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SMALL BUSINESS AND RURAL ECONOMIC DEVELOPMENT

HEARING

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SMALL BUSINESS AND RURAL ECONOMIC DEVELOPMENT

TUESDAY, JUNE 4, 2002

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 2:47 p.m., in room 215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Also present: Senators Kerry, Lincoln, and Grassley.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

First, I apologize to the committee and all in attendance for the delay in beginning this meeting.

We are here to consider legislation to increase the minimum wage. I think that is a good idea. I think a lot of people do. But it may raise some costs for some businesses, and the question is, what can we do to help those businesses? That is what this hearing is all about.

Small business employs more than their share of minimum wage workers. That is clear. They employ 51 percent of America's workers, but 61 percent of minimum wage workers.

Small businesses generate most of the new jobs in the economy, 65 to 75 percent in most years. Small businesses are especially important in rural areas. In my State of Montana, 98 percent of our businesses—98 percent, about 30,000—have fewer than 500 employees. That is the Small Business Administration's definition of a small business.

But minimum wage is also more common in rural areas. About 20 percent of rural workers earn the minimum wage or less, compared to about 40 percent of urban workers.

Rural communities are facing other challenges, particularly in America's heartland. We will hear today about rural areas that are losing people, as well as losing jobs.

Our rural communities have, in effect, the opposite problem. They are growing rapidly. Rapid growth brings differing concerns: transportation, housing, environment. Tribal communities face some of the biggest challenges and deserve special attention themselves. Our hearing today will help us identify what we can do to help these diverse rural areas and to help small businesses in general.

I am proud of what we have done in the past: the Tax Reform Act of last summer, for example, and the recent economic stimulus package is another example.

But there is more we can do. There are a number of small business and rural economic development bills before the Finance Committee. Senator Grassley and I have co-sponsored legislation to give tax relief, for example, for farmers and for fishermen.

I am also developing a proposal to give small businesses a tax credit of up to 50 percent for the cost of providing health insurance to their employees. Today, it is often too expensive for small business to provide health plans for their employees, and I think this tax credit can make a real difference for small business.

Senator Kerry heads the Small Business and Entrepreneurship Committee. Chairman Kerry has introduced bills on financing, equipment expensing, and other small business issues. Senators Hatch, Breaux, Lincoln, and Thompson on this committee have a bill to reform rules for S corporations.

Senator Rockefeller has a bill to encourage broad-band Internet access for rural and under-served areas. Senators Dorgan and Hagel will tell us about their rural development bill that has been referred to this committee.

So, there are a lot of good ideas. But before we take action on specific bills, we need to hear directly from the people that are affected by our legislation. Today we will hear from a great variety of people from across our country. Some of them are experts in business, in taxes, in technology. They are from universities, they are from government, and from business organizations.

Alongside them, we have the real-world experts. They can educate us about the challenges they face in operating farms and operating ranches, and small businesses in rural America. That is where the rubber really meets the road. Not just the advisors, but where paychecks are written and where bills are paid.

We look forward to learning from all these witnesses on how we can help America's businesses and communities thrive better and prosper more. After the hearing, I look forward to working with Senator Grassley and all members of the committee to come up with a package of small business tax incentives that will make good sense and can be enacted into law.

I would like to turn to my good friend from Iowa, Senator Grassley.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman, for holding this hearing.

All across America, the problem of high taxes is evidence. Wall Street, of course, measures the economic slow-down by high-tech stock prices. Main Street uses the number of farmers buying equipment at the local dealer or taking out loans at the community bank.

Both measures are important, but one of them leads to farm auctions and empty storefronts. To get the economy back on track, we have to visit both Wall Street and Main Street. Today, our focus is upon Main Street.

A significant portion of the tax burden is borne by small business and farm people. These are the taxpayers who do business on Main Street. Farmers and small businesses rarely do business in the conventional corporate form.

Most farmers and small business are owned by sole proprietors, partnerships, LCCs, or S corporations. That means farmers and small business folks' taxes are paid on their 1040 form.

Now, last June President Bush's tax relief bill cut marginal individual tax rates and greatly helped farmers and small businesses. That is just one of many reasons to support making tax relief permanent. If we do not make it permanent, then ask any farmer why he or she should pay 39.6 versus 35 percent paid by Fortune 500 companies.

In addition to marginal rate cuts, there are many tax problems faced by Main Street businesses that we will look at in today's hearing. We will explore several topics, but the ones I want to point out are those that are faced by small business and farmers, and how we address those tax problems, including what we call farm accounts and income averaging for farmers.

Last year, we had a hearing entitled "Preserving and Protecting Main Street, USA." Last year, the chief economists of the U.S. Small Business Administration testified that their research shows 75 percent of new jobs created in this economy come from small businesses, and two-thirds of those new jobs were created by firms with fewer than 20 employees.

In addition, the Small Business Administration felt that evidence suggests that small business is affected more severely in a downturn, and that lowering and simplifying taxes helps small business with increased productivity.

In this Congress, I have sponsored, with Chairman Baucus, the Tax Empowerment and Relief for Farmers and Fishermen Act, and also included in that are farm accounts, income averaging for farmers, and several proposals to simplify the questions concerning self-employment tax exposure and cooperative measures within that bill.

In a previous hearing, I laid out three principles that I planned to use on tax legislation: efficiency, equity, and simplicity. On the first, efficiency, we must make sure that we change the Tax Code in a way that grows the economy. In regard to equity, I think that is simple: fairness for all.

My third, is simplicity. Everyone who fills out a Form 1040 knows about the complexity of the Code. All across the country, Americans are dealing not only with the burden of paying Federal taxes, but the additional burden of tax complexity.

Thank you, Mr. Chairman, for giving all these issues an opportunity to be heard, and I will look forward to continue to work with you. As I said, these issues are very bipartisan.

Thank you.

The CHAIRMAN. Thank you very much, Senator.

I would like, now, to turn to the chairman of the Small Business and Entrepreneurship Committee, who also is a member of our committee, Senator Kerry, for his statement.

OPENING STATEMENT OF HON. JOHN F. KERRY, A U.S. SENATOR FROM MASSACHUSETTS

Senator KERRY. Mr. Chairman, thank you very, very much. I appreciate that, and I ask my colleagues' indulgence. I'll be very brief.

I would ask unanimous consent that my full statement be placed in the record in full.

The CHAIRMAN. Without objection.

[The prepared statement of Senator Kerry appears in the appendix.]

Senator KERRY. And I would like to ask, also, consent that I could leave a couple questions in writing, if I may.

The CHAIRMAN. Without objection.

Senator KERRY. Mr. Chairman, let me just say very quickly, you summarized effectively the impact of small business, not just in Montana, but in the country. Ninety-eight percent of the businesses in the country are small businesses, and more than 52 percent of the workforce nationally is small business.

One of the reasons that we asserted the concept of entrepreneurship in the work of our committee, is really that there is a whole role of entrepreneurial activity that can be enhanced through the actions we take, the tax structure and otherwise, that often is not thought of when people think specifically of small business.

There are a number of proposals that our committee has brought to the attention of the full Finance Committee, and we hope in the context of this important initiative that we can come up with an fiscally responsible small business stimulus bill that would have an impact, hopefully, also in addressing some of the minimum wage issues people have.

Let me just, very quickly, summarize them. In the Affordable Small Business Stimulus Act, which we submitted last November in response to the events of September 11, we have seven key provisions, including several with very broad support.

There is an increase in the Section 179 expensing and a reduction in the depreciation recovery period for computers and software. Those efforts will help small business and high-tech at the same time.

In addition, we extend the existing income averaging provisions to cover fishing, as well as farming, which I know both you and the Ranking Member support.

We also modify and expand a 1993 law regarding new equity investments in small business stock. I think this is something that Republicans and Democrats ought to be able to get excited about, which is allowing new companies with capitalization of up to $100 million at the time of investment, they could have a 75 percent capital gains exclusion if the investments are held for 3 years.

It might be that we want to change 3 years to 5 years. That was originally thought of during the period when the return on investment cycle had sped up so significantly in the 1990's. Now we seem to be back to a more normal incubation period, so we might think more in terms of 4 years or 5 years.

But that exclusion for such investment could become 100 percent—100 percent—capital gains exclusion if they are made in a business involved in certain critical technologies which happen also to be almost exclusively high value-added jobs, which are the places where we get the greatest gain in our economy in terms of tax base.

They would also be for specialized small business investment companies. I hope the committee will consider broadening Section 1202 in this way as we approach this. It would have a profound impact on the flow of capital to new investments, and it is not that costly in terms of the overall revenue.

We also have a single-point tax filing initiative which simplifies the tax filing process for employers by allowing the IRS and State agencies to combine in one form both State and Federal employment tax returns.

We passed, in the Senate, this provision on two occasions, but it has yet to become law. We would hope that we would be able to do that.

Finally, we modify the tax treatment of investors' investments in so-called debenture small business investment companies, the SBICs, so they are less likely to create unrelated business taxable income, UBTI, liability.

In so doing, the bill encourages greater investment in SBICs, which provides critically needed venture capital to emerging small businesses. That change is very important to the SBICs. It also has very little revenue cost.

I would just quickly call your attention to a bill Senator Snowe and I introduced a little while ago called the BRIGE Act, which is the Business Retained Income Growth and Expansion Act.

It is a new idea, and it fills an important gap in capital financing for growing entrepreneurial companies by allowing them to access new capital by deferring a portion of their own Federal income tax liability if the money is reinvested in their own business. It is a two-year deferral. It is limited to $250,000 of tax liability and it is repayable, with interest, over a 4-year period.

So the deferral aspect of it actually provides working capital to companies out of their own income, out of their own revenue, and just defers the payment to the Federal Government.

For small businesses, that can often be particularly critical, especially when you look at some of the problems businesses have in the wake of September 11th. They are viable businesses. They have had a great track record.

They have a momentary downturn, they have a crunch on capital, the banks have tightened lending, they do not have the ability to find the capital. What better way than to take it out of their own revenue with a deferment which has a specific repayment schedule and interest repayment?

I would like to thank Patrick Von Bargen, who is going to testify today, of the National Commission on Entrepreneurship for his early support, and energetic support, of this.

The last thing we need to do, Mr. Chairman, is we have got to change the individual Alternative Minimum Tax treatment on incentive stock options. In the year 2000, thousands of employees of Massachusetts and elsewhere around the country—a lot in California, a lot in Texas, Florida—were hurt when the exercise of their options generated huge tax liabilities, but the values of the options had declined. Many workers around the country now owe thousands of dollars in taxes on income that they never realized.

The Tax Code does a lot of crazy things, I think we would all admit, but it should not tax people for income that they never had. I bring this up because the stock option issue is receiving a lot of attention because of Enron and other accounting irregularities.

But I do not think we should lose sight of the value entrepreneurs place on incentive stock options as a key tool to attract—and in many cases it is the key tool, it is the only way you attract—early talent to a start-up venture and keep qualified people for a period of time.

Senator Grassley and I worked, at the end of the last session, to try to have a fix on this. We were not able to pass it. But I would hope we would be able to do this in the course of this, and I think we could do it probably, Mr. Chairman, in a bipartisan way.

So, I thank the Chair very, very much for your indulgence, and I thank my colleagues.

The CHAIRMAN. Well, I appreciate it, Senator. You have got a lot of really good ideas there, and I hope that we can enact some of them.

I know in our State in Montana, you mentioned the point where State and local government employment taxes could file a single form. We have a pilot project in Montana doing just that, and I hope that can be extended.

Thank you very much, Senator.

We are very honored today to have two senior Senators.

The Senator for Arkansas. Absolutely. Two minutes. You have got it.

OPENING STATEMENT OF HON. BLANCHE L. LINCOLN, A U.S. SENATOR FROM ARKANSAS

Senator LINCOLN. Thank you, Mr. Chairman. I want to thank you for holding the hearing on small business and rural economic development. And to our colleagues that are here to testify, I promise you I will be brief.

I just wanted to point out a couple of things that I think are very important that we are going to be discussing in this hearing.

I have always supported helping small businesses by offsetting the pressure of wage increases, which I do think are important, by coupling minimum wage increases with a package of tax cuts that are targeted to businesses.

As you will notice, I have seen this map before. I think someone testified in here, one of our colleagues testified before we broke. There is a considerable red area in the Mississippi Delta region, mostly eastern and southern Arkansas. So, we have seen an incredible out-migration in my old Congressional district, as well as a good part of our State.

I want to thank the Chairman and the Ranking Member for highlighting several bills here. First, the S. 312 bill, which is a package of needed farm belt tax changes. I am proud to be a cosponsor of that, Mr. Chairman.

I am also particularly glad that the hearing will also focus on S. 1201, the S Corporation Modernization Act. Earlier in this Congress I worked very hard with Senators Hatch, Breaux, Thompson and Graham to produce this legislation, which I think is absolutely necessary to eliminate confusion and tax traps for the unwary and to expand growth and investment by making available more capital.

This legislation will also help advance what I see as an important long-term goal of eliminating the double layer of tax on American business.

So I would like to just mention one other issue, that I have got out a bill, S. 1278, the U.S. Independent Film Incentives Act, currently has 26 co-sponsors, including Senators Breaux, Torricelli, Jeffords, Kerry, and Snowe of this committee.

The bill would provide for a two-tiered targeted wage credit designed to stem the outflow of one of our biggest industries in this country, and that is the American films to foreign markets.

Some think that, on the face, the bill appears to just help Hollywood. It actually will boost the segment of the market most vulnerable to the impact of runaway films and television production, and to helping small business that support it.

It is only available if total wage costs are more than $200,000 and less than $10 million, and provides for 25 percent wage credit equal to the first $25,000 of qualified wages and salary, and a 35 percent credit of such cost if it is incurred in low-income communities, which many of these areas happen to be.

So, I certainly would appreciate some focus on that, and being able to tell my colleagues that it is a good bill. Many of our States have been very paramount in film industry production in years past, most of which has gone to Canada, Australia, and other countries.

According to a Commerce Department study, every year we do not act we lose $10 billion worth of our most American industry, the film industry, to the tax incentive that foreign countries have created to lure their lucrative and economically stimulating industry across our borders, much of which has been out in rural America in times past and in years past.

So, Mr. Chairman, I thank you very much. I appreciate our colleagues being here to testify and talk about these important issues of helping to stimulate the economy in rural America, and hopefully put some type of a stop-gap on the out-migration that we are seeing in areas like, certainly, eastern and southern Arkansas, and other States.

Thank you, Mr. Chairman. I would like to ask unanimous consent to have my entire statement in the record.

The CHAIRMAN. Without objection.

Senator LINCOLN. Thank you.

The CHAIRMAN. Thank you, Senator, for that excellent statement.

[The prepared statement of Senator Lincoln appears in the appendix.]

The CHAIRMAN. All right. We are now honored to have two of our colleagues with us today. First, Senator Byron Dorgan from North Dakota is on my left, and Senator Chuck Hagel from Nebraska on my right.

Senator Dorgan, why do you not proceed?

STATEMENT OF HON. BYRON L. DORGAN, A U.S. SENATOR FROM NORTH DAKOTA

Senator DORGAN. Senator Baucus, thank you very much.

No doubt, many in this room have seen the movie "Four Weddings and a Funeral." There is a variation on that theme in New England, North Dakota, a small town in southwestern North Dakota. The Lutheran minister in New England's name is Donna Dorman, Reverend Dorman.

She told me that, at her Lutheran church, she officiates at four funerals for every wedding. What she was saying, of course, was that in her small town, the population is older. The town is shrinking. There are fewer young people moving in and fewer people having babies. So at that Lutheran church, there are four funerals for every wedding.

Now, that happens to be from a county that I grew up in, in southwestern North Dakota called Heddinger County. It is slightly larger than the State of Rhode Island. When I left Heddinger County, graduating in a high school class of nine—top five, by the way—there were 5,000 people living in the county. Now there are 3,000 people living in the county.

That map that I have prepared shows you a relentless, gripping, devastating change in the heartland of our country, the map which most of the audience perhaps cannot see. But it outlines in red the counties in America that have lost more than 10 percent of their population in the past two decades.

Ninety percent of North Dakota's counties have lost more than 10 percent of their population; one-third of Arkansas' counties have lost more than 10 percent of their population; 54 percent of Montana's counties have lost more than 10 percent of their population; 59 percent of Iowa's counties.

This is not just a North Dakota problem, or an Iowa or Nebraska problem. It is a problem that affects the heartland of our country. It is a systematic depopulation of the middle of America.

Senator Grassley and I joined together to write a piece of legislation that analyzes whether we ought not try to save the heartland in our country. A century and a half ago, we created a homestead program. We said to people, if you come out there and improve the land, and live on the land, we will give you some land. That was called the homestead program.

My great grandmother, an immigrant Norwegian woman who lost her husband, took her six kids on the train and went to Heddinger County, North Dakota, pitched a tent, built a home, ran a farm, raised a family, had a son who had a daughter, who had me. That is how I came from southwestern North Dakota. Almost everybody in this room who comes from the middle part of the country has a similar story about the Homestead Act.

Now, Mr. Chairman, we do not have land to give away anymore so we cannot propose a Homestead Act, or I would be here proposing a Homestead Act with land.

Senator Hagel and I have suggested something different. When America's cities were in trouble, economic blight in the middle of our cities, the cry was, let us save America's cities. Congress went to work on an urban renewal program, a Model Cities program, to invest in and save Americas cities.

The programs were quite effective, as a matter of fact. Now there is this relentless move to depopulate the middle part of our country, and the question is, do we want to try to save the heartland of America? In my judgment, we ought to.

These are wonderful places in which to live, great places to raise a family. They have what most people aspire to have: they have good schools, by and large, good neighborhoods, low crime rates. Yet, there is this relentless out-migration.

So the question is, what can we do about that? My hope is that the committee will consider a big idea. We mess around here in Congress with a lot of small ideas, and some big ideas. Senator Hagel and I are proposing a big idea, and we understand that it is going to take some time.

But the big idea is called the Homestead Economic Opportunity Act, where we put together really four pieces: homestead opportunities for individuals who locate in these high out-migration counties, forgiving up to a certain percent of college loans each year for those that go back and locate in those areas; a tax credit for home purchases in those areas; protecting home values that inevitably fall in those areas by allowing the deduction of the loss from Federal income taxes; establish individual homestead accounts which become, in effect, their quarter section of land, tax incentivized homestead accounts.

In addition to that, we provide incentives for businesses to expand or locate in high out-migration areas, including directed investment tax credits and acceleration depreciation for equipment purchases.

Then, too, we create a new homestead venture capital fund. We are venture capital starved in the heartland of our country. So, these are the things that we propose. I will not go into them in great detail. I have to leave.

Senator Hagel is also going to testify. He, as you know, Mr. Chairman and Senator Lincoln, comes from Nebraska. In Nebraska, I believe 65 percent of their counties have lost more than 10 percent of their population.

But it is not just a North Dakota, Montana, Nebraska, Arkansas problem. This is a relentless, gripping problem that is occurring in the heartland of America that we must try to do something about.

If I might finish, I have a couple of other suggestions on some tax issues in my statement which I would ask that you consider.

But let me just tell you, there is so much that is wonderful about rural America that we will lose if we somehow believe that family farms and small towns are like the little old diner that gets left behind when the interstate comes through. It is much more than that. It is part of the character of this country.

A wonderful author named Critchfield described the nourishment and refreshment of family values that has always flowed in this country from family farms to small towns to big cities. You lose part of that character, you lose something important that is American.

In a little town with 80 people in it, Sentinel Butte, North Dakota, there was a national story here a while back about a couple that runs a gas station. But they are nearing retirement age and do not want to work full days.

So what they do at their gas station, is they close at 1:00. But they hang the key up on a nail outside the door, and if you need gas, you unlock the pump and you put gas in, and then you make a note on the pad just below the nail how much gas you took.

Now, Mr. Chairman, there are some areas of the country where that would last about 15 minutes. But it works real well in Sentinel Butte, North Dakota. Why? Because part of our rural interests are about character and about the things that we also have trouble attaching a value to, or a cost to, but things that contribute immeasurably to American life.

So, I hope you will take a look at this. I think from the standpoint of Montana, there is a lot to say for this legislation. Let me say a special thanks to my colleague, Senator Hagel. He has been a delight to work with on this, and I hope perhaps we can get the Finance Committee to work with us and move some legislation.

Mr. Chairman, thank you very much.

The CHAIRMAN. Well, thank you, Senator. You put your finger on a huge problem in this country. I know I speak for my colleagues from Arkansas and Nebraska. You have come up with a big idea, and clearly we need some big ideas because the trend is very much in the wrong direction. I hope that we can enact a good bit of what you are suggesting.

As you say, I am not sure we can do it all, but we can certainly move down that road. If we do not, the trend is going to continue and it is going to be more than 10 percent out-migration pretty soon. There will be a lot more than 10 percent. But thank you very much.

[The prepared statement of Senator Dorgan appears in the appendix.]

The CHAIRMAN. Senator Hagel?

STATEMENT OF HON. CHUCK HAGEL, A U.S. SENATOR FROM NEBRASKA

Senator HAGEL. Mr. Chairman, thank you. I, too, appreciate the opportunity for Senator Dorgan and I to discuss, within the context of your larger picture here today, Mr. Chairman, the issues that I think are fundamental, not just for the growth of this country, but as Senator Dorgan pointed out, to the cultural dynamics.

The chairman of the Small Business Committee talked about the value of small business. We understand that it is there in that universe where new jobs are created, where new ideas come from, where inventions come from. It is the engine that has always driven this country.

The cultural dynamic that is attached to that is a part of it. It may well be the most important, understated part.

I, of course, cannot claim the stratospheric intellectual standing of my colleague from North Dakota on his high graduation standing. I am not sure where I ended up. But, fortunately, that is not the point of this hearing.

We are here, as Senator Dorgan has noted, as you have, as others have, to talk about incentivizing not just rural America, but all of America and economic growth.

The fact is, we have seen over the last 20 years, as you survey Senator Dorgan's map, the consequences of these smaller communities not sharing in a good deal of the economic boom that has taken place in this country during that time.

A recent report by the National Corn Growers Association says that one of every two rural counties lost population in the 2000 Census, and three of every four rural counties experienced below-average economic growth, despite record levels of farm subsidies, for example, in the 1990's.

Now, we have just finished debating and voting on a new farm bill, and that farm bill is the most expensive farm bill we have ever reported out of this Congress. We spent a lot of money in the 1990's on the farm bill.

So, these numbers and these observations that were issued by the National Corn Growers Association are important because they are relevant to what we are talking about today.

The fact is, during the past 50 years America's non-metropolitan counties have lost more than one-third of their population. More than a third across the board of that population has been lost. During the same period, the number of people living in metropolitan areas has grown by over 150 percent.

As the National Corn Growers' report states, "These trends challenge policymakers to shift emphasis from commodity subsidies to rural programs that will enhance job growth and opportunities for a broader set of rural residents than farmers alone. In short, farm policies' commodity price supports have done little to help farm communities reverse the decline."

Again, I point to that example, Mr. Chairman, because I think we have tended over the years to move in a direction that, in fact, has de-incentivized growth and have not been the productive machines that we had hoped that they would be to enhance growth and prosperity.

As Senator Dorgan said last February, we introduced our new Homestead Economic Opportunity Act, S. 1860. The focus of this act, as he noted, was to explore in some detail, but also as most pieces of legislation are, general areas where we could work with committees and work with our colleagues to come up with a solution.

We know, as Senator Dorgan said, that this is a beginning, just what we have heard so far today during this hearing from our colleagues.

Your range of cataloguing some of the legislative initiatives that have been put forward, all are part of the composite that you and this committee are reaching for. For that, we appreciate that very much.

In Nebraska, which you may be aware of, Mr. Chairman, the first actual homestead site was in Nebraska. As you know, we just celebrated the 140th anniversary last month of the Homestead Act.

The first homestead was right outside of Beatrice, Nebraska, so we have some understanding of what that meant and how that transformed our State, and of course the Midwest, and really all of America.

As our people became more productive in this country 140 years ago and through that period as they moved west, that brought about new markets for the people in the east who were already established, the financing, the capital, the incentives, the supplies, the services. So, it all does connect.

As I have noted, I think one of the points I made in a floor speech I gave a couple of months ago on this, this is not just a Midwest, Rocky Mountain, southern issue because of the fact that it has the marketing and growth consequences that it does.

As Senator Dorgan mentioned, we build upon a number of existing programs. We actually focus on three new areas where we would incentivize: individuals, businesses, and capital formation.

There are some areas of notable success in various States. Oklahoma, for example, has an area that could be used very much and very clearly as a role model for capital investment with a joint venture consisting of the State and private sources in various Federal programs.

So there are models out there. There are formats that have been used successfully at a local State level that we would try to build into what we are doing.

But without going into the details of what we are about, because you have other panels behind our panel and I know you want to get to those, I would just summarize by just saying that we, Senator Dorgan and I, and our co-sponsors are grateful that this committee is looking at the completeness of this challenge for our country.

We recognize fully that our bill is just but a part of that, and we are grateful for this committee's consideration of our bill as you go forward. We would stand ready to assist this committee in any way that we could.

Again, Mr. Chairman, thank you very much.

[The prepared statement of Senator Hagel appears in the appendix.]

The CHAIRMAN. Well, thank you, Senator. That was a very thoughtful statement. I am struck with your observation, which I think is essentially true. Even though we have just passed a farm bill which will help agriculture in our country I think far better than the previous farm bill, still, I do not know if that is sufficient for rural America because, as you know better than I, often the growth is where the value is added. The value tends to be added where the people are, not where the people are not.

We have had a huge problem and challenge in our State trying to get value added, whether it is a pasta plant, or we are trying to get a malt plant in Montana. There are more people over in Idaho Falls than there are even in Montana, even though that is a little bit of value added for our Nation's breweries.

But your thoughts of incentives for businesses in addition to commodities, I think, is a good one. I think it is, frankly, necessary. Our country needs some kind of a paradigm shift if we are going to address this problem. Senator Dorgan alluded to it by little bills here and there, and they help, and so forth.

But this problem, the out-migration from rural America, is huge. It is going to require a whole different set of thinking. I think you begin to put your finger on part of the solution, and I appreciate that very much.

Senator HAGEL. Mr. Chairman, thank you.

The CHAIRMAN. Thank you.

All right. We will go to our panel now. It is a large one, but my thought is, with a large panel, you can have a lot of interaction among our panelists to help get to the heart of the matter here.

First, Mr. Lawrence Gibbs, who is a former Commissioner of the IRS. Next, Patrick Von Bargen, executive director of the National Commission on Entrepreneurship; Stephen Visocan, president and owner of Visocan Petroleum in my hometown, Helena, Montana; Steven Dodd Hughes, who is a gunmaker, writer, and photographer from Livingston, Montana; Peter Froelich, assistant for Special Projects, Dickinson State University, Dickinson, North Dakota; Lynn Cornwell, former president of the NCBA, National Cattlemen's Beef Association, from Glasgow, Montana; Jeffrey Seidel, president of Parkway Muni Resources in Minneapolis, Minnesota; and Jan Fox, vice president for Information Technology and the chief information officer at Marshall University in Huntington, West Virginia.

All right. Mr. Gibbs, why do you not begin?

STATEMENT OF LAWRENCE B. GIBBS, FORMER COMMISSIONER, INTERNAL REVENUE SERVICE, WASHINGTON, DC

Mr. GIBBS. Mr. Chairman, thank you. It is good to be back before you again.

The CHAIRMAN. I hope so.

Mr. GIBBS. As a former tax Commissioner, it is the best way to appear before this committee, I can promise you.

The CHAIRMAN. All right. Good.

Mr. GIBBS. When I was Commissioner, I always valued your support, as well as your constructive criticism and suggestions about how to make our tax system operate better, particularly for small businesses that often find our complex tax laws difficult and expensive to cope with.

I, therefore, particularly appreciate your invitation to testify before this committee on several proposals to help offset the rising costs of small businesses, including a possible increase in the minimum wage, as you mentioned.

Rather than get into the proposals, in light of the size of the panel, I think all I will do is simply summarize the five suggestions that I make for your consideration, and this committee's consideration, with respect to pending tax proposals that would benefit small business.

The CHAIRMAN. Thank you. I might say, I would like each of you to hold your statements to 5 minutes. Your complete statements will be in the record. But we have got a lot to cover today, so in consideration of others on the panel, I would urge you to keep within five minutes.

Mr. GIBBS. Well, I look forward to hearing other statements, and I will simply summarize it by basically saying that I would suggest that the committee consider increasing the amount of the so-called 179 deduction that has been discussed here earlier, that you consider increasing depreciation deductions, that you consider proposals to modify the requirements applicable to the so-called small business or S corporations.

Fourth, I would suggest that you consider certain changes to self-employment taxes that are applicable to small businesses. Fifth, and finally, I would suggest that you consider certain health care proposals, particularly accelerating the full deduction of health care insurance premiums for self-employed individuals in order to permit small business owners to enjoy the same after-tax benefits that employees of larger corporations now enjoy.

I will conclude my testimony. Thank you again for asking me to appear, and I look forward to what others have to say.

The CHAIRMAN. Well, thank you very much, Commissioner. You get a gold star. [Laughter.]

[The prepared statement of Mr. Gibbs appears in the appendix.]

The CHAIRMAN. Mr. Von Bargen, you are next.

STATEMENT OF PATRICK VON BARGEN, EXECUTIVE DIRECTOR, NATIONAL COMMISSION ON ENTREPRENEURSHIP, WASHINGTON, DC

Mr. VON BARGEN. That will be a tough act to follow, Mr. Chairman.

The CHAIRMAN. But be just as pithy and to the point. [Laughter.]

Mr. VON BARGEN. I understand. It is going to be a tough act to follow.

Thank you very much, Mr. Chairman, for the opportunity to testify.

At the National Commission on Entrepreneurship, we are concerned about companies we call entrepreneurial growth companies. These are a small subset of small businesses that intend to grow very large, very fast.

We did a report called “High Growth Companies: Mapping America’s Entrepreneurial Landscape.” We used the database in the Census Bureau that tracks every company that pays payroll taxes.

We asked, how many of those companies grew by 15 percent a year over a 5-year period in terms of new employment. We found out that about 5 percent of all U.S. employers met that standard.

But, interestingly, we found out that they were not all high-tech. In fact, a majority of them were not in high-tech industries. We also found that there were some of these companies in every single one of 394 different regions of the country, including the most rural parts of the United States.

Now, why do we care about these companies? For many of the reasons already articulated. The fraction “two-thirds” comes to mind. They create about two-thirds of all the new jobs in the economy. They actually create close to 90 percent of all the new jobs during economic downturns like the one we are experiencing today.

They create at least two-thirds of the innovations in the economy. They account for about two-thirds of the difference in economic growth across the G–7 countries. So, these are very important companies to economic growth in the United States and throughout the country.

Now, these companies, by their nature, face two big challenges. One, is how do they attract talented people to leave existing employment to come join them? The other one is, how do they acquire the amount of capital they need also to grow their companies?

I am going to talk mostly about capital today, but on the first point, as Senator Kerry, I think, indicated earlier, the key device that these companies use to attract key, talented employees is stock. That means stock options.

Therefore, leadership of members of this committee in trying to reverse the IRS regulation that would put withholding tax on incentive stock options as of January 2003 is very important, and also looking at proposals to remove the Alternative Minimum Tax from incentive stock options is also critical.

But let us go to the capital question. The capital issue that these companies face is really not venture capital. Actually, the minimum investment deal for a venture capital firm is about $3 million, and most of these companies do not reach that level yet.

The second fact to keep in mind, because of policy changes made by this Congress over the last 20 years, we actually have a lot of venture capital. Even now, after the dot.com crash, there is more venture capital being invested every day than any year prior to 1999. So, that is not the problem.

It is not a bootstrap capital problem, as far as we can tell. And by bootstrap, I mean when entrepreneurs start their companies they convince friends and families to invest in their companies, they take out second mortgages on their homes, they invest their savings, and they sign up for every single credit card that comes through the mail. That does not seem to be the problem.

What the problem is, is when a company needs to get capital to continue to grow, let us say between $200,000 and $2 million, there is the problem. The research we have done indicates there is a severe capital gap in that region. There are really only three ways to deal with that capital gap.

The first one, is if the company is beginning to grow and is already making profits, can the company reinvest its profits in its continued growth, to hire more employees, get more equipment, and expand its marketing.

That is where the proposal called the BRIGE Act, which Senator Kerry referred to earlier, could be critical, because what that would do, is that would allow companies to take Federal taxes that they would owe on that profit, deposit it in a bank, and then use it for collateral for working capital loans that would allow them to expand. So, over a 10-year period, it actually makes money for the Treasury and it allows these companies to grow.

Note that that proposal applies to any company. These are not high-tech, big venture capital-financed companies. These are small companies that really want to grow anywhere in the country, but they need a small amount of capital in order to continue to grow.

The second possible solution to the capital debt problem is from individual investors in the regions in which these companies operate.

These individual investors tend to be extremely tax sensitive. That is why proposals to modernize Section 1202 of the Internal Revenue Code, which provides very enhanced capital gains treatment for stock purchased in these companies, could be so critically important.

Then the third potential resource for this capital gap are community development venture capital funds that are in SBIEC form or CDFI form that will invest in smaller amounts in smaller companies and accept a lower level of return.

The CHAIRMAN. Thank you. Very, very good. Thank you.

[The prepared statement of Mr. Von Bargen appears in the appendix.]

The CHAIRMAN. All right. Steve, you are next.

STATEMENT OF STEPHEN D. VISOCAN, PRESIDENT AND OWNER, VISOCAN PETROLEUM, HELENA, MONTANA

Mr. VISOCAN. Good afternoon, Mr. Chairman. My name is Steve Visocan, and I am a small businessman from Montana. As president of Pop Inn, I own three convenience stores and three taverns around Helena, Montana, and I have 76 employees.

I would, first, like to thank you for inviting me to testify on tax issues relating to small business, and I will focus today on repeal of the Special Occupational Tax on alcohol, often referred to as the SOT tax.

This is a particularly bad form of taxation, and today I would like to help members of this committee—to the extent that they read my testimony, anyway—understand why this tax should be repealed.

First, I believe you will agree with me that the tax has outlived its purpose. Congress has a long history of alcohol occupational taxes. The first version of the SOT was enacted over 200 years ago, but was repealed in 1817.

Today's version of the SOT was established in the 1860's to generate revenue for the Civil War. Despite the end of the Civil War, the tax has remained relatively unchanged for more than a century.

Then in 1987, Congress passed the Omnibus Budget Reconciliation Act and raised the SOT to its current level. At least in Montana, we understand that the Civil War is over.

Second, I would like you to reflect on the extreme regressiveness of this taxation. The 1987 law increased the tax from $54 and $24 annually per store for liquor and beer retailers respectively, to $250 per year, per store. This was an incredible 1,000 percent tax increase.

Retailers must annually pay $250 per location, wholesalers pay $500, and vintners and distillers pay $1,000. Retail outlets are generally small businesses, and repealing the SOT would be an immediate and very visible tax cut.

Because the SOT is levied on a per-location basis, small business owners like me are hit the hardest. Three convenience stores and three taverns generated an SOT tax of $1,500. That is $500 more in annual taxes than the Nation's largest single-site brewery or distillery plant. By the same token, a single Elks Lodge pays the same in tax per year as a single Wal-Mart Super Center, $250.

Small retail companies like mine were most affected by the increase in 1987. Whether it is a seasonal restaurant, an Elks or Eagles Lodge, an American Legion, a bowling center, campground, florist that delivers wine with flowers, or a convenience store operator, no one is spared from this tax. In fact, more than 90 percent of all SOT revenue is collected from retailers.

Not only is this tax regressive, its revenue is not even targeted to offset the cost of alcohol enforcement. The tax is administered by the Bureau of Alcohol, Tobacco and Firearms, but the revenue collected does not go toward BATF activities. Rather, it is channeled back into the general treasury.

Mr. Chairman, as you well know, repeal of the SOT has garnered support from both sides of the aisle. I want to personally thank you and Senator Thompson for introducing S. 808, which repeals the SOT.

I would also like to thank Senator Nickles and the other 15 Senators who have agreed to co-sponsor your legislation. The House has also introduced a companion measure which enjoys large bipartisan support.

Not only does the repeal of the SOT have bipartisan support in Congress, but the Joint Committee on Taxation has recommended the repeal of the SOT in their simplification recommendations to Congress last year.

Moreover, the General Accounting Office has examined the effectiveness of the SOT several times and consistently found it to be flawed.

Mr. Chairman, the SOT is not only a burdensome tax on small businesses, but it is a flawed tax. I wholeheartedly agree with your comments when you said on the Senate floor that this is an inequitable tax that has outlived its original purpose and is a clear example of an antiquated approach to Federal taxation.

With the economy slowly rebounding, a small business owner needs your help. Just like the tax rebate last year that put $300 in the pocket of every American was economic stimulus, so, too, would be putting $250 in the hands of small businesses around this country. Believe me, getting back my $250 for the SOT tax would be welcome relief.

Again, thank you, Mr. Chairman, for this opportunity to testify. I would be happy to answer any questions.

The CHAIRMAN. Well, thank you very much, Steve. I hope that members do read your statement. It is a very good one. I do not know if they will, but maybe their staffs will tell them about it.

[The prepared statement of Mr. Visocan appears in the appendix.]

The CHAIRMAN. Steve Hughes, you are next.

STATEMENT OF STEVEN DODD HUGHES, GUNMAKER, WRITER, PHOTOGRAPHER, LIVINGSTON, MONTANA

Mr. HUGHES. My name is Steven Dodd Hughes. I am a custom gunmaker from Livingston, Montana, a town of 7,000 individuals. I have run a sole proprietorship, which I call a one-man shop, for 24 years.

The majority of my business income is generated outside of the State of Montana and brought into a State with little industry. Out in the west, the locals appreciate the dollars coming into the community.

Most custom gunmakers live in the rural west. In fact, several western communities, such as Glen Rock, Wyoming and Big Timber, Montana boast custom gunmaking as a major income source for the entire community.

I am here to testify on the need for an excise tax exemption for custom gunmakers. The current 11 percent excise tax was originally part of the 1937 Pittman-Robertson Act to set aside funds for wild lands and to build shooting ranges. It is levied on all firearms manufacturers.

The tax is tallied by the serial number of the gun's action at the time of manufacture. For manufacturing and taxation purposes, the rifle action would be defined as "the frame or the receiver of the gun."

It is a good tax, but it was never meant to be applied to a one-man shop scenario. I do not actually build new guns, and should not be subject to the manufacturer's tax.

As a custom gunmaker, I take an existing rifle action and completely rebuild it into an artistic firearm for an individual, updating it and upgrading it. I complete about four to five custom guns per year. Some of my associates create as many as 20 guns per year.

I hold a Federal firearms license, just like a hardware store would that sold guns. Those who make rifle actions are required to hold a manufacturer's firearms license.

Every business that I know of that makes rifle actions in any quantity holds this manufacturer's license. Although we call ourselves custom gunmakers, we do not manufacture the actions or the frame of the gun.

On the cover of this book I wrote are a couple of photos of a couple of rifles that I built.

The CHAIRMAN. Would these be in some of the postcards that you sent?

Mr. HUGHES. Yes. For these rifles, the taxes are already paid on the actions that I used to create them, and in fact has been paid on the actions for most of the guns that custom makers use.

In fact, the current interpretation of the regulation is so ambiguous, that if a client supplies a rifle action to me, he is deemed the manufacturer and he is liable for the tax.

I am wondering, who is going to assess and collect that tax from the client, and who is going to determine how much tax was previously paid on that rifle action?

As a small business owner, as many of you realize, I do the bookkeeping, I keep my Federal firearms license records, I do the advertising, promotion, I travel to show my work, and I sweep the shop floor; all this besides building the guns.

This tax has been a long-time source of confusion for small businesses and I believe it has been an administrative headache for the IRS and the BATF. Congress has agreed with me in the past. In 1982, Congress passed an appropriations bill prohibiting BATF from collecting this tax from custom gunsmiths. Later, the Department of Treasury took the position that the 1982 provision expired at the end of fiscal year 1982.

Now, I believe the intent of that law was to establish a permanent ban on the collection of firearms excise tax from small shops like mine. In the past, members of the committee, and you, Mr. Chairman, in particular, have introduced legislation to correct this problem.

I hope that we can clear up the confusion soon, because this burdensome tax has the potential to put many small shops like mine out of business.

In conjunction with the American Custom Gunmakers Guild and the NRA, I have been personally trying to get an exemption of this tax since 1977. This cottage industry of custom gunmaking is one of the last bastions of high-quality hand craftsmanship in America. We do not manufacture firearms. Further taxation might snuff us out.

I represent just a few hundred craftsmen around these United States. I work with these hands. Most of my work, and that of my associates, is done by hand. My clients call me an artist. I call my self an artisan. This tax was never meant to be applied to these hands working in a one-man shop. I am here to request that you consider exempting artisans from this manufacturing excise tax.

I thank you very much for your consideration.

The CHAIRMAN. Well, thank you very much, Steven. That is a very good statement.

[The prepared statement of Mr. Hughes appears in the appendix.]

The CHAIRMAN. Peter Froelich?

STATEMENT OF PETER FROELICH, ASSISTANT FOR SPECIAL PROJECTS, DICKINSON STATE UNIVERSITY, DICKINSON, ND

Dr. FROELICH. Mr. Chairman, members of the committee, I would like to thank you for the honor of speaking here today. My name is Peter Froelich. I am the assistant to the president at Dickinson State University in Southwestern North Dakota. I am also the coordinator of the Great Plains Population Symposium Project, which was funded by a special grant from Congress.

As coordinator of the symposium, I have had a real opportunity to meet and speak with many of the finest people in this Nation who are concerned with the future of rural America.

I have also had the privilege of gaining input from many of over 650 citizens of the Great Plains who participated at two conferences that we have hosted in the past few months. The written testimony I have provided reflects many of the things that I have learned from all of these people.

I would like to commend you, and all the members of Congress, for passing a number of important initiatives, such as the ones that created our symposium project, and also the REAP project and the new Rural Strategic Investment Program that is in the farm bill.

We in rural America need a comprehensive new framework for rural policy that articulates a new vision for rural life that goes beyond agriculture to include all of us.

There are other important initiatives, such as S. 1860, which you heard about from Senators Hagel and Dorgan, the new Homestead Economic Opportunity Act, that deserve your full consideration.

S. 1860 includes provisions such as an incentive for educated young people to stay and own homes in rural places. It also includes tax incentives for investment in rural businesses and critically needed venture capital for rural entrepreneurs.

Out-migration is creating a looming crisis in many parts of rural America, especially in the Great Plains. Of the 1,009 counties in the Great Plains, 38 percent lost population in the last decade, and most of that population was in rural counties, not in the metropolitan counties of the Great Plains. I would also say that most of that loss was among young people, not among old people.

When our rural communities lose their young people through out-migration, it robs them of their biological, their economic, and their civic vitality. Just an aside here, right now in North Dakota, the legislature is considering a constitutional amendment to allow counties to elect state's attorneys who are not residents, because there are an increasing number of rural counties who do not have one attorney who resides in them who can be a state's attorney. So, there is a good example of the loss of civic vitality by the loss of our younger generations.

In our symposium on April 1, I heard Dr. John Allen, who is at the University of Nebraska, say that there are two kinds of generations: those who are builders and those who are maintainers. I think that we are at a point in rural America where we must have a new generation of builders.

Federal leadership has always been critical for rural America, and it has never been more critical than it is right now. After a lifetime, myself, of trying to stay on the Great Plains and after nearly 2 years of thinking specifically about this issue, I am convinced that the single greatest challenged faced by rural communities is a need for a new vision of rural life that individual citizens can connect with and pursue to build lives for themselves.

The most important question that I have heard from people on the Great Plains over and over again, when they are struggling to either stay there or come back, is what could I do here? We need to have an answer to that question, or we need more than one answer to that question.

As our Nation's leaders, your actions will be a deciding factor in whether or not we will have a vision that allows people to build lives in rural places. Your initiatives must consistently and coherently reflect the possibility for youth to stay and thrive in rural communities, and they must facilitate new kinds of connections between rural places and other parts of the Nation. They also must demonstrate that there are great opportunities to be gained by investing in the creative capacity of rural citizens.

If you do these things, I believe you will establish a new era in American history and you will be the true successors of great visionaries of our history, such as Thomas Jefferson, whose vision of an agrarian democracy has shaped rural life for two centuries, and Abraham Lincoln, who signed the original Homestead Act.

With that, I would like to thank the committee for this hearing and for the honor of speaking here, and I will do my best to answer any questions you might have.

The CHAIRMAN. Thank you, Dr. Froelich, very much. That was helpful.

[The prepared statement of Dr. Froelich appears in the appendix.]

The CHAIRMAN. Next, Lynn Cornwell from Glasgow, Montana.

STATEMENT OF LYNN CORNWELL, FORMER PRESIDENT, NATIONAL CATTLEMEN'S BEEF ASSOCIATION, GLASGOW, MONTANA

Mr. CORNWELL. Chairman Baucus, thank you, sir. Ranking Member Grassley and distinguished members of the committee, my name is Lynn Cornwell. For the sake of brevity, I will summarize my comments and submit a written testimony for the record.

My family owns and operates a diversified ranching and feeding operation northwest of Glasgow, Montana. I am here today representing the National Cattlemen's Beef Association, where I served most recently as their president, and the hundreds of thousands of other ranchers just like myself nationwide.

NCBA applauds the committee for holding this hearing. Agriculture and the supporting industries is the backbone of this Nation. The success or failure of many rural communities is directly tied to the growth, development, and profitability of farms and ranches that surround these communities.

Mother nature and current markets have placed the beef industry in the midst of some interesting times. Cow/calf producers that should have experienced highly profitable seasons have seen incomes slashed by droughts and fires.

While other segments of agriculture may rely upon a safety net, we do not. The beef industry has rejected those efforts in the past, and will likely continue to reject them in the future.

Most ranchers' success is largely dependent on the investment into assets that build equity on these ranches. The traditionally low rate of return on investment has meant that we look at this committee more often than others to address our long-term successes and concerns.

We continue to believe that long-term investments in our operations and sustainable investments in conservation and technology will allow us to keep our operations profitable and in our family's name in the future.

For these reasons, the elimination of the death tax is, and remains, a top priority for the NCBA. I know, Chairman Baucus, you have had a great stake and a personal interest in this death tax debate, and we thank you.

We appreciate the leadership and other members of this committee for their efforts this past year in taking a first vital step to repeal the death tax. I would encourage you to renew those efforts and make last year's success permanent, and finish the job of ending this horrible death tax.

Farm, fishing, and ranch risk management accounts. An equally important step forward is to give producers the ability to manage their own resources through the typical highs and lows of the market.

NCBA supports legislation that will empower producers to invest their own resources in a way that will benefit their family farming operations. That creates stronger rural communities that can withstand some of the economic storms that have plagued rural America that we are all familiar with.

NCBA has long supported the creation of farm, fishing, and ranch risk management accounts, FARM, to help family farmers and ranchers manage risk through savings.

Using FARM accounts, ranchers would be able to save money in good economic times for use when times were less profitable without penalties usually assigned to those savings.

Many of the increased pressures we face in balancing my ranch budget are the same as any small business: livestock, fuel, equipment, repairs, building maintenance, insurance, utilities, payroll.

These are all part of managing a ranch in today's environment, much as any other business. The key differences being that those of us in agriculture find ourselves at the mercy of the weather and the fluctuating marketplace that is based more on supply and demand than on the costs of production.

We cannot expect for the laws of supply and demand to disappear, but with your help we can take steps to allow producers to better prepare for lean times ahead. FARM accounts would allow producers to defer income during the profitable years and then draw on those funds, their own money, during times of need.

FARM accounts would allow producers to defer up to 20 percent of their income, allowing them more efficient management of their own resources. As a result, lendable funds will be more available to other individuals and businesses in rural communities.

FARM account deposits stored in local banks would be available for others in the community to utilize, resulting in additional capital investments elsewhere in the rural community, good for ranchers, good for rural communities, truly a win-win for all of rural America.

FARM income averaging provides farmers and ranchers with a valuable tax management tool. However, the intended benefit of income averaging is being eroded by the Alternative Minimum Tax. Ranchers who take advantage of income averaging, those with wide swings in income, are hurt most by AMT-imposed limits on farm and ranch income averaging.

Income averaging helps ensure the long-term viability of ranchers and ranch families because they are no longer over-taxed in profitable years, leaving more funds to pay expenses and prepare for the downturn.

Capital gains, ranching, and beef production is a capital-intensive business that requires a tremendous investment in land, buildings, and equipment. Capital gains taxes are a deterrent to producers' investments in new breeding stock, equipment, and buildings. Capital gains threaten the transfer of ranches between generations.

They artificially increase the price of land, making it more difficult for the younger generation to take over farms while their parents are still alive. NCBA does support a number of the efforts to provide relief from capital gains, and we encourage the committee to continue to evaluate these options.

A number of issues of importance to rural America could be addressed through measures before this committee. Improvements in Subchapter S laws would help community banks, thereby helping producers in and around those communities.

Farmers and ranchers that pay self-employment taxes are disturbed by court rulings in the past several years that changes the classification of rental income, specifically from programs like the Conservation Reserve Program.

NCBA believes it is unfair to treat active farmers and ranchers differently from other taxpayers when imposing self-employment taxes on rental income.

In closing, Mr. Chairman and members of the committee, I thank the committee for this opportunity to testify and to express our support for the Tax Empowerment and Relief for Farmers and Fishermen's Act, and other similar measures.

In our statement we have outlined a number of important provisions that we hope the committee will address. Again, I thank you, and will be happy to answer any questions, friend, Chairman Baucus.

The CHAIRMAN. Thank you very much, Lynn. I appreciate that.

[The prepared statement of Mr. Cornwell appears in the appendix.]

The CHAIRMAN. Next, is Jeffrey Seidel, president of Parkway Muni Resources, Minneapolis.

STATEMENT OF JEFFREY D. SEIDEL, PRESIDENT, PARKWAY MUNI RESOURCES, MINNEAPOLIS, MINNESOTA

Mr. SEIDEL. Thank you, Mr. Chairman. I am here to take a left turn in the discussion, I believe, and talk about Indian country, but it does pertain to rural economic development as well.

I am the founder and president of Parkway Muni Resources in Minneapolis, Minnesota. I specialize in obtaining financing for non-profit, tribal, and commercial enterprises, especially those who do not easily qualify for conventional financing. Many of my clients are Indian tribes.

It is apparent to me that economic development in Indian country is still in its infancy, despite recent successes of some tribes in gaming. Most tribal land on reservations is still without adequate infrastructure and the resources, including quality education, to fully develop tribal economies to their potential.

Economic gains can come within the reservation and from external sources. I am here to speak on behalf of two issues in Indian country, one to increase economic development from outside capital investment, and one from within.

The first issue speaks to the outside capital investment on qualified Indian land. In 1993, Congress passed legislation which, among other things, allowed for accelerated depreciation of property used predominantly on Indian reservations under Section 168(j) of the Tax Code.

While the program has been slow to develop, it has gained some momentum as companies looking to make capital investments in the area of manufacturing or energy production look to shave costs as much as possible during this period of economic downswing.

Also, even with all things being equal—which they are not on reservations—tribes still need help in the form of targeted economic incentives to attract these companies.

However, many of the projects that we talk about take time to develop, particularly in Indian country where I found that tribal leaders' thoughtful deliberation in considering all aspects of a project, combined with changes in council configuration due to the 2-year election cycle, leads to delays in starting these projects up.

As you may know, the House last year extended the accelerated depreciation language for 3 years, but limited application of the credit to energy projects. We are respectfully requesting that the Senate extend the benefits through 2005, and without the limitation of the use of the credit to energy projects only.

With this extension, tribes may pursue long-range projects with the knowledge that the incentives will be there for years to come. It is these projects which will provide a stable foundation for economic growth in Indian country.

With regard to economic development from within a tribe, I believe the greatest gains to be made come from the most under-developed resource of Indian country: the children.

It is well-established through treaties that the Federal Government is responsible for the funding of new construction or capital improvements to BIA schools. Yet, if you visit most of the 187 schools funded by the Federal Government, you will be shocked by the conditions under which these children must attempt to learn.

The frustration felt by the children and their parents, who were also victims to these dilapidated schools in their youth, is manifested in high drop-out rates and the lack of higher schooled youths and young adults.

Fixing or replacing these schools needs to become a high priority for the Federal Government if we are to improve the economic depression found in so many tribes. Better schools means more high school graduates, more college graduates, and more post-graduate degrees. All of these translate into a better workforce for tribal and non-tribal industries on the reservations.

For a number of years I have been working with the members of the Dakota Area Consortium of Treaty Schools, Senators, and Congressmen on both sides of the aisle to improve the physical plant of these schools. Direct funding is obviously the best answer, but traditionally only two to four schools per year are funded for redevelopment.

Even with the President's promise to eradicate the $1 billion backlog of known repair and replacement projects, the recession and budget deficit has cut the number of schools to be repaired or replaced at about two to four per year.

At this pace, the direct funding approach will take anywhere from 50 to 70 years to replace schools which are, today, condemned by local authorities.

S. 243 describes a method of financing which will help alleviate some of the backlog today and finally provide tribes with a full package of design, construction, and now funding mechanisms to complete these school replacements on a timely basis.

Basically, the financing mechanism of S. 243 allows tribes to issue 15-year bonds through the capital markets, the proceeds of which will build the schools.

The principal on the bonds will be repaid through an escrow account which will be funded at closing with enough money so that, in 15 years, the combination of the original funding, plus interest earnings, would be sufficient to pay the principal on the bonds in full.

The payment of interest will be made in the form of tax credits to the investors, such tax credits being applied over the 15-year period of the bonds. There will be a fiduciary, a bond trustee, to oversee the bonds. These trustees are found in nearly all major banks in the United States and do this duty on billions and billions worth of bonds every year.

With a bonding mechanism, tribes will gain access to the elusive capital markets. They will derive short-term economic benefits during the construction phase of the project, and they will derive long-term economic benefits through better educated children and a stronger workforce to offer companies looking to do business on the reservation.

I ask that you strongly support S. 243, along with the Indian Affairs Committee, not for me, but for these children. I thank you for your time, and I would be happy to answer any questions you may have.

The CHAIRMAN. Thank you, Mr. Seidel. I appreciate it very much.

[The prepared statement of Mr. Seidel appears in the appendix.]

The CHAIRMAN. Next, Jan Fox, who is vice president for Information Technology and chief information officer at Marshall University in Huntington, West Virginia.

STATEMENT OF JAN I. FOX, VICE PRESIDENT FOR INFORMATION TECHNOLOGY/CIO, MARSHALL UNIVERSITY, HUNTINGTON, WEST VIRGINIA

Dr. FOX. Thank you, Mr. Chairman. I am here for the re-introduction of S. 88. This is the Broad-Band Internet Access Act of 2001, sponsored by Senator Rockefeller and co-sponsored by many members of this committee, including yourself.

This legislation will provide tax credits and encourage deployment of broad-band facilities in areas where such technologies have not, and without Congressional support, perhaps, will not be available.

Broad-band technologies in any part of the U.S., whether rural or urban, are really the essence, essence not just for business, but for education, for health care, and even our own e-government.

Broad-band technologies are one of the basic building blocks, just as we had electricity and telephones. Without broad-band deployment, we are literally limiting our rural communities, and even urban communities if they are not deployed with next generation technologies, from our growth.

We live in a world that is described as "innovation," "next economy," "new economy," "based on innovation," and "based on resources to information." Without those access points, basically we cannot progress.

We cannot progress with our educational resources. Many of these include being lifelong learners. We are building those types of challenges in our young children and throughout our adults to learn forever, to continue to access resources.

Many of these technologies, including on-line education and video, require access to broad-band. At Marshall University, we have 16,000 students. Ten thousand students of the 16,000 use on-line courses for their education.

That means they can be anywhere, any time, whether they are in Korea, Australia, or in the most rural parts of West Virginia. That means really delivering education to our students and really building that innovation factor that builds business. It is based on learning, based on resources.

I have dealt in many parts of the South and throughout the United States with businesses, and the first thing they ask for is space, the second thing, is do I have connections.

Whether you are trying to sell or whether you are trying to create, that access to resources is a major building-block factor to the creation of education and the creation of business, and the creation of our communities.

In West Virginia, we have two of those counties with a mass exodus, number one and number two that happened last year, Mingo and McDowell Counties. Of all the counties in the United States, those lost more per capita than anywhere.

But let me tell you about a wonderful solution that was broad-band. Because of that mass exodus, we actually put broad-band in Gilbert, West Virginia. Gilbert is a very rural county area, including, right up front, is the Hatfield and McCoy—Doublance Hatfield's actual burial plot. That is how rural we are talking about.

An area where coal was the king. Coal is not our big pressure point anymore, but innovation still is. In that innovation, we have put broad-band in a community learning center.

Part of that community learning center, at 3:10 after the kids got out of school, they fill out that center and they learn, and they bring their families into the center and they learn. They try to do their own businesses. They actually have innovation things they send back to the university.

In addition, they have health care. That same center provides access to students looking for health care, and to families. Our Governor's Cabinet on Children and Family actually had meetings in that center to discuss health care and access to resources. Additionally, that same broad-band connection provides telemedicine access for people looking for dermatology.

The problem is, in that one wonderful connection, I cannot buy any more. We were totally full of what we can have in capacity in Gilbert, West Virginia. We cannot get any more without some type of incentives to go further.

Those types of ideas are what is happening in economics and in health care. We are dealing with major research issues where broad-band is the major incentive. We speak of access to massive amounts of information. That only happens if we have connections.

Whether in rural West Virginia, whether in Alabama, whether in New York, whether in Alaska, whether you are in a rural area, whether you are in an urban area, minimal broad-band or next-generation broad band really are a baseline to innovation, to new work ethics, to new access to information, to building new models for education.

In West Virginia, we come from an area of beautiful minds and rocket boys, where innovation and access to information is really a key to our success. It is a key to success to any community, whether you are little, small, urban or rural. This bill truly will provide those tax incentives.

We are truly in our infancy in the Internet, and we will grow and expand, not just from a community, but from a Nation, based on access to information, based on quality health care resources, and based on good-quality business.

Thank you.

The CHAIRMAN. Thank you. That was an excellent statement.

[The prepared statement of Dr. Fox appears in the appendix.]

The CHAIRMAN. I would like each of the panelists to kind of—this is hard to do because small business is so varied across America. We have rural areas in some parts of America, and then we have really rural areas in other parts of America, particularly home in my State of Montana.

But what struck me a little bit, is one solution that is analogous to the repeal of the Special Occupation Tax, and also the 11 percent excise tax, because those hit individual, smaller operations much more, disproportionately more, than they hit a big outfit. You mentioned Wal-Mart, for example, Steve. Of course, you mentioned, Mr. Hughes, how you make about, what, six or seven——

Mr. HUGHES. I have no vehicle to even implement a procedure for paying the tax.

The CHAIRMAN. Right. Right.

But my point is, you could think about some areas where the current tax law really disproportionately hits smaller business. It is kind of analogous to how the SOT disproportionately hurts small business, and the 11 percent excise disproportionately hits small entrepreneurs like Mr. Hughes.

It is a bit unfair, because I know you have not been thinking of the problem in quite those terms. But it seems to me that is one way to begin approaching this problem and trying to find a solution, is finding those kinds of area where current tax law, again, disproportionately hits the smaller guy as opposed to the bigger.

Now, in a certain sense, a lot of this is just regulations and paperwork and all that that a small business person has to fill out, which is disproportionately much more difficult than a large business, which is computerized and so forth.

But that raises the question, well, should the income tax be less for small business, and all those kinds of questions, which are quite difficult.

But does anybody want to take a stab at this? Where in the current tax law does income tax, or any tax, excise taxes, disproportionately kind of hit smaller business compared with bigger business where we might be able to take a whack at it?

Yes, Mr. Von Bargen?

Mr. VON BARGEN. Mr. Chairman, I had briefly referred to the BRIGE Act solution.

The CHAIRMAN. Right.

Mr. VON BARGEN. The dynamic there is pretty interesting. You have a small business that is trying to grow very quickly. It has profits. It is reporting profits on an accrual basis, even though it is actually going cash flow negative.

That is, as it is expanding, it is running out of cash to hire new employees to grow to get new investment in equipment. But from a tax standpoint, all the tax law sees is there is the profit here that should be taxed at the corporate rate.

Now, larger companies do not face that dilemma because they are out of that no man's land of going cash flow negative. Smaller companies that are not growing do not necessarily face that dilemma because they do not need the amount of growth capital that these growing companies need.

So, they are caught in this bind where they are actually doing quite well. The reason they are going cash flow negative, is there was a demand for their product and services and they are trying to expand their capacity to deliver that. But the tax law does not see that.

So what the BRIGE Act would do, I think, is it would say, we recognize this no man's land, if you will, this cash flow negative situation. In order to help you through that, we will allow you to defer your taxes for a while. When you get out of that difficult period, then you can repay the taxes.

So I think that applies to a lot of small businesses that are growing fast, but it is an anomalous situation that I think few people think about. If you think a company is profitable, it is profitable. But, in fact, when they are going through this growth period, they really are going cash flow negative.

The CHAIRMAN. I am struck with the potential of greater broadband, higher speed, better connections, and so forth, the potential to help rural areas. I wonder if we could get a little conversation going here between Dr. Fox and Dr. Froelich, and maybe Mr. Cornwell. You live in kind of rural parts of our country. I know Lynn does, certainly.

Tell me the degree to which you think that can help. I would also like to ask, and maybe you will play devil's advocate a little bit here, Lynn, and maybe Dr. Froelich, and say, well, gee, that sounds great.

I do not know what you are going to say, but I do not want to just say, oh, boy, that is the greatest thing since sliced bread. That is going to solve all of our problems. That is a panacea, a silver bullet. Clearly, it is not a panacea, but it is certainly part of the solution.

So do you want to talk a little bit about that?

Dr. FOX. One of the points I did not make, is the issue with broad band is that our technologies are becoming more information-intensive. So it is not just a problem now, it is a growing problem. We have multi-media technologies that include voice data and video that basically cannot be deployed out there now.

So, as we are speaking about business opportunities and resources, whether a company is trying to put their business on the Web or trying to actually order from the Web, or any other component of business, they need that connection for growth.

The CHAIRMAN. What do you think, Lynn? How much is that going to help?

Mr. CORNWELL. Well, where I come from, Senator Baucus, I think Opime High School had three graduating seniors.

The CHAIRMAN. I gave the commencement address there several years ago.

Mr. CORNWELL. Yes, sir. We heard the great Senator from the State of North Dakota talking about their problems. We need this service. This broad-band service is great, to have that.

But I guess my fear is, we are not going to have any young people left in these areas unless we address some of these immediate concerns to enhance business and figure out a way to keep some of these younger minds active and keep them in these rural areas, like we have heard from most of the panelists today.

I think that is job one. If we do not address the Alternative Minimum Tax and figure out ways to help agriculture, and I am talking our State—your State, my State—that is very rural, if there is not a way to keep those operations in business, through droughts and through all these other things, and there are not any people there to serve, in all due respect to what Dr. Fox is talking about, it kind of falls on deaf ears because there is not anybody left.

The CHAIRMAN. What is your reaction to that, Dr. Fox?

Dr. FOX. Our issue with keeping the young minds, is basically back to the broad-band issue. We are able to deliver education anywhere into those areas, quality education, so that we have quality math and science.

We have NASA experiments going on in rural parts of our State in those areas that do have broad-band. Where they do not, we do not have that access at all.

The CHAIRMAN. Dr. Froelich?

Dr. FROELICH. I think that having access to broad-band services, the same as having a highway, in the age we are moving into, all of the places that do not have it are going to be left out of this society and they are going to die.

I think it is one of the critical things, to build both broad-band access out in rural America, but also wireless service. I do not know how many people I have had come to North Dakota and check their little personal assistant, and they are off-line until they leave.

When I was trying to talk to my boss to see about coming here today, he was in the electronic black hole in western South Dakota and I had to wait half a day before his cell phone would work. That is a huge disincentive.

The other thing I would say in terms of keeping youth, is that a lot of our youth are fleeing because the economy that is there, the existing infrastructure, is stagnant. It does not offer any opportunities for them.

It is important for us to build new opportunities. I think that broad band is one of the areas where there is a resource that entrepreneurs can use to create new opportunities and engage the younger generation.

So, I agree with him about needing to keep some youth, but I think broad-band is important as a tool for doing that.

The CHAIRMAN. What are other countries doing to help small business, anybody know? Mr. Von Bargen?

Mr. VON BARGEN. Interestingly, one that I am thinking of right now is the United Kingdom. It has taken a very aggressive stand toward dramatically reducing capital gains rates for new entrepreneurial companies. They now have a capital gains treatment better than the United States.

Then other countries are subsidizing the creation of entrepreneurial networks in regions of their countries that we believe are critical to establishing the social infrastructure for new businesses to start.

So I would say in those two areas of capital gains treatment and in the seeding of networks and investment ANGEL networks, several companies have taken steps.

The CHAIRMAN. Commissioner, do you have thoughts on that?

Mr. GIBBS. Yes, I do. Based on my experience, and for the last 12 years, my experience has largely been in the large corporate area. Prior to that time, Mr. Chairman, beginning in Corpus Christie, Texas, even when I moved back to Dallas, a much larger part of my practice was in the smaller business area.

The thing that strikes me, and as I have traveled and talked to tax people throughout the world, a key consideration, it seems to me, for small business—and we have touched on it, really, in many ways, the panel has today—is whatever you can do to increase the cash availability, the cash flow, realizing that you are talking oftentimes to folks that are leasing rather than owning, people that are borrowing instead of having all the cash reserves to do whatever they need to do with it.

That is, I think, one of the reasons, as you begin to focus on what small business needs, and in a way how it is distinguished from your larger businesses. Your larger businesses tend to be much more interested in earnings per share, whereas your smaller businesses could care less. They are interested, really, in that cash flow.

Therefore, as you focus on things, fundamental things like depreciation changes, like increasing expensing, those types of things, what you are doing is, to the extent you are pulling down the taxes, you are increasing automatically the after-tax cash flow of the small business man or woman. At least in my experience, that is really where the rubber meets the road.

The CHAIRMAN. That is probably a pretty good summary. Anybody want to comment? Yes?

Mr. CORNWELL. Chairman Baucus, we just passed a FARM bill that is the most lucrative FARM bill to some segments of the country of any bill we have ever passed. One of the biggest criticisms that we hear in rural America, is we are an aging population. We saw that pointed out today.

It seems kind of futile to me to put the money, to some extent, in agriculture's pockets, an older generation of producers, and then watch that money leave these rural communities. And you know what I am talking about. You and I have had this discussion. The CRP checks that go to Phoenix, the CRP checks that go to areas of retirement, and the vacant buildings, the vacant operations.

But the point I am making, in following what the Commissioner said, when that money leaves that community, it is gone forever, whether it is invested in the stock market, whether it is the Coal Trust, whether it is the interest off the Coal Trust in Montana that goes to Wall Street. All these dollars that leave these communities rob that community of the ability to enhance growth and keep the young minds.

So I think your bill here, these FARM accounts, are a great step and a great opportunity to encourage agriculture, in this case, to keep that money in the local banks. These local banks are what drive these local communities.

And if we can keep those dollars on Main Street, my grandfather used to say those dollars will roll down Main Street as big as a wagon wheel if we can keep them in those local communities. I think you are doing the right thing here, but I hate to see these dollars leaving these areas.

The CHAIRMAN. We are going to have to conclude very, very quickly. But Mr. Visocan? Go ahead, Steve.

Mr. VISOCAN. Mr. Chairman, something else that Mr. Cornwell mentioned a minute ago, too, is the death tax, which I think is very, very important to small business. He mentioned money going out of the State, out of the country.

More and more, what I see is consolidation going on in a lot of the businesses that are in America, in Montana. When someone passes away and is unable to pass that business they have on to their children, on to their grandchildren, or whatever, then a large corporation typically comes in and buys it. Again, it goes out of State, or goes out of the country, or whatever.

Having the death tax repealed that we have now, and continuing that, is very, very important, I think, more so to small business than to any other group.

The CHAIRMAN. Well, I will tell you, we all say it, but sometimes the trite things are the most true, and I think this is another example. But small business really is the backbone of America. It is the values we have been talking about. I do worry very much about the concentration of economic power in America. It is getting more and more concentrated, and I think that is not good.

So, thank you all very much for your ideas. Clearly, we have got a long ways to go here. I was very interested in the ideas of the Homestead Act that Dr. Froelich is a part of, because I do think we need a whole new paradigm to shift movement towards small business and helping to keep people alive and well in rural America.

As we did in the past with urban renewal, modernization, and so forth to help the cities, now I think it is time to help rural America. It is going to take some work, because we are kind of in this mind-set of free competition, deregulation, and so forth. The more we go down that road, the more it just tends to help the urban areas, in many respects, and hurt the rural areas.

We are all for competition. We are all for letting everybody pursue his own dream economically, and so forth. But, on the other hand, we are all still one country. Clearly, past policies, although they have helped build America, have also in some respects hurt small business and hurt rural America. So, we are going to have to figure out the right balance here. The pendulum has got to swing back a little bit more, back to small business in rural America. Your testimony should help us to find that balance, but, as I said, we have got a lot further to go.

Thank you very, very much. I am very, very appreciative. I want to thank all of you who came great distances. It is not inexpensive, sometimes, to fly from certain parts of our country to Washington, DC. Thank you very much.

The hearing is now recessed.

APPENDIX

Testimony of

Patrick Von Bargen
Executive Director
National Commission on Entrepreneurship

Mr. Chairman and Members of the Committee:

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

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

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

Small entrepreneurial growth companies create jobs – about two-thirds of the new jobs between 1993 and 1996, and even a higher percentage in the recession of 1990-1992.

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

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

Who are these entrepreneurial growth companies? In an NCOE study called *High-Growth Companies: Mapping America's Entrepreneurial Landscape,* we used a Census Bureau database to study every employer in the United States in each of 394 different labor market areas, or regions, comprising the entire country. We found that:

Fewer than 5% of all U.S. businesses and all U.S. start-ups grow at least 15% a year over a five-year period

4.7% of existing businesses increased employment by 100% over five years

4.5% of start-ups grew to more than 20 employees by the end of the five-year period

We also found that these companies were not just in high technology industries:

Business Services	10%
Manufacturing	11%
Distributive	13%

Local Market	40%
Retail	24%
Extractive	2%

And finally, we determined that these growth companies are found in every region of the country. Los Angeles, with a population of 14.5 million people had 14,000. But even tiny Amsterdam, New York – which did not rank high in our report – had 53.

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

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

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

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

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

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

One difference, unlike the popular myth, is that entrepreneurs do not accept all the risk themselves; they are notorious for sharing both the risks and rewards of success. They excel in convincing employees, customers, suppliers, and lawyers to share in the risk. And the only thing of value they can offer key employees to entice them to leave more secure and better paid jobs with larger established companies is stock. That is why it is so important for this Committee to convince the Treasury Department through legislation or other means to withdraw proposed January 2003 regulations that would subject incentive stock options and employee stock purchase plans held by rank-and-file workers to payroll withholding tax. The members of this Committee, led by Senators Bingaman and Hatch, who have written Secretary O'Neill to that effect are to be commended for their understanding of, and commitment to, this issue.

Two, entrepreneurial growth companies depend on public policy investments in research and development of new technologies, transfer of those technologies to the business sector, and policies that strike the correct balance between protecting private ownership rights in intellectual property and putting into the marketplace ideas that can be modified and commercialized.

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

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

Five, all entrepreneurial growth companies experience one thing in common – the need for growth capital. Traditional debt financing is hard to get for entrepreneurs – they usually don't have a long enough business history or collateral that attracts traditional debt financing. And many banks find the due diligence and other costs of lending less than $1 million to an entrepreneurial company are prohibitive. With traditional debt financing not an option, entrepreneurial growth companies have to rely on sources of equity capital to fund their growth. Therein lies the challenge facing entrepreneurs.

The equity capital challenge does not arise because there is too little venture capital. Federal policy changes in 1979 and 1980 have been remarkably successful in encouraging the growth in venture capital from less than a total of $700 million under management in 1978 to over $100 billion invested in a single year in 2000. Even during these currently tough times, venture capital funds are investing today at a rate higher than any year before 1999. Companies needing more than $3 million in venture capital – the minimum investment size considered by most venture firms -- can generally find it, although the regionally concentrated networks of venture capitals can be difficult to crack for entrepreneurs who are not part of those networks.

Nor does the equity capital challenge arise for most entrepreneurs because they can't put together enough "bootstrap" capital to get started and seed their growth. Most entrepreneurs can combine money from "friends and family," many credit card lines, second mortgage proceeds, and personal savings to get started. Depending on the wealth and savings of these entrepreneurs and their friends and family, they can raise from $50,000 to $300,000 in these ways.

The challenge really arises when an entrepreneur needs to raise more money to grow her company beyond the bootstrap amount but below the venture capital minimum investment – the range of, say, $250,000 to $1 million or $2 million. NCOE believes this challenge constitutes an "early-stage capital gap." There are only three potential sources for this money: (1) reinvesting profits from the firm; (2) the purchases of the company's stock by individual, wealthy ("angel") investors; or (3) SBICs and other government-subsidized community development venture funds that will invest at these dollar levels and that require a lower rate of return than institutional venture funds.

Profits from early-stage sales of entrepreneurial company products or services can be critical to the continued growth of the company. Early-stage companies can go through what some experts have called a "no-man's land," where they are making profits but experiencing negative cash flow, because of the need to invest in new equipment, inventory, and new personnel. Therefore, every dollar that the IRS takes in corporate taxes from these profits worsens the negative cash-flow situation for these companies. The money used to pay these taxes is not available to purchase materials for more inventory as they increase sales to customers, to pay for new equipment to produce more products, or to hire new employees to provide more services to customers. If an entrepreneurial company cannot find the money to pay for these growth-related expenses, it will either go out of business altogether or dramatically slow its growth.

The Committee has asked whether the Business Retained Income During Growth and Expansion (BRIDGE) Act of 2002 (S. 1903, sponsored by Senators Kerry, Snowe, Bingaman, and Bennett) would effectively address this problem. I believe it does, in a manner that produces more revenue for the Treasury over a period more than 10 years. By allowing growth companies to use deferred corporate tax payments as collateral against which they can borrow bank funds to meet their growth needs, the BRIDGE Act would not only help fill this early-stage capital gap, but it would also have the side benefit of establishing banking relationships for these growth companies that will continue to serve them well as they expand even more beyond their early-stage growth period. I have attached a summary of the provisions of the bill to this testimony.

The second major source of equity investment that can fill this early-stage capital gap is from wealthy individual investors, sometimes called "business angels." These angel investors have two important characteristics to keep in mind. First, they enjoy a panoply of investment options – everything from oil and gas deals to real estate investments to public securities, and mutual and indexed funds that combine these and other investment opportunities in every combination imaginable. Second, these investors are extremely tax-sensitive. Tax-free or lower-tax investment options make them pause to consider.

With just a few interruptions, federal policy has long offered capital gains tax rates that are lower than ordinary income tax rates. That policy has provided individual investors with some incentive to consider long-term investments in equity securities over interest-bearing investments, and certainly that has included investments in the stock of entrepreneurial growth companies. But until 1993, there was no particular incentive to consider investing in higher risk, early-stage growth companies over, say, blue-chip public stocks. The capital gains tax rate was the same for both types of investments.

Section 1202 of the Internal Revenue Code, enacted in 1993, was designed to address this problem. The section cuts the capital gains rate by half for investments in "qualified small businesses" – those that would meet our definition of "entrepreneurial growth companies." The critical contribution of Section 1202 is that its operation could provide angel investors a powerful incentive to consider investments in early-stage growth companies in preference to other equity investments. If many more angel investors channeled funds to these companies, they would do much to address the early-stage capital gap.

Unfortunately, the imposition of the alternative minimum tax to these Section 1202 gains and a set of Treasury regulations that encumbered the use of the provision discouraged these investors. The Committee has asked whether S. 1676, The Affordable Small Business Stimulus Act of 2002 (sponsored by Senators Kerry and Cleland) would help revive Section 1202, and once again the answer is "Yes." The bill would expand the definition of qualified businesses to those with less than $100 million in paid-in-capital, increase the capital gains exclusion to 75% (and 100% for critical technology companies), and extend the period for tax-free rollovers on investments in one qualified small business to another from 60 days to 180 days. The bill does not address the alternative minimum tax problem, but another bill authored by Senators Collins, Breaux, and Hatch (S. 455) would.

Finally, a provision of S. 1676 and a companion bill sponsored by Ranking Member Grassley (S. 2022) makes an important contribution to the availability of funds from the third source of funds to help fill the early-stage capital gap, specifically the debenture small business investment companies (SBICs). The bill would allow tax-exempt entities, including pension funds and university endowment funds, to invest in these SBICs without incurring unrelated business taxable income (UBTI) liability. This could vastly increase the sources of funding available to these SBICs and could encourage more of them to invest in early-stage growth companies.

Thank you for this opportunity to testify before the Committee today. I look forward to the discussion and appreciate the opportunity to provide input from our experience with entrepreneurial growth companies.

Committee
On Finance
Max Baucus, Chairman

NEWS RELEASE http://finance.senate.gov

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STATEMENT OF CHAIRMAN MAX BAUCUS
SENATE COMMITTEE HEARING ON SMALL BUSINESS
AND RURAL ECONOMIC DEVELOPMENT

The Senate may soon consider legislation to increase the minimum wage. I think that's a good idea, but it will raise costs for some businesses. What can we do to help those businesses? That's what this hearing is about.

Small businesses employ more than their share of minimum-wage workers. They employ 51 percent of America's workers, but 61 percent of the minimum-wage workers. And small businesses generate most of the new jobs in the economy: 65 to 75 percent in most years. Small businesses are especially important in rural areas. In Montana, 98 percent of our businesses – about 30,000 of them – have fewer than 500 employees. That is the Small Business Administration's definition of small.

The minimum wage is also more common in rural areas. About 20 percent of rural workers earn the minimum wage or less, compared to about 14 percent of urban workers. Rural communities are facing other challenges, too – particularly in America's heartland. We will hear today about rural areas that are losing people as well as jobs.

Other rural communities have, in effect, the opposite problem. They're growing rapidly. Rapid growth brings different concerns: transportation, housing, environment.

Tribal communities face some of the biggest challenges, and deserve special attention.

Our hearing today will help us identify what we can do to help these diverse rural areas, and to help small businesses in general. I am proud of what we have done in the past year to help businesses. The tax reform of last summer, the recent economic stimulus package, but there is more we can do. There are a number of small business and rural economic development bills before the Finance Committee.

Senator Grassley and I have co-sponsored legislation to give tax relief for farmers and fishermen. I am also developing a proposal to give small businesses a tax credit of up to 50% for the cost of providing health insurance to their employees because today it is often too expensive for a small business to provide health plans for their employees. I think this tax credit can make a difference for small businesses.

Senator Kerry heads the Small Business and Entrepreneurship committee. He has introduced bills on financing, equipment expensing, and other small business issues. Senators Hatch, Breaux, Lincoln, and Thompson have a bill to reform rules for S corporations. Senator Rockefeller has a bill to encourage broadband Internet access for rural and under-served communities and Senators Dorgan and Hagel will tell us about their rural development bill that has been referred to this committee.

There are a lot of good ideas out there. But before we take action on specific bills, we need to hear directly from the people that are affected by our legislation. Today we will hear from a great variety of people from across America. Some of them are experts in business and taxes and technology. They are from universities, government, and business organizations. Alongside them we have the "real-world" experts. They can educate us about the challenges they face operating farms, ranches, and small businesses in rural America.

We look forward to learning from all of these witnesses how we can help America's businesses and communities thrive and prosper. After the hearing, I look forward to working with Senator Grassley and all members of the Committee to come up with a package of small business tax incentives that makes good sense and can be enacted into law.

PREPARED STATEMENT OF HON. CHRISTOPHER S. BOND

Chairman Baucus and Ranking Member Grassley, thank you for giving me an opportunity to comment on an important initiative pending before the Committee on Finance that has great potential to enhance small business economic development. This past March, I introduced the "Small Business Investment Company Capital Access Act of 2002 (S. 2022)," whose purpose is to increase the amount of venture capital available to small businesses. My good friend from Iowa, Senator Grassley, the Ranking Member on the Senate Finance Committee, is the principal cosponsor of this important bill.

During the past two years, there has been a significant contraction of the private-equity market. During this same period, the Small Business Administration's Small Business Investment Company program has taken on a significant role in providing venture capital to small businesses seeking investments in the range of $250,000 to $3 million.

Small Business Investment Companies (SBICs) are government-licensed, government-regulated, privately managed venture capital firms created to invest only in original issue debt or equity securities of U.S. small businesses that meet size standards set by law. In the current economic environment, the SBIC program represents an increasingly important source of capital for small enterprises.

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

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

In 1958, Congress created the SBIC program to assist small business owners in obtaining investment capital. Forty years later, small businesses continue to experience difficulty in obtaining investment capital from banks and traditional investment sources. Although investment capital is readily available to large businesses from traditional Wall Street investment firms, small businesses seeking investments in the range of $500,000–$3 million have to look elsewhere. SBICs are frequently the only sources of investment capital for growing small businesses.

Often we are reminded that the SBIC program has helped some of our Nations best known companies. It has provided a financial boost at critical points in the early growth period for many companies that are familiar to all of us. For example, when Federal Express needed help from reluctant credit markets, it received a needed infusion of capital from two SBA-licensed SBICs at a critical juncture in its development stage. The SBIC program also helped other well-known companies, when they were not so well-known, such as Intel, Outback Steakhouse, America Online, and Callaway Golf.

What is not well known is the extraordinary help the SBIC program provides to Main Street America small businesses. These are companies we know from home towns all over the United States. Main Street companies provide both stability and growth in our local business communities. A good example of a Main Street company is Steelweld Equipment Company, founded in 1932, which designs and manufacturers utility truck bodies in St. Clair, Missouri. The truck bodies are mounted on chassis made by Chrysler, Ford, and General Motors. Steelweld provides truck bodies for Southwestern Bell Telephone Co., Texas Utilities, Paragon Cable, GTE, and GE Capital Fleet.

Steelweld is a privately held, woman-owned corporation. The owner, Elaine Hunter, went to work for Steelweld in 1966 as a billing clerk right out of high school. She rose through the ranks of the company and was selected to serve on the board of directors. In December 1995, following the death of Steelweld's founder and owner, Ms. Hunter received financing from a Missouri-based SBIC, Capital for Business (CFB) Venture Fund II, to help her complete the acquisition of Steelweld. CFB provided $500,000 in subordinated debt. Senior bank debt and seller debt were also used in the acquisition.

Since Ms. Hunter acquired Steelweld, its manufacturing process was redesigned to make the company run more efficiently. By 1997, Steelweld's profitability had doubled, with annual sales of $10 million and 115 employees. SBIC program success stories like Ms. Hunter's experience at Steelweld occur regularly throughout the United States.

In 1991, the SBIC program was experiencing major losses, and the future of the program was in doubt. Consequently, in 1992 and 1996, the Committee on Small Business worked closely with the Small Business Administration to correct deficiencies in the law in order to ensure the future of the program.

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

The "Small Business Investment Company Capital Access Act of 2002" is important for one simple reason: once enacted it paves the way for more investment capital to be available for more small businesses that are seeking to grow and hire new employees. According to the National Association of Small Business Investment Companies (NASBIC), a conservative estimate of the effect of this amendment would be to increase investments in Debenture SBICs by $200 million from tax-exempt investors in the first year and $400 million in the second year. Government-guaranteed SBIC leverage commitments equal to $400 million in year one and $800 million in year two would be added to the private capital. Thus, total year one capital available for investment would equal $600 million and total year two capital would equal $1.2 billion.

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

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

The cost of this legislation is low and the potential for economic gain is great. Enactment of the bill will make the Government's existing SBIC program more effective in providing growth capital for America's small business entrepreneurs.

And most importantly, it will provide sorely needed capital for the sector of our economy that provides about 75% of the net new jobs—small businesses. That is a real stimulus that would cause new investments to be made and the creation of critically needed new jobs. Our economy is primed for this kind of support.

Thank you for providing me with an opportunity to comment on S. 2022, the "Small Business Investment Company Capital Access Act of 2002."

STATEMENT

OF THE

NATIONAL CATTLEMEN'S BEEF ASSOCIATION

To The

SENATE FINANCE COMMITTEE

SMALL BUSINESS AND RURAL DEVELOPMENT

Presented by

LYNN CORNWELL

NCBA IMMEDIATE PAST PRESIDENT

RANCHER, GLASGOW, MT

June 4, 2002

Chairman Baucus, Ranking Member Grassley and distinguished members of the Committee, my name is Lynn Cornwell. My family owns and operates a diversified ranching and feeding operation Northwest of Glasgow, Montana. I am here today representing the National Cattlemen's Beef Association (NCBA) where I served most recently as President, and the hundreds of thousands of other ranchers just like myself nationwide.

NCBA applauds the Committee for holding this hearing. Agriculture, and the supporting industries, is the backbone of this nations rural community. The success or failure of many rural communities is directly tied to the growth, development and profitability of farms and ranches that surround those communities.

Mother Nature and current markets have placed the beef industry in the midst of some interesting times over the past several years. Cow-calf producers that should have experienced highly profitable seasons have seen income slashed by drought and wildfires and feeders have seen some of the most unprofitable margins in recent history. While other segments of agriculture may rely upon a safety net, we do not. The beef industry has rejected those efforts in the past and will likely continue to reject them in the future.

Death Tax Repeal

Most ranchers' success is largely dependent on the investment into assets that build equity. The traditionally low rate of return on investment has meant that we look at this committee more often than others to address our long-term concerns. We continue to believe that long-term investments in our operations and sustainable investments in conservation and technology will allow us to keep our operations profitable, and in our family's name, in the future. For those reasons, the elimination of the Death Tax is and remains a top priority of NCBA.

We continue to support all efforts to fully and finally repeal taxes upon a person's estate at the time of death. To quote another past president of NCBA "death is a lousy event to tax." We appreciate the leadership and other members of this Committee for their efforts last year in taking a first and vital step toward the repeal of the Death Tax. I would encourage you to renew those efforts to make last year's success permanent and finish the job of ending the Death Tax. Without a permanent repeal, farmers and ranchers like myself must continue to make investments in estate planning that serve no purpose other than to offset the losses my heirs will experience when the federal government takes away vital equity and cash from our farming and ranching operation upon my death.

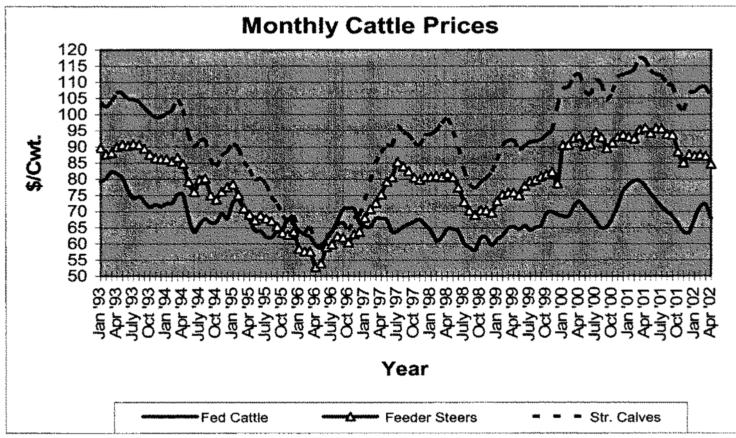
Farm, Fishing and Ranch Risk Management Accounts (FFARRM)

An equally important step forward is to give producers the ability to manage their own resources through the typical highs and lows of the market. NCBA supports legislation that will empower producers to invest their own resources in a way that will benefit their family farming and ranching operations. That creates stronger rural community that can withstand some of the economic storms that have plagued rural America.

NCBA has long supported S.313 and the creation of Farm, Fishing and Ranch Risk Management Accounts (FFARRM) to help family farmers and ranchers manage risk through savings. Using FFARRM Accounts, ranchers would be able to save money in good economic times for use when times are less profitable without the penalties usually assigned to those savings. NCBA believes that the use of FFARRM Accounts would further limit the need for government intervention in agriculture by way of subsidies and safety nets.

Many of the increased pressures we face in balancing my ranch budget are the same as any small business. Livestock, fuel, equipment, repairs, building maintenance, insurance, utilities and payroll are all part of managing a ranch in today's environment--much the same as any business. In addition, seasonal expenses that range from seed, feed, animal health products and fertilizer to machinery are also part of every producers business plan.

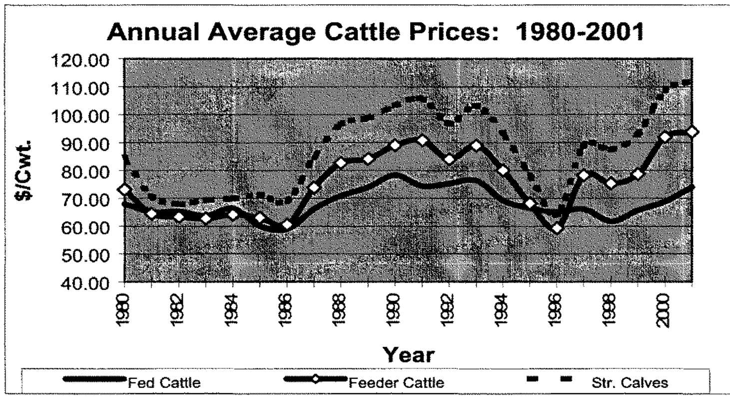
The key differences being that those of us in agriculture find ourselves at the mercy of weather and a fluctuating marketplace that is based more on supply and demand than the cost of production. As indicated by the chart [below] many cow-calf operators have experienced above average prices over the past two years. Those same high calf prices are a significant reason why the feeding segment is experiencing some of the most significant losses in equity in recent history. Furthermore, its important to point out that a number of producers have been significantly impacted by drought conditions, altering the normal cattle cycle. We cannot expect the laws of supply and demand to disappear, but with your help we can take steps to allow producers to better prepare for the lean times.



FFARM Accounts would allow producers to defer income during the profitable years and then draw on those funds, their own money, during times of need. FFARRM Accounts would allow producers to defer up to 20% of their income, allowing them more efficient management of their own resources.

Money could remain in the account for no more than five years and would be subject to income taxes at withdrawal while interest would be taxed as it is earned. Safeguards in the bill limit the use of FFARRM Accounts to bonafide farmers and ranchers and also require that FFARRM funds be held in interest-bearing accounts.

As a result, lendable funds will be more available to other individuals and businesses in rural communities. FFARRM Account deposits stored in local banks would be available for others in the community to utilize, resulting in additional capital investments elsewhere in the rural community. S.313 would be a great tool that allows producers to better manage a widely fluctuating income stream and provide much-needed capital for others in rural communities to utilize. Good for ranchers, good for rural communities-- truly a win-win situation for everyone in rural America.



INCOME AVERAGING AND THE ALTERNATIVE MINIMUM TAX (AMT)

Farm Income Averaging provides farmers and ranchers with a valuable tax management tool. However, the intended benefit of Income Averaging is being eroded by the Alternative Minimum Tax (AMT). Ranchers who take advantage of Income Averaging, those with wide swings in income, are hurt most by AMT imposed limits on farm and ranch Income Averaging.

The income for a typical ranch can vary by thousands of dollars per year and provides little reference of true profitability for the operation--high income is not the only indicator of profit. Income Averaging helps assure the long term viability of ranchers and ranch families because they are no longer overtaxed in profitable years leaving more funds to pay expenses and prepare for the downturn. Without Income Averaging, farmers and ranchers will pay more in taxes than people with steady incomes even though they both had the same final aggregate earnings over time.

In short, the AMT undoes the good of Income Averaging and should be eliminated. Producers nationwide, and many outside of agriculture, complain of the complexities in calculating AMT and many are surprised by AMT expense well after the initial planning for their production year has already begun--leaving the producer in position of taking away from planned expenses to pay an unfair and burdensome tax.

CAPITAL GAINS

Ranching and beef production is a capital-intensive business that requires a tremendous investment in land, buildings, and equipment. When farmers and ranchers sell most farm assets-- they are faced with capital gain taxes on the amount that asset has increased in value while they owned it. With a lifetime's earnings tied up in long term investments in livestock, land, buildings and other assets. Ranchers, processors and livestock markets all find this tax to be one of the most limiting factors in staying current with today's technology.

Capital gains taxes are a deterrent to producers' investments in new breeding stock, equipment and buildings. Those upgrades generally come at the expense of existing assets that when sold generate capital gains. Long-term holdings, or assets, are the most difficult to upgrade based on the penalties associated with their sale. Sales of land or like assets can be the realization of more than 30 years of equity that is also the base collateral for many of the ranch's other operating expenses.

Capital gains taxes threaten the transfer of ranches between generations. They artificially increase the price of land making it more difficult for the younger generation to take over farms while their parents are still alive. The tax makes it even more expensive for farmers to acquire land to expand so that an additional family member can enter the family business. While NCBA would prefer that capital gains be eliminated, we also understand that the complete elimination of capital gains at this time is unlikely.

NCBA does support a number of the efforts to provide relief from capital gains and we would encourage the Committee to continue to evaluate those options at every opportunity. NCBA supports measures that allow farmers and ranchers to enhance conservation on their land without suffering the effects of capital gains on the resulting income.

OTHER ISSUES

A number of issues of importance to rural America could be addressed through measures before this Committee. Improvements in Subchapter S laws will help community banks thereby helping producers in and around those communities.

Farmers and Ranchers that pay self-employment taxes are disturbed by court rulings in the past several years that changes the classification of rental income, specifically from programs like the Conservation Reserve Program (CRP). NCBA believes it's unfair to treat active farmers and ranchers differently from other taxpayers when imposing self-employment taxes on rental income.

Because of the Mizell (1996) and Wuebker (2000) cases, the IRS now singles out farmers and ranchers as landlords liable for the self-employment tax. For other taxpayers receiving CRP payments and cash rental payments, not materially participating in a farming operation, the payments are considered to be rental income not subject to self-employment tax.

SUMMARY

In closing, I thank the Committee for this opportunity to testify and to express our support for S. 312, Tax Empowerment and Relief for Farmers and Fishermen (TERFF) Act and similar measures. In our statement we have outlined a number of important provisions that we hope the Committee will address, again I thank you and will be happy to answer any questions.

PREPARED STATEMENT OF HON. BYRON L. DORGAN

Mr. Chairman, Senator Grassley and other members on the Senate Finance Committee. I appreciate this opportunity to visit with you about the New Homestead Economic Opportunity Act (S. 1860). This legislation speaks to one of the most pressing issues facing rural areas throughout the nation: the out-migration of people.

In its own way, this measure could be as significant to America as the original Homestead Act of the nineteenth century. Back then the problem was getting people on to the farm. Now the issue is out-migration from the heartland of this country. Mr. Chairman, over the past two decades, for example, some 54-percent of the counties in Montana have lost at least 10 percent of their population. Over 90 percent of our counties in North Dakota have suffered comparable losses in population. The number of youth in my state has fallen by more than a third and the median age of its residents is up by more than 10 years. As a result, many rural counties in my state now lack the critical mass of people and resources it takes to keep them alive and growing.

Out-migration is not just a problem for Montana or North Dakota. It is a national problem. A massive exodus from rural areas is happening throughout the nation's heartland—from North Dakota and Nebraska to Texas. Nearly twenty-five percent—that's 25%—of all counties in the country have experienced such double-digit losses in population, largely due to the out-migration of people. The sad fact is that there are hundreds of small towns in our rural areas that may not survive. Yet most Americans do not even know about their struggle. The economic and social costs resulting from this decline are staggering.

Senator Hagel and I want to change that. We want to initiate a national debate about the problem of out-migration in rural America. Moreover, we want all Americans to understand not just the challenges that rural America faces, but the all-American values that it offers as well, such as close-knit communities, good schools, low crime rates, and high levels of civic involvement. Finally, we want to make the case to all Americans that these small rural towns, which were once so instrumental in developing our great nation, deserve an opportunity to hope and grow again.

To start that debate, Senator Chuck Hagel and I introduced the New Homestead Economic Opportunity Act. Our bipartisan legislation has been cosponsored by many of our Senate colleagues. It also has garnered the strong support of many state and local government and business organizations such as the National Association of Counties, the National Telecommunications Cooperative Association and the Credit Union National Association.

Inspired by the Homestead Act of 1862, our bill proposes new incentives for people and businesses that are willing to make a commitment to live, work, and prosper in rural areas. We can't give land anymore. But our legislation provides rural communities with other financial resources to fight against out-migration which is slowly strangling so much of America.

S. 1860 would provide states and localities with meaningful incentives to attract new residents and businesses to a rural county that has suffered net out-migration of at least 10% over the past 20 years.

- Forgiving up to 50% of college loans for recent graduates who live and work in high out-migration areas for 5 years (maximum of $15,000);
- Providing a $5,000 tax credit for the home purchases of individuals who locate there for 5 years (or 10% of purchase price, whichever is lower);
- Protecting home values in high out-migration areas by allowing losses in home value to be deducted from federal income taxes;
- Establishing tax-favored Individual Homestead Accounts to help build savings and increase access to credit;
- Providing rural investment tax credits and accelerated depreciation for qualifying business investments made in high out-migration areas; and
- Establishing a $3 billion venture capital fund to ensure that businesses and entrepreneurs in these rural areas can get the money they need to start and grow their enterprises.

It is critical that we aggressively tackle the problem of rural out-migration. Left unaddressed, many rural communities will disappear.

This doesn't have to happen. The federal government needs to do what it did for urban areas a generation ago. At the time, our cities were losing people and jobs, and it was considered a national problem. Our leaders ultimately committed billions of dollars to this cause and it did make a difference. We can and must do the same for rural towns fighting against out-migration in the heartland. S. 1860 will help ensure that rural communities get that opportunity.

On a separate matter, let me briefly call to your attention three tax policy matters that are also relevant to today's hearing and need to be addressed by this Committee.

First, as you know, the IRS has been waging an aggressive campaign to re-characterize Conservation Reserve Program (CRP) payments as earnings from self-employment and subject to self-employment taxes. The IRS's position is not what Congress intended, nor is it supportable in law in my judgment. Unless we act soon to overturn this ill-advised position, many farmers in North Dakota, Iowa, Kansas and other farm states could face massive tax bills at the very time our nation's family farmers are struggling with a depressed farm economy and high fuel costs. I have joined Senator Brownback of Kansas in introducing legislation (S. 315) that clarifies that CRP payments received by farmers are properly treated for tax purposes as rental payments from real estate and not subject to self-employment taxes.

Second, Senator Hagel and I have introduced legislation (S. 362) to ensure that family farmers can get some benefit from the $500,000 capital gains exclusion for home sales that would otherwise be unavailable to them for all practical purposes. Those of us from farm states understand that the current $500,000 capital gains exclusion does not effectively deal with the special circumstances of farm families. By itself, the farmhouse often has relatively little value in relation to the surrounding land and structures. The IRS allocates only a small portion of the sales price to the farmhouse itself when the farm is sold, and consequently the $500,000 capital gains exclusion is of little or no use. Specifically, S. 362 would expand the $500,000 capital gains exclusion for home sales to cover family farmers who sell their farmhouses or surrounding farmland, so long as they are actively farming prior to the sales.

Finally, I have authored legislation called the Main Street Business Incentive Act (S. 364) that would address a major flaw in the current federal income tax expensing provisions that hinder many small businesses from making needed building improvements. Under current law, small businesses generally can deduct immediately up to $24,000 in qualifying purchases of equipment and machinery. But they must depreciate over 39 years the costs of any storefront or other structural building improvements, even if those improvements are crucial to the business or to the maintenance of a Main Street business.

S. 364 would resolve this senseless distinction by expanding the current $24,000 expensing provision in Section 179 of the Internal Revenue Code to cover investments in depreciable real property. There are Main Streets across this country that were built or refurbished decades ago and now need investments and improvements. Our federal tax laws ought to assist small businesses to make such improvements, and my legislation is a simple way to accomplish that. This legislation has previously garnered the support of the NFIB, the Realtors and many other business groups.

Mr. Chairman, each of these three proposals enjoys strong bipartisan support in the Senate. In fact, the Senate unanimously agreed to an amendment I offered to a larger tax bill in 2000 that would have made the three changes I have outlined above. Unfortunately, none of them were ultimately included in the final version of that tax bill or other legislation before the 106th Congress adjourned.

I hope that the Finance Committee will favorably report all of these bills as it crafts tax legislation in the coming months. I look forward to working with the Senate Finance Committee on these suggested changes.

Senate Committee on Finance
"Broadband and Economic Development in Rural America"
June 4, 2002

Prepared Remarks of Dr. Jan I. Fox, Marshall University

Mr. Chairman, members of the Committee, thank you for the opportunity to testify before you today. I am Dr. Jan I. Fox, Vice President for Information Technology/CIO at Marshall University in Huntington, WV. For the past 18 years, I have been directly involved in rural education, telemedicine, and economic development throughout Appalachia. By serving on many state and national committees, including the Technology Council of the Southern Growth Policies, WV PSC State Telecommunications Committee and chair of our state's Policy Board for Telecommunications (WVNET), I have been directly involved in discussions of the major telecommunications barriers that are limiting our rural communities. While I was on executive loan to Governor Bob Wise as his Special Technology Assistant, I worked on several broadband projects that were tied to state economic development strategies. It is a pleasure to share insights on the impact of broadband telecommunications services on economic development and its importance in maintaining the economic health of rural communities.

Advanced telecommunications capabilities are crucial to the future of an increasingly interconnected America. These advanced capabilities mean that data can be delivered at rates that far exceed what can be carried by an ordinary telephone voice circuit. Access to computers and the Internet, along with the ability to effectively use this technology, are becoming increasingly important for full participation in America's economic, political, and social life. People are using the Internet to find lower prices for goods and services, work from home or start their own business, acquire new skills using distributed learning, and make better informed decisions about their healthcare needs. The ability to use technology is also becoming increasingly important in the workplace, with jobs in the rapidly growing information-technology sector paying wages almost 80 percent higher than the average private-sector wage. Broadband Internet access is going to be a key competitive factor for all states, and the regions that do not have this capability are going to be left behind in the New or Next Economy.

Because technology has permeated almost every aspect of our lives, a strong telecommunications infrastructure is now critical for success in all sectors, particularly economic development. It is imperative that a cost effective, flexible, dependable broadband solution for all of our communities continue to be developed. High-speed network and Internet services that are accessible to all state agencies, businesses and homes are now a basic need for success. It is critical that rural communities are not isolated from current regional broadband telecommunication strategies. We must have the appropriate cost effective infrastructure to retain and attract new businesses.

West Virginia is a very mountainous and beautiful state. Our rugged topology traditionally has been a challenge for many telecommunications providers. Our state must make major changes in our economic and telecommunications infrastructure if we are to succeed in any current or next economy. The goal of a learning society will be to give people the tools to adapt to changes in their personal lives and in their career paths. For most individuals, this process will combine formalized instruction and self-directed learning. Our state is actively involved in many distributed education projects that provide educational resources directly to our citizens, regardless of location. This can be in the form of online education or video linkages. Advanced capabilities are becoming ever more important as sophisticated applications incorporating audio and video which require sustained high information rates. A major limiting factor in access to these resources is bandwidth restrictions in the home or even at the community level. We have addressed part of this issue with community learning centers, but this is merely a stop gap until bandwidth is available.

Telemedicine represents a marriage of advanced telecommunications technology and new approaches to improving medical and health care. Be it through online consultations between rural clinics and specialists at major medical centers, telehomecare for homebound frail patients, or access to comprehensive databases of health and medical information for consumers over the Internet, telemedicine holds the promise of using telecommunications to improve the lives of all Americans.

Telemedicine encompasses a multimillion-dollar industry with rapid growth predicted over the next five years in many parts of health care. However, the promise of telemedicine will go unfulfilled for rural America without access to high speed, affordable telecommunications. The deployment of telemedical links to rural medical centers requires communications networks that are affordable, reliable and capable of handling large amounts of data in a short time.

New business formation and creation flow directly from research, development and commercialization of new technologies. Creating unique competitive advantages rooted in the science and technology institutions of a state advances attraction of industrial clusters. Research intensive industries, such as biometrics and biotechnology, require advanced telecommunications networks.

Professional fields not only require network access from formal work settings, but will also need access from home. We are still struggling with DSL or Cable Modem access beyond our major cities. Additionally, it may take more than six months for a business to acquire broadband service, even in our major cities. We still have major areas in our states where broadband is not on any installation calendar. Despite the recent growth of alternate bandwidth choices such as wireless (cellular, satellite), as well as terrestrial (cable, DSL), rural communities are still limited in the availability of high-speed communications and where available, have problems with reliability and cost.

The U.S. has a history of providing incentives to offer utility services in those areas where costs are high and subscription densities are low. These are places where for-profit companies are reluctant to go if they cannot build a business case for economic investment. An example is the providing of low cost loans to member cooperatives for electric and telephone service in the 1930s. These areas could lose jobs and investment from industries that they desperately need, because affordable broadband Internet services are passing them by. When companies that depend on e-commerce are evaluating expansion opportunities, they look for areas with skilled labor and access to broadband.

Cost concerns have many high-speed Internet providers targeting lucrative business customers rather than residential customers in order to recover their investments as quickly as possible, leaving consumers with fewer choices. Those who live in a poor suburban neighborhood, inner city, or rural area are at risk. Moreover, providers that have spent years building their broadband infrastructure do not come back and fill in the underserved areas, which leaves businesses and individuals in these communication infrastructure-poor areas less likely to be integrated into the national electronic marketplace. Their absence would put a damper on the growth of the digital economy for everyone - not just for those in rural areas. While this may be shrewd financial strategy, the social impact is devastating. Community access to affordably priced broadband digital networks is critical to long-term economic development. Not taking an active approach on this issue could leave rural communities in economic ruin.

It is for this reason that I would urge the Committee, and the Senate, to act on S.88, the Broadband Internet Access Act of 2001, sponsored by Senator Rockefeller and cosponsored by many members of this Committee, including the Chairman and the Ranking Member. This legislation would provide tax credits to encourage deployment of broadband facilities in areas where such technologies have not -- and, without Congressional action, perhaps will not -- be made available. With the help of the tax credit, people and businesses in these areas will be able to more fully benefit from the networked economy, and from the kinds of opportunities like distance learning and telehealth that I have been discussing. Moreover, this bill would help not just rural and areas. All of us will benefit if broadband can be more fully used to combat geographic and social isolation in such areas. Passage of this bill would be a good first step towards ensuring that all Americans are able to participate in our increasingly digital world.

Thank you. I will be happy to answer any questions you may have.

Testimony of Peter K. Froelich, Ph.D.
Coordinator of the Great Plains Population Symposium Project
before the United States Senate Committee on Finance
Hearing on Small Business and Rural Economic Development
June 4, 2002

Mr. Chairman, I would like to thank this committee for providing me with the honor of speaking with you today. There is a crisis in Rural America with implications that I believe will eventually threaten the fabric of the entire nation. The communities in agriculturally dependent rural areas have been slowly eroding for decades, and many are now either gone or very nearly at their end. Nowhere is this erosion more evident than at the very center of the nation, in the Great Plains. As rural communities vanish, the rural American culture is also disappearing. I believe that the conditions leading to the loss of youth and young families through out-migration are the greatest current threat to rural America and that an absence of viable populations and healthy local societies will eventually undermine the social order and the security of America's vast rural territories along with the security of America's food system.

I thank you for your holding this hearing and congratulate you for your wisdom in recognizing that this is a critical issue for our nation. My name is Peter Froelich and I am an assistant to the President at Dickinson State University in Dickinson North Dakota. Since July of 2000 I have served as the coordinator of the Great Plains Population Symposium Project. By profession I am a sociologist. I am not an expert on policy but I have devoted my life to understanding communities, culture, and the lives of people. While I have lived in other places, I am also a citizen of the rural Great Plains and my origins are there. I know many of the difficulties faced by residents of rural communities through my own life's experience.

The Great Plains Symposium project was created by Congress to focus on the population trends affecting the Great Plains along with national, state, and local strategies through which we might address them. Our project was planned in collaboration with advisors and researchers at Iowa State University, Colorado State University, University of Montana at Missoula, and North Dakota State University. We also collaborated with an amazing collection of experts and intellectuals from around the country who are concerned for the future of rural America and we discussed the issues impacting rural communities with an array of over 650 citizens who attended facilitated workshops during the two events we hosted. On our web site we have posted videos of the presentations of many of our collaborators. When we are finished we will have a video archive of collected wisdom from over 40 experts that is available to anyone with internet access. I am indebted to all of these people.

Although the problems of rural America may be manifested at the local level, the roots of those problems are often far beyond the reach of local leaders. The vision, understanding, and support of our national leaders is critical for rural well being. If its communities are to survive, rural America needs a national policy that aggressively addresses population loss. Only a small minority of rural Americans farm as their primary occupation. This is a fundamental change in the underpinnings of rural communities that demands a new vision for rural society. I believe such a vision can only develop through the understanding and considered action of national leaders such as yourselves. Your work here is critical and the members of this body should be commended on the progress they have made. Despite numerous important rural initiatives, however, there is no single framework outside of agriculture through which a new vision and new policies to address the diversity of issues affecting rural communities can be articulated. The New Homestead Economic Opportunity Act (S. 1860) that has been proposed by Senators Byron Dorgan and Chuck Hagel is a promising step toward such a framework. It is a proposal that I support and I encourage you to give it your full consideration.

I have been asked to briefly describe the population trends affecting rural America and to lay out at least some of the general principles that may help guide your efforts to sustain rural America. I am grateful for your consideration of these issues and sincerely hope that what I have learned will be useful to you.

<u>Trends and Conditions</u>

There has been a consistent and continual loss of a substantial portion of the population from rural, agriculturally dependent areas of the United States, particularly in the Great Plains. This loss has occurred for at least half a century in many areas and now threatens the well being and the very existence of many communities within these regions. Figure 1 shows the distribution of population declines nation wide between 1990 and 2000.

The out-migration of younger people has been accompanied by the aging of those who remain. Shifts in the age structure of rural populations have lead to declining birth rates and there has been natural population decrease in an increasing number of rural counties where deaths now exceed births. Figure 2 shows counties that have experienced natural population decrease within the Great Plains states between 1980 and 1999. Because the trend for out-migration from rural areas is on-going and tends to occur most heavily among the young, we can expect that the extent of natural decline will spread in coming years and an increasing number of rural communities will lose the biological vitality needed to reproduce themselves.

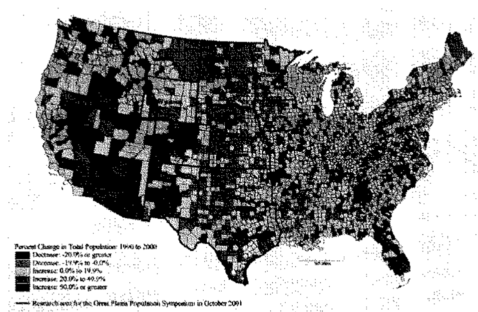


Figure 1: Population Change 1990 to 2000

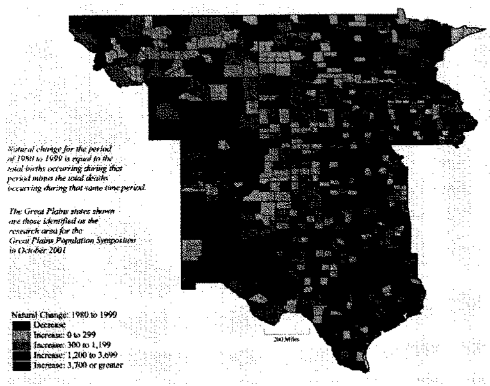


Figure 2: Natural Population Change in Great Plains States 1980 to 1999

The impact of out-migration on the populations of rural areas can also be seen when the age and sex structure of rural counties are displayed graphically in the form of population pyramids. The graph for a healthy population that is maintaining itself or growing will be shaped more or less like a pyramid and will be wider at the base where the bars for younger cohorts are displayed and narrower at the top where the bars for older cohorts are displayed. The population pyramids for many rural counties are beginning to look like inverted pyramids in that the bars for the oldest cohorts are wider than those for younger generations. As an example, figure 3 shows a population pyramid for McIntosh county in south central North Dakota. It depicts a population with failing vital signs that has all but lost the possibility of maintaining itself without an influx of people in their childbearing years. In addition, it indicates that this county will face enormous social and economic problems. It will face a staggering burden in meeting the social and health needs of a growing population of elderly people, its schools and services for youth will be difficult to maintain, its entry level labor force is all but depleted, and its pool of potential new leaders is almost gone. Out of a total of 53 counties in North Dakota, the pyramids for all but 3 indicate the development of a similar pattern of loss among the younger ages, particularly young adults. This population pyramid for McIntosh county North Dakota portends an unfolding disaster and it is a pattern that is repeated in many rural areas suffering from out-migration.

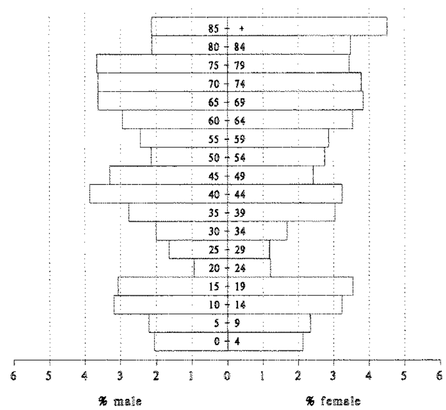


Figure 3: 2000 Age and Sex Structure - McIntosh County, North Dakota.

In October of 2001, my colleagues and I hosted a symposium conference focused on national policies for addressing the ongoing population losses from the rural Great Plains in Bismarck, North Dakota. At the symposium we heard evidence of a wide variety of problems impacting the Great Plains and rural America in general. The problems faced by McIntosh County are faced by counties across rural America. Population loss and the shifting age structure has strained the social infrastructure and makes it increasingly difficult to maintain services for younger people while also meeting the growing needs of the elderly. Out-migration is a growing constraint on the potential for rural prosperity with the loss of labor, income, leadership, and entrepreneurs.

At a time when health care is becoming a critical concern for meeting the needs of an aging population we find that our rural health care system lags behind the nation in terms of availability, affordability, and quality. As might be expected, the health status of rural residents is also lower than that of non-rural residents. Rural health care receives inadequate support and reimbursement from government programs, and the insurance industry. There are fewer quality facilities, and payments for services are lower in rural areas. It is more difficult to find and retain physicians and health professionals who want to practice in rural areas. Rural residents are more likely to be uninsured and must often travel for even basic care. There are fewer alternatives for care in areas with low population density and it is difficult to achieve economies of scale. Costs for services and for prescriptions tend to be higher. The challenge of providing even basic health care has contributed to a lack of emphasis on preventive medicine and a higher proportion of rural residents who suffer from ailments which could have been avoided.

While rural areas and communities of the Great Plains are known for high levels of certain aspects of what is called "social capital;" growing shortages of leadership, the increasing potential for conflicts of interest, continuing social inequality, exclusion of some groups from development efforts, and the inability or unwillingness of many rural people and communities to abandon small town rivalries are all identified as barriers to development of the kinds of social capital needed for successful rural development. The rural economy in the Great Plains and elsewhere in the United States continues to be dominated by commodity agriculture and low wage employment. Communities with local economies based primarily on the availability of low cost labor and commodities which can be produced cheaply in many places around the globe are truly involved in a global race to the bottom of the economic ladder. For those communities economic inequality and decline are likely to continue.

Rural businesses that could once rely on high rural fertility to supply them with cheap labor are soon likely to find that they cannot hire help at any price. Although increased wages for rural workers may be difficult for some small business enterprises, the first response to low wages by today's rural young people is often simply to leave. In North Dakota, it is rare to find a young person who says they are willing to accept minimum wage employment in order to stay in their community. None of these businesses are likely to survive when their local labor pools are finally emptied. On average, the State of North Dakota loses roughly the same number of college educated people as its colleges and universities produce. The flat opportunity structure of rural economies are out of step with a society that values educational achievement.

Rural assistance has depended heavily on government payments to the individuals involved in agriculture. In comparison with urban America, a much smaller proportion of federal funds go to rural community development projects. The emphasis on individual transfer payments over funding for community development contributes to a lack of investment in rural economic infrastructure and a continuing lag in rural well being. It is critical that our national policies recognize the need for new investment in the infrastructure and economic capacity of rural places and seek to either provide or stimulate that investment. It is also critical that our policy makers consciously avoid creating policies that create unintended disadvantages to people and businesses located in rural areas. For example, eligibility for assistance through federal grants often hinges on criteria that make sense for the conditions in urban but not in rural America. While high rates of poverty or unemployment may indicate the distress of urban communities, high out-migration is often the key symptom of distress among rural communities.

Although there has been job growth in some rural areas over the past decade, the economic progress of rural communities is uneven and on average rural wage earners make only about 70% of what their urban counterparts make. At present, approximately 60% of rural communities are seeking new "economic engines" to sustain them. New technologies are often promoted for their promise to reduce the disadvantages of rural location, however, that promise is not being realized. Rural communities continue to lag behind urbanized areas in the development of new technological infrastructure and commercial e-business enterprises. There is a digital divide between rural and urban America, and rural America lags in two key areas: access to state of the art broadband internet services and wireless services for voice and data communication.

Rural development efforts often focus too narrowly on economic development. Although jobs are an important reason for many people to move to or stay in a community, our research shows that people are most likely to come to a rural Great Plains community because of family connections. Unless forced to leave, they are most likely to stay in a community because it is a nice place to live and because of their family connections. The rural policies of many other western societies recognize the value of maintaining rural communities and approach rural out-migration as an issue of "social equity."

Social and economic relationships are both important. The people most likely to leave rural communities are those who are the least connected to their communities, regardless of employment opportunities. They tend to be under the age of 30, live alone, and dislike the social climate and/or the lack of infrastructure and services. People can find economic opportunities in many places, but they are most likely to stay in rural communities when they are connected to those communities by more than a job. Rural economic development is most likely to have long term success when it fosters local entrepreneurship, leads to a high quality of life that is enjoyed by residents, creates products and competitive advantages that reflect the uniqueness of the places where they originate, and encourages collaboration among neighboring communities to enhance regional competitiveness.

If the Great Plains states are to prosper, the must have a national rural policy that recognizes the diverse conditions faced by different rural places and allows for regional governance that can address the real range of local issues and local people. The United States has become a suburban nation and achieving such a policy will be an immense challenge because there is no unified vision for the future of rural America. Rural Americans are pleading with their national leaders to help them find a new vision to sustain their communities and institutions and at no time since the civil war has the need for a new national vision of rural prosperity been greater.

It is an enormous challenge and I must admit that until recently there have been few promising signs, but there are a few. This hearing and the willingness of Congress to fund programs such as the Great Plains Population Symposium which I have been involved with shows your willingness to aid rural Americans in their search for that new vision. The REAP program is providing a model for developing federal and local partnerships for regional rural investment. Great strides have also been made with the recent passage of legislation such as the Rural Strategic Investment Program in the Farm Bill. I believe that the "New Homestead Economic Opportunity Act" (S. 1860) will be a major step toward reinventing rural America if it is enacted into law. Its provisions would attack rural population decline at several levels. It will help address the loss of youth with incentives for college graduates to locate within distressed rural counties and tax provisions to encourage home ownership and it includes important incentives and resources that will be keys for the development of rural businesses including tax credits and the development of venture capital funding that is devoted to the unique needs of rural enterprise. I would again like to strongly encourage you to give serious consideration to this proposal.

After the symposium on National policies for addressing population loss in the Great Plains last October I tried to summarize the major ideas pertaining to national policies that had emerged. I would like to share those ideas with you and emphasize that the extent to which your actions reflect these principles and the measures you have enacted already encompass these suggestions you can be assured you will have the gratitude of many rural Americans. There is more information about the outcomes of the Great Plains Population Symposium Project on the internet at: http://gppop.dsu.nodak.edu .

Values and Principles For Rural Policy

There is great diversity within rural America and it is difficult to anticipate all of the decisions that are likely to have implications for the populations of rural communities. Yet if we are to have sustainable communities there must also be consistency. For this reason, policy decisions should be made within the framework of a broader vision for rural America that is in tune with the times and with the specific places where it is applied but which also has consistent and ethical principle at its foundation. It is critical, therefore, that we articulate the outcomes we value and the principles that will guide us. During the course of the symposium project, a number of ideas were forthcoming that may be considered as expressions of values and/or principles to guide policy decisions. The following ten statements summarize those ideas:

1) **Rural economic policies must not focus only on protecting vested interests, but must also foster new interests.** The policy framework for rural America must not favor one sector, one group, or one type of capital. Rural economic policies should utilize all available resources and seek to create both opportunity and equality.

2) **National policies and programs for rural America must be made more comprehensive. They must extend beyond a narrow focus on agriculture and begin to address the full range of rural people and rural issues.** Although federal agricultural policy may be justifiable on its own merits, it must be recognized that agricultural policy is not synonymous with rural policy.

3) **Rural America cannot be viewed in isolation from, or in opposition to, the rest of the nation.** We must have a cohesive constituency for rural America and rural policy should reflect that. Rural people and their leaders can ill afford bitter partisanship or devotion to narrow special interests. They must achieve a shared vision and form broad coalitions. They must also have political support for rural issues from the suburban population. It is critical that rural leaders articulate the value of rural America for today's nation and help rural people appreciate and accommodate the values that are likely to guide the views of non-rural Americans.

4) **The maintenance of rural population and settlements should be made an overt goal of**

rural policy. Although many policies may be assumed to support rural communities, their potential impacts on rural population is seldom described or evaluated in explicit terms. If we intend to maintain the populations of rural communities, especially in farm dependent areas, we must make it an explicit goal and we must take care to insure that the array of policies which relate to rural issues do not contradict this goal.

5) Rural policy should be "place based policy" and should focus on enhancing the opportunities and the quality of life in specific rural places. "Quality of place" relies on a range of natural, cultural, social, and commercial amenities that characterize any given place. Rural policy should help communities establish their identities as "places" and find ways to raise the quality of life they offer. In this light, economic development efforts should attempt to develop or capitalize on unique qualities of individual rural places. Rural policy should also facilitate collaboration among neighboring communities to pursue regional projects that are beyond the grasp of a single community but that may benefit them all. Although subsidies to individuals and businesses may sometimes be necessary, a substantial proportion of public support for rural areas should be invested in developing the aspects of places necessary to support thriving communities.

6) **Rural policy must acknowledge the diversity of places, communities, and people in rural America.** In a world where people can live where they choose, the attractiveness of a place or a community is likely to rest at least in part upon its uniqueness. Although communities may share some problems in common and must all meet the basic needs of their people, they also possess their own unique qualities and face their own unique problems. Rural policy must recognize the diversity of rural America. Rural programs must have the flexibility to assist rural communities to differentiate themselves, address their unique problems, and develop competitive economic advantages based upon the unique qualities of the places where they exist.

7) **Rural development efforts should emphasize local entrepreneurship over business recruitment.** Although communities should not ignore or discourage development or investment from outside, they must be careful not to offer incentives from which they may gain too little benefit. Communities may gain a great deal more from the efforts of successful entrepreneurs with local roots. It is critical that we develop and support a new generation of entrepreneurs who want to live and work in a rural area and who have ties to the community they live in. Rural residents must be made to once again believe that they live in a land of opportunity where it is possible to start a successful enterprise within their own community.

8) **The nations policy should enhance the value of rural areas by encouraging the preservation and restoration of the rural landscape and support rural people as good stewards of the environment.** Although rural and urban Americans may differ in their views regarding some environmental issues, both populations value high environmental quality. Most of the nations scenic and natural wealth are in rural America and rural policies should recognize and support the scenic and recreational value of rural landscapes as well as the ecological services rural areas provide for the society as a whole. Rural policies should seek to protect the quality of rural environments and enhance the economic opportunities for rural people that may

stem from the unique environmental features of the areas where they live. All policies affecting rural areas should avoid the creation of perverse incentives for environmental abuse and should reward sound environmental practices.

9) **Space is an important resource in the rural Great Plains.** Although distance is often framed as a rural liability, it is also true that the space in rural America can be viewed as an asset. Rural space offers opportunities for developments that may be problematic for already congested urban areas. Many urban areas that are struggling to cope with increased overcrowding and congestion may benefit by forming partnerships with rural areas for a more dispersed pattern of development. While the space available in some rural places may be valuable for its potential to alleviate urban overcrowding, rural space may also offer recreational opportunities that cannot be had in more crowded urban areas. It is important, therefore, to preserve the environmental and scenic qualities of many rural places, while finding appropriate ways for rural residents to benefit from the space they enjoy.

10) Agricultural policies should seek to maintain rural settlement and help the economies of rural communities move away from a narrow dependence on the large scale production of low value commodities. Agriculture in the rural Great Plains is an important national resource. It is a foundation for the safety, security, and quality of the nation's food system. The consolidation of agriculture, however, has contributed greatly to the decline of rural communities. If communities are to recover, relatively small scale agriculture must be made profitable, and it must become possible for young people to enter successful careers in agriculture. Farm policy must support the production of higher value specialty crops, reward farmers for "ecological" services, begin to discourage further consolidation of agricultural wealth, and facilitate the inter-generational transfer of agricultural resources to younger people.

Recommendations for Rural Policy

Perhaps the most difficult aspect of the symposium process has been the effort to develop meaningful recommendations for national level policies that could directly impact the demographic trends occurring in the rural Great Plains. Many good suggestions may not actually influence population trends and some of the factors driving current demographic trends are not susceptible to direct influence by government, at least not within our society. Other pressing issues can only be addressed at the local level or possibly by the states. Nonetheless, it is unlikely that successful efforts to mitigate the population losses on the Great Plains will occur without the legal and organizational framework or the resources that only the federal government can provide.

The following list of policy recommendations generally representative of the many suggestions from participants at the symposium. They are formulated to be understandable in a general sense and can be taken as relevant to the national government. Although this list does not address every issue faced by rural people, it does attempt to address key issues raised at the symposium and describes, at least in a general fashion, how the federal government should respond to what is happening in the Great Plains.

1) **A New Rural Policy Framework** Congress should begin development of coherent legislation aimed at sustaining the whole of rural communities and reconcile current farm legislation into that broader framework.

2) **Criteria for Federal Aid** Extensive population loss through out-migration should be recognized and explicitly included among the criteria that are sufficient to qualify for federal programs aimed at helping distressed communities.

3) **Equity of Payments for Services** Revise the systems used by federal programs to pay for services to insure that the quality of services and the level of reimbursement are equal between rural and urban providers. This is especially critical for health care providers, but should be enacted for any professional services that are vital to the well being of rural communities.

4) **Congressional Commission on Rural Life** Create a permanent commission on rural issues to advise Congress about rural people, rural problems, new programs, and the impacts of legislation on rural communities and rural population.

5) **Public Investment in Rural Development** Expand the REAP program into a flexible system for public investment in the diverse rural development and rural infrastructure needs that exist throughout the Great Plains.

6) **Rural Technological Infrastructure** Provide incentives and direct investments to make state of the art technological infrastructure, such as broad band internet access, available to the residents of all rural areas within the Great Plains. Where possible, government agencies should also combine their purchasing power to serve as "anchor customers" in order to encourage private investment in rural technological infrastructure. The national government should promote universal access to state of the art technological infrastructure as a means of providing a new kind of "homesteading" opportunity that can be capitalized upon by entrepreneurs seeking to make their lives in rural areas.

7) **New Technology and Innovation Extension Service** - Sponsor a new type of rural extension service focused on conducting research and providing technical assistance to rural residents and communities regarding: leadership development, entrepreneurship, new technologies, and new opportunities.

8) **Regional Rural Innovation Centers** - Establish a system of multi-county regional rural innovation centers to promote rural innovation. These centers would become a locus for programs aimed at maintaining rural communities and for the development and promotion of innovations useful to the rural communities within their regions. These centers would offer technical assistance to community leaders, entrepreneurs, and developers. They would conduct regionally focused applied research on problems of importance to the communities they serve. They would be repositories of information about efforts that have been tried in other places, and would conduct programs to educate rural residents and especially youth about entrepreneurial possibilities. They would also serve to facilitate networking among people, businesses,

organizations and agencies needed for people to bring their ideas to fruition.

9) **Immigration policy** - Federal immigration policy should be formulated to encourage new residents from foreign lands to move into rural areas as an alternative to larger urban centers. Resettlement and refugee programs should be expanded to assist rural communities throughout the Great Plains to meet the needs of new international migrants and also to make positive adjustments to the changes necessitated by greater diversity.

10) **Educational Enhancement** - Provide expanded support for rural schools to meet the needs of rural residents by enabling them to expand their use of technology, establish networks with institutions of higher learning for providing adult learning opportunities and technical education, and to develop appropriate learning enhancement programs to meet the needs of multi-cultural students.

11) **Venture Capital and Business Financing** - Create and/or encourage new venture capital funds and business financing programs for entrepreneurs in rural areas that seek to make sufficient returns to maintain the availability of funds, but also have rural community development as a goal and can therefore accept lower returns than might be possible with other investments.

12) **New Focus for Agricultural Research** - Shift the focus of federally funded agricultural research toward the development of technologies, crops, value added processes, and "ecological services" that can be economically viable and sustainable for smaller scale farm and community enterprises.

13) **A New Emphasis for Federal Aid to Rural Areas** - Shift the emphasis of federal spending for rural assistance away from a narrow focus on individual transfer payments to agricultural producers toward more general investments in the social, health care, commercial, and productive infrastructure of rural communities. Support for agriculture through farm subsidies should continue as needed, but must be more narrowly targeted to support smaller agricultural producers who are in need. Care should be taken that farm subsidies do not inadvertently support the further consolidation of agriculture into large operations.

14) **Beginning Farmers Program** Create a program to support beginning farmers that will include: special financial support, mentoring and technical assistance regarding best practices and new opportunities in agriculture, and incentives to encourage the transfer of agricultural resources from older farmers to younger beginning farmers such as tax breaks or subsidies.

15) **The Management of Public Lands** The management of public lands within the Great Plains should preserve and enhance their scenic and recreational value. Managing agencies should also be directed to provide organizational support and resources to encourage local entrepreneurs and agriculturalists, who wish to become partners in developing new services that enhance the recreational, tourism, or other **non-consumptive** values of public lands while also contributing to local community development.

I would like to thank you again for the opportunity to contribute to this important debate and I hope that my comments will be useful in your deliberations.

RESPONSE TO A QUESTION FROM SENATOR GRASSLEY

Question. In your testimony, you discussed the importance of establishing incentives that encourage entrepreneurial investment in rural areas facing high-out-migration. In fact, you emphasize those incentives over traditional agriculture-based incentives and the recruitment of large mass production business facilities to those rural communities. To the extent that you believe that economic engines of those communities may be restarted instead through entrepreneurial economic development, how successful do you believe that venture capital funding programs such as that included in S. 1860 will be in generating new entrepreneurial investment?

Answer. I want to be sure that my comments about agricultural programs are not misunderstood. Agriculture will continue to be an important component of rural economies and rural culture and it should be supported. Rural economies have changed, however, and our current system of agriculture does not provide the economic base for communities that it once did. With low commodity prices and consolidation of farms, there are simply too few opportunities for a new generation of people to become successful farmers or ranchers. Today, less that 2 percent of the rural population farms for their primary source of income. While I do not think we should abandon agriculture, I do I argue that our approach to rural policy must be dramatically broadened. We need to support and develop other aspects of the rural economy that will allow rural communities to maintain the critical mass needed to remain viable.

The recruitment of existing large scale businesses to relocate in rural places has not paid off for many communities. I believe that rural communities must be open to outside investments and to outside businesses that may want to relocate, but that they should avoid offering incentives that may cost them more than they can recoup. They must also avoid getting into competitions with neighboring communities that may benefit the businesses but be mutually destructive to the communities. Even if they offer every incentive they can muster, the chances that many declining rural communities will recruit the businesses needed to sustain them are slim. Only a very few rural places will ultimately succeed with this strategy. Most will have a better chance if they try to enhance the quality of life they offer to all their citizens and work to build their own futures from within by developing and supporting locally based entrepreneurs. Ultimately, outside business people will probably also be more attracted to places with these qualities and if they choose to relocate of their own accord they should be welcomed.

In the long run, a more inclusive approach to rural policy is important for both the farm and non-farm segments of the rural population. The non-farm economy has become increasingly important for the well being of farmers. As much as 90% of all farm household income is now derived from off farm sources. In addition, the most critical threat faced by many rural communities is the loss of young people. Unless we can create new incentives in rural places that attract more young adults we will face a shortage of workforce that will threaten all industry in those areas, including agriculture. I have spoken to farmers in this area who have told me that there are no longer enough young people in the community to enlist as help for working their cattle and that they can no longer find hired help who are able to operate their equipment. My prediction is that it will not get easier for these farmers or for other rural employers unless we create an environment in which new generations of people perceive real economic and social opportunities for themselves in rural places. To do this we must invest in rural America.

There are unique challenges in rural areas that discourage private investment and rural Americans have not generally had access to venture capital. Rural entrepreneurs may need much smaller investments than is the norm for urban oriented venture capital funds and it may take longer for them to produce yields. Private capital is likely to bypass rural areas and flow to places where the prospects for maximal financial returns are better. Thus, rural communities need venture capital that is tailored to rural needs. Government is important because it can legitimately include community development and the social well being of citizens in its calculation of the returns on its investments. While financial returns may still be expected, the involvement of government can temper the need for initial high profits.

Government backed venture capital funding will be critical for helping rural communities find adequate new economic underpinnings especially if it is paired with other kinds of support for entrepreneurship such as training and education about the uses of capital, the development of ideas so they can be successfully commercialized, and the identification of potential products and markets. The creation of new venture capital funding that is firmly rooted in rural America and appropriately scaled to the needs of rural enterprises will be a powerful tool for revitalizing rural communities. Our success in restarting the economic engines of rural communities will rest, to a great extent, on having this tool and learning how to use it well. It will also rest on our belief and confidence that those engines can be restarted. Your leadership in supporting initiatives such as those in S. 1860 will help to build and extend that belief which is also critical to our success.

I apologize for the length of this response but hope that it is helpful to you. I thank you for your concern with these issues and I thank you, Senator Baucus, and the entire finance committee for the opportunity you have extended for my participation in this process.

PREPARED STATEMENT OF LAWRENCE B. GIBBS

Thank you for inviting me to provide the Committee with comments about the impact of several tax legislative proposals to ameliorate the effect of certain increasing costs of small businesses, including a possible increase in the minimum wage. My comments assume the Committee has made or will make the policy decision to consider tax reduction proposals to reduce the impact on small businesses of these costs.

Recently, we have read and heard a great deal about the importance of after-tax earnings per share to the executives and shareholders of corporations whose stock is traded on Wall Street. To the owners of small businesses on Main Street, however, after-tax cash flow is much more important. After-tax cash flow is important because it provides: cash to pay back the mortgage and other borrowings. Cash to carry larger inventories. Cash to buy new machinery and equipment. Cash to expand and to hire and train new employees.

Recently, we have read and heard a great deal about some Wall Street companies that take advantage of the complexity of our federal tax laws to reduce their taxes. For the small businesses on Main Street, tax complexity often is a cost burden rather than a savings opportunity.

Recently, we have read and heard a great deal about some Wall Street companies that seek a competitive advantage through tax reduction transactions, some of which represent appropriate tax planning techniques and others of which are abusive tax shelters. Main Street small businesses that usually cannot afford expensive tax consultants are more concerned about ensuring a level tax playing field, so that their competitors cannot use tax techniques to gain a competitive advantage, and about clear rules, so they do not have to worry about possible disagreements with the IRS about how the rules apply to their businesses.

Therefore, as the Committee begins to consider tax proposals to assist small businesses, I would urge that you consider relatively straight forward, easy to understand proposals that will increase after-tax cash and minimize competitive disadvantage. As you know and we will learn again, these three goals – tax proposals that are simple, efficient and fair – are easy to state and hard to obtain, particularly when they compete with one another.

1. Increasing section 179 deductions. The usual tax rule is that the cost of new property used in a trade or business must be capitalized and depreciated over time. Currently, section 179 provides a limited exception to the normal rule by permitting business taxpayers to elect to deduct (rather than capitalize and depreciate) a portion of the cost of certain new business property. The deduction is allowed in the year the new property is placed in service, up to $24,000, except that the $24,000 is reduced proportionately by the cost of such new property placed in service that is in excess of $200,000. Last year the Committee considered a proposal that would (a) increase the amount of the deduction from $24,000 to $35,000 and (b) increase the point at which the deduction is reduced from $200,000 to $325,000.

The proposal is relatively straightforward and easy to understand. Most small businesses are aware of and used to claiming deductions under section 179. Small businesses would benefit from this proposal because it would permit them to deduct more of the cost of property that they purchase to use in their businesses, thereby reducing their taxes and increasing their after-tax cash flow. Although the deduction is an exception to the normal rule requiring capitalization and depreciation, the policy decision to permit this exception has been in Code for over 20 years and, therefore, is well established. By increasing the point at which the deduction begins to be reduced, under this proposal, more types of property would qualify for the maximum deduction, thereby reducing competitive disadvantages among taxpayers, albeit at a cost to the fisc. Finally, the IRS has been administering this provision for over 20 years, and the proposed changes do not appear to involve any unusual administrative difficulties.

2. Increasing depreciation deductions. There are several proposals to increase depreciation deductions available to small businesses. Some would shorten the period of time over which the cost of leasehold improvements could be recovered by a business, thereby increasing the amount of the annual depreciation deduction and increasing the amount of after-tax cash flow to small businesses that lease and improve property they use in their business. Other proposals would permit the cost of office furniture to be recovered over 5 years or permit the cost of certain retail restaurant property to be recovered over 15 years.

Although I am not an economist, to the extent that these provisions would more closely match the depreciation period to the economic useful life of the affected business properties, they would seem to be supported by sound economic principles. For many of the reasons similar to those previously indicated above in discussion about increasing section 179 deductions, these depreciation deduction proposals would appear to benefit small businesses without unduly adding complexity to the Code, causing major competitive disadvantages, or creating major administrative burdens for the IRS.

3. Proposals to reform the requirements applicable to S corporations. There are several proposals to change the requirements applicable to S corporations, which are entities created under state incorporation statutes that generally protect the owners from personal liability with respect to the business activities at the corporate level. Unlike regular corporations that pay taxes on net business profits at the corporate level and again at the shareholder level when the after-tax profits are distributed to the shareholders, the business net profits of an S corporation generally are not taxed at the entity level but are taxed to the corporation's owners. Previously, S corporations were popular among small businesses owners who wished to pay only one tax on their business net profits and who also wanted the limited liability protection afforded by the use of a corporation.

Because of the complexity of the numerous tax rules applicable to S corporations and the severity of the tax cost if the rules were violated, small business owners faced the dilemma of whether (a) to incur the ongoing costs of a tax consultant in order to avoid violating the complex rules or (b) to risk incurring substantial, unanticipated taxes if the rules were violated in the absence of a tax consultant's day-to-day advice.

More recently, under rules issued by the Treasury and the IRS, many small business owners have been able to use limited liability companies ("LLCs") to obtain the benefit of protection from liability for the business activities at the entity level and also enjoy the economic benefit of paying only one level of tax, by electing to treat the LLC as a partnership for tax purposes. However, some small businesses are prevented from using LLCs to conduct their business. Other small businesses that previously have chosen to use a corporate form cannot switch to a partnership form without incurring potentially substantial taxes or risking the possibility of having to pay such taxes.

Because my law firm has been retained by private clients to request that certain, specific changes be made in the requirements applicable to S corporations, I do not wish to discuss the specific changes that are being proposed to the S corporation requirements. However, I do wish to make a general observation. The policy decision has been made to permit new small business owners to use an LLC to conduct its business and thereby avoid payment or risk of payment of two levels of tax – one at the entity level and one at the ownership level – and also to avoid the tax complexities and risks of an S corporation. In light of that policy decision, I would urge the Committee to take a hard look at proposed changes in the S corporation rules that would permit the appropriate reduction or elimination of the existing S corporation complexities in order to permit existing S corporations to more closely match the greater tax simplicity of the LLCs, to achieve the tax efficiencies of the LLCs, and to avoid the after-tax disadvantages now faced in competing with the LLCs.

4. Self-employment tax changes for unincorporated small businesses. The Taxation Section of the American Bar Association and the Tax Division of the American Society of Certified Public Accountants previously have proposed amendments to section 1402(a)(13) of the Code, and I believe the Committee should consider these proposals in connection with its consideration of proposals to assist small businesses. The problem addressed by these proposals arises, in part, out of statutory amendments to section 1402(a)(13) enacted in 1977 after some taxpayers were becoming limited partners to attempt to qualify for Social Security benefits through the payment of self-employment tax, Social Security, and Medicare ("SECA taxes"). A number of changes have occurred over the last 25 years, including changes in the state laws applicable to limited partnerships, the increasing importance of LLCs, the treatment of LLCs as partnerships for tax purposes under certain circumstances pursuant to the so-called "check-the-box" entity classification regulations (effective for 1997), and the issuance of two sets of Treasury regulations (in 1994 and 1997) applying SECA taxes based on the 1977 provisions. The uncertainties and perceived inequities arising out of the confluence of these changes and a 1997 one-year statutory moratorium (that expired on July 1, 1998) prohibiting any further changes by regulation have caused small business owners and their tax advisors to request that changes be made in the statutory rules applicable in determining the amount of SECA taxes to be paid by owners of unincorporated small business entities.

Although the ABA Tax Section and AICPA Tax Division proposals have minor differences, they both seek to address the confusion that many small business owners now face when they conduct their businesses in the form of LLCs, partnerships (general or limited), or proprietorships. In such event, the confusion is over the extent to which amounts paid or distributed by the business to each of its owners constitute "net earnings from self-employment" for purposes of the SECA taxes. Both proposals would amend the provisions of section 1402(a)(13) to permit SECA taxes to be computed without the inclusion in "net earnings from self-employment" of distributions that represent a return of capital to an owner of a LLC, partnership or proprietorship, and both would provide for safe harbors that owners can elect to use in order to avoid the difficulties of having to deal with a test based on all of the facts and circumstances to determine the portions of distributions attributable to compensation for an owner's services and to a return of owner's invested capital. Both proposals provide for the Treasury to be given discretion to issue regulations to deal with anticipated (and unanticipated) issues and situations that will arise under the proposed new statutory rules.

The SECA taxes problems to which the proposals are directed are real for affected small business owners, particularly as Social Security and Medicare taxes continue to increase. The proposals appear to represent a reasonable attempt to balance taxpayer and Treasury needs. Therefore, I urge the Committee to consider making a statutory change in this area to address the confusion, inefficiencies, and costs that now exist for the IRS and small business owners alike.

5. Healthcare proposals. Several proposals have been made to increase the healthcare insurance deductions for self-employed individuals, so that they will be able to deduct all of their allowable healthcare costs.

Some might argue that the cost of a person's healthcare is a personal cost that should not be subsidized by the tax law. However, the policy decision long ago was made to encourage individual and family health insurance to be provided through business employment relationships. Thus, the federal tax law has long permitted corporations, as employers, to deduct the cost of the premiums of healthcare insurance and also has permitted the employees to avoid including the economic benefit of such employer-provided insurance in their taxable incomes.

As the cost of health and medical expenses has continued to rise, this policy has assumed increasing importance. In light of these growing costs, the failure of the existing employment system to provide health insurance coverage to over 45 million working Americans and their families has become a cause for national concern.

I would urge the Committee to reconsider the present failure to permit self-employed to be able to immediately deduct the cost of their health insurance premiums in light of these developments, rather than wait for the phase-in of the full deduction in the future. If necessary, I would suggest that such acceleration of the full deduction be made subject to whatever dollar limitations may be deemed appropriate to make the change feasible. However, I also would urge the Committee to carefully consider any other changes that would place self-employed small business owners in the same position as small businesses owners who are employed by their own corporations.

UNITED STATES SENATOR • IOWA
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Opening Statement of Senator Chuck Grassley
Hearing of the Senate Committee on Finance
"Small Business and Rural Economic Development"
Tuesday, June 4, 2002

Chairman Baucus and I have called this hearing to focus on an issue on which Republicans and Democrats all agree -- the importance of tax relief for small business and farmers. All across America, the problem of high federal taxes is evident. Wall Street measures the economic slowdown by high-tech stock prices. Main Street uses the number of farmers buying equipment at the local dealer or taking out loans at the community bank. Both measures are important, but only one of them leads to farm auctions and empty storefronts. To get the economy back on track, we have to visit both Wall Street and Main Street. Today, we look at Main Street.

A significant portion of the tax burden is borne by small business and farm folks. These are the taxpayers who do business on Main Street. Farmers and small businesses rarely do business in the conventional corporate form. Most farms and small business are owned by sole proprietors, partnerships, LLCs or S-corporations. That means farmers and small business folks' taxes are paid with their 1040.

Now last June, President Bush's tax relief bill cut marginal individual income tax rates and greatly helped farmers and small businesses. That's just one of many reasons to support making the tax relief permanent. If the President's tax bill was permanent, farmers and small businesses would pay a lower marginal rate than the Fortune 500. If we don't make it permanent, then ask any farmer why he or she should pay 39.6 percent versus 35 percent paid by Fortune 500 companies.

In addition to marginal rate cuts, there are many tax problems faced by Main Street businesses that we will look at in today's hearing. We will explore several topics, such as expensing and accounting methods, and differing income tax treatments for the various business choices made by small business and agriculture. We will examine several legislative proposals designed to address tax problems faced by small business and farmers, to include Farm, Fishing and Ranch Risk Management (FFARRM) accounts and income averaging for farmers and fishermen.

Last year we had a hearing titled "Preserving and Protecting Main Street USA," and we focused on the fact that small business pays the lion's share of the tax and carries the burden in these tougher economic times of keeping the economy going. Last year the chief economist of the U.S. Small Business Administration testified that their research shows that 75 percent of the new jobs created in this economy comes from small business and two-thirds of those new jobs were created by firms with fewer then 20 employees. In addition the SBA felt that evidence suggests that small business is affected more severely in a downturn and that lowering and simplifying taxes helps small business increase productivity.

In this Congress I sponsored the *Tax Empowerment and Relief for Farmers and Fishermen (TERFF) Act.* Chairman Baucus was my co-sponsor, and we have been joined by 22 additional senators. There are 12 provisions contained in the TERFF Act, led by the FFARRM accounts, income averaging for farmers and fishermen, and several proposals to simplify questions concerning self-employment tax exposure and several cooperative provisions, just to name a few. I believe we should be committed to passing this bill in its entirety, but any one of the provisions would greatly enhance cash flow for all areas of agriculture and cooperatives.

In a previous hearing I laid out three principles I plan to use in all tax legislation: efficiency, equity, and simplicity. On the first, efficiency, we must make sure that we change the tax code in a way that grows our economy. Small businesses and farms are a key to jobs and growth. We should ensure that the tax system does not strangle this important part of our economy with irrational rules.

My second principle is equity or fairness. I want to make tax policy changes that address inequities in the tax code. There are many inequities in the code, some that hit small businesses and farmers hard, and we will hear about some of them today.

My third principle is simplicity. Everyone who fills out a Form 1040 knows about the complexity of the tax code. All across this country, Americans are dealing not only with the burden of paying federal taxes, but the added burden of tax complexity. Our witnesses today will address those complexities that specifically affect small businesses and farms in the Internal Revenue Code.

An overview of present law and selected proposals regarding the federal income taxation of small business and agriculture, including FFARRM accounts, is available at http://www.house.gov/jct/pubs02.html, document number JCX-45-02.

PREPARED STATEMENT OF HON. CHUCK HAGEL

Thank you for holding this hearing. It is a privilege to join my colleague from North Dakota to speak about one of the most pressing challenges facing rural America today—the problem of out-migration of people and businesses from rural areas. Senator Dorgan has become a leader on addressing population loss in rural America, and no member in this body has put more energy into this issue than the Senator from North Dakota.

Both Senator Dorgan and I are here today because most smaller communities in rural America have not shared in the boom that has brought prosperity to urban America.

A recent report by the National Corn Growers' Association says that one out of every two rural counties lost population in the 2000 census, and three of every four rural counties experienced below average economic growth—despite record levels of farm subsidies in the 1990s. The fact is, during the past fifty years, America's nonmetropolitan counties have lost more than a third of their population (34 percent). During the same period, the number of people living in metropolitan areas has grown by 151 percent.

As the National Corn Growers' report states: "These trends challenge policymakers to shift emphasis from commodity subsidies to rural programs that will enhance job growth and opportunities for a broader set of rural residents than farmers alone. In short, farm policies (commodity price supports) . . . have done little to help farm communities reverse this decline."

Last February, Senator Dorgan and I introduced the "New Homestead Economic Opportunity Act" (S. 1860) to explore solutions that will help close the gap between rural America and the rest of our country.

By using an array of incentives aimed at attracting individuals and businesses back to rural areas, our bill would encourage more people to live and work in areas suffering population loss—from Maine to Oregon—from Texas to Montana.

Some might ask whether the federal government has a role in aiding these struggling communities. In 1862, Congress passed The Homestead Act, giving land to individuals who were willing to develop, live and work in unsettled areas of the country. The Homestead Act transformed America's Heartland into a productive and vibrant part of our country.

We Nebraskans are proud that the first claim made under this act was just outside Beatrice, Nebraska—and, as you know, we recently celebrated the 140th Anniversary of that revolutionary legislation.

Today—140 years after President Lincoln signed The Homestead Act—Nebraska is one the states most hard hit by out-migration. Of Nebraska's 93 counties, 61 of them have had net out-migration of at least 10 percent over the past 20 years. Nationally, 556 rural counties have lost 10 percent or more of their residents.

Why are people leaving rural America? For jobs and opportunities. One of the main provisions of our legislation addresses this issue by providing incentives to small businesses to expand and locate in rural areas. Small businesses are a critical element of the rural economy—accounting for nearly two-thirds of all rural jobs.

Our legislation builds upon the same spirit of The Homestead Act of 1862 by offering economic incentives to attract individuals back to rural America. S. 1860 targets three different categories individuals, businesses, and capital formation.

For individuals who choose to locate in high out-migration counties, which we define as a nonmetropolitan county that has suffered a net out-migration of at least 10 percent over the past 20 years, the legislation provides the following:

- Forgiveness of up to 50% (maximum of $15,000) of college loans for recent graduates who live and work in these counties for 5 years.
- A $5,000 tax credit for home purchases for individuals who choose to locate in eligible areas for 5 years.
- Allows for the deduction of losses in home values in high out-migration counties.
- Establishes Individual Homestead Accounts that individuals can use for educational expenses, unreimbursed medical expenses, first-time home purchases and small business loans.

The second measure targets those who wish to locate or expand a small business in a high out-migration area. Our legislation creates a Rural Investment Tax Credit for states and counties to use for the improvement of new or existing buildings and other development costs.

Qualifying out-migration states would be eligible for $1 million in tax credits, for every high out-migration county. We also accelerate the depreciation for equipment purchases that are made through a Rural Investment Tax Credit project.

The last section of the legislation addresses the need for start-up capital. Just as in metropolitan areas, small firms located in rural areas need capital to exist and expand.However, over the past decade rural communities have witnessed their financial institutions consolidating or fading away altogether.

In an effort to combat this problem, we create a $3 billion Venture Capital Fund that invests in high out-migration counties, with a collection of federal, state and private money to help attract business ventures. This concept of joint public-private capital formation is being used effectively today in some states, such as Oklahoma.

I thank the Committee for allowing me to present my views, and hope that the merits of S. 1860 will be considered as this Committee explores legislation that aims to support rural development and addresses the challenges facing rural America. Thank you.

PREPARED STATEMENT OF HON. ORRIN G. HATCH

Mr. Chairman, I would like to thank you for scheduling today's hearing on the tax burdens facing small businesses. This is an important issue on which I have worked together with many of my Finance Committee colleagues, and I hope we will have a chance before the end of the year to advance legislation that is friendly to this engine of innovation and entrepreneurship.

At the same time, the underlying purpose of this hearing is unfortunate. Once again, some of my colleagues on the other side of the aisle are hoping to raise the minimum wage and steal away the ladder of opportunity from at least a hundred thousand American workers. Leading economists tell us that a 20 percent rise in the minimum wage would lead to at least this many job losses, and possibly many more.

But if the Senate does choose to pass legislation to increase the minimum wage this summer, at least this Committee can try to undo some of the economic damage we would be creating. By improving the tax code to help our small businesses become more efficient and more productive, then possibly our small businesses would not have to lay off quite as many workers.

I especially hope that today's witnesses can tell us what we can do to improve our tax treatment of small corporations. For years, I have been working with my Finance Committee colleagues to improve the way our tax code treats small corporations that elect tax treatment under Subchapter S of the tax code, so-called "S-Corporations." Just to remind my colleagues, Subchapter S was designed to give entrepreneurs some of the legal protection available to corporations, without taxing these small businesses twice on their profits—first as corporate income and then as personal income—the way our corporate tax law does.

There are already more than 2.6 million corporations organized as S Corporations, but I have had Utahns telling me for years that the Subchapter S provisions just aren't that useful for many companies because of their limitations, restrictions, and pitfalls for the unwary. Clearly, this is no way to run a small-business-friendly tax code. And, even though some very important improvements have been made over the years, including many enacted the last time we raised the minimum wage, more needs to be done to bring the tax treatment of these important businesses into the 21st Century.

That's why I, along with my colleagues Senator Breaux, Thompson, Lincoln, and Gramm, have sponsored S. 1201, the Subchapter S Modernization Act of 2001, which we think would dramatically improve the tax treatment of S corporations, and help entrepreneurs to get the benefits of being organized as a corporation while being taxed as a partnership or sole proprietor.

Mr. Chairman, small businesses are key to the continued growth of our economy and to future job creation. The way I see it, it is the job of government to see that unnecessary restrictions and barriers to the success of these businesses are removed so that these small enterprises can attract capital and function with the maximum of efficiency.

I look forward to hearing what our witnesses today can tell us about the state of small and rural business in America today.

Testimony of Steven Dodd Hughes

My name is Steven Dodd Hughes. I am a custom gunmaker from Livingston, Montana, a town of 7000 individuals. I have run a sole proprietorship - I call it a one man shop - for 24 years. The majority of my business income is generated outside of Montana and brought into a state with little industry. Out in the west, the locals appreciate the dollars coming into the community. Most custom gunmakers live in the rural West: Montana, Wyoming, Idaho and other states. In fact, several communities such as Glenrock, Wyoming, and Big Timber, Montana, boast custom gunmaking as a major income source for the community.

I am here to testify on the need for an excise tax exemption for custom gunmakers. The current 11% excise tax was originally part of the 1937 Pittman-Robertson Act to set aside funds for wild lands and to build shooting ranges. It is levied on all firearms and ammunition manufacturers. The tax is tallied by the serial number of the gun's action at the time of manufacturer. For manufacturing and taxation purposes, this rifle action would be defined as the frame or receiver of the gun. It is a good tax but was never meant to be applied to the one man shop scenario.

I don't actually build new guns and shouldn't be subject to the tax.

Let's look at it this way: I'm getting to the age of having crowns made for my teeth. Does that make the dentist a tooth manufacturer? Or is he updating and upgrading what is already there?

As a custom gunmaker I take existing rifle action and completely rebuild it into a uniquely artistic firearm for an individual, updating and upgrading it. I complete about 4 to 5 custom guns per year. Some of my associates create as many as 20 guns per year. I hold a Federal Firearms license just like a hardware store that sold guns would. Those who make rifle actions are required to have a Manufacturers Firearms License. Every business that I know of making rifle actions in any quantity holds a Manufacturers license. Although we call ourselves Custom Gunmakers, we do not manufacture the gun's frame or action.

Here are photos of my work. The two rifles on the cover of this book I wrote were made from existing rifle actions that had already been levied with this tax. This excise tax has already been paid on most of the rifle actions used by custom gunmakers. In fact, the current interpretation of the regulation is so ambiguous that if a client supplies the action to the gunmaker the client is deemed the manufacturer and he is liable for the 11% tax. Who is going to assess and collect it from this client? Who is going to determine how much tax has been previously paid on that rifle action?

As a small business owner I do the bookkeeping, keep my Federal Firearms License records, do the advertising, promotion, travel to show my work and sweep the shop floor. All of this besides building the guns.

This tax has been a longtime source of confusion for small businesses, and I believe it has been an administrative headache for the IRS and BATF. And Congress has agreed with me in the past. In 1982, Congress passed an appropriations bill that prohibited BATF from collecting the firearms excise tax from custom gunsmiths. Later, the Department of Treasury took the position that the 1982 provision expired at the end of fiscal year 1982. I believe the intent of the law was to establish a permanent ban on the collection of the firearms excise tax from small shops like mine.

In the past, members of the Committee, including you Mr. Chairman, have introduced legislation to correct this problem. I hope we can clear up the confusion soon, because this burdensome tax has the potential to put many shops like mine out of business.

In conjunction with the American Custom Gunmakers Guild and the NRA, I have been trying to get this exemption since 1977. This cottage industry is one of the last bastions of high quality hand craftsmanship in America. We do not manufacture firearms. Further taxation might snuff us out.

I represent a few hundred craftsmen around these United States. I work with these hands. 85% of my work, and that of my associates is done by hand. My clients call me an artist. I call myself an artisan. This tax was never meant to be applied to these hands working in a one man shop. I am here to request that you consider exempting artisans from a manufacturing excise tax.

Thank you!

PREPARED STATEMENT OF HON. BLANCHE L. LINCOLN

Thank you, Mr. Chairman, for holding this hearing on small business and rural economic development. It goes without saying that small business is the backbone of Arkansas commerce and employment and rural development has been my paramount concern as a member of the Congress.

I believe that Congress should increase the minimum wage. A significant number of Arkansans earn the minimum wage and they haven't gotten a raise in 5 years.

I have always supported, however, helping small businesses offset the pressure of these wage increases by coupling the minimum wage increase with a package of tax cuts targeted to the businesses most effected.

I want to thank the chairman and ranking member for highlighting their bill S. 312, the TERFF bill which is a package of needed farm belt tax changes and I am proud to be a cosponsor of that bill.

I am also particularly glad that this hearing will focus on S. 1201, the S corporation modernization act. Senators Hatch, Breaux, Thompson, Gramm and I have worked together to produce this legislation which is absolutely necessary to eliminate confusion and tax traps for the unwary and to expand growth and investment.

This legislation will also help advance what I see as an important long term goal of eliminating the double layer of tax on American business.

I would like to use my remaining time to address a few other important small business and rural investment initiatives which I believe should be considered by this committee.

S. 1278, the US Independent Film Incentive Act, currently has 26 cosponsors including Senators Breaux, Torricelli, Jeffords, Kerry, and Snowe of this committee.

The bill would provide for a two tiered targeted wage credit designed to stem the outflow of American films to foreign markets. While on its face this bill appears to help Hollywood, it actually will boost the segment of the market most vulnerable to the impact of runaway film and television production and to helping the small businesses that support it.

It is only available if total wage costs are more than $200,000 and less than $10 million and provides for 25 percent wage credit, equal to the first $25,000 of qualified wages and salaries and a 35 percent credit of such costs if incurred in a "low-income community."

According to a Commerce Department study, every year we don't act, we lose $10 billion dollars worth of our most American industry to the tax incentive that foreign countries have created to lure this lucrative and economically stimulating industry across our borders.

Over 15,000 direct jobs in the forest products industry will be affected by an increase in the minimum wage bill. Many jobs in the forestry side of the business are small businesses. That is why I believe that S. 1002, the Reforestation Tax Act, should be up for consideration for any minimum wage small business tax reduction.

The RTA would lift the current $10,000 cap on reforestation costs, allowing timber growers to amortize all reforestation costs over a 7-year period and would increase the current cap on the reforestation credit from $10,000 to $25,000; it also would provide a capped Inflation Adjustment Provision which reduces gross income from the sale of timber by 3% times the number of years a landowner holds the timber.

TESTIMONY OF JEFF SEIDEL

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BEFORE THE SENATE FINANCE COMMITTEE

HEARING ON SMALL BUSINESS AND RURAL ECONOMIC DEVELOPMENT
June 4, 2002

Mr. Chairman and Members of the Committee, my name is Jeff Seidel and I am the president of Parkway Muni Resources, a firm located in Minneapolis, Minnesota. Our firm specializes in obtaining financing for non-profit, governmental and commercial enterprises, particularly those that do not easily qualify for conventional financing in either the commercial banking or the investment banking markets. Currently, many of my clients are American Indians, who as we all know, often have a difficult time financing non-gaming activities in the conventional markets.

Today, I welcome the opportunity to comment on both the extension of tax incentives for business investment on reservations and the important task of financing the construction and capital improvements of Bureau of Indian Affairs (BIA) School Facilities throughout the nation.

First of all, I want to thank you for your strong support for tax incentives that promote business investment on tribal lands, and specifically for your recent efforts to extend section 168(j) of the Internal Revenue Code. This provision provides for accelerated depreciation of business property located on Indian reservations. It was extended to operate through 2004 as part of the stimulus package that was enacted earlier this year.

Extension of Tax Incentives: **As you know, many Indian reservations face extremely high unemployment rates, little or no industrial base and inadequate infrastructure. Tribes are generally unable to attract the investment capital that is necessary to create economic development opportunities and bring stable jobs to the reservation economy. That is why targeted incentives are so important. Property on qualified Indian land and accelerated recovery under section 168(j) has the potential to reverse this trend and**

bring investment and jobs to the reservation. For example, accelerated cost recovery has been responsible for bringing a 540 megawatt merchant power plant to the Fort Mojave Tribe in Arizona. In addition, many Western tribes are hoping to use the benefits of this incentive to attract companies interested in energy and natural resource development. These economic development opportunities, however, require a substantial commitment of capital over an extended planning horizon. Many companies are hesitant to invest on tribal lands not knowing whether 168(j) will be renewed after 2004. For this reason, it is critically important that Congress act to extend 168(j) through 2005.

Energy developments are good examples of projects with long term placed-in-service horizons, but many investors rely on this incentive for non-energy projects. Non-residential real estate development and business equipment also benefit from accelerated cost recovery. They are key ingredients to economic development that should not be excluded from the investment incentive.

Tribal School Bonding Bill (S243): Regarding BIA School Facilities, while most public schools are funded through locally generated taxes, based primarily on property values within a particular school district, the same does not hold true for almost all BIA-funded Indian School Districts. For the most part, as many of us know, the responsibility for funding new construction or capital improvements to BIA Schools rests entirely with the federal government.

The GAO has determined that there is a $1.0 billion backlog in BIA School construction and improvements. While there have been bipartisan efforts to increase the appropriations available for construction, the unfortunate reality is that these increases have been insufficient to significantly reduce the backlog.

The Dakota Area Consortium of Treaty Schools and others who have been concerned about this issue believe that leveraging federal funds could help speed up these needed construction projects and reduce the backlog while helping the Tribes develop relationships with financial markets that could help economic development in other areas. We have worked with Senator Tim Johnson, Senator Ben Nighthorse Campbell and other Senators and Congressmen on both sides of the aisle to develop this idea.

The issuance of bonds supported by tax revenues (or moneys derived from taxes) has been used for years in public schools and also for county and state projects. Many Tribes have sought the same solution for Indian projects and schools, only to find tremendous resistance from both the Department of Treasury and from those in the budgeting process. Other financing vehicles, such as contracting with the General Services Administration to lease schools over a period of time, and leveraging those lease payments (as has been done for many federal buildings), or utilizing the capital reimbursement program authorized by PL93-638, as amended, have each met with opposition from both the capital markets and the federal agencies involved. Direct appropriations are, of course, the simplest solution, but appropriations are obviously quite limited given the gargantuan need that continues to grow exponentially. Even in the prosperous times of the 1990's, only two to three schools were funded each year. At

that pace it is doubtful that the federal government will ever reduce the backlog. We have looked at all of the alternatives we could think of, and the culmination of that effort is a proposal to allow Tribes to issue bonds to construct schools, where the principal portion of the bonds is paid through an escrow account established at closing and funded through monies funded in the bill, and the interest is paid in the form of federal tax credits. Also, a bond trustee will be retained to monitor the payments of both the principal on the bonds and the application of tax credits. This will provide ample protection to bondholders, and therefore greatly interest the capital markets in this form of financing. As such, an assignment or pledge of the schools as collateral will be unnecessary.

Specifics for the Extension of Section 168(j) of the Internal Revenue Code

Perhaps the most effective way in which to encourage economic development on tribal lands (and encourage the job and revenue creation that flow from project development) is to accelerate the depreciation rules for property used predominantly within an Indian Reservation (section 168(j) of the Code). While this provision does not expire until the end of 2003, the enormous investment capital and extended planning horizon of energy projects make it imperative that the rule is extended in the near future so that tribes can attract these many projects. In addition, Indian tribes throughout the country have requested that Congress act to extend 168(j) as part of the energy tax legislation recently passed by the Senate Finance Committee.

In 1993, Congress passed legislation that created a variety of incentives for businesses to invest on tribal lands and for tribes to spur economic development. These incentives became effective on January 1, 1994 and will expire on December 31, 2003. One key incentive provided by Congress was the ability of taxpayers doing business on reservations to take accelerated depreciation on "qualified Indian reservation property" and "qualified infrastructure property" (168(j) of the IRC).

Also, as you may know, comprehensive energy legislation passed by the House of Representatives last year included a provision that extended 168(j) for an additional three years (while narrowing the application of the credit to energy related projects). The Senate bill extends the expiration date to the end of 2005 but does not limit the benefits only to energy projects. The Joint Tax Committee estimated the revenue cost of that extension at $175 million over ten years.

In order for a taxpayer to qualify for this accelerated depreciation provision the "qualified Indian reservation property" must satisfy several conditions:

- **The property must be used by the tax payer predominately in the active conduct of a trade or business within an Indian reservation;**
- **The property must not be used or located outside the Indian reservation on a regular basis;**
- **The property must not be acquired directly or indirectly from a person who is related to the taxpayer;**

- No portion of the property is placed in service for purposes of conducting certain gaming activities; and

"Qualified infrastructure property" is also eligible, and can include property located outside the Indian reservation. Tribal infrastructure must be available to the general public, and be placed in service in connection with the active conduct of a business within the reservation. This type of property includes roads, power lines, water systems, rail spurs and communications facilities.

Property qualifying under Section 168(j), benefit under the following accelerated depreciation schedule:

Regular Depreciation Schedule	Accelerated Schedule
3 year property	2 years
5 year property	3 years
7 year property	4 years
10 year property	6 years
15 year property	9 years
20 year property	12 years
Nonresidential real property (39 years)	22 years

Again, with an extension of Section 168(j), Tribes may pursue long-range projects with business investors with the knowledge that the tax incentives associated with the project will be available for many years to come. Long term projects with significant levels of capital investment can provide a stable foundation for economic growth in Indian country.

Specifics for the Tribal School Bonding Bill - S243

S243 represents efforts by both the public and private sectors to find at least a partial solution to the backlog for Tribal Schools. The program created by S243 provides tax credits to pay interest on school construction bonds and establishes a cash escrow account to pay the principal on these bonds, which would be issued for the purpose of funding building renovation and new school construction at BIA and grant schools.

In order to receive a bond allocation under S243, a Tribe would submit a plan of construction to the Secretary of the Department of the Interior. The plan would demonstrate that a comprehensive survey has been undertaken of the construction and renovation needs and would describe how the Tribe would ensure that proceeds from the bond issue are used for the purpose intended by the proposal. After reviewing the proposal, the Secretary of the Interior would allocate a designated amount of bonds to the Tribe, and the Tribe would access the public markets for the purpose of raising funds for the project. It should be noted that those projects on the BIA's prioritization list shall be given first priority to qualify, and then other projects can be qualified on a

first-come, first-served basis. (This should not be construed as an endorsement of the current priority list. We believe there are inequities in the current list, but these should be addressed separately.)

Under existing public laws, Tribes may contract with local architects, engineers and construction firms, among others, for the purpose of determining the physical plant needs of the Tribal school and for the design and engineering of such facilities). Under this bill, the Tribe will also have the authority, once the Secretary of the Interior has provided a bond allocation, to contract with a financial advisor, underwriter, attorney, trustee, and any other professional who would be able to assist the Tribe in issuing bonds to the public sector.

Under S243, individual Tribes will be allowed to issue taxable bonds for the purpose of new construction or facility improvement and repair, with the following collateral provided by the bill. As you know, Tribes already have the statutory right to issue both taxable and tax-exempt bonds, but this collateral is for the benefit of the bondholders.

The <u>Principal portion</u> of these taxable bonds would be set aside up front in an escrow account. The bill authorizes an annual appropriation of $30 million for this purpose. Once a tribal plan has been approved, the Tribe would be able to issue bonds on an "interest only" basis for a period of 15 years, at which time the entire balance of principal would become due and payable. The funds in the escrow account would be invested in very secure investments (such as SLGS, Treasuries, and Agencies,) that would ensure funds would be available at that time to pay bondholders. It is common practice to have a national accounting firm confirm that the funds would be available.

Under current market conditions, $30 million invested for 15 years could grow to about $70 million. Thus, the effect of this bill would be to allow the Secretary to approve up to $70 million in projects in the first year of the project. Leveraging federal funds in this way would help to reduce the backlog more quickly than simply appropriating funds directly without increasing the cost to the federal government.

The <u>Interest portion</u> of these taxable bonds will be paid in the form of a "tax-credit" to be provided by the federal government through this bill. This is similar to the credit provided to purchasers of the Qualified Zone Academy Bond program, which Congress recently extended. The total amount of tax-credits provided to new and future bondholders will depend on the amount of bonds issued, and the prevailing market rate on the bonds. For each of the two years covered by S243, the sum of $200 million in bonds would be authorized for issuance. The total cost of these bonds to the federal government is significantly less; the JCT estimated the cost to be $111 million over 10 years.

It is not expected that the program, using the principal escrow account as authorized in this proposal, will utilize all of this bonding authority. But there may be alternative uses for this authority among Tribes which may have some cash to pledge to establish separate escrow accounts, with that cash building in value over the 15 years as described above. Thus, some Tribes could take advantage of the interest portion of this program, even if no additional funds are available to pay the principal on the bonds.

For the bondholders, instead of receiving interest in the form of cash, they will receive a tax credit against their federal income tax liability. If $70 million in bonding allocation is approved, the investors will receive about $75 million in tax credits over 15 years, at current market conditions. And the remaining tax credits may be used for future financing if more money is funded in the escrow account.

The bill also provides detailed definitions of the roles of bond trustees, needed to successfully issue these bonds. The bond trustee would act as a gatekeeper of funds transfers, both from investors to contractors, and from the federal government to the investors (the escrow funds and the tax credits). While not specifically mentioned, the method of transfer of funds is provided through industry standard, and can be written in the bond indenture to avoid timing issues.

Given the rules governing trustees and the statutorily-defined safety of the investments, there is strong certainty that bondholders will be repaid. However, neither the issuing Tribe nor the federal government will have a legal obligation to repay the bond principal, and tribal sovereign immunity will remain intact. Furthermore, neither the education facility(ies) nor the land the itself will be mortgaged or used as collateral for the bonds. In the extremely unlikely event of a default, the bondholders will not have any recourse to the Tribe or its assets.
We do not think any of these arrangements, or the lack of a federal "guarantee," will scare off investors. To the contrary, our experience in this field tells us that the appropriated escrow, with the statutory conditions on its management and use, will attract eager investors from the private markets. The bonds issued under S243 will be seen as good, safe, and sound investments.

Other Benefits: The proposed bonding process would greatly assist Tribal Schools in obtaining timely funds for their projects. This bill will also help connect Tribal communities to investment banking markets. Granted, the source of repayment for these bonds does not come from the Tribes. However, having worked in Indian Country this past decade, I see the hesitancy many investment banking firms have in doing business with Tribes, and also the relative distrust Tribes have for the capital markets. Many abuses have happened. This bonding bill will assist in breaking these barriers down, which is essential if the Tribes are to pursue economic development successfully.

The other benefit for Tribes is that this program would finally allow for the design and construction process for Tribal Schools to proceed locally, using bonded architects, engineers and construction companies. It would permit use of the trust departments of private financial institutions to maintain control over disbursement and re-investment of the funds. It would allow Tribal Schools to raise "seed" money for professional services such as architects and engineers, through the issuance of debt guaranteed by the eventual issuance of these bonds. And it would involve federal oversight but without the tremendous delay in the design, engineering and most importantly, the funding of the projects.

Because local architects will be used, the designs should take into account the local environment and other considerations unique to the area and culture. Also, local

contractors would use Indians and other minorities to help build the school, providing employment and developing job skills. But most importantly, local firms which are familiar with designing and building public facilities would complete the project in an accelerated manner, as compared to the current system, and thus remove the added costs of construction-delay inflation. Under S243, we could give them a budget, provide them with mandatory deadlines for this pilot program, and let them work with the local Tribal School District to complete the project on a timely basis.

Thank you for this opportunity to testify today in support of S243 and the extension of tax incentives that promote business investment on tribal lands. Your interest in this issue sends an important message to Indian country that you care about what happens on our reservations and about the future of Indian children. I would be pleased to respond to any questions you may have.

Points of Interest regarding Tribal Schools:

- There exists a unique political and legal relationship between the government of the United States and governments of Indian Tribes. Indian Tribes have a legal relationship with the United States government which is set forth in the Constitution of the United States, Treaties, federal statutes and judicial decisions.
- The Constitution of the United States gives the Congress plenary (full) powers over Indian affairs, and through treaties, statutes, executive orders, course of dealing and custom, the United States has undertaken a trust obligation to protect Indian Tribes and tribal resources.
- The trust responsibility includes the duty to protect, preserve and enhance tribal assets and resources, and to assist Indian Tribes in improving the socio-economic status of Tribes and their members in an effort to encourage economic development and strengthen powers of self-government.
- By fostering the development of accommodative financial markets and tribal access to capital, the federal government can assist in providing fundamental tools to greater economic development and powers of self-government.
- The need for financial capital by Indian Tribal governments is acute, and the federal government should work to facilitate capital creation and those mechanisms that will permit the tribes, with the assistance of the federal government, to issue debt instruments as a means of financing Tribal government needs.
- For the benefit of Indian people across the United States to increase their commerce, welfare and prosperity and the improvement of their health and living conditions, it is essential that this and future generations of youth be given the fullest opportunity to learn and develop their intellectual and mental capacities.
- It is essential that institutions of education be provided with appropriate additional means to assist such youth in achieving the required levels of learning and development of their intellectual and mental capacities.
- Institutions should be enabled to finance indebtedness to preserve and enhance the facilities for the purposes of education.
- There is approximately 16,600,000 square feet of space in Indian schools nationwide.
- There exists a backlog in Grant Schools and Bureau of Indian Affairs School facility improvement, repair and new construction needs of $754 million as of March, 1998. It is estimated that the cost of the $754 million in deferred maintenance grows by $22.6 million per year due to inflation , and approximately $33.9 million per year due to natural aging and deterioration, for an annual total of $56.5 million per year in growing needs.
- The replacement value for Tribal schools is estimated to be $2.2 billion.

- The magnitude of the dollars and number of projects has risen to a level where these projects cannot be funded by current Facility Improvement and Repair and New Construction program funds.
- With the physical condition of Grant and Bureau schools deteriorating, and with the population within these schools increasing, there is an immediate need for funding of these projects.
- It is the purpose of this bill to provide a measure of assistance and an alternative method of financing to enable the tribal institutions of education to provide the facilities and structures which are sorely needed to accomplish the purposes of this bill.
- True self-determination in any society of people is dependent upon an educational process which will ensure the development of qualified people to fulfill meaningful leadership roles. This bill will incorporate the commitment of the federal government to guarantee payments of principal (through a direct appropriation of an escrow fund) and of interest (through the allowance for future tax-credits to investors), so that Tribes with negligible resources may issue bonds to fund school improvements and/or new construction.
- This bill will also incorporate the commitment and support of Tribal self-determination by utilizing PL93-638, Section 102 and PL100-297 to allow tribes to manage their own construction projects.

PREPARED STATEMENT OF STEPHEN D. VISOCAN

PRESIDENT, POP INN
HELENA, MT

Good afternoon, Mr. Chairman. My name is Steve Visocan, and I am a small businessman from Montana. As president of Pop Inn, I own three convenience stores and three taverns, around Helena, Montana, and have 76 employees.

I would first like to thank you for inviting me to testify on tax issues relating to small businesses. I will focus my testimony today on repeal of the special occupational tax (SOT) on alcohol. This is a particularly bad form of taxation and today I would like to help members of this committee understand why this tax should be repealed.

First, I believe you will agree with me that this tax has outlived its purpose. Congress has a long history with alcohol occupational taxes. The first version of the SOT was enacted over 200 years ago, but was repealed in 1817. Today's version of the SOT was established in the 1860's to generate revenue for the Civil War. Despite the end of the Civil War, this tax remained virtually unchanged for more than a century. Then, in 1987, Congress passed the Omnibus Budget Reconciliation Act and raised the SOT to its current levels. The Civil War has ended.

Second, I would like you to reflect on the extreme regressiveness of the SOT. The 1987 law increased the tax from $54 and $24 annually per store for liquor and beer retailers respectively, to $250 per year per store. This was an incredible 1000% tax increase! Retailers must annually pay $250 per location; wholesalers pay $500; and vintners and distillers pay $1,000. Retail outlets are generally small businesses, and repealing the SOT would be an immediate and visible tax cut.

Because the SOT is levied on a per location basis, small business owners like me are hit the hardest. Three convenience stores and three taverns generate an SOT tax of $1,500. That's $500 more in annual taxes than the nation's largest single site brewery or distillery plant. By the same token, a single Elks Lodge pays the same in tax per year as a single Wal-Mart Supercenter -- $250.

Small retail companies, like mine, were most affected by the increase in 1987. Whether it's a seasonal restaurant, an Elks or Eagles Lodge, an American Legion, bowling center, campground, florist that delivers wine with flowers, or a convenience store operator, no one is spared from the tax. In fact, more than 90% of all SOT revenue comes from retailers.

Not only is this tax regressive, its revenue isn't even targeted to offset the costs of alcohol enforcement. The tax is administered by the Bureau of Alcohol, Tobacco and Firearms, but the revenue collected does not go towards BATF activity. Rather, it is channeled back into the General Treasury.

Mr. Chairman, as you well know, repeal of the SOT has garnered congressional support from both sides of the aisle. I want to personally thank you and Senator Thompson for introducing S. 808, which repeals the SOT. I also want to thank Senator Nickles and the other 15 Senators who have agreed to cosponsor your legislation. The House has also introduced a companion measure, which enjoys large bipartisan support.

Not only does repeal of the SOT have bipartisan support in Congress, the Joint Committee on Taxation recommended the repeal of the SOT in their simplification recommendations to Congress last year. Moreover, the General Accounting Office has examined the effectiveness of the SOT several times and consistently found it to be flawed.

Mr. Chairman, the SOT is not only a burdensome tax on small businesses, but it is a flawed tax. I wholeheartedly agree with you when you said on the Senate floor that, "This is an inequitable tax that has outlived it's original purpose and is a clear example of an antiquated approach to federal taxation."

With the economy slowly rebounding, small business owners need your help. Just as the tax rebate last year that put $300 in the pocket of every American was economic stimulus, so too is putting $250 back in the hands of small businesses around this country. Believe me, getting my SOT tax back would be welcome relief for me.

Again, thank you Mr. Chairman for your time today. I look forward to continuing our work together on tax issues for small businesses. I am happy to answer any questions from the committee.

COMMUNICATIONS

THE AMERICAN FARM BUREAU FEDERATION

Farm Bureau commends the Senate Finance Committee for holding a hearing to focus attention on the needs of farmers and ranchers. While much of America has prospered over the last decade, this has not been the case with American agriculture. Many farmers and ranchers have suffered substantial financial losses over the last few years. There are many reasons for this and just as many possible solutions. Some of these solutions involve changes in the tax code.

We are pleased that Chairman Baucus and Senator Grassley have recognized many of these tax provisions and introduced them as S. 312. Farm Bureau supports S. 312, the Tax Empowerment and Relief for Farmers and Fishermen Act, and the legislation that carries the bill's components are freestanding measures. This statement also contains support for repeal of death taxes and several changes in the way capital gains are taxed.

FARM, FISHING AND RANCH RISK MANAGEMENT ACCOUNTS (FFARRM)

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act—Section 2

S. 313 Farm, Fishing and Ranch Risk Management Act

Unpredictable weather and uncontrollable markets determine whether or not farmers and ranchers will be able to harvest a crop and the price they will receive for the commodities they are able to market. As a result, farmers and ranchers are never certain of their incomes. Serious financial problems arise in low-income years when not enough revenue is generated to cover farm expenses. Farmers and ranchers need new risk management tools that encourage savings as a means of stabilizing their incomes.

Farm Bureau supports the creation of Farm, Fishing and Ranch Risk Management Accounts (FFARRM) to help farmers and ranchers manage risk though savings. Using FFARRM accounts, agricultural producers would be encouraged to save money in good economic times for the ultimate lean economic years.

Like other small businessmen, farmers and ranchers have predictable expenses. Each month they must pay for fuel, animal feed, equipment repairs, building maintenance, insurance, utilities and payroll. They must plan for seasonal expenses such as taxes, seed, heat and fertilizer and must also budget for major purchases such as equipment, land and buildings.

While many expenses can be predicted and to some degree controlled, farm income is neither predictable nor controllable. Farmers and ranchers do not know from one year to the next if theirgross income will exceed expenses or if their income will fall short of what they need to pay their bills.

FFARRM accounts would encourage farmers and ranchers to save "for a rainy day" by deferring income tax, but not self-employment taxes, on up to 20 percent of their net farm income. Money could remain in the account for no more than five years and would be subject to income taxes at withdrawal while interest would be taxed as it is earned. Safeguards in the bill limit the use of FFARRM accounts to bonafide farmers and ranchers and require that FFARRM funds be held in interest-bearing accounts.

SELF-EMPLOYMENT TAXES

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act—Sections 3 and 4

S. 315 Conservation Reserve Program Tax Fairness Act of 2001

S. 369 Relating to the exclusion of certain farm rental income from self-employment taxes

Most farmers and ranchers are self-employed. They currently pay self-employment (SE) tax at the rate of 15.3 percent on earned income. The self-employment tax does not ordinarily apply to rental income, because rental income represents a return on investment not on earned income.

In 1996, a tax court case (Mizell case) imposed new SE taxes on cash rental income received by some farmers and ranchers. As a result, landlords, who are actively involved in a partnership or corporation that farms their land, must pay SE tax on rental income. The Mizell decision doesn't apply to any other group of taxpayers, which means that farmers are being taxed differently than other rental property owners. While an Eleventh Circuit appellate ruling (McNamara, Bot and Hennen) sided with farmers, additional IRS legal action could still occur and the obligation to pay SE taxes on cash rental income remains clouded.

Also in 1996, the tax court ruled (Wuebker Case) that Conservation Reserve Program (CRP) payments were considered rental payments and therefore would not be subject to the SE tax. USDA makes CRP payments to owners and operators of land who sign a rental agreement and agree to refrain from farming the enrolled property in order to conserve and improve the environmental resources of that land. CRP covers almost 34 million acres of environmentally sensitive land.

But, in March 2000, the Sixth Circuit Court of Appeals reversed the tax court's opinion, placing an additional tax burden of 15.3 percent on farmers for their CRP payments and allowing the IRS to retroactively collect these taxes from the last four years on farmers participating in CRP.

It is unfair to treat active farmers and ranchers differently from other taxpayers when imposing SE taxes on rental income. Because of the Mizell and Wuebker cases, the IRS now singles out farmers and ranchers as landlords liable for the SE tax. For other taxpayers who receive CRP payments and cash rental payments, and are not materially participating in a farming operation, the payments are considered to be rental income not subject to SE tax.

The CRP issue not only impacts farmers and ranchers, but also the environment. Self-employment tax on CRP payments may discourage farmers and ranchers from future participation in this program. Environmentally-sensitive acreage that has been taken out of production to protect its natural resources may be forced back into production if CRP payments are subject to SE taxes.

Farm Bureau believes that farmers and ranchers should be treated the same as other taxpayers and not have to pay SE taxes on unearned income like CRP payments and the cash rental of land.

INCOME AVERAGING AND THE ALTERNATIVE MINIMUM TAX

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act—Section 8

Farm income averaging provides farmers and ranchers with a valuable tax management tool. The intended benefits of income averaging, however, are being eroded by the Alternative Minimum Tax (AMT) for some farmers and ranchers who use income averaging. Producers who stand to benefit the most from income averaging, those whose incomes vary greatly from year to year, are hurt most by AMT-imposed limits on farm and ranch income averaging.

Income averaging helps assure the long-term viability of production agriculture because farmers and ranchers are no longer overtaxed in profitable years, leaving more funds to pay expenses and prepare for the next economic downturn. Without income averaging, farmers and ranchers pay more in taxes than people with steady incomes even though they both had the same aggregate earnings over time. By implementing income averaging, Congress ensured that effective tax rates would be the same for agriculture producers and other taxpayers.

Farm Bureau supports legislation to ensure that farmers and ranchers are able to take full benefit of income averaging without the added burden of paying the Alternative Minimum Tax.

CHARITABLE DEDUCTION FOR CONTRIBUTIONS OF FOOD INVENTORY

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act—Section 7

S. 37 Good Samaritan Hunger Relief Tax Incentive Act

Despite the wealth of our country, low food prices and ongoing government food assistance programs, some people still have difficulty purchasing food for a proper diet. Farm Bureau believes that tax policy should encourage individuals and companies to do all they can to help people in need. Farm Bureau supports legislation designed to increase donations to food banks, soup kitchens and other hunger relief charities by creating a charitable deduction for contributions of food inventories.

SMALL ETHANOL PRODUCER CREDIT

S. 312 Tax Empowerment and Relief for Farmers and Fishermen Act—Section 11

Farm Bureau has been an aggressive supporter of expanding the production and use of ethanol. The energy supply problems of the last few years have made ethanol an even more important part of the total energy supply for the country. The small ethanol producer credit program provides incentives for producers of alternative energy to boost production. The U.S. Department of Agriculture program will reimburse plants that increase production for the commodities used to make ethanol.

Changing the definition of a small ethanol producer would be a tremendous boost for small ethanol plant producers. It would give them an economic incentive to enhance the output of each plant that participates in the program. Currently the program covers 42 ethanol and 12 biodiesel makers in 19 states. It is projected that these plants will increase ethanol production by 264 million gallons and boost biodiesel production by 37 million gallons. Expanding the parameters to the next tier of plants, to producers of 60 million gallons, would almost double these numbers.

We are pleased that this provision is contained in the Senate-passed energy bill now in conference.

CAPITAL GAINS TAXES

Farming and ranching is a capital-intensive industry that requires huge investments in buildings, equipment and land to produce food and fiber. When they sell a farm asset, agriculture producers pay capital gains taxes on the amount that asset has increased in value while they owned it. This tax can be huge because on the average, farmers and ranchers own their land for 30 years during which it increases in value five to six times.

To remain efficient and profitable, farmers and ranchers must constantly adapt their businesses to produce the goods wanted by American and overseas consumers. Because capital gains taxes are imposed when buildings, breeding livestock and farmland is sold, producers are discouraged from selling unneeded assets to adapt and upgrade their operations.

Capital gains taxes also threaten the transfer of farmland between agricultural producers. Capital gains taxes increase the price of land making it more difficult for children to take over farms while their parents are still alive. The tax makes it harder for farmers to acquire land to expand so that additional family members can enter the business. In addition, capital gains taxes make it more difficult for family members who want to keep farming to buy out their non-farming relatives who may have inherited part of the farm.

S. 1329 To provide capital gains tax incentives for land sales for conservation purposes

One farmland preservation tool embraced by some state and local governments and a growing number of private conservation groups are voluntary conservation easements. These programs compensate farmers and ranchers who are willing to give up the right to develop or to sell their property for development.

The value of a conservation easement is typically the difference between the development and agricultural value of a piece of property. Because farmers and ranchers tend to reinvest their earnings in their businesses, they consider their land to be their retirement savings. Few are willing to give up the right to develop, and thereby lessen the value of their land, without compensation.

Programs that purchase conservation easements from farmers overcome this issue and successfully protect farmland from development. But, because income from the sale of conservation easements triggers capital gains taxes, farmland preservation programs are not as successful as they could be.

Farm Bureau supports S. 1329 to exclude 50 percent of gain from the sale of land from gross income to an entity intending to put the land in a conservation use. This tax code change will encourage more landowners to designate land for conservation purposes because capital gains taxes will be lower than if the property were sold for development.

The change will also encourage and assist farmers and ranchers who wish to voluntarily preserve land as habitat for endangered or threatened plants and animals. Rewarding landowners who choose to protect habitat is a much better approach than mandatory programs that restrict the use of land without compensating landowners.

S. 362 To provide exclusion for gain from the sale of farmland

Congress increased the homeowner exclusion in 1997 and made the benefit usable once every two years. While these improvements were very helpful for homeowners, the benefits for farmers and ranchers are limited. Unlike homeowners who tend to buy and sell homes multiple times during their lives, farmers tend to live in their homes until they leave their farms. And, unlike many taxpayers whose homes represent their most valuable asset, a house on a working farm has a low value because it can't be easily separated from the farm operation.

Farm Bureau supports. S. 362, legislation to expand the $500,000 per couple homeowner capital gains exclusion to include farmland. A broadening of this exemption will insert a measure of equity into the tax code. We also believe that the maximum capital gains tax rates should be reduced to no more than 15 percent. Enactment of these provisions will allow assets to move to their best and most productive use.

DEATH TAXES

No Farm Bureau statement on taxes would be complete without a statement on death taxes. Eliminating death taxes is the top tax priority of our organization. Families own 99 percent of our nation's farms and ranches and unless death taxes are repealed, many of these family farms are at risk. The impact of death taxes, with rates as high as 55 percent, is so severe that its imposition can destroy farm businesses. When this happens open space can be lost, surviving family members can be displaced, employees can lose their jobs and rural communities can lose their economic base.

Anything less than total repeal fails to completely remove the burden that death taxes place on our nation's agriculture producers. Farms and ranches, and the families that operate them are not stagnate, but grow and evolve over time. Farmers do not know when they are going to die and they do not know what their operations are going to be worth when they do. As long as death taxes remain on the books, farmers and ranchers will be required to divert resources from their businesses to pay for costly, cumbersome and time-consuming estate planning. Even with the best of planning, no one can guarantee that a farm or ranch will be protected at death.

THE BUREAU OF WHOLESALE SALES REPRESENTATIVES

[SUBMITTED BY ABRAHAM SCHNEIER, LEGISLATIVE DIRECTOR]

Chairman Baucus: On behalf of the members of the Bureau of Wholesale Sales Representatives, (BWSR), we appreciate the opportunity to submit this statement for the record for the June 4th hearing on "Small business and Rural Economic Development".

Who is the Bureau

BWSR is an organization of sales representatives who are in turn members of the National Alliance of Sales Representatives Associations (NASRA). NASRA is comprised of memberships of different sales representatives organizations, including members in the apparel industry, furniture industry, shoe industry, and gift industry. Each NASRA member is an independent sales representative, which means that they are each an independent business owner. They are free to represent a variety of manufacturers and each pays his or her expenses out of their earned commissions, they are not reimbursed.

This differentiates the independent sales representative from sales representatives that are employees of various manufacturers, as the independent sales representative is totally dependent on his or her individual efforts. Some have employees while many run their businesses on their own, sometimes with the help of a spouse. In addition many of them travel the roads of rural America for up to 200 days per year meeting with the independent businesses that reside in small towns throughout the country.

What is a Sales Representative?

Walk through a department store and notice the variety of merchandise. You are seeing the results of a sales representatives work. Have you ever stopped to wonder how all of this merchandise in its variety of sizes, colors, shapes came to be in this store, you have seen the effort of a sales representative.

It is an old industry truism; that nothing gets sold unless a sales rep sells it first.

A sales representative knows his products and his customers. They understand the product and how it is manufactured. They also understand the needs of their customers. They also know what is available, when it can be shipped, how to arrange financing, the works.

Sales Representatives are a critical part of the distribution chain, after all where did you think all of that merchandise came from.

It might surprise you to know that every day in rural America Sales Representatives are busy selling everything from computers, to boots, to farm implements.

Helping Small Business and Rural America

Sales representatives are integral to the entire distribution process and have worked for years without federal assistance. All the while they must deal with all of the legislative and regulatory issues that every small business owner faces. They must deal with these issues while traveling up to 200 days per year, paying for hotels, and finding opportunities to take buyers out for a coffee and doughnut at the local diner, maintaining their vehicle, and continuously upgrading their computers to be able to work efficiently with the manufacturers they represent.

Again these individuals are independent business owners, they are not independent contractors, and they are not statutory employees. They are taxpaying business owners.

They are critical to the distribution process, especially in rural America because as you know the local retailer does not have the time to attend the variety of trade shows. They are, however, very dependent on the sales representative coming to them to help them stock their shelves and warehouses.

Critical Issues for Sales Representatives

Not surprisingly the issues of greatest concern to sales representatives are those issues that permit them to do their business.

Increased Depreciation on Vehicles and Removing Section 280F Limitations

A Sales representative will purchase a vehicle large enough so that there is adequate space to carry their product samples. In some cases they purchase motor homes to allow for permanent display space yet many more will purchase the wide variety of Vans, mini vans, and sports utility vehicles.

These individuals will then drive between 25,000–40,000 miles per year. Yet if the vehicle does not weigh more than 6,000 pounds the vehicle must be depreciated over more than five years. This is impractical from the perspective of the fact that the cost of purchasing and maintaining the vehicle are cash outlays that they should be permitted to recoup over a more practical time frame.

In addition many of these vehicles are outfitted with racks and other specialty items to permit carrying the product samples in a safe manner.

Title II, Section 205 of S.1493, the Small Business Leads to Economic Recovery Act of 2001, proposed by Senator Bond, would increase the Section 280 F Limits thereby permitting the business owner to write off the vehicle over a reasonable period of time.

Full Meal Deduction

These small business owners are not dining at the Palm, or the Capitol Grille. Their average meals cost less than $12 because they are dining in Rural America. When was the last time you spent $50 dollars for a meal back home.

The meal, whether a sandwich or bagel, is an opportunity for the business owner to get the buyer away from the office and the telephone, and to spend a few moments concentrating on the sale.

Is this business related; yes. Do you think the sales representative would be spending this money just on a lark? So why is only half of the $12 deductible. These meals again help rural America. They help the restaurant, they help the retailer, and of course they benefit the sales representative in the conduct of his or her business.

Senator Bond has proposed in S.1493, Small Business Leads to Economic Recovery Act of 2001, in Title II, section 206 of the bill, proposes to increase the meal deduction to 100%.

Increased Depreciation on Computers and Software

The existing rules on depreciating computers and software ignore the economic realities that computers are practically worthless in two years and software in less time than that. Reducing the depreciation life on computers and software would also be helpful as sales representatives increasingly move to incorporate technology in their daily business.

The Cost of Fuel

The cost of fuel for a sales representative goes right to his bottom line. When the cost varies by up to 40% during a year, it makes predictions of profits impossible, and can in some cases wipe out a years work. They can to go back and renegotiate commissions and they cannot stop traveling.

We seem to be helping every other sector of the transportation industry or every other part of the distribution chain that is energy sensitive.

What about the traveling Sales Representative?

Conclusion

Mr. Chairman, this hearing sought to focus on issues affecting small business and rural America. Here is an opportunity to help both at the same time.