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Special Report: Legislative Update

As part of its mission to encourage policies that support the development and growth of small business, the Office of Advocacy follows legislative activities of the Congress. The following is a review of legislative activity of the second session of the 104th Congress affecting small

business. Because of their extreme importance to small business, the Small Business Regulatory Enforcement Fairness Act and the Telecommunications Act of 1996 are featured in this issue (see pages 6 and 7, respectively).

Banking Regulation

The **Economic Growth and Regulatory Paperwork Reduction Act of 1996** (included in P.L. 104-208) eliminates many duplicative, overlapping, and burdensome statutory requirements in an effort to improve the efficiency of the banking system. Of particular importance to small businesses are the reaffirmation of limited liability for financial institutions (when acting in a fiduciary capacity) for environmental hazards; and the reduction of examination schedules and other regulatory burdens for well-run community banks. Additionally, the law mandates that a comprehensive study examining small business financing is to be conducted every five years by the Federal Reserve Board, the Small Business Administration (SBA), and other banking regulators and federal credit providers.

Enterprise Zones

The **Local Empowerment and Flexibility Act** (S. 88), introduced Jan. 4, 1995, proposed to streamline the process under which federal agencies may waive statutory

and regulatory requirements within enterprise zones and empowerment communities. No further action occurred, and the Clinton Administration is working with the Senate Governmental Affairs Committee to craft a bipartisan bill.

The **Enhanced Enterprise Zones Act** (S. 1252), introduced Sept. 18, 1995, sought to provide additional tax incentives to businesses and individuals located in enterprise zones. The bill was the subject of a Senate Small Business Committee hearing on Oct. 19, 1995, but no further action occurred.

Environmental Policy

Superfund. Although the House Commerce and the Senate Environment and Public Works Committees were working on reforms of Superfund legislation last year, neither committee marked up a bill. Rep. Thomas Bliley (R-Va.), chairman of the House Commerce Committee, and Sen. John Chafee (R-R.I.), chairman of the Senate Environment and Public Works Committee, have stated that Superfund reform is a top priority for their respective

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committees in the 105th Congress.

Clean Water Act. In early 1995, the House passed the Clean Water Act Amendments of 1995 (H.R. 961). The Senate failed to act. Clean Water Act reauthorization is on the agenda of the 105th Congress.

Health Care

On Aug. 21, 1996, President Clinton signed into law the **Health Insurance Portability and Accountability Act of 1996** (P.L. 104-191). The legislation, sponsored by Senators Ted Kennedy (D-Mass.) and Nancy Kassebaum (R-Kans.), guarantees that those who lose or leave a job will be able to retain their health care coverage, even if they are ill. The inclusion of medical savings accounts became the main sticking point between House and Senate negotiators. Eventually the parties reached a compromise: a medical savings account pilot demonstration project that imposes a cap of 750,000 on the number of medical savings account policies available to small businesses (with 50 or fewer employees) and the self-employed.

The new law also increases the tax deductibility of health insurance premiums for the self-employed (including sole proprietors, general partners, and subchapter S corporation shareholders) and their dependents, from 30 percent to 80 percent by calendar year 2006. (In 1995, the Office of Advocacy testified before the House Ways and Means Committee, urging 100-percent deductibility for self-employed taxpayers. Businesses organized as C corporations are allowed to deduct 100 percent of their health insurance expenses.)

Additionally, the law expands federal authority and resources to combat Medicare fraud; establishes consumer protection standards for certain long-term care insurance policies (and provides tax clarifications to make those policies more affordable); and provides for the de-

velopment of national standards for the electronic submission of health insurance claims to reduce doctors' and hospitals' paperwork and administrative costs and burdens.

The chairman of the Senate Small Business Committee, Sen. Christopher Bond (R-Mo.), has expressed his desire to address the issue of 100-percent deductibility in the 105th Congress.

Home Office Deduction

Standards were established in 1976 to clarify which home office business expenses could be deducted in order to reduce the perceived abuse of the deduction. Among the standards was a requirement that the home office had to be "the principal place of business" for the taxpayer. In its 1993 decision in *Commissioner of Internal Revenue v. Soliman*, the U.S. Supreme Court severely limited what can count as a "principal place of business," thus significantly reducing the kinds of expenses that could be deducted.

The Small Business Jobs Protection Act (P.L. 104-188), signed into law Aug. 21, 1996, restored the deduction for costs incurred in storing inventory in the home.

Today's changing workplace, where more and more businesses are located in the home, puts additional emphasis on the importance of the home office deduction. The issue will be revisited by the Administration and the 105th Congress. Senate Small Business Committee Chairman Bond has indicated his desire to take legislative action on the home office deduction.

Independent Contractor Classification

Worker classification legislation was introduced and strongly supported—there were more than 200 co-sponsors in the House and 30 in the Senate—but was only partially addressed during the 104th Congress. In Aug. 1996, changes

strengthening the Sec. 530 "safe harbor" provisions were enacted as part of the Small Business Jobs Protection Act (P.L. 104-188). The changes allow small businesses to rely on previous IRS actions and determinations to avoid reclassification of independent contractors as employees. The legislation leaves open the key question of what exactly is an independent contractor.

To make the definition of an independent contractor as clear as possible under current law, the IRS issued a training manual to its personnel on the independent contractor issue; introduced procedures for facilitating rapid determinations and appeals; and reduced penalties where a business acts in good faith to classify its contractors. The Administration also would welcome clarification, which can only be done legislatively.

Job Training

Two bills (S. 143 and H.R. 1617) seeking to consolidate job training programs made their way to conference committee. However, the Administration had serious concerns about a number of provisions proposed by the conferees. No further action was taken.

Labor and Wage Issues

Two bills (S. 141 and H.R. 500) sought to repeal the Davis-Bacon Act, which pegs pay rates on federal construction contracts to union-based "prevailing wage rates." Both bills were introduced in the first session, but no further action was taken. The Administration supports reform, but strongly opposes repeal of the Davis-Bacon and Service Contract Acts.

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Microenterprises

The **Microenterprises Opportunity Expansion Act of 1995** (H.R. 1019) introduced Feb. 23, 1996, sought to assist in the development of microenterprises and micro-enterprise lending. The bill was referred to the House Committees on Banking and Finance and Ways and Means. No further action took place.

Minority Enterprise

Several hearings took place during the second session of the 104th Congress dealing with federal set-aside programs, including the SBA's 8(a) program. No action was taken, but it is likely that many affirmative action issues will be revisited during the 105th Congress.

Pension Fund Investments

Legislation passed by the House (H.R. 1594) sought to restrict "economically targeted investments" by employee benefit plans. Most investments in small businesses by pension funds have been categorized by the Department of Labor as economically targeted investments. The legislation would have made such investments a violation of the Employee Retirement Income Security Act. The bill died in the Senate at the close of the second session.

Pension Plans

The Small Business Jobs Protection Act (P.L. 104-188), signed into law on Aug. 20, 1996, included a series of pension simplification proposals that allow for establishment of a new retirement plan called "Savings Incentive Match Plans for Employees" (SIMPLE). The provisions make state and local governments and tax-exempt organizations eligible for Section 401(k) plans; sim-

plify distribution rules; and modify non-discrimination rules.

Procurement Reform

Competitiveness Demonstration Project. On Sept. 30, 1996, President Clinton signed into law H.R. 3610, the Omnibus Consolidated Appropriations Act for FY 1997. This legislation includes a one-year extension (from Sept. 30, 1996, to Sept. 30, 1997) of the Competitiveness Demonstration Program. The program measures the effectiveness of small business set-asides. The act also repeals Section 717(f) of the program's authorizing statute, which prohibited the SBA from adjusting the numerical size standards for the four designated industry groups participating in the demonstration program.

Federal Prison Industries. On June 27, 1996, Small Business Committee Chair Jan Meyers (R-Kans.) and Rep. Peter Hoekstra (R-Mich.) introduced H.R. 3745, the Prison Inmate Training and Rehabilitation Act. The bill would require Federal Prison Industries (FPI) to compete commercially for federal contracts and remove FPI's preferential "mandatory source" status. The Office of Advocacy expressed support for this legislation in a letter to Chairwoman Meyers. No further action occurred.

Contract Bundling. On July 31, 1996, Rep. William Zeliff (R-N.H.) introduced H.R. 3934, as anti-bundling legislation. The bill was intended to curb contract bundling by mandating that federal agencies avoid unnecessary agency contract consolidations. No further action was taken.

On Sept. 28, 1996, Small Business Committee Chair Jan Meyers introduced H.R. 4313, the Small Business Preservation Act of 1996. The bill sought to strengthen small business protections in federal procurement and curb contract bundling by federal agencies. No further action was taken, but

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Rep. Meyers said she hoped the bill would be reintroduced in the 105th Congress.

Product Liability

On May 2, 1996, legislation was vetoed that would have rewritten rules governing product liability suits in federal and state courts, limiting the liability of companies that make faulty products. The House failed to get the two-thirds majority vote needed to override the veto. The bill (H.R. 956) would have capped damage awards intended to punish negligent behavior at \$250,000 for small businesses. For large businesses, damage awards would have been limited to the greater of \$250,000 or two times the total economic damages (such as lost wages) and non-economic damages (such as pain and

suffering). In his veto message, the President indicated support for reform, but not for several of the reforms contained in the legislation that was vetoed.

House-passed provisions that would have limited medical malpractice liability and shielded the makers of medical devices and drugs were not included in the final compromise version of the bill. There is a strong possibility that similar legislation will be introduced during the 105th Congress.

SBA Appropriations

Agency Funding. On Sept. 30, 1996, President Clinton signed into law the Omnibus Consolidated Appropriations Act for Fiscal Year 1997 (P.L. 104-208). The law covers numerous agencies (including the U.S. Small Business Adminis-

tration) and departments that are usually funded in separate appropriations bills.

The law provides the SBA with total regular FY 1997 appropriations of \$717.4 million, an increase of \$28.1 million over the FY 1996 amount. This includes \$277.7 million for the business loans programs account, \$191.9 million for the Disaster Loan program, and \$3.7 million for the Surety Bond Revolving Fund. The bill also provides \$135.0 million (not included in the \$717.4 million) in emergency supplemental appropriations for the Disaster Loan program.

SBA Loan Programs. Included in P.L. 104-208 was the Small Business Improvement Act of 1996, which made changes to various SBA business support programs. The key changes include restoration of a 90-percent SBA-guarantee rate on Export Working Capital Pro-

gram loans, enactment of program changes and new fees for the 504 Loan Program (which reduce the FY 1997 subsidy rate for the program to zero), and extension of authority for the Small Business Technology Transfer (STTR) program for one year. For the 7(a) loan program, the law grants greater discretion to Preferred Lenders (and Certified Lenders in a pilot program) with regard to routine servicing and liquidation of loans, restricts the Low Doc Loan Program to lenders with "significant experience," and limits pilot loan programs to no more than 10 percent of the total number of loans guaranteed in a fiscal year.

Securities Law

On Oct. 11, 1996, President Clinton signed into law what many consider the most sweeping changes to securities laws since the 1930s. The **National Securities Markets Improvement Act of 1996** (P.L. 104-290) revises federal securities laws in an effort to promote efficiency and capital formation in financial markets. The act contains changes to laws pertaining to capital markets (including small business and broker-dealer areas), investment advisors, investment companies, and mutual funds. In addition to giving the Securities and Exchange Commission (SEC) expanded authority to grant exemptions and directing the Commission to promote efficiency, competition, and capital formation in its rulemakings, the law directs the SEC to conduct a study of state securities laws and their effects upon small businesses.

Subchapter S Corps.

The Small Business Jobs Protection Act (P.L. 104-188) expands and reforms tax provisions relating to Subchapter S corporations, making them more user-friendly. The law includes provisions to allow S corporations to create employee stock ownership plans (ESOPs) beginning Jan. 1, 1998.

Taxes

Capital Gains. Prior to the Tax Reform Act of 1986, 60 percent of net long-term capital gains were exempt from taxes. The 1986 act repealed this capital gains exemption. Capital gains are now taxed at regular income tax rates, subject to a maximum tax rate of 28 percent.

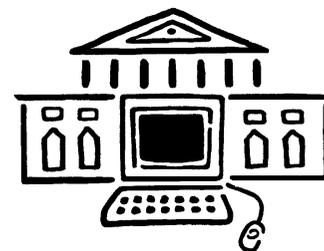
During the 104th Congress, bills were introduced that would restore preferential treatment for capital gains and preserve the existing preferential treatment of gains from investment in small business. The President vetoed the Budget Reconciliation Bill, which included restoration of the 60-percent capital gains exclusion, citing the immense cost and the fact that it would disproportionately favor wealthy taxpayers at a time when the budget deficit was a prime concern.

Research undertaken by the Office of Advocacy disclosed that, without some incentive, a very small percentage of capital gains tax savings would go to new productive investment in plant, equipment, or manpower for small companies. Advocacy urged that some differential be preserved to provide an incentive for investing in small business.

Electronic Filing. In the North America Free Trade Agreement legislation, signed Dec. 17, 1992, Congress included a provision requiring the Internal Revenue Service to phase in electronic tax filings and deposits by business. Companies with yearly deposits of \$50,000 or more were to have started using the electronic processes on Jan. 1, 1997. In July 1996, the IRS sent out notices about electronic filing. Small businesses complained they had not been given enough notice. The Office of Advocacy urged the IRS to delay implementation. Congress also directed that the plan be delayed six months. The plan will now go into effect on July 1, 1997. The Office of Advocacy is working with the IRS to allay concerns of

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Special Report: Regulatory Reform

SBREFA: Not Just a Pretty Acronym

The Small Business Regulatory Enforcement Fairness Act (SBREFA) (P.L. 104-121) provides small businesses with more opportunities to participate in the federal regulatory process and creates new rights for small businesses in regulatory compliance assistance and enforcement actions by federal agencies.

Putting real teeth into the Regulatory Flexibility Act (RFA), SBREFA allows small businesses for a fixed time to bring lawsuits against agencies that fail to comply with the RFA. The Office of Advocacy has been authorized to file *amicus* briefs in such lawsuits.

The new law also requires the Environmental Protection Agency (EPA) and the Occupational Safety

Signed into law on March 29, 1996, the Small Business Regulatory Enforcement Fairness Act is ushering in a new era in business regulation.

and Health Administration (OSHA) to take extra steps in collecting the recommendations of small businesses. Specifically, the SBREFA amendments require that the agencies receive input from affected

small businesses *before* a proposed rule is published.

For each significant proposal, the EPA or OSHA will convene a Small Business Advocacy Review Panel. This interagency panel—including officials from the SBA's Office of Advocacy, the Office of Management and Budget, and the federal agency issuing the regulation—will ask small business representatives to review the draft proposal and give feedback to the panel. The agency will use the participation of the small businesses and the other agencies to help assess the impact on small businesses and make revisions to the rule.

Regulation Under SBREFA

A number of new procedural elements in the federal regulatory process come into play with the enactment of SBREFA, among them compliance assistance, a new regulatory ombudsman, and relief for small businesses subject to administrative or judicial proceedings. Here are some details on the most important of these changes.

Compliance Assistance. Beyond amending the Regulatory Flexibility Act, SBREFA requires federal agencies to provide plain language guides for new regulations that will have a significant impact on small businesses. If a small business is cited for violating the regulation, any court review of an agency enforcement action may include the content of the guide in assessing the reasonableness of the proposed penalty.

Small businesses that are confused by a regulation or need clarification often ask agencies for an explanation. Under the new law, agencies also are required to estab-

lish a system for addressing the inquiries from small businesses. The inquiry process must be in place by March 1997. Guidance provided by an agency may be considered as evidence of the reasonableness of proposed penalties, fines, or damages assessed against the small business.

Enforcement. In September 1996, then-SBA Administrator Philip Lader appointed Peter Barca the Small Business and Agriculture Regulatory Enforcement Ombudsman, a new position created by SBREFA. (See the October 1996 issue of *The Small Business Advocate*.)

The ombudsman is required to identify federal agencies' enforcement-related activities that are of concern to small businesses. Ombudsman Barca will be assisted in this task by the Small Business Regulatory Enforcement Fairness Boards. A five-member board was established in each of the SBA's 10 regions to collect complaints from small businesses about aggressive

enforcement actions. The board members are small business owners and operators appointed for one-year terms.

Penalty Policy. Under the new law, each agency must establish a policy to provide for the reduction and, under appropriate circumstances, waiver of civil penalties for violations of statutory or regulatory requirements.

Equal Access to Justice. Small businesses are granted more relief by amendments to the 1980 Equal Access to Justice Act contained in SBREFA. In administrative and judicial proceedings, if the government's demand is unreasonable when compared with the judgment or decisions, then the small business can be awarded attorney fees and other expenses related to defending against the action. Allowable attorney fees were increased from \$75 to \$125 per hour.

SBREFA and the IRS: A Foot in the Door for Small Business

SBREFA amended the Regulatory Flexibility Act (RFA) by expanding the coverage of the law for the first time to IRS paperwork regulations.

Since the passage of SBREFA, the IRS has made an extra effort to work with the Office of Advocacy on implementation plans. In addition, the IRS is keeping the Office of Advocacy informed of upcoming regulatory and notice actions, whether they require regulatory flexibility analyses or not. The IRS has sent representatives to all of Advocacy's SBREFA training sessions and has sought additional Ad-

vocacy consultation.

SBREFA leaves many IRS regulations untouched. For example, under the provisions of SBREFA, the RFA applies to IRS regulations only to the extent that they impose a "collection of information" requirement on small entities. Under this test, most IRS regulations fall outside the jurisdiction of the RFA. Collection of information is defined to include record keeping requirements and repetitive documents.

Even where there is a collection of information requirement, only the portion of the proposed regula-

tion that contains that requirement—not the entire regulation—needs to be analyzed for its impact on small business and regulatory alternatives explicitly considered.

Also, by a specific provision contained in SBREFA, the amendments do not apply to interpretive rules that were proposed prior to the date of SBREFA's enactment, March 29, 1996. By the end of 1996, there were regulations still being finalized that had been proposed prior to SBREFA's enactment.

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the affected small businesses.

Estate Tax. The President's FY 1997 budget plan includes a proposal to address cash flow problems created by estate tax law. Under current law, the first \$600,000 of one's estate is exempt from tax. However, families often cannot afford to inherit the small business or farm that is left to them by a decedent. The House and Senate have debated proposals to reduce the impact of estate tax on heirs to a small business. Sen. Herb Kohl (D-Wisc.) is preparing legislation to eliminate the estate tax altogether—a recommendation of the 1995 White House Conference on Small Business. Also, Sen. Christopher Bond (R-Mo.) has indicated that estate tax reform will be one of his key focus areas in the 105th Congress.

Telecommunications

On Feb. 8, 1996, President Clinton signed the **Telecommunications Act of 1996** (P.L. 104-104), one of the most far-reaching revisions of communications law since the original Communications Act was passed in 1934. (See box at right.)

The Telecommunications Act of 1996

The Telecommunications Act of 1996 opened the door to competition in a number of telecommunications markets that had been monopolies for long periods of time. Small businesses will be among the new competitors to take advantage of the newly opened markets.

The act contained a number of provisions that specifically addressed small business needs:

- **Competition in local service.** The FCC regulations implementing the act's mandate to allow competition in local telephone service were particularly favorable to smaller competitors' entry into this market. At this time the rules are being challenged in federal court.
- **Lending to small telecommunications firms.** The act also established the Telecommunications Development Fund, for the purpose of lending to small telecommunications businesses. The fund receives its moneys from the interest earned on up-front deposits made by spectrum auction bidders. To date, more than \$10 million in interest has been earned for

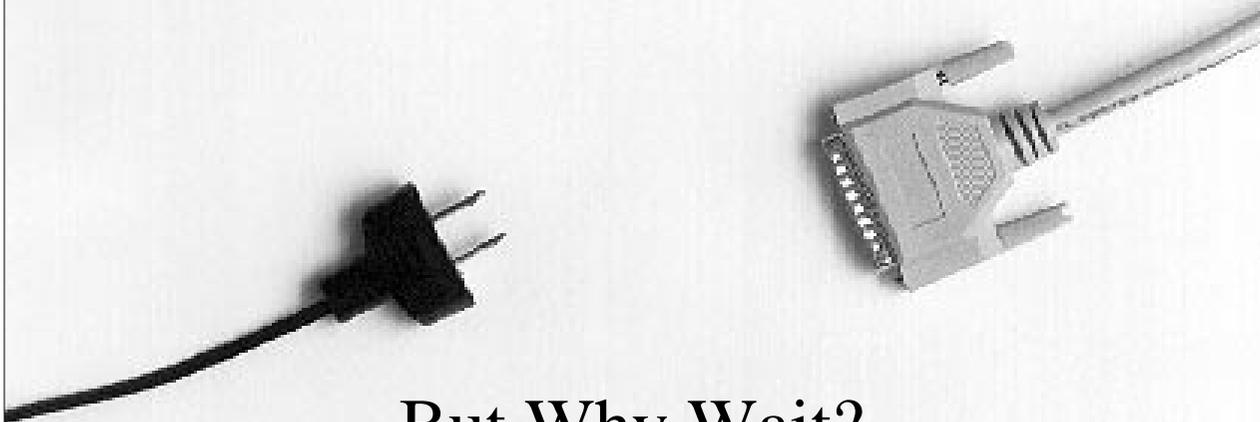
the fund.

- **Elimination of market entry barriers.** The act requires the FCC to identify and eliminate market entry barriers to small telecommunications businesses. The FCC has begun the process of implementing this important provision.

- **Less regulation for small cable operators.** The act expanded the scope of small cable rules to include a wider variety of operators. Operators with up to 1 percent of all cable subscribers nationwide are now eligible for less regulation.

- **Special provisions for rural telephone companies.** A series of special provisions were included to ensure that smaller telephone companies serving rural communities are not unfairly treated in the transition to competition.

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