

**FINAL REPORT  
OF THE  
SEC GOVERNMENT-BUSINESS FORUM  
ON  
SMALL BUSINESS CAPITAL FORMATION**

**July 1999**

This report has been compiled by the staff of the Division of Corporation Finance, U.S. Securities and Exchange Commission. The views and recommendations in this report, however, are those of the Forum participants and not of the Commission, the Commissioners or any of the Commission's staff members.

**PREFACE**

In September 1998, the Government Business Forum on Small Business Capital Formation met in Chicago, Illinois. The recommendations from the 1998 Forum follow. We believe that many worthwhile proposals are evidenced. Participants gave careful consideration to a wide range of issues, including, once again the recommendations of the 1995 White House Conference on Small Business.

One purpose of the Forum is to give the capital-raising needs of small business greater attention, with the hope that these needs may be accommodated, consistent with investor protection. It is apparent from the following Forum recommendations that this purpose has been well-served. We thank them for their efforts and are pleased to present this report.

The Executive Committee for  
the Seventeenth Annual SEC  
Government-Business Forum on  
Small Business Capital Formation

**EXECUTIVE COMMITTEE**

Chairman:  
Richard K. Wulff  
Chief, Office of Small Business

Division of Corporation Finance  
U. S. Securities and Exchange Commission

Jerry Arnold  
Professor of Accounting  
University of Southern California

Mary E. T. Beach  
Consultant  
(former Associate Director for Small Business at the U.S. Securities and Exchange Commission)

Charles Bennett  
Vice-President, Syndicate  
Edgar M. Norris Company, Inc.

Janice Booker  
Director  
Community Development Division  
Office of Comptroller of the Currency

Deborah Bortner  
Director  
State of Washington Securities Division

Michael S. Caccese  
Senior Vice President & General Counsel  
Association for Investment Management & Research

Chip Cooper  
Executive Director  
Missouri Innovation Center

Albert S. Dandridge, III  
Partner  
Mesirov Gelman Jaffe Cramer & Jamieson, LLP

Gregory Dean  
Assistant Chief Counsel for Advocacy  
U.S. Small Business Administration

Jerry Feigen  
Adjunct Professor, Georgetown University Law Center;  
President, Jerry Feigen Associates

Bruce Goldberg  
Director  
National Emerging Business Services  
PricewaterhouseCoopers LLP

John J. Huntz, Jr.  
Fuqua Enterprises, Inc.

Daryl Jackson  
Deloitte Touche LLP

Charles Ludlam  
Executive Director  
Biotechnology Industry Organization

Todd McCracken  
Executive Director  
National Small Business United

E. Burns McLindon  
Councilor, Buchanan & Mitchell  
(Representative of the American Institute of Certified Public Accountants)

Lee Mercer  
President  
National Association of Small Business Investment Companies

Marc H. Morgenstern  
Partner, Kahn, Kleinman, Yanowitz & Amson Co., L.P.A.  
(Representative of the American Bar Association)

Alien Neece  
Neece, Cator & Associates, Inc.

Karen O'Brien  
General Counsel  
North American Securities Administrators Association

Douglas F. Parrillo  
Parrillo Communications, Inc.

Greg Riddle  
Legislative Assistant

## Biotechnology Industry Organization

Martha Scanlon  
Deputy Associate Director  
Division of Research and Statistics  
Federal Reserve Board

Mark Schultz  
Consultant

Thomas Selman  
Vice-President  
NASD Regulation, Inc.

BettyLynn Smith  
President  
National Association of Investment Companies

Wayne Upton, Jr.  
Project Manager  
Financial Accounting Standards Board

Clay H. Womack  
President  
Direct Stock Market, Inc.

## **OPENING PANEL**

### **"HOW TECHNOLOGY IS CHANGING THE WAY SMALL BUSINESSES ARE FINANCED"**

Moderator --  
Greg Dean, Assistant Chief Counsel for Advocacy  
Office of Advocacy  
U.S. Small Business Administration  
409 Third Street, S.W.  
Washington, D.C. 20416

Along with --  
Glen Faulkner  
Vice President Issuer Services, Inc.

The Nasdaq Stock Market, Inc.  
33 Whitehall Street  
New York, NY 10004-2190

Michael Mack  
Director of Marketing  
Zap Power Systems  
17 Morris Street  
Sebastopol, CA 95472

Broc Romanek  
Counselor to Commissioner Laura Unger  
U.S. Securities & Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549

## **CORE PRESENTERS**

### **TAXATION ROUNDTABLE**

Moderator --  
Daryl Jackson  
Deloitte Touche, LLP  
333 Clay Street Suite 2300  
Houston, TX 77002-4196

Along with --  
Russ Orban, Assistant Chief Counsel for Tax Policy  
Office of Advocacy  
U.S. Small Business Administration  
409 Third Street, S.W.  
Washington, D.C. 20416

**INDUSTRY CONSOLIDATIONS AND ROLL-UPS --**  
Thursday, September 24, 1998

Moderator --  
DeAnn Brunts  
Partner  
Pricewaterhouse Coopers, LLP  
30 South 17th Street  
Philadelphia, PA 19103

Along with --  
Patrick Hurley  
Partner  
Howard Lawson & Company  
Two Penn Center Plaza  
Philadelphia, PA 19102

David A. Gerson  
Partner  
Morgan, Lewis & Bockius, LLP  
One Oxford Centre Thirty-Second Floor  
Pittsburgh, PA 15219-6401

Jennifer Kreischer  
Senior Manager  
Pricewaterhouse Coopers, LLP  
30 South 17th Street  
Philadelphia, PA 19103

Scott H. Lang  
Director  
BGL Capital Partners  
225 West Washington Street, Suite 1600  
Chicago, IL 60606

Christine M. Tierney  
Senior Vice President  
Bank of America NY & SA  
231 South La Salle Street  
Chicago, IL 60697

Alan R. Tekerlek  
Vice President  
Lehman Brothers  
601 South Figueroa Street, Suite 4425  
Los Angeles, CA 90017

INDUSTRY CONSOLIDATIONS AND ROLL-UPS --  
Friday, September 25, 1998

"New Economic Data on Mergers & Acquisitions in the Financial Institutions Industry"

Presentation by Dr. Robert E. Berney, Office of Advocacy, U.S. Small Business Administration

Moderator --  
DeAnn Brunts  
Partner  
Pricewaterhouse Coopers, LLP  
30 South 17th Street  
Philadelphia, PA 19103

Patrick Hurley  
Partner  
Howard Lawson & Company  
Two Penn Center Plaza  
Philadelphia, PA 19102

David A. Gerson  
Partner  
Morgan, Lewis & Bockius, LLP  
One Oxford Centre Thirty-Second Floor  
Pittsburgh, PA 15219-6401

Jeffrey W. Horine  
Citadel Investment Group, LLC  
225 W. Washington, 9th Floor  
Chicago, IL 60606

Christine M. Tierney  
Senior Vice President  
Bank America NT & SA  
231 South La Salle Street Chicago, IL 60697

Alan R. Tekerlek  
Vice President  
Lehman Brothers  
601 South Figueroa Street Suite 4425  
Los Angeles, CA 90017

Mike Wathen  
Partner  
Pricewaterhouse Coopers, LLP  
30 South 17th Street  
Philadelphia, PA 19103

EARLY STAGE DEALMAKING/EXITING STRATEGIES --  
Thursday, September 24, 1998

Moderator --

Albert S. Dandridge, III  
Partner, Mesirov Gelman Jaffe Cramer & Jamieson, LLP  
1735 Market Street  
Philadelphia, PA 19103 -7598

Jerry Arnold  
Professor, Marshall School of Business  
University of Southern California  
Los Angeles, CA 90089-1421

Don Christensen  
Associate Administrator for Investment  
U.S. Small Business Administration  
SBA Investment Division  
409 Third Street, S.W. Suite 6300  
Washington, D.C. 20416

Robert Kramer  
Chairman  
Trautman Kramer & Co, Inc.  
500 Fifth Avenue Suite 1440  
New York, NY 10110

Marc Morgenstern  
Partner, Kahn Kleinman Yanowitz & Arnson Co., L.P.A.  
The Tower at Erieview Suite 2600  
Cleveland, OH 44114-1824

Lee Petillon  
Petition & Hansen  
1260 Union Bank Tower  
21515 Hawthorne Boulevard  
Torrance, CA 90503

INTERNATIONAL STRATEGIES FOR GROWTH --  
Friday, September 25, 1998

Moderator --

Wayne S. Upton, Jr.  
Senior Project Manager  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

Bruce W. Shewmaker  
former President and Chief Executive Officer  
The U.S. Russia Investment Fund/Merrill Lynch  
Oklahoma Venture Partners  
12 Briarwood Drive  
Short Hills, NJ 07078

Andrew Findeisen  
President and Founder  
A.M.F. International Consultants  
812 North Wood Avenue  
Linden, NJ 07036

Edward S. Best  
Mayer Brown & Platt  
190 South  
La Salle Street  
Chicago, IL 60603

Richard P. Miller  
7500 N. Mockingbird Lane  
Paradise Valley, AZ 85253

#### 1998 FORUM STAFF

Barbara C. Jacobs, Staff Director  
David Burton  
Jacki Walker  
Twanna Young

#### TABLE OF CONTENTS

I. SUMMARY OF FORUM RECOMMENDATIONS

II. INTRODUCTION

III. TAXATION

IV. CREDIT

V. SECURITIES REGULATION

VI. MISCELLANEOUS

## **I. SUMMARY OF FORUM RECOMMENDATIONS**

### **TAXATION**

#### **Statement of Issues**

Tax policy can impose a heavy burden upon smaller businesses. Uncertainty as well as frequent changes in the rules further complicates the area for most small businesses that are already overburdened with demands upon time and resources. Tax policy also can be used in ways that encourage certain activities that could foster the successful operations of the smaller entrepreneur.

#### **Preamble**

The Internal Revenue Code is overly complex, internally inconsistent and unduly difficult to administer. The current code has evolved into a compendium of hidden revenue enhancement, double taxation and deductions based on social and political policy. Our national system of taxation should be limited to revenue measures and we should avoid using it as an indirect instrument of policy when possible. Social and political objectives can be more efficiently rewarded directly.

#### Recommendations

##### *Fundamental Reform*

##### *Federal Income Tax -- Begin the Analysis*

It is important that the federal government commence an analysis of our current tax system and report on improvements and simplification including, fundamental tax overhaul. Congress should enact legislation that would call for an end to the current tax code and replace it with a simpler and fairer system. In anticipation of a vote for a new tax code by a date certain, Congress should establish and fund

a team to provide a comparative analysis of the various alternative tax system proposals that should receive thorough analysis (e.g., consumption tax systems, flat tax systems, semi-flat tax systems, etc.) In addition, the team should oversee the analysis and development of a proposal that makes sensible modifications to the current income tax system. For example, it should be the goal of the reviewers to reduce duplications, standardize definitions and make them uniform throughout the code, eschew complicated formulas, reconcile contradictory policies and eliminate double taxation. A vote would then be held by a date certain (December 31, 2001, for example) where all proposals, including our current tax system, would be voted on and eliminated until one system received the majority of support. Congress would be free to leave the current tax system in place and/or prescribe the tune for transition if a new system were adopted. Once in place, the forum recommends a ten-year moratorium on changes to the tax code (excluding technical amendments, amendments to correct unfair and unanticipated results and amendments to close abused loopholes.)

### *Social Security Reform*

The inaction of Congress has contributed to the instability of the current Social Security System. Congress and the Administration must work together to enact legislation by the end of 1999 to make the existing Social Security System actuarially sound and to guarantee the commitments already made to all current participants. This should be done without placing additional new burdens on the present payroll tax system.

### *Estate and Gift Tax*

Our Forum calls on Congress to repeal the estate and gift tax. Property passed by gift or devise or inheritance would, however, retain its original cost basis.

### *Federal Accountability*

The federal government and all agencies thereunder shall operate financial systems using Generally Accepted Government Accounting Standards (GSGAS) and report their results to the public annually. It is inappropriate and misleading to use a unified budget to combine unrelated fund balances. All surpluses and deficits should be reported separately by fund for each trust and general account.

### *Intra-Jurisdictional Taxation (nexus)*

The lines of taxing authority giving rights to one government jurisdiction to tax an entity located in another governmental jurisdiction (known as nexus) have become blurred with the explosive growth of electronic commerce that instantly crosses all boundaries. Congress and the state legislatures should set uniform

guidelines. These guidelines are to be used by the appropriate agencies in assessing and resolving international and multi-state tax issues.

### *Implementation of IRS Restructuring*

The Forum members support the IRS Reform and Restructuring Act as passed by Congress and the changes to the IRS instituted by Commissioner Rossotti, with the support of the President. These changes must continue to focus on customer service and education of IRS personnel and the public. A primary goal of the IRS should be to help small businesses comply with the law and fight the IRS predisposition to treat all small businesses as fraudulent. The Service should strive to apply all tax laws fairly, equitably and consistently.

### **Transitional Recommendations**

Pending complete tax overhaul, and major structural reform, the Forum recommends the following transitional changes to improve the current tax code for small businesses. These changes would help small business owners attract or retain capital:

#### *Welfare to Work Tax Credit -- Intermediaries*

The Welfare to Work Initiative is a valuable tool to help welfare recipients join the labor force. The way the credit is structured, however, the company that actually uses the labor (the consumer company) cannot always take advantage of the credit if the consumer company uses an intermediary to facilitate hiring. For example, some non-profit programs have been established to smooth the way for welfare to work employment by helping bring small businesses and welfare workers together. The intermediary serves the useful purpose of teaching a new worker basic work skills while temporarily shielding a small employer from the occasional mismatch. Once it is clear that the worker has made a smooth transition, then the worker goes directly on the employer's payroll. Employers should not be penalized for participating in these intermediary hiring programs. The law should be written to permit them to qualify for the credit once the worker comes on the payroll.

#### *Self-Employment Tax -- Partnerships*

There should be some proportion of a distribution of income to an active partner in a partnership (or Limited Liability Corporation (LLC) or Limited Liability Partnership (LLP)) that is attributed to a return on capital investment and therefore should not be subject to self-employment tax.

#### *Alternative Minimum Tax (AMT) and Small Business*

The AMT is one of the costs to small business of acquiring capital. In the interest of finding ways to provide abundant capital sources to encourage small business growth, this Forum urges Congress to exempt all components of personal AMT that is generated by "small business." For the purpose of this exemption, a "small business" shall be defined as one that meets the capitalization requirement as defined by Congress in Internal Revenue Code Section 1202 dealing with special Small Business Stock (e.g., capitalization of less than \$50 million).

Congress should certainly do away with the AMT as part of any comprehensive tax overhaul proposal. In the meantime, Congress should not add the AMT to any new provisions of the tax code. Congress should instead carefully review the impact of this provision on investments in small business and repeal AMT in those instances where it discourages such investments. The AMT takes capital out of circulation that could be invested in a small company. The AMT has a disproportionately damaging effect on small businesses that are competing in the market for capital because sophisticated investors with the ability to analyze and invest in small businesses are the likely targets for the AMT. The Forum urges Congress to consider that substantial risks are already inherent in small business investments.

### *Technology Expenses*

It is critical that American business be competitive in the global economy. The Administration and Congress should recognize that there are strong public policy reasons to encourage investment in technology and quality control solutions to improve our national productivity and our global competitiveness. With faster and faster rates of change due to innovations and shorter and shorter useful lives of technology products, fixed depreciation schedules for technology purchases are unrealistic. Expenditures by small businesses for technology costs and quality control systems, such as the "Year 2000" software and hardware corrections (Y2K) and ISO 9000 quality levels, should be "expensed" in the year incurred even though they may benefit future years.

### *Business Continuity*

Pending the repeal of the estate and gift tax, Congress needs to encourage small businesses to accept the risks of a business start-up as well as to save and reinvest their profits by excluding the transfer of a small business from federal estate tax and gift tax as long as 51% of the business is owned by the founders or up to 4th generation successors.

### *Changes to Qualified Small Business Stock*

(Recommended amendments to Internal Revenue Code Sections 1202 and 1045)

The tax rate on capital gains on Qualified Small Business Stock should be set at 50% of the rate on long term capital gains. (For example, the long term capital gains rate is 20% so Section 1202 stock would be taxed at an effect rate of 10%.)

Sections 1202 and 1045 shall be available for investors in a "Subchapter S Corporation" where the corporation meets all other requirements of Section 1202.

The Alternative Minimum Tax should not apply to investors for the purpose of computing the amount of tax on a gain under Section 1202.

Expenditures that qualify under the working capital rules listed in Section 1202 should be made based on sound business judgment and not hastily made to comply with an arbitrary two-year limit to avoid company disqualification. The law should be so amended.

Investors should be permitted 180 days to "roll over" qualifying investments under the provisions of Section 1045 rather than 60 days.

#### *Independent Contractor Clarification*

The definition of an independent contractor must be clarified so that small businesses can act as independent contractors or hire independent contractors without fear of future reclassification by the IRS and the imposition of substantial penalties. Therefore, Congress should recognize the legitimacy of an independent contractor. The Forum urges Congress to pass a legislative solution to this serious small business problem including a simplified safe harbor to insulate businesses that hire independent contractors.

#### *Costs of an Aging Workforce*

Small business' greatest need is labor but it may not be able to afford to maintain the level of benefits offered all employees if Congress raises the federal mandated retirement age. A rise in the federal mandated retirement age shifts disproportionate additional healthcare costs to small business. The Forum recommends that a tax credit for the additional cost of healthcare be allowed. This credit could be calculated at the small business' marginal tax rate times the amount of the additional incremental cost.

Older workers should not be penalized when they reach the qualifying age for social security retirement benefits and continue to work. Congress needs to raise the level of outside salaries or wages that can be earned before social security

benefits would phase out. The level should be raised to a level comparable to four times federal mandated minimum hourly wage for a standard work year. Congress needs to encourage retirees to stay in the labor market.

#### *Insolvency Restructuring (Section 1017)*

Congress should extend the provisions of Internal Revenue Code 1017 allowing asset basis reduction to insolvent taxpayers for capital gains tax incurred as part of a formal or informal reorganization.

#### *Net Operating Loss*

Net Operating Loss Internal Revenue Code Section 382 -- So as not to artificially impede the acquisition, merger or other consolidation of loss companies Congress shall repeal Section 382. This would allow the buying and selling of net operating losses, which may be the only substantial asset that a failed company has.

### **CREDIT**

(These issues were discussed in the roundtables following the panel discussions on industry consolidations and roll-ups.)

### **Recommendations**

The top 60 recommendations of the 1995 White House Conference on Small Business should be re-endorsed. In particular, emphasis should be on recommendations #5A, #25, and #286.

The SBA should increase the number of non-bank, small business lenders (SBLCs) eligible to process SBA loans.

Congress should appropriate funds as a permanent line item in the SBA's budget for the Office of Advocacy to finance small business economic and technical needs research as currently performed by the SBA's Office of Advocacy. Permanent line item budgetary funding will provide continuity for long-term multiple year research projects, advocacy efforts and existing service programs.

The SBA's Office of Advocacy should be made a "permanent" and "independent" agency within the budget of the SBA. Congress should appropriate funds on a permanent line item basis in the SBA's budget for the Office of Advocacy to ensure the continuity of research and advocacy services provided by the Office of Advocacy.

The SEC and the SBA should continue to enhance the services provided to the small business community via electronic means, including informational resources and information dissemination via the Internet. These services provide a valuable resource to small business development. Use of the Internet to provide these services is timely and cost-efficient. Every effort should be made to expand these types of services.

Access to capital continues to be a critical issue to small business development. The increasing trend of bank mergers and acquisitions that has reduced the number of local and community-based banks, as well as the standardization of the credit and loan review processes, has made it increasingly difficult for small businesses to comply with the loan requirements of larger, non-local banks. The increasing prominence of asset-based lenders is disproportionate to the increasing number of service and nominal asset-based businesses. Efforts should be made to revise the methods used in determining the credit worthiness of small business loan applications that are service-related or have nominal fixed assets available to pledge as collateral. Efforts should be made to develop loan programs that meet the needs of businesses with nominal assets. Research should be conducted to determine the feasibility of implementing incentive programs for lending institutions willing to make loans to these types of businesses.

The SBA should develop revised guidelines and regulations regarding community-based banks, allowing them to participate in the SBA guarantee loan program as "preferred lenders" to facilitate increased loan volume to small businesses. Revised guidelines and regulations should allow for loans to be reviewed for credit worthiness in a "character loan" evaluation method, rather than an "asset-based loan" evaluation method.

The SBA should develop a loan program for non-asset based lending with government guarantees.

The SBA should develop a program to market SBA-guaranteed loans on the secondary market.

Federally chartered or insured credit unions should be permitted to make small business loans.

The \$100,000 FDIC insurance limit should be raised to \$500,000 to match that of SIPC.

More pension money should be available for investing in small businesses. ERISA's prudent man rule should be revised to accommodate this goal.

## **SECURITIES REGULATION**

### **Recommendations**

#### *Securities Act of 1933*

##### *Exemptions*

The Forum strongly opposes the SEC rule proposal that would amend Rule 504 of Regulation D and require securities issued in Rule 504 offerings to be deemed "restricted securities". The Forum believes adoption of such a measure would be extremely harmful to small business capital formation and the proposal's detriments far outweigh its benefits.

The Forum supports maintaining Rule 504 of Regulation D in its current form and opposes additional regulatory changes that would restrict its use.

The Commission should endorse NASAA's suggestion regarding the transferability of securities in a Rule 504 transaction, which is set forth in NASAA's comment letter to the Commission dated July 30, 1998. Specifically, NASAA urges that the Commission only impose restrictions on Rule 504 securities when these securities are offered and sold by issuers that do not register the securities in at least one state that requires registration and the delivery of a prospectus.

If the Commission were to adopt the changes to the Rule 504 regulatory scheme suggested by NASAA, then the Commission should increase the amount that may be raised in a Rule 504 offering to \$5 million and in a Regulation A offering to at least \$7.5 million, but not to exceed \$10 million. Increases in these offering amounts would attract broker-dealers to these offerings and reduce offering costs as a percentage of the amount raised.

Rule 504 should be amended to increase the aggregate annual offering limitation to \$3.0 million.

The SEC should increase the exemption provided by Rule 504 to \$5 million. Securities issued without compliance with state registration should be restricted securities under the Securities Act of 1933.

The dollar ceiling for SCOR offerings ought to be increased.

The National Securities Market Improvements Act (NSMIA) preempted the states from regulating Rule 506 offerings but not Rule 505 offerings. Since the

requirements of Rule 505 and Rule 506 are virtually identical except for investor qualification standards, most practitioners advise their clients to do Rule 506 offerings rather than 505 offerings. Given the limited usefulness of Rule 505 since the passage of NSMIA, the Commission should consider rescinding Rule 505.

There should be greater standardization and uniformity for procedures for Regulation D Rule 506 private placements at the state level. All states should be required to accept only federal Form D, impose filing fees based upon a uniform schedule, require filings be made at the same time, and impose uniform monetary penalties for noncompliance.

Either encourage NASAA to have states agree to uniform fees and Form D filing times on 506 offerings or the function will default to federal standards after three years.

Regulation A and 505 issues should be preempted from state regulation, and in the event there is no preemption, for the sake of uniformity, have national coordinated equity review limited to disclosure -- not merit review -- and include 504 in such coordination.

The Commission should recognize Rule 1001 as an exemption from federal registration for issuers relying on the NASAA Model Accredited Investor exemption. In the alternative, the Commission is encouraged to issue a release proposing a federal exemption for all states that have adopted the NASAA Model Accredited Investor Exemption.

The Commission should extend Rule 1001 as an exemption from federal registration for all issuers relying on the NASAA Model Accredited Investor exemption. In the alternative, the Commission is encouraged to issue a release proposing a federal exemption for all states that have adopted the NASAA Model Accredited Investor exemption. Pursuant to the authority granted in NSMIA, the Commission should adopt the Accredited Investor definition for a "qualified purchaser" under Section 18(a) of NSMIA.

NASDAQ Small Cap securities should be "covered securities" under NSMIA.

Whether by SEC rule under its delegated authority under NSMIA or by statutory change, the definition of "covered security" under NSMIA should be expanded to cover securities issued under Regulation A offerings that have been declared effective by the SEC.

The Commission should craft a new exemption that would permit general solicitation over the Internet so long as sales are made only to accredited investors and up to 35 non-accredited investors who have a pre-existing relationship with the issuer. In exchange for this flexibility, the issuer must reasonably believe that the accredited investors are, in fact, accredited.

The Commission should consider expanding the availability of the "safe harbor" provided by Rule 144A for the resale of securities to qualified institutional buyers ("QIBs") by reducing the net worth/asset requirements for QIBs.

The "test the waters" concept should be expanded to permit such communications in transactions that are eligible to be registered on Forms SB-1 or SB-2; and state regulators ought to be precluded from prohibiting communications that come within the federal safe harbor.

In all new issuances of securities, funds should be required to be delivered to the issuer within one day of effectiveness (T+ 1).

### *Registration Issues*

The Commission should further clarify the limits of permissible activity for electronic road shows and should address the issue in the context of private offerings.

Increased participation/standardization of the states in required SCOR review and coordinated equity review of Regulation A and S-B filings ought to be encouraged.

On the Internet, all regulatory efforts should be directed towards sales only -- not offers. NASAA should encourage the states to adopt a uniform definition of sales, and in the event there is no uniform definition within 3 years, the SEC should promulgate a uniform definition.

The states, through NASAA, should adopt a policy of timely review and response to issuers' offering materials and correspondence in order to facilitate issuers' time schedules.

### *Other*

The Commission should sponsor analysis of the costs and economic impact to small business (i.e., what is the cost of not having federal preemption or total coordination among the states).

In connection with a business combination involving a small business as defined by SBA regulations, where GAAP requires "purchase" accounting and there is a GAAP step-up but not necessarily a tax step-up in the Company's value, there should be a corresponding tax deduction permitted.

The Commission should work with the states to extend the capabilities of EDGAR to all 50 states, the NASD, and the exchanges.

Documents filed in EDGAR (or equivalent system) should be deemed filed with the states upon notice to the state.

#### *Securities Exchange Act of 1934*

NASDAQ's small cap retention group should take responsibility to provide assistance and information to companies who have been or are going to be delisted due to changes in listing maintenance standards. Information to be provided should include alternate markets and trading systems to assist companies in making the transition.

The SEC, NASD and NASAA should promote proposals that facilitate secondary markets for non-NASDAQ trading companies. These efforts should focus on regulatory reform to facilitate secondary trading.

A committee or task force should be established to examine whether the NASD's underwriting compensation limits or other factors are restricting the willingness of registered broker/dealers from participating in smaller dollar offering transactions, whether they are public or private. Participants ought to include NASD member firms, issuers affected and their respective counsel. The task force ought to examine whether the posting of an offering document on a broker/dealer's web site, where the dealer is not affirmatively recommending or soliciting its customers to purchase the offered securities, constitutes underwriter's conduct.

The NASD should modify its computer system to enable the NASD to identify whether a security is an electronic bulletin board quoted security. This could simply be done by adding a fifth symbol.

A new market should be established for small companies with its own SRO.

Electronic Communications Networks (e.g., Instinct and SelectNet) should be registered as broker/dealers and subject to all of the rules and regulations.

The Commission's cold-calling rule should be amended to provide a safe harbor for contacts with existing customers if they are accredited or sophisticated investors and the investment would not involve more than 10 percent of the

person's liquid assets.

To discourage "bear raids," the Commission should establish rules prohibiting short selling in the over-the-counter market after a security has crossed a certain downward trigger; this would be analogous to current rules for listed securities.

The same "uptick" rules should apply to all stocks (OTC Bulletin Board, Nasdaq SmallCap) as a requirement to make a short sale.

Broker-dealers should be strictly required to meet the same coverage requirements for naked shorts as applied to customers and a 100% haircut on such shorts should be strictly enforced against violators.

A system should be implemented to determine accurately through reporting requirements the number of shares that have been shorted and vigorously enforce the rule.

The shorting of all stock within ten business days after effectiveness of an initial public offering should be prohibited.

#### *Investment Company Act of 1940*

The BDC Law has been a dismal failure. There is a need for a professionally managed fund/pool for venture capital in order to broaden the base beyond existing institutions and wealthy individuals to retail/ individual investors. The SEC should work with the SBA to undertake a thorough study to the end of coming up with recommendations for such a financing source in order to provide an additional funding mechanism for small businesses. The SBA should be the lead agency in this effort relative to working with Congress.

The Commission should consider amending the Investment Company Act of 1940 ("1940 Act") to exempt Small Business Investment Companies ("SBICs") with more than 100 shareholders from the provisions of the 1940 Act provided that:

- the SBICs shares are registered under the Securities Act of 1933; and
- the SBICs operations are in compliance with Small Business Administration regulations.

#### **Miscellaneous**

The Forum's annual report to Congress should include an addendum that highlights those measures that have been adopted or implemented during the preceding year(s).

The Forum ought to increase its outreach to attract greater attendance from a broader spectrum of governmental agencies such as the Federal Reserve Board, regional Federal Reserve Banks, and similar banking related agencies, including participation of individuals at the district level.

The SBA, in general, and the Office of Advocacy, in particular, perform a valuable function and require continued support to further their mission of assisting gazelle companies in obtaining needed equity capital for business expansion and job creation. Thus, the Forum urges the Congress to strongly support the Office of Advocacy in these vital efforts.

Efforts to increase public/private coordination of AceNet should be stepped up to facilitate public awareness of this mechanism as a device to bring angel investors in contact with a broader array of potential investment opportunities in promising small companies.

State Department staff, particularly in Embassies overseas should have publicly available e-mail addresses. This would facilitate entrepreneurs' ability to do business overseas because it would allow them to effectively obtain business and political information quickly and efficiently.

All U.S. Embassies should have Web sites providing information about personnel, the Country plan, hyperlinks to other U.S. government information regarding available funding, calendars of events and all other information that could aid a small business trying to do business in the international marketplace.

## **II. INTRODUCTION**

The U.S. Securities and Exchange Commission hosts an annual forum that focuses on the capital formation concerns of small business as provided in the Small Business Investment Incentive Act of 1980. Thus, in each of the past seventeen years, the SEC Government-Business Forum on Small Business Capital Formation has been convened. A major purpose of the Forum is to provide a platform for small business to highlight perceived unnecessary impediments to the capital-raising process. Numerous recommendations have been developed at these Forums seeking legislative and regulatory change in the areas of taxation, securities regulation, financial services and state and federal assistance. Participants at the Forum typically are small business owners,

venture capitalists, government officials, trade association representatives, academicians and advocates of small business. While a number of different formats have been tried over the years, a very effective one for purposes of the development of recommendations for governmental action has included the use of small interactive participant groups; and in recent years, the Forum has typically included this feature. The Seventeenth Annual Forum was held in Chicago, Illinois on September 24 and 25, 1998.

The Forum is governed by an Executive Committee comprised of senior government officials and representatives of small business who have a strong interest and expertise with the issues and capital-raising problems of small business. The Executive Committee organizes, plans and implements the Forum.

The topic areas of taxation, industry consolidations/roll-ups and securities were selected as the focus of this year's Forum. The Executive Committee had determined that the format of the morning sessions would present a variety of roundtable discussions, each devoted to one of the three targeted disciplines. Each roundtable would highlight current issues in its targeted topic area, and be moderated by a member of the Forum's Executive Committee, with a core staff of presenters and commentators comprised of several experts in the particular discipline. Because all of the roundtables would be offered concurrently, Forum participants had to select the roundtable discussion in which they wished to participate. As in prior years, time would be devoted to discussion in small interactive break-out groups in order to permit Forum participants sufficient opportunity to develop thoughtful recommendations. These groups were to be comprised only of participants who had attended a particular topic roundtable.

Welcoming remarks on behalf of the Executive Committee at this year's Forum were offered by Richard K. Wulff, Chief of the Office of Small Business in the Division of Corporation of the U.S. Securities and Exchange Commission. Jere Glover, Chief Counsel for Advocacy of the U.S. Small Business Administration presented his annual assessment of the state of small business. Greg Dean, Assistant Chief Counsel for Advocacy, then moderated an opening panel discussion entitled, "How Technology Is Changing the Way Small Businesses are Financed." The panel was followed by the scheduled roundtable discussions. Jeffery Adduci, President of the Regional Investment Bankers Association, gave the luncheon address. Break-out sessions among the Forum participants were conducted throughout the afternoon.

The second day's session followed the same basic format. Frank G. Zarb, Chairman of the National Association of Securities Dealers, Inc., addressed the participants in the morning. A luncheon panel entitled "Financing of Small Businesses in the state of Illinois" was moderated by Thomas Thornton, President of The Illinois Coalition. Other panelists included John Dougherty of the

Illinois Coalition, Jeffrey Lyons, Managing Director of Marquette Consulting Group, Inc, and Robert H. Newton, Director of the Illinois Securities Department. Break-out sessions followed in the afternoon.

The Forum participant break-out sessions produced 82 recommendations, all of which were finally endorsed and are highlighted in the following section of this report.

While the U.S. Securities and Exchange Commission hosts this annual convocation of small business friends and advocates, and is pleased to serve as such, it in no way seeks to sponsor or influence any of the Forum's recommendations. While a number of these matters are of substantial interest to the Commission as an institution, it takes no position on any of the recommendations. The views in this report are those of the Forum participants.

### **III. TAXATION**

#### **A. Statement of Issues**

Tax policy can impose a heavy burden upon smaller businesses. Uncertainty as well as frequent changes in the rules further complicates the area for most small businesses that are already overburdened with demands upon time and resources. Tax policy also can be used in ways that encourage certain activities that could foster the successful operations of the smaller entrepreneur.

#### **B. Recommendations**

##### **Preamble**

*The Internal Revenue Code is overly complex, internally inconsistent and unduly difficult to administer. The current code has evolved into a compendium of hidden revenue enhancement, double taxation and deductions based on social and political policy. Our national system of taxation should be limited to revenue measures and we should avoid using it as an indirect instrument of policy when possible. Social and political objectives can be more efficiently rewarded directly.*

##### **Recommendations**

###### *Fundamental Reform*

###### *Federal Income Tax -- Begin the Analysis*

*It is important that the federal government commence an analysis of our current tax system and report on improvements and simplification including, fundamental tax overhaul. Congress should enact legislation that would call for an end to the current tax code and replace it with a simpler and fairer system. In anticipation of a vote for a new tax code by a date certain, Congress should establish and fund a team to provide a comparative analysis of the various alternative tax system proposals that should receive thorough analysis (e.g., consumption tax systems, flat tax systems, semi-flat tax systems, etc.) In addition, the team should oversee the analysis and development of a proposal that makes sensible modifications to the current income tax system. For example, it should be the goal of the reviewers to reduce duplications, standardize definitions and make them uniform throughout the code, eschew complicated formulas, reconcile contradictory policies and eliminate double taxation. A vote would then be held by a date certain (December 31, 2001, for example) where all proposals, including our current tax system, would be voted on and eliminated until one system received the majority of support. Congress would be free to leave the current tax system in place and/ or prescribe the time for transition if a new system were adopted. Once in place, the Forum recommends a ten-year moratorium on changes to the tax code (excluding technical amendments, amendments to correct unfair and unanticipated results and amendments to close abused loopholes.)*

The current federal income tax system places a financial and recordkeeping burden on small businesses. The volume of paperwork and the complexity of certain tax formulas make it impractical for proprietors to independently manage their tax reporting. Instead, small business owners must expend vital resources on tax preparation and planning services. A simplified and less cumbersome federal tax structure would benefit small businesses.

### *Social Security Reform*

*The inaction of Congress has contributed to the instability of the current Social Security System. Congress and the Administration must work together to enact legislation by the end of 1999 to make the existing Social Security System actuarially sound and to guarantee the commitments already made to all current participants. This should be done without placing additional new burdens on the present payroll tax system.*

Uncertainty over the fiscal soundness of the social security system has contributed to an overall increase in the cost of employee benefit programs. These costs have had a disproportionate adverse impact on the ability of small businesses to compete for scarce labor resources. Modifications to Social Security would help to increase capital formation and assure a more productive national retirement system.

### *Estate and Gift Tax*

*Our Forum calls on Congress to repeal the estate and gift tax. Property passed by gift or devise or inheritance would, however, retain its original cost basis.*

Inheritances and gifts to the founders of small businesses can provide a significant share of the start-up capital necessary to finance the enterprise. The federal estate and gift taxes place a severe limitation on the ability of entrepreneurs to maximize the capital that is essential to the success of the venture. These taxes negatively effect small businesses in capital formation and business continuity and should be eliminated.

### *Federal Accountability*

*The federal government and all agencies thereunder shall operate financial systems using Generally Accepted Government Accounting Standards (GSGAS) and report their results to the public annually. It is inappropriate and misleading to use a unified budget to combine unrelated fund balances. All surpluses and deficits should be reported separately by fund for each trust and general account.*

It is difficult to discern the appropriation of funding to specific federal government agencies without providing separate fund balances prepared with uniformly-accepting accounting standards. Consequently, there can be no reasonable accountability for inadequate performance by certain operating components as well as how resources are distributed to the small business community.

### *Intra-Jurisdictional Taxation (nexus)*

*The lines of taxing authority giving rights to one government jurisdiction to tax an entity located in another governmental jurisdiction (known as nexus) have become blurred with the explosive growth of electronic commerce that instantly crosses all boundaries. Congress and the state legislatures should set uniform guidelines. These guidelines are to be used by the appropriate agencies in assessing and resolving international and multi-state tax issues.*

Rapid advances in technology have created many jurisdictional issues of law and this is true in the area of taxation policy. The recommended guidelines would establish some baseline for decision making and certainty where no or inadequate guidance currently exists.

### *Implementation of IRS Restructuring*

*The Forum members support the IRS Reform and Restructuring Act as passed by Congress and the changes to the IRS instituted by Commissioner Rossotti,*

*with the support of the President. These changes must continue to focus on customer service and education of IRS personnel and the public. A primary goal of the IRS should be to help small businesses comply with the law and fight the IRS predisposition to treat all small businesses as fraudulent. The Service should strive to apply all tax laws fairly, equitably and consistently.*

Implementing a "kinder, gentler" approach to satisfying the requirements of federal tax laws should be the primary focal point of any restructuring or reform of the IRS and its tax code. The complex nature of current tax regulations warrant the development of better relations and communication to foster a degree of trust between the IRS and small businesses in an effort to eradicate suspicion and eliminate (or reduce) errors and irregularities. In this context, consistency of approach is an essential feature of effective compliance with federal tax laws.

### **Transitional Recommendations**

*Pending complete tax overhaul, and major structural reform, the Forum recommends the following transitional changes to improve the current tax code for small businesses. These changes would help small business owners attract or retain capital.*

#### *Welfare to Work Tax Credit -- Intermediaries*

*The Welfare to Work Initiative is a valuable tool to help welfare recipients join the labor force. The way the credit is structured, however, the company that actually uses the labor (the consumer company) can not always take advantage of the credit if the consumer company uses an intermediary to facilitate hiring. For example, some non-profit programs have been established to smooth the way for welfare to work employment by helping bring small businesses and welfare workers together. The intermediary serves the useful purpose of teaching a new worker basic work skills while temporarily shielding a small employer from the occasional mismatch. Once it is clear that the worker has made a smooth transition, then the worker goes directly on the employer's payroll. Employers should not be penalized for participating in these intermediary hiring programs. The law should be written to permit them to qualify for the credit once the worker comes on payroll.*

Changes in the Welfare to Work Initiative to permit small businesses to participate in intermediary hiring programs without losing the tax credit would encourage more small businesses to hire welfare workers; all parties would benefit from these proposed changes.

#### *Self-Employment Tax -- Partnerships*

*There should be some proportion of a distribution of income to an active partner in a partnership (or Limited Liability Corporation (LLC) or Limited Liability Partnership (LLP)) that is attributed to a return on capital investment and therefore should not be subject to self-employment tax.*

Currently, distributions to partners of a profitable partnership are subject to self-employment tax. Congress should enact legislation for a portion of these distributions to be treated as a reduction in basis rather than as taxable income. This would enhance the market for investments in small business partnerships and could enable these enterprises to retain a greater degree of their capital.

### *Alternative Minimum Tax (AMT) and Small Business*

*The AMT is one of the costs to small business of acquiring capital. In the interest of finding ways to provide abundant capital sources to encourage small business growth, this Forum urges Congress to exempt all components of personal AMT that is generated by "small business." For the purpose of this exemption, a "small business" shall be defined as one that meets the capitalization requirement as defined by Congress in Internal Revenue Code Section 1202 dealing with special Small Business Stock (e.g.. capitalization of less than \$50 million).*

Encouraging investment in small business is sound tax policy. Elimination of the AMT on preference items derived from small business sources would provide additional capital for growth of small businesses.

*Congress should certainly do away with the AMT as part of any comprehensive tax overhaul proposal. In the meantime, Congress should not add the AMT to any new provisions of the tax code. Congress should instead carefully review the impact of this provision on investments in small business and repeal AMT in those instances where it discourages such investments. The AMT takes capital out of circulation that could be invested in a small company. The AMT has a disproportionately damaging effect on small businesses that are competing in the market for capital because sophisticated investors with the ability to analyze and invest in small businesses are the likely targets for the AMT. The Forum urges Congress to consider that substantial risks are already inherent in small business investments.*

The AMT was devised to recapture excessive tax savings by high income taxpayers. Preference items derived from small business sources should not be subject to a provision directed to high income levels. Adjustments and preference items may be especially burdensome to small entities when their potential investors are subject to taxes at both corporate and non-corporate levels.

### *Technology Expenses*

*It is critical that American business be competitive in the global economy. The Administration and Congress should recognize that there are strong public policy reasons to encourage investment in technology and quality control solutions to improve our national productivity and our global competitiveness. With faster and faster rates of change due to innovations and shorter and shorter useful lives of technology products, fixed depreciation schedules for technology purchases are unrealistic. Expenditures by small businesses for technology costs and quality control systems, such as the "Year 2000 " software and hardware corrections (Y2K) and ISO 9000 quality levels, should be "expensed" in the year incurred even though they may benefit future years.*

Expenditures by small businesses for new technology and quality control systems is vital to American business and a competitive presence in the global economy. Competitive pressure often reduces the useful lives of such technology below the fixed depreciation schedules required by current law to be used to recoup such costs. Expenditures by small businesses for such technological purchases should be expensed as incurred in order to provide the necessary incentives for small businesses to stay competitive and not actually penalize business investment by requiring the use of outdated depreciation schedules.

Business Continuity

*Pending the repeal of the estate and gift tax, Congress needs to encourage small businesses to accept the risks of a business start-up as well as to save and reinvest their profits by excluding the transfer of a small business from federal estate tax and gift tax as long as 51% of the business is owned by the founders or up to 4th generation successors.*

Congress should acknowledge the significance of estate and gift taxation on the disruption of the continuity of family small businesses. Entrepreneurs should have the incentive to risk the start up of a new business venture and retain capital earned or invested in the business by allowing the transfer of such business to family members without incurring estate and gift tax.

*Changes to Qualified Small Business Stock  
(Recommended amendments to Internal Revenue Code Sections 1202 and 1045)*

*The tax rate on capital gains on Qualified Small Business Stock should be set at 50% of the rate on long term capital gains. (For example, the long term capital gains rate is 20% so Section 1202 stock would be taxed at an effective rate of 10%.)*

Tax policy should be used to encourage investments in small businesses. The reduced tax rate would encourage the investment of risk capital. The recommended tax rate would make the investment in small businesses more attractive to the nation's investors.

*Sections 1202 and 1045 shall be available for investors in a "Subchapter S Corporation" where the corporation meets all other requirements of Section 1202.*

A change in the tax policy should be considered that would provide infusion of capital into the presently non-qualified small businesses and therefore encourage the growth of the small business section of the economy.

*The Alternative Minimum Tax should not apply to investors for the purpose of computing the amount of tax on a gain under Section 1202.*

Persons subject to the AMT appear to be investors who are likely to be interested in the risk capital situations that exist in small and developing businesses. Repealing this tax could open an important financing source for small businesses.

*Expenditures that qualify under the working capital rules listed in Section 1202 should be made based on sound business judgment and not hastily made to comply with an arbitrary two year limit to avoid company disqualification. The law should be so amended.*

The need for the two-year working capital requirement is not clear. The intention of Congress is not made known, therefore, there does not appear to be a basis for the two-year period. Review of this time period should be undertaken with consideration given to the benefits of sound business judgment. This would result in immediate significant benefits for small business.

Investors should be permitted 180 days to "rollover" qualifying investments under the provisions of Section 1045 rather than 60 days.

Tax policy should be used to encourage investments in small businesses. Section 1045 encourages the investment of risk capital in small businesses by allowing taxpayers to defer gain recognition on the sale of qualified small business stock if the proceeds are used within 60 days to purchase other small business stock. The recommendation would improve the recently revised provisions to help small businesses even more by making the investment more attractive to the nation's investors.

*Independent Contractor Clarification*

*The definition of an independent contractor must be clarified so that small businesses can act as independent contractors or hire independent contractors without fear of future reclassification by the IRS and the imposition of substantial penalties. Therefore, Congress should recognize the legitimacy of an independent contractor. The Forum urges Congress to pass a legislative solution to this serious small business problem including a simplified safe harbor to insulate businesses that hire independent contractors.*

The uncertainty that surrounds the classification of the term "employee" versus independent contractor needs to be eliminated. From the perspective of small businesses, the determination impacts the decision whether tax withholding is necessary and if improperly decided by the employer could result in significant tax penalties.

### *Costs of an Aging Workforce*

*Small business' greatest need is labor but it may not be able to afford to maintain the level of benefits offered all employees if Congress raises the federal mandated retirement age. A rise in the federal mandated retirement age shifts disproportionate additional healthcare costs to small business. The Forum recommends that a tax credit for the additional cost of health care be allowed. This credit could be calculated at the small business' marginal tax rate times the amount of the additional incremental cost.*

Congressional action raising the mandated retirement age of the work force could result in small businesses bearing a disproportionate amount of the resulting increase in healthcare costs. One major reason for this disproportionate increase would result from the effects of average age of the insured pool common in small business. A tax credit for the additional cost of health care should be allowed to small business and it should be calculated at the small business' marginal tax rate times the amount of the additional incremental cost.

*Older workers should not be penalized when they reach the qualifying age for social security retirement benefits and continue to work. Congress needs to raise the level of outside salaries or wages that can be earned before social security benefits would phase out. The level should be raised to a level comparable to four times federal mandated minimum hourly wage for a standard work year. Congress needs to encourage retirees to stay in the labor market.*

Small businesses can potentially be deprived of the valuable services of older workers who wish to continue in the work force after reaching the qualifying age for social security retirement benefits. Congress should raise the level of outside salaries or wages that can be earned before social security benefits would phase out. The level should be raised to four times the federal mandated minimum

hourly wage for a standard year, thereby encouraging retirees to continue in the labor market.

#### *Insolvency Restructuring (Section 1017)*

*Congress should extend the provisions of Internal Revenue Code 1017 allowing asset basis reduction to insolvent taxpayers for capital gains tax incurred as part of a formal or informal reorganization.*

An insolvent taxpayer generally may exclude discharge of indebtedness (DOI) income from taxable income if he simultaneously reduces his asset basis by the amount of such DOI income. This allows the taxpayer to defer the income tax until the affected assets are disposed. However, capital gains may not be similarly deferred. Small business investments would be more attractive if any related capital gains taxes could be deferred under Section 1017.

#### *Net Operating Loss*

*Net Operating Loss Internal Revenue Code Section 382 -- So as not to artificially impede the acquisition, merger or other consolidation of loss companies Congress shall repeal Section 382. This would allow the buying and selling of net operating losses, which may be the only substantial asset that a failed company has.*

Under federal tax rules, a business is generally allowed to carry back a net operating loss (NOL) to each of the preceding three taxable years and forward to each of the succeeding 15 years. However, net operating loss carry forwards are limited in the case of certain changes of company ownership. In some cases of ownership change, the NOL may be completely lost. Changes in this tax provision may make the stock of small companies more attractive to investors.

## **IV. CREDIT**

*The top 60 recommendations of the 1995 White House Conference on Small Business should be re-endorsed. In particular, emphasis should be on recommendations #5A, #25, and #286.*

White House Conference Recommendation #5A seeks regulatory streamlining or the development of investment vehicles for pension funds so that public and private pension funds can more readily invest in small businesses. White House Conference Recommendation #25 makes specific recommendations with respect to SBA's loan guarantee programs. White House Conference Recommendations

#286 concerns the future of the SB A. Specifically, it recommends that the Guaranteed Loan Program, the 504 Loan Program, and the Small Business Development Center Program should be maintained, increased, and enhanced and that the Office of Advocacy should maintain its independent role within the government.

*The SBA should increase the number of non-bank, small business lenders (SBLCs) eligible to process SBA loans.*

Currently, the SB A has 14 Small Business Lending Companies that participate in the SBA's 7(a) Guaranteed Program. These non-bank lending institutions, like their bank counterparts, are partnered with the SBA in making loans to the small business community. Unlike banks, Small Business Lending Companies are solely regulated by the SBA and its oversight resources.

*Congress should appropriate funds as a permanent line item in the SBA's budget for the Office of Advocacy to finance small business economic and technical needs research as currently performed by the SBA's Office of Advocacy. Permanent line item budgetary funding will provide continuity for long-term multiple year research projects, advocacy efforts and existing service programs.*

The SBA's Office of Advocacy should be made a "permanent" and "independent" agency within the budget of the SBA. Congress should appropriate funds on a permanent line item basis in the SBA's budget for the Office of Advocacy to ensure the continuity of research and advocacy services provided by the Office of Advocacy.

The SBA, in general, and the Office of Advocacy, in particular, perform a valuable function and require continued support to further their mission of assisting gazelle companies in obtaining needed equity capital for business expansion and job creation. Thus, the Forum urges the Congress to strongly support the Office of Advocacy in these vital efforts.

The Office of Advocacy of the U.S. Small Business Administration is mandated by law to represent the views and concerns of small businesses before federal regulatory agencies and Congress. The Chief Counsel for Advocacy is responsible for federal agencies' compliance with the Regulatory Flexibility Act of 1980. The Office of Advocacy also houses the center for small business economic research within the federal government.

*The SEC and the SBA should continue to enhance the services provided to the small business community via electronic means, including informational resources and information dissemination via the Internet. These services provide a valuable resource to small business development. Use of the Internet to*

*provide these services is timely and cost-efficient. Every effort should be made to expand these types of services.*

The SEC and the SBA have been continuing their efforts at creating information and electronic documents to provide information to entrepreneurs on debt and equity capital such as "Q&A: Small Business and the SEC" and the SEC's and the SBA's respective Internet sites. On the SEC's Internet site, the Q&A booklet has links to SBA's loan and equity programs. In addition, the SBA continues to grow and develop new Internet-based and electronic information to help businesses in starting, growing, financing, . It also provides technical business assistance, procurement information, and international trade opportunities. Recently, the SBA has developed online classrooms for entrepreneurs to develop their businesses.

*Access to capital continues to be a critical issue to small business development. The increasing trend of bank mergers and acquisitions that has reduced the number of local and community-based banks, as well as the standardization of the credit and loan review processes, has made it increasingly difficult for small businesses to comply with the loan requirements of larger, non-local banks. The increasing prominence of asset-based lenders is disproportionate to the increasing number of service and nominal asset-based businesses. Efforts should be made to revise the methods used in determining the credit worthiness of small business loan applications that are service-related or have nominal fixed assets available to pledge as collateral. Efforts should be made to develop loan programs that meet the needs of businesses with nominal assets. Research should be conducted to determine the feasibility of implementing incentive programs for lending institutions willing to make loans to these types of businesses.*

As the U.S. economy rapidly grows toward service-and information/ technology-based industries, traditional lending profiles will need to be updated. These industries are less dependent upon the traditional bricks and mortar type of businesses and therefore may not have the typical forms of collateral that many bankers still require to make loans. Advances in credit scoring and loan processing centers have helped overcome some of these problems for smaller-sized loans. However, the type of loans needed to grow businesses, the larger-sized loans, may at times be elusive for businesses in these industries.

*The SBA should develop revised guidelines and regulations regarding community-based banks, allowing them to participate in the SBA guarantee loan program as "preferred lenders" to facilitate increased loan volume to small businesses. Revised guidelines and regulations should allow for loans to be reviewed for credit worthiness in a "character loan" evaluation method, rather than an "asset-based loan" evaluation method.*

The SBA has two specialized lender programs, Certified Lenders and Preferred Lenders. Certified Lenders are those who have been heavily involved in regular SBA loan-guaranty processing. They receive a partial delegation of authority and are given a three-day turnaround by the SBA on their applications. Preferred Lenders are chosen from among the SBA's best lenders and enjoy the full delegation of lending authority in exchange for a lower rate of guaranty. Repayment ability from the cash flow of the business is a primary consideration in the SBA loan decision process but good character, management capability, collateral, and owner's equity contribution are also important considerations. All owners of twenty percent (20%) or more are required to personally guarantee SBA loans.

*The SBA should develop a loan program for non-asset based lending with government guarantees.*

The SBA has established several working capital type loan programs to help small businesses such as the CAPLines Program and the Export Working Capital Program. The CAPLines Program offers five types of loans to finance the short-term, cyclical working-capital needs of small businesses. Under this program, loan proceeds generally will be advanced against a borrower's existing or anticipated inventory and/or accounts receivable. Generally, for all SBA guaranteed loans, repayment ability from the cash flow of the business is a primary consideration in the SBA loan decision process but good character, management capability, collateral, and owner's equity contribution are also important considerations. All owners of twenty percent (20%) or more are required to personally guarantee SBA loans.

*The SBA should develop a program to market SBA guaranteed loans on the secondary market.*

The secondary market for the guaranteed portion of SBA-backed loans has been long established. Recently, the SBA has permitted banks and small business lending companies to sell the unguaranteed portion of the loans.

*Federally chartered or insured credit unions should be permitted to make small business loans.*

All credit sources should be available to small business. Despite recent changes making the banking system more homogenous in regard to the activities lending institutions are permitted to engage in, there remain restrictions on the types of loans some lending institutions are allowed to make. With respect to small business loans, all lending institutions should be permitted to consider and if they see fit, to make such loans.

*The \$100,000 FDIC insurance limit should be raised to \$500,000 to match that of SIPC.*

The Securities Investor Protection Corporation (SIPC), which was established by Congress in 1970 to protect securities investors when a brokerage firm fails, insures up to \$500,000 of securities and \$100,000 of cash per investor. If the FDIC insurance limit were raised, it would protect [sentence ends in original].

*More pension money should be available for investing in small businesses. ERISA's prudent man rule should be revised to accommodate this goal.*

According to a recent study by the SBA, less than one percent of public pension funds is invested in small businesses. Under ERISA, private pension plans may only make investments that would be made by a "prudent man." Generally, pension fund managers view investing in small businesses as inherently risky. Recently, the Department of Labor recognized the SBA Small Business Investment Company program as a viable investment tool.

## **V. SECURITIES REGULATION**

### **Securities Act of 1933**

#### *Exemptions*

*The Forum strongly opposes the SEC rule proposal that would amend Rule 504 of Regulation D to require securities issued in Rule 504 offerings to be deemed "restricted securities." The Forum believes adoption of such a measure would be extremely harmful to small business capital formation and the proposal's detriments far outweigh its benefits.*

*The Forum supports maintaining Rule 504 of Regulation D in its current form and opposes additional regulatory changes that would restrict its use.*

*The Commission should endorse NASAA 's suggestion regarding the transfer ability of securities in a Rule 504 transaction, which is set forth in NASAA 's comment letter to the Commission dated July 30, 1998. Specifically, NASAA urges that the Commission only impose restrictions on Rule 504 securities when these securities are offered and sold by issuers that do not register the securities in at least one state that requires registration and the delivery of a prospectus.*

Securities issued without compliance with state registration should be restricted securities under the Securities Act of 1933.

Rule 504, a limited offering exemption under Regulation D, is designed to help small businesses raise "seed capital." It permits non-reporting issuers to offer and sell up to \$1 million in securities in a 12-month period to an unlimited number of persons without regard to their sophistication or experience. Until recently, general solicitation and advertising was permitted and the securities could be resold freely by non-affiliates of the issuer.

In May 1998, the Commission issued a proposal (Release No. 33-7541) to eliminate the freely tradable nature of securities issued under the Rule 504 exemption given some disturbing developments in the secondary markets for some securities issued under Rule 504 and to a lesser degree, in the initial Rule 504 issuances themselves. If the proposal had been adopted, the securities could only have been resold only after the one-year holding period of Rule 144, through registration or through another exemption, such as Regulation A, if available. Almost all commenters objected to the proposal, since it would have required issuers to offer a significant liquidity discount in all Rule 504 issuances, even fully state-registered ones, causing a significant reduction in the amounts of capital that could be raised. Commenters, including the North American State Securities Administration, believed that the Commission's alternative approach, which was to reinstate the rule largely as it had been in effect for number of years before 1992, would be equally, if not more, effective since if an issuer goes through state registration and must deliver a disclosure document to prospective investors, sufficient information ought to be available in the markets to permit investors to make more informed investment decisions and thus deter manipulation of Rule 504 securities.

In February 1999, the Commission adopted more narrowly targeted amendments to Rule 504 (Release No. 33-7633) Thus, these amendments establish the general principle that securities issued in a Rule 504 transaction, just like the other Regulation D exemptions, are restricted, and general solicitation and advertising would be prohibited, unless the specified conditions for a public Rule 504 offering are satisfied:

- the transactions must be registered under a state law requiring public filing and delivery of a substantive disclosure document to investors before sale;
- for public sales to occur in a state without this sort of provision, the transactions must be registered in another state with such a provision and the substantive disclosure document must be filed in that state must be delivered to all purchasers before sale in both states; or

- the securities must be issued under a state law exemption that permits general solicitation and advertising so long as sales are made only to accredited investors.

*If the Commission were to adopt the changes to the Rule 504 regulatory scheme suggested by NASAA, then the Commission should increase the amount that may be raised in a Rule 504 offering to \$5 million and in a Regulation A offering to at least \$7.5 million, but not to exceed \$10 million. Increases in these offering amounts would attract broker-dealers to these offerings and reduce offering costs as a percentage of the amount raised.*

Currently, Rule 504 limits the amount of securities that may be offered to \$1 million in a 12-month period while Regulation A restricts the amount to \$5 million; Small Corporate Offerings (SCOR) include offerings under Rule 504, Regulation A and the intrastate offering exemption. Many broker-dealers do not wish to participate in these exempt offerings since they are not cost-effective from their perspective. If the offering amounts under these exemptions were increased, broker-dealers may be more inclined to participate in these offerings. Small businesses would benefit from increased offering amounts since broker-dealers should be able to more readily bring investors into the offering and their cost of capital would be reduced.

*The National Securities Market Improvements Act (NSMIA) preempted the states from regulating Rule 506 offerings but not Rule 505 offerings. Since the requirements of Rule 505 and Rule 506 are virtually identical except for investor qualification standards, most practitioners advise their clients to do Rule 506 offerings rather than 505 offerings. Given the limited usefulness of Rule 505 since the passage of NSMIA, the Commission should consider rescinding Rule 505.*

Rule 505 permits issuers to offer up to \$5 million of securities in a 12-month period from no more than 35 non-accredited purchasers so long as certain requirements are satisfied while Rule 506 is generally the same except that an issuer can raise an unlimited amount and that purchasers must be sophisticated either alone or with a purchaser representative. The Uniform Limited Offering Exemption ("ULOE"), which was developed by NASAA, was designed to be a coordinating state exemption with Rule 505 of Regulation D, and optionally Rule 506. Since the passage of NSMIA, states are permitted to regulate Rule 505 offerings but not Rule 506 offerings. Some issuers have been advised that it would be more cost-effective for them to comply with the more stringent Rule 506 investor qualifications rather than be subject to state regulation and a \$5 million limit.

*There should be greater standardization and uniformity for procedures for Regulation D Rule 506 private placements at the state level. All states should be required to accept only federal Form D, impose filing fees based upon a uniform schedule, require filings to be made at- the same time, and impose uniform monetary penalties for noncompliance.*

Either encourage NASAA to have states agree to uniform fees and Form D filing times on 506 offerings or the function will default to federal standards after three years.

Under Regulation D, a Form D must be filed with the Commission within 15 days after the first sale and there is no federal filing fee. Uniformity and standardization among the states for Regulation D offerings would simplify the offering process for all issuers and reduce offering costs. States would have an incentive to move towards uniformity and standardization if after the end of three years the federal standards were instituted.

*Regulation A and 505 issues should be preempted from state regulation, and in the event there is no preemption, for the sake of uniformity, have national coordinated equity review limited to disclosure -- not merit review -- and include 504 in such coordination.*

National coordinated equity review of Regulation A and Rule 504/505 offerings would ensure consistency of state regulation and avoid duplicative review. Small business issuers would be able to set timetables for their offerings with greater certainty and offering costs would be reduced.

*The Commission should recognize Rule 1001 as an exemption from federal registration for issuers relying on the NASAA Model Accredited Investor exemption. In the alternative, the Commission is encouraged to issue a release proposing a federal exemption for all states that have adopted the NASAA Model Accredited Investor Exemption.*

Rule 1001 exempts from the registration requirements of the Securities Act offers and sales up to \$5 million that are exempt from state qualification under paragraph (n) of Section 25102 of the California Corporations Code. The California law provides an exemption from state law registration for offerings made to specified classes of qualified purchasers that are similar, but not the same as, accredited investors under Regulation D. Certain methods of general solicitation are permitted under the California law. NASAA's Model Accredited Investor Exemption, which has been adopted by a number of states, permits solicitations similar to those permitted under the California provision. It also provides that securities may be sold to persons who are, or are reasonably believed to be, accredited investors as defined in Rule 501 of Regulation D. The

Commission should acknowledge the model exemption as an appropriate exemption under federal law as well.

Efforts to increase public/private coordination of Ace-Net should be stepped up to facilitate public awareness of this mechanism as a device to bring angel investors in contact with a broader array of potential investment opportunities in promising small companies.

Ace-Net is the Internet-based network sponsored by the SBA's Office of Advocacy. It is a valuable option for small businesses seeking investors and for investors seeking small business investments outside of government loan programs since it permits investors to view the Rule 504 or Regulation A offerings of companies via the Internet. Until Ace-Net, there had been no nationwide, centralized listing service identifying small, growing companies for angel investors to examine.

*Pursuant to the authority granted in NSMIA, the Commission should adopt the Accredited Investor definition for a "qualified purchaser" under Section 18(a) of NSMIA.*

NSMIA preempts state registration and review of "covered" securities. The definition of "covered securities" includes securities that are offered or sold to "qualified purchasers," as defined by the Commission by rule. The Commission should make its accredited investor categories the ones for whom state protection is unnecessary.

*NASDAQ Small Cap securities should be "covered securities" under NSMIA.*

*Whether by SEC rule under its delegated authority under NSMIA or by statutory change, the definition of "covered security" under NSMIA should be expanded to cover securities issued under Regulation A offerings that have been declared effective by the SEC.*

NSMIA preempts state registration and review of "covered securities." The definition of "covered securities" does not include offerings of securities that are traded on the Nasdaq Small Cap market or securities issued under Regulation A. Nasdaq Small Cap issuers are typically smaller, less mature companies with limited revenues, assets and capitalization while Regulation A issuers are generally very similar but the issuer is non-reporting with the Commission. Including securities of these entities within the definition of "covered securities" could benefit small issuers because they could avoid the expense, effort and time associated with state regulation.

The Commission should craft a new exemption that would permit general solicitation over the Internet so long as sales are made only to accredited investors and up to 35 non-accredited investors who have a pre-existing relationship with the issuer. In exchange for this flexibility, the issuer must reasonably believe that the accredited investors are, in fact, accredited.

Rule 502(c) of Regulation D prohibits the use of general solicitation or general advertising in connection with Regulation D offerings, except with public offerings under Rule 504. According to administrative positions of Rule 502(c), one way to determine whether a solicitation or advertisement is general or limited is the existence of a relationship between the issuer and the offerees. The use of the Internet to raise capital has not changed this position. Under this recommendation, offers could be made over the Internet without restriction, but sales could only be made to accredited investors or to a limited number of non-accredited investors with whom the issuer has a pre-existing relationship, thus permitting small business issuers to raise capital more efficiently and quickly.

*The Commission should consider expanding the availability of the "safe harbor" provided by Rule 144A for the resale of securities to qualified institutional buyers ("QIBs ") by reducing the net worth/asset requirements for QIBs.*

Rule 144A of the Securities Act permits resales of securities to QIBs without registration under the Securities Act, provided that certain conditions are satisfied, such as the QIB in the aggregate owns and invests on a discretionary basis at least \$100 million in securities of unaffiliated issuers. This recommendation would increase the number of QIBs eligible to use Rule 144A, thus possibly expanding the universe of investors that might be interested in purchasing the securities of small business issuers.

### *Registration Issues*

The "test the waters" concept should be expanded to permit such communications in transactions that are eligible to be registered on Forms SB-1 or SB-2; state regulators ought to be precluded from prohibiting communications that come within the federal safe harbor.

In 1992, the Commission adopted Rule 254 of Regulation A that allows an issuer to "test the waters" for public interest before making an exempt public offering under Section 3(b) of the "Securities Act. In 1995, the Commission issued a proposing release requesting comment on proposed Rule 135d, which would permit issuers to test the waters for initial public offerings including offerings on Forms SB-1 and SB-2. Permitting "testing the waters" in a registered public offering context would constitute an intermediate step in revising the "offer" analysis in the Commission's regulatory system.

*SEC should further clarify the limits of permissible activity for electronic road shows and should address the issue in the context of private offerings.*

As part of the securities offering process, an issuer and its underwriter may conduct a "roadshow," which is a series of meetings between representatives of the issuer and its underwriter and prospective investors. At the meetings, prospective investors listen to presentations by these representatives, ask questions, and obtain preliminary prospectuses. Commission staff has allowed the video transmission of these meetings over the Internet in registered securities offerings, so long as certain conditions are met. Commission staff could extend its position to allow transmission of videos of roadshow meetings in exempt private offerings. This would reduce the costs of roadshows and enhance the ability of issuers to attract investors and raise capital.

*Increased participation/standardization of the states in required SCOR review and coordinated equity review of Regulation A and S-B filings ought to be encouraged.*

Certain states participate in coordinated equity review programs for offerings registered at the state level. Under these programs, the participating states coordinate the review of the registration statement and provide only one comment letter to the issuer that includes all the comments from the participating states. These programs simplify the registration process for issuers and reduce their registration costs and burdens. All states should be encouraged to participate in these programs.

*On the Internet, all regulatory efforts should be directed towards sales only -- not offers. NASAA should encourage the states to adopt a uniform definition of sales, and in the event there is no uniform definition within three years, the SEC should promulgate a uniform definition.*

Issuers of securities may post offering materials on the Internet. These Internet communications may be considered an offer of securities in any state where a person might access the communication. If considered an offer of securities, the communication would be subject to state regulatory requirements. NASAA adopted a resolution addressing the offering of securities through Internet communications in January 1996. If the states were to exclude all Internet communications from the definition of offer and regulate only the sale of securities on a uniform basis, issuers would be able to reduce the risks of using the Internet in their offerings. Their offering costs should be reduced and their offering documents would be broadly disseminated. States would have an incentive to adopt a uniform definition of sales if at the end of this period a federal definition were to be instituted.

*The states, through NASAA, should adopt a policy of timely review and response to issuers' offering materials and correspondence in order to facilitate issuers' time schedules.*

After a registration statement is filed with a state securities commission, the state usually examines the document for compliance with its regulatory requirements. The state commission typically provides comments to the issuer if state requirements are not met. The issuer then responds to the comments, and the state reviews the response for compliance with the comments. This process continues until the state no longer has comments. The review and comment process may vary among the states and require a lengthy time period. This process may delay start of the offering and prevent issuer planning. A uniform state review period would reduce these delays and uncertainties.

#### *Securities Exchange Act of 1934*

*NASDAQ's Small Cap retention group should take responsibility to provide assistance and information to companies who have been or are going to be delisted due to changes in listing maintenance standards. Information to be provided should include alternate markets and trading systems to assist companies in making the transition.*

When small businesses are faced with the prospect of being delisted due to changes in maintenance listing requirements, the support of the Nasdaq Small Cap market is necessary so that these entities can make informed decisions about alternate markets or trading systems, thus preserving the ability of these companies to raise capital.

The SEC, NASD and NASAA should promote proposals that facilitate secondary markets for non-NASDAQ trading companies. These efforts should focus on regulatory reform to facilitate secondary trading.

Regulatory initiatives are necessary to promote the liquidity of non-Nasdaq trading in the secondary markets.

*A committee or taskforce should be established to examine whether the NASD's underwriting compensation limits or other factors are restricting the willingness of registered broker/dealers from participating in smaller dollar offering transactions, whether they are public or private. Participants ought to include NASD member firms, issuers affected and their respective counsel. The taskforce ought to examine whether the posting of an offering document on a broker/dealer's web site, where the dealer is not affirmatively recommending or soliciting its customers to purchase the offered securities, constitutes underwriter's conduct.*

The Internet has become a viable vehicle for selling securities. Broker-dealers, who might otherwise use their websites to attract prospective investors, may be discouraged from doing so because of the NASD's underwriting restrictions and other limitations. A task force, including affected small business issuers, should be created to examine whether the posting of an offering document alone should constitute underwriter's conduct.

*The NASD should modify its computer system to enable the NASD to identify whether a security is an electronic bulletin board quoted security. This could simply be done by adding a fifth symbol.*

Investors need to be able to identify whether a security is an over-the-counter bulletin board security, since these securities typically have less liquidity as compared to other securities such as those on the Nasdaq Small Cap market or Nasdaq National Market system. The NASD could modify its system by adding a fifth symbol, thus ensuring universal identification of such securities.

*In all new issuances of securities, funds should be required to be delivered to the issuer within one day of effectiveness (T+ 1).*

Currently, Commission rules provide that three business days after trade (T+3) is the standard settlement time frame for most broker-dealer trades. This recommendation would shorten the time frame, which would reduce the potential exposure of underwriters, dealers and investors to disproportionate credit and market risk in the secondary markets for new issues.

*A new market should be established for small companies with its own SRO.*

Small companies have difficulty or in most cases find it impossible to meet the listing requirements of the major securities exchanges or Nasdaq. This situation greatly reduces the liquidity option for potential investors and makes it harder for these issuers to raise capital. A new market needs to be established that is dedicated to transactions in the securities of small companies needs to be established by private entrepreneurs since the Commission does not have the authority to establish markets. Rather, the Commission only regulates markets that are established by others.

*Electronic Communications Networks (e.g., Instinet and SelectNet) should be registered as broker/dealers and subject to all of the rules and regulations.*

In December 1998, the Commission adopted a new regulatory framework for alternative trading systems, which include ECNs, and exchanges (Rel. No. 34-40760). Under this framework, small alternative trading systems can choose to

register as broker-dealers. To ensure that small and start-up alternative trading systems have an opportunity to compete, alternative trading systems that register as broker-dealers have no obligations in addition to those of traditional broker-dealers until the alternative trading system begins to trade significant volume of securities. This recommendation would require that all ECNs be regulated regardless of size.

*The Commission's cold-calling rule should be amended to provide a safe harbor for contacts with existing customers if they are accredited or sophisticated investors and the investment would not involve more than 10 percent of the person's liquid assets.*

The "cold-call" rule has been effective in combating many of the abuses that occurred during the infamous "penny stock" market of the early 1990s. Now that the Commission has had experience and has a better focus on the abuses and the impact of the rule, the rule could be revisited to see if it can be of assistance to small businesses in their capital-raising activities, consistent with investor protection. By exempting certain broker transactions with its existing customers, small companies would have a greater opportunity to raise capital through the brokerage community. This exemption would be in addition to the "established customer" exemption currently found in Rule 15c-9(c)(3) of the Exchange Act.

*To discourage "bear raids," the Commission should establish rules prohibiting short selling in the over-the-counter market after a security has crossed a certain downward trigger; this would be analogous to current rules for listed securities.*

One goal of short sale regulation is to prevent so-called "bear raids." To accomplish this goal, a short seller is prevented from selling at sequentially lower prices. In other words, a short sale may not be executed on a price down-tick. This restriction is not triggered by a particular downward trend, but applies relative to the previous transaction.

Currently, short selling in the non-Nasdaq NMS OTC markets is not regulated. The Commission should consider executing certain short sale restrictions to these markets.

*The same "uptick" rules should apply to all stocks (OTC Bulletin Board, Nasdaq SmallCap) as a requirement to make a short sale.*

The "uptick" rule is effective for restricting abusive short selling in exchange-listed securities. The Nasdaq short sale rule operates off of the current inside bid. In considering a rule for OTC securities, the Commission should examine the different approaches to determine which would provide the most effective means of regulating these markets.

*Broker-dealers should be strictly required to meet the same coverage requirements for naked shorts as applied to customers and a 100% haircut on such shorts should be strictly enforced against violators.*

Coverage requirements, which require a member to make an affirmative determination that it will receive delivery of a security or that it can borrow the security by settlement date, are applicable to both customers and broker-dealers with limited exceptions for certain market-making activities.

*A system should be implemented to determine accurately through reporting requirements the number of shares that have been shorted and vigorously enforce the rule.*

The Commission should consider the feasibility of adopting a regulation to require certain short sale reporting. Such a regulation could include periodic disclosure of all short sales and the short sellers. In the alternative, the Commission could consider a rule that requires only large short sellers to report their positions.

*The shorting of all stock within ten business days after effectiveness of an initial public offering should be prohibited.*

The Commission should consider whether certain events, including initial public offerings, warrant specific restrictions on short selling.

*Investment Company Act of 1940*

*The BDC Law has been a dismal failure. There is a need for a professionally managed fund/pool for venture capital in order to broaden the base beyond existing institutions and wealthy individuals to retail/ individual investors. The SEC should work with the SBA to undertake a thorough study to the end of coming up with recommendations for such a financing source in order to provide an additional funding mechanism for small businesses. The SBA should be the lead agency in this effort relative to working with Congress.*

A mechanism needs to be developed that will make available to small companies the pool of money that comes from ordinary or retail investors. While the BDC program was developed with this goal in view, it was not successful. The Commission needs to work with the SBA to develop a meaningful, successful program.

*The Commission should consider amending the Investment Company Act of 1940 ("1940 Act") to exempt Small Business Investment Companies ("SBICs")*

*with more than 100 shareholders from the provisions of the 1940 Act provided that:*

- the SBICs shares are registered under the Securities Act of 1933; and
- the SBICs operations are in compliance with Small Business Administration regulations.

The revitalized SBIC program is adequately regulated by the SBA. The Commission should seek relief for these companies from the additional regulation imposed by the 1940 Act. Compliance with the registration requirements of the Securities Act is sufficient Commission involvement in the transactions of these regulated entities. Reducing regulation will provide greater efficiencies in their operation, reduce the costs of funds for the small companies working with the SBIC and not jeopardize investor protection.

## **VI. MISCELLANEOUS**

*The Commission should sponsor analysis of the costs and economic impact to small business (i.e., what is the cost of not having federal preemption or total coordination among the states.)*

The states are preempted from the registration of offerings of "covered securities." The states continue to have authority to register and review offerings of securities that are not "covered securities," including the securities of smaller companies and securities issued in many exempt offerings. The Commission should study the cost and economic impact of state registration and review on small companies. By determining the extent of this impact, regulators could determine the full benefits that would be realized from federal preemption of these offerings or from a state registration process.

*In connection with a business combination involving a small business as defined by SBA regulations, where GAAP requires "purchase" accounting and there is a GAAP step-up but not necessarily a tax step-up in the Company's value, there should be a corresponding tax deduction permitted.*

A business that acquires another business may be required by generally accepted accounting principles to write-up the dollar amount of assets received in the business combination. Tax laws, on the other hand, may prohibit a write-up in assets, which in turn prevents higher depreciation and amortization deductions for tax purposes. The Internal Revenue Code should be revised to permit these deductions for companies that qualify as small businesses under SBA's regulations. This change would lower the tax burdens on small businesses.

*The Commission should work with the states to extend the capabilities of EDGAR to all 50 states, the NASD, and the exchanges.*

Documents filed in EDGAR (or equivalent system) should be deemed filed with the states upon notice to the state.

All domestic companies that are subject to review by the Divisions of Corporation Finance and the Division of Investment Management must file electronically with the Commission via EDGAR. If one-stop filing were implemented so that the states and the self-regulatory organizations were able to receive EDGAR filings, small businesses would save considerable time and expense.

*The Forum's annual report to Congress should include an addendum that highlights those measures that have been adopted or implemented during the preceding year(s).*

Over the years, a number of rules or administrative positions have resulted from Forum recommendations. Many of these have resulted in positive changes affecting small businesses. It would be meaningful to compile a list of these measures for inclusion in the Forum's final report.

*The Forum ought to increase its outreach to attract greater attendance from a broader spectrum of governmental agencies such the Federal Reserve Board, regional Federal Reserve Banks, and similar banking related agencies, including participation of individuals at the district level.*

It is imperative that small businesses have greater access to a broad spectrum of governmental agencies. This increased exposure would enable small businesses to have the opportunity to discuss the feasibility of recommendations with representatives of the various agencies.

*State Department staff, particularly in Embassies overseas, should have publicly available e-mail addresses. This would facilitate the ability of entrepreneurs to do business overseas because it would allow them to effectively obtain business and political information quickly and efficiently.*

The web sites of the U.S. embassies generally provide the address, office hours, telephone number and fax numbers. E-mail addresses could readily be added to these sites. Businesses would benefit because they could easily obtain information regarding the nation's business, political and economic climate at little cost and in a timely manner.

*All US Embassies should have Web sites providing information about personnel, the Country plan, hyperlinks to other U.S. government information regarding available funding, calendars of events and all other information that could aid a small business trying to do business in the international marketplace.*

Information on U.S. Embassy web sites is provided through the U.S. State Department web site (<http://www.state.gov/>). This web site provides a selection entitled, "Regions." When "Regions" is selected, a site called U.S. Missions Online will appear that provides links to U.S. mission that have web site listing available for the U.S. embassy in the country. Some web sites provide the reader with a wealth of information about the country, its business agencies, and other items. Small businesses would find it useful for all U.S. embassies to have detailed information.