many assets, including a highly educated audience, visible on-air personalities, and high quality news programming, CWV proposed that the station launch a news and education themed café that would utilize the station's name recognition while extending their mission of supporting public discussion of current events. As the station had no experience in operating a restaurant, CWV identified experienced operators to handle the day-to-day running of the retail establishment.

- **New Jersey Network** - CWV worked with this state-owned public television station to develop a business around the organization's experienced film production team. While the station had been engaged in a limited amount of fee-for-service work, CWV helped them to identify the true scope of their market opportunity, and developed a business plan to help them grow the business to its true potential.

- **Safer Foundation** - CWV worked with this large Chicago-based nonprofit that provides rehabilitative services to ex-offenders. The president initially hired CWV to research, evaluate and recommend new venture opportunities, but the relationship grew to include organizational development, strategic planning and merger and acquisition work. CWV's work helped the organization to anticipate the organizational ramifications of implementing a community wealth endeavor and positioned the organization to change accordingly. The organization is currently considering purchasing a franchise business.

***Example of working with nonprofits on community wealth in a group consulting setting***

- **Fannie Mae Foundation/Eugene & Agnes E. Meyer Foundation** - CWV worked with two of the largest foundations in the DC area to design and implement an 18 month group consulting project. CWV worked with a cohort of eight foundation grantees through both a standardized and customized consulting process focused on community wealth generation. Several of the eight organizations have launched new or improved existing revenue-generating ventures. As a result of this success, both foundations have agreed to fund a second cohort in the Washington DC area that began in April 2002.

***Examples of working with Corporations and Foundations on related issues***

- **Venture Philanthropy Partners** – CWV provides this venture philanthropy group with on-going research work focused on the venture philanthropy community. VPP and CWV recently released a third annual report on venture philanthropy entitled *Venture Philanthropy 2002: Advancing Nonprofit Performance Through High-Engagement Grantmaking.*

- **The Timberland Company** – CWV worked with this international footwear company to develop an employee service tool kit for rollout to its 6,000+ worldwide employees. CWV codified the company's existing volunteer program and assisted the company in establishing a link between its corporate volunteerism and its business objectives. In addition, the service manual produced by CWV currently serves as a practical guide for all Timberland employees interested in engaging in meaningful service.

***Example of nonprofit merger and alliance work***

- **Million Mom March and the Brady Center for Hand-Gun Control:** CWV worked with two of the nation's leading gun control organizations to structure a merger that would take full advantage of the unique strengths of each organization. The similar missions of the two organizations enabled CWV to bring the parties together in joint meetings to negotiate critical merger issues such as name, structure, board, staffing, and focus. The new organization combines the legislative advocacy and financial strength of the Brady Center with the grassroots support and volunteer base of the Million Mom March.

- **Fannie Mae Foundation:** CWV researched and developed an extensive report on the potential impact strategic alliances and mergers can have on the nonprofit sector. The report profiled numerous case studies and lessons learned from the field. Additionally, it developed a practical guide for any nonprofit considering a strategic alliance as well as a high-level look at the impact the strategy might have in the Washington DC Metropolitan area.

# The U.S. Chamber of Commerce's Small Business Tax Policy and Priorities

A robust small business community is vital to economic recovery and prosperity in America. Creating a tax code that allows entrepreneurs the flexibility and incentive to invest, grow, and create jobs, will foster continued economic growth and provide an enhanced standard of living. Therefore, the U.S. Chamber of Commerce encourages tax policy that promotes a positive environment for small entity growth and investment for the broadest number of enterprises. We see this as having the greatest impact on job growth and prosperity in the economy while restricting the increased complexity of the tax code. Our small business tax agenda includes the following priorities:

**Make the elimination of the Estate Tax permanent.** The current estate and gift tax system can deplete the estates of those who have saved the entire lives, force family businesses to liquidate and lay off workers, and motivate people to make financial decisions for estate tax purposes rather than for business or investment reasons. Current law, due to the arcane rules of the Senate, allows for the gradual phase-out of the tax in 2010 followed by its full reinstatement the following year. Until this tax is permanently eliminated, small business owners must continue to divert resources for estate planning and protection from job growth and development.

**Repeal the Alternative Minimum Tax (AMT).** Originally designed to ensure that all taxpayers pay a minimum amount of taxes, the AMT unfairly penalizes businesses that invest heavily in plant, machinery, equipment and other assets. The AMT significantly increases the cost of capital and discourages investment in productivity-enhancing assets by negating many of the capital formation incentives provided under the regular tax system, most notably accelerated depreciation. Furthermore, for the small business owner, the AMT is extremely complex, burdensome and expensive to comply with.

**Increase the allowance and phase-out of the "Section 179" depreciation expense allowances for small businesses.** The U.S. Chamber supports the full expensing of business equipment for all businesses or, at the very least, a further increase and/or acceleration of the "Section 179" equipment expensing allowance. Such measures would spur additional investment in business assets and lead to increased productivity and more jobs. Under current law, businesses can expense up to $24,000 for 2002. Businesses investing more that the annual expensing allowance must recover the cost of their expenditures over several years through the depreciation system. Inflation, however, erodes the present value of the future depreciation deductions.

**Accelerate and make permanent tax code changes in the "Economic Growth and Tax Relief Reconciliation Act of 2001".** In order to provide the maximum economic benefit for small business owners in their investment decisions, they must have the certainty of permanence in the tax code that affects those decisions. Current changes in the tax code affecting pensions and marginal tax rates will expire in 2011 providing the risk of uncertainty for many of the assumptions needed for small business investment decisions.

**Reduce the complex and burdensome subchapter S rules that impedes the growth of small business.**
S Corporations operate in every business sector in every state and account for almost one-half of all corporations. The current rules-adopted in 1958 when S corporations were created, and subsequently amended-are out of sync with modern economic realities and continue to impede the growth of small businesses and burden them with unnecessary administrative complexity.

# National Association for the Self-Employed (NASE)

Small Business Access to Capital
Roundtable

Senate Small Business Committee

May 22, 2002

**OPENING STATEMENT**

The National Association for the Self-Employed (NASE) is the nation's leading resource for the self-employed and micro-businesses, bringing a broad range of benefits to help entrepreneurs succeed and to drive the continued growth of this vital segment of the American economy. Of our 200,000 plus members, our average member has 5 employees. With approximately 14 million self-employed individuals in our nation, the NASE asserts that a small business with five (5) employees or less has very different needs, **including working capital requirements**, than a small business with 25, 50 or 150 employees. Thus, with the current definition of small business as 500 employees or under, programs for and research regarding "small business" access to capital does not always reflect the needs of the self-employed or micro businesses. The NASE supports the concept of the BRIDGE Act as well as fully supports the Affordable Small Business Stimulus Act. However, we urge the Senate Small Business Committee, Congress and the Administration to focus efforts on assisting our nations' micro businesses in gaining access to working capital (i.e. loans of less than $50,000). While there are organizations that offer micro loans such as Accion and Count Me In, the demand is much greater than the supply.

## Key Issues regarding Small Business Access to Capital

1. Small Business is NOT receiving enough capital.

   - According to the SBA Office of Advocacy report, Small Business Economic Indicators 2000, "Surveys from the Federal Reserve Board show that banks have been tightening lending standards and bank rates have been increasing more rapidly than their costs."

   - Banks are less likely to offer loans to small businesses. Reasons for this:
     i. The perception that start-ups and small enterprises are risky investments since growing businesses typically exhibit erratic bursts of growth and downturn.

ii. Current regulations on banks regarding requirements for loan loss reserves, capital ratios, etc. have made it necessary for banks to restrict their lending practices.
iii. Increasing mergers and consolidations of banks have led to larger regional or national banks buying out small, local banks. Large banks are less interested in making loans to small, local businesses. Also, where a small business owner once had a long-standing, cultivated relationship with a local bank, the owner will be forced to deal with a new system and staff. This all affects lending.

- The approximate 600 venture capital companies in the Unites States, managing 35-40 billion dollars, only provide about 3% of all business financing in U.S. Again, the issue is the high risk associated with new, small and emerging businesses. Most venture capital companies do not lend money in small amounts (i.e. the amount a 5 employee or less firm would need). Also, the cost of utilizing a venture capital company (i.e. stock, ownership, partnership in the company) is much higher for small businesses owners. Another issue is access to potential investors and investment companies that will invest in small amounts.

2. Due to lack of capital micro-businesses and the Self-Employed are increasingly dependent on credit cards.

   - Credit Card usage statistics:
     - Almost 70 percent of those using credit cards use them for travel and entertainment expenses.
     - 64 percent are using their credit cards for day-to-day expenses.
     - 34 percent of businesses use credit cards for purchasing inventory for resale.
     - 46 percent of small businesses use a credit card for large capital outlays.

   - Large capital expenses are not a safe way to utilize credit cards. Other types of financing do not require the high interest rates of credit cards however the problem is SMALL BUSINESS ACCESS TO CAPITAL. Credit Card usage by the self-employed and small business owners continues to increase.

3. Due to lack of capital Small Businesses and the Self-Employed do NOT have a financial cushion during economic decline.

   - Businesses with 5 employees and under continually utilize their own capital, loans, and revenues to fund, maintain and grow their business. They usually do not retain large amounts of capital and thus many self-employed individuals and small businesses do not have the ability to wade through an economic downturn. Without assistance, their businesses will cease to exist.

However during times of economic decline, when small businesses and the self-employed need capital the most, banks and investors restrict loans and investments.

## BRIDGE Act/ S.1093

**Summary:** The BRIDGE Act would allow a rapidly growing business to elect to defer up to $250,000 in Federal income tax liability for 2 years, with payment over a 4-year period, with interest payable on the deferral at the Federal underpayment rate. The GAO (General Accounting Office) is requested by this legislation to study the applicability and effectiveness of this tax deferral with a report to Congress.

**Eligibility:** Businesses that grow at least 10% in gross receipts above the prior 2-year average would be eligible if they are on the accrual accounting method and have $10 million or less annual gross receipts.

**Effective Date:** Taxable years beginning after the date of enactment. The tax deferral would apply through December 31, 2005.

**POSTITIVES**

- Would create working capital for small business.

**MINUSES**

- May not extend to sole proprietors.
- Excludes professional service industries (i.e. in the fields of law, health, architecture accounting, and consultants.)
- Doubt micro-businesses will utilize since tax deferrals are modest.

## The Affordable Small Business Stimulus Act/ S.1676

Summary: Contains many important provisions for small business such as increasing expensing limits to $35,000, allowing for 100% deductibility for health insurance now, alters depreciation rules for computers or peripheral equipment from five years to three, and for software from three years to two, includes the Single Point Tax Filing Act, which will simplify the tax filing process.

In regards to access to capital, S. 1676 would provide new investments in companies with capitalization of up to $100 million at the time of investment will have a 75 percent capital gains exclusion if the investments are held at least three years. The exclusion for such investments will be 100 percent if they are made in a business involved in certain critical technologies, or for investments in specialized small business investment companies. Both the 75 and 100 percent exclusion levels would be available for investments made by both individuals and corporations. In addition, the rollover period for such investments would be increased from 60 days to 180 days.

**POSITIVES**

- Due to tax-free gain on stock, will encourage more investment in small business.

**MINUSES**

- Does not apply to sole proprietorships or partnerships. Would apply only to C corps and S corps.
- Should be expanded to include limited liability companies since many businesses are moving to utilize LLC status versus S corp status.

## Possible Solutions for Micro Businesses to Gain Access to Capital

1. Encourage lending to small businesses by non-traditional financial institutions, such as commercial finance companies and private/ public sector cooperative organizations. Examples Accion, Count Me In.

2. The Small Business Administration should work with financial institutions to lessen the administrative and minimum loan standards for micro businesses.

## NASE's Access to Capital Assistance to the Self-Employed and Small Business Community

- To assist our membership with access to capital, the National Association for the Self-Employed has created a partnership with American Express and ACCION International.

- NASE Members can sign up for American Express's small business credit card and with every purchase made, 1% of those purchases goes to ACCION International, a non profit, microlending organization.

- ACCION International is one of the world's leading microfinance organizations dedicated to bringing financial services to these smallest of small business people such as street vendors, deli owners, seamstresses, etc.