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WHAT IS WORKING: TAX INCENTIVES TO AID SMALL BUSINESS RECOVERY

ROUNDTABLE

BEFORE THE

COMMITTEE ON SMALL BUSINESS AND ENTREPRENEURSHIP UNITED STATES SENATE

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

DECEMBER 3, 2009

Printed for the Committee on Small Business and Entrepreneurship

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WHAT IS WORKING: TAX INCENTIVES TO AID SMALL BUSINESS RECOVERY

THURSDAY, DECEMBER 3, 2009

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS
AND ENTREPRENEURSHIP,
Washington, DC.

The Committee met, pursuant to notice, at 10:07 a.m., in Room 418, Russell Senate Office Building, Hon. Mary L. Landrieu (chair of the committee) presiding.

Present: Senator Landrieu.

OPENING STATEMENT OF DONALD CRAVINS, DEMOCRATIC STAFF DIRECTOR AND CHIEF COUNSEL, SENATE COMMITTEE ON SMALL BUSINESS

Mr. CRAVINS. Good morning, ladies and gentlemen. We are going to go ahead and get started. I think we are still waiting on a few witnesses who are going to be coming in. My name is Donald Cravins, and I have the pleasure of serving as the Majority Staff Director for the Senate Small Business Committee.

Senator Landrieu is going to be here in about 15 minutes, but she did want us to get started because she knows some of you have traveled and probably have flights and plans to get back. She wanted us to get started so we wouldn't keep you around later than we had to. Thank you all for agreeing to participate.

At this time, I am going to turn it over to our committee's Tax Counsel, Ms. Krystal Brumfield. I also want to thank my colleagues on Senator Snowe's staff who are here this morning. It is always good when you can work with people across the aisle and we do that very well on our committee.

Krystal.

Ms. BRUMFIELD. Good morning, everyone. Thank you again for joining us today to discuss these very important expiring tax provisions. We would first like to start by allowing you to introduce yourselves, so if we could just go around the room and just have a few words from you.

Please, Keith.

Mr. HALL. Thank you. My name is Keith Hall. I am with the National Association for the Self-Employed. We represent about 250,000 of the smallest small businesses, micro businesses, and I am really happy to be here.

Ms. BRUMFIELD. Sure.

Mr. RYS. Hi. I am Bill Rys, Tax Counsel with the National Federation of Independent Business. We represent about 350,000 small

business owners, not just the micro businesses but all small businesses, and thanks for inviting us.

Ms. STEWART. Hi. Nikki Stewart from Sarasota, Florida, representing Women Impacting Public Policy. I am also a CPA. I am looking forward to this. Thank you for inviting us.

Mr. VILLALOBOS. Jose Villalobos with Telacu, a nonprofit Community Development Corporation based in East Los Angeles, and I am also an Executive Committee member of the New Markets Tax Credit Coalition, which represents over 150 Community Development entities involved in New Markets Tax Credit across the country.

Mr. KOENIG. Good morning. I am Dave Koenig, Director of Tax and Profitability at the National Restaurant Association. We represent 945,000 restaurant and food service outlets in the country. Seven out of ten restaurants are single-unit operators, which means that the restaurant industry is really, for the most part, an industry of small businesses, and we really thank you for the opportunity to be here today.

Mr. FLETCHER. Good morning. I am Jeff Fletcher. I am with Appleton Papers. I am the Controller for the country. We are an employee-owned S Corporation. We appreciate the opportunity to be here.

Mr. GREENBLATT. Hi. I am Drew Greenblatt. I am the owner of Marlin Steel Wire. We make wire baskets in Baltimore City. We make 100 percent in the USA and we export all over the world. We have 29 employees and we are growing.

Mr. BERGER. I am Matthew Berger. I am the Economist for Senator Snowe.

Ms. BLACK. I am Kathleen Black. I work for Senator Snowe on the Republican Staff of the Small Business Committee and I am her tax and finance advisor.

Ms. BRUMFIELD. And we have Paula, who just stepped in.

Ms. CALIMAFDE. I am Paula Calimafde, Chair of the Small Business Council of America, and we represent the more stable, successful small business sector of the economy and we are thrilled to have on our advisory board some of the leading tax advisors, insurance folks, actuaries, and accountants in the country.

Ms. BRUMFIELD. Well, welcome, everyone. We have a nice-sized group. I will briefly explain the format of the roundtable. If you seek to be recognized, please stand up your name card in such manner so that we will get around to everyone. I am looking forward to a very thought-provoking discussion, so let us get started with questions.

[Pause.]

Okay. We will start off with a very general question, and whoever would like to respond may. The first question would be with regards to the Alternative Minimum Tax (AMT). What would be the consequence of allowing the increase in AMT exemption amount to sunset? What impact would that have on small business owners? Anyone?

Mr. Greenblatt.

Mr. GREENBLATT. The AMT, the whole concept of it is not good because we have to figure out our taxes not once, but twice, which doubles the cost for tax preparation. I pay about 30-plus grand a

year—I am a little company—30-plus grand a year just to figure out my taxes. I do nothing fancy. I could instead hire an unemployed Baltimore City welder rather than figuring out taxes. It should be on a little postcard. Having a second tax system is very burdensome on us and wasteful. And then to increase the threshold is going to only add more taxes, and again, so we hire less people.

Ms. BRUMFIELD. Okay. Bill? And we will work our way around.

Mr. RYS. I don't want to just keep hogging the time. Mr. Greenblatt is right, but I would like to add to that. Not only is it the increased amount of tax you are going to pay, but it is also the complexity issue. Small business owners face a heavy burden in terms of tax compliance. The cost of complying with taxes is 66 percent higher, on average, for a small business than it is for a large business. Tax complexity is a major problem.

Every other year, we do a problems and priorities survey, and for the first time in the 2008 survey, we added tax complexity to a list of 75 possible issues. It ranked third. So this is a big problem for small business owners.

I would also like to note, the AMT is not indexed for inflation, and that is a problem. But I would just warn that there are a number of bills moving through Congress right now that are also not indexed for inflation. So I would hope that we don't fill the tax code with AMT time bombs—the estate tax, health care, payroll taxes. I would keep that in mind as you are moving other legislation along, as well.

Ms. BRUMFIELD. Sure.

Keith.

Mr. HALL. I also agree. I think for particularly the smallest businesses, the micro businesses, complexity is a problem. I think just keeping up with the tax code, having AMT implications, having complications in even filling out the home office deduction form, makes it difficult for the smallest guy to even do the forms. And I think one of the things they end up doing is foregoing some of the deductions that they would normally have or be eligible for, like the home office deduction.

And as AMT comes into play, they may not even recognize it is due. It puts them in a position of filing a tax return without the AMT calculations. It puts them in a position of getting the nice little letter from the IRS that they don't like a year and a half later. So that causes additional problems.

I think it also exacerbates those that are already in a tough situation, because the typical smallest person, the individual who is going to be affected by the AMT, is someone who has higher than average mortgage interest cost, or higher than average state income tax, for example. Those are some of the things that get left out of the AMT calculation. So somebody who may be in New York or California, already paying a bunch of state income tax, those are also the places that their houses are typically bigger, so they have more mortgage interest. So the people who get hit by it are those already being hit by higher taxes, also. So it is just not only the complexity, it is those that are affected by it just seems even more unfair.

Ms. BRUMFIELD. Sure.

Paula.

Ms. CALIMAFDE. Well, I think it hits small business harder than anybody, really, because many small business entities are what is referred to as pass-through entities, which means the business income is part of the owner's income, and AMT, in effect, is sort of a system that takes away all the deductions and says, figure out your tax and here is the rate. If that is higher than what you would have had to pay otherwise, well, go to it. You get the higher tax rate.

So it is hitting the small businesses much harder than, for instance, a regular C Corporation with a larger business. So it is, in some senses, a very hard-hitting issue for small business, as is the increased tax rates that are supposed to hit next year. It is the same issue because of the pass-through entity.

Ms. BRUMFIELD. Jose.

Mr. VILLALOBOS. The AMT puts the New Markets Tax Credit at a competitive disadvantage with other tax credits because the New Markets Tax Credit is not exempt from the AMT. And in last year's economic recovery bill, the Low-Income Housing Tax Credit and the Historic Tax Credit received exemptions from the AMT. So now as we go into the marketplace to try to attract investors for the New Markets, we have to compete against others that have an exemption. The New Markets Tax Credit has been critical in terms of getting capital into underserved low-income communities. A lot of that is targeted directly to the benefit of small businesses in underserved communities.

We would propose that the New Markets Tax Credit actually be exempted from the AMT, similar to the LIHTC and the Historic Tax Credit, and such an exemption actually was included in last year's recovery bill, economic recovery bill, in the Senate bill, but was dropped in conference.

Ms. BRUMFIELD. Keith, response?

Mr. HALL. I don't know if I get to say twice. I will use Jeff's, since he isn't here yet.

[Laughter.]

Ms. BRUMFIELD. Just this time.

Mr. HALL. We are not actually talking here about getting rid of the AMT or having everyone who is currently affected by the AMT exempted from the AMT. This is just the exemption amount changing. So the people that are going to be affected by allowing this provision to sunset are only going to be the smallest people anyway, the people who have that level of exemption. The richest people, the people that the AMT was targeted at to begin with, won't be affected by this sunset provision. It is only the smaller people with the lower level of earnings that are even going to be affected by allowing this provision to sunset anyway.

Ms. BLACK. To follow up on that, and Paula started the conversation on pass-throughs and tax rates in general. Today, the President is holding a Jobs Summit on a lot of important questions Congress will ultimately have to consider. Small businesses will in 13 months have to contend with another major set of expiring provisions, including individual tax rates. As pass-through entities, small businesses will be subject to higher tax rates 13 months from now. I would like to get an idea from representatives of the business community or small business owners about your planning

cycle. Looking at this wall of new taxes that you are going to be facing, a year from now, I'd like to know what that means to you for planning and what that means to you for retained earnings and the ability to reinvest in your businesses.

We will start with Nikki. She has got the first one up.

Ms. STEWART. Yes. Hi. I guess as a general comment with this issue, the question that you just raised as well as the AMT and going into the estate tax issue, as a financial planner, my world gets very complicated because it seems like there are continually changing amounts that we have to worry about for our clients.

For instance, the estate tax. As we all know, next year it is repealed and then it goes back to $1 million. There are so many planning issues that we have to deal with. It would be so nice, in a perfect world, to have consistent values for us, because—and again, it goes to the tax rates, as you mentioned, and a year or so from now—most of the complaints I get from my clients—again, they are all small businesses. They pay a lot of money to get their taxes done. I think a lot of that complexity could be changed if we could just come up with something that we all know we can plan on year after year.

Mr. GREENBLATT. This is really important. We export to 27 countries. I compete with factories in Germany, France, Taiwan. These countries have lower taxes than I do. You are putting us at a massive disadvantage with our current taxes, because what is happening is when I compete against Germany, if I lose, I have less work for my guys, so I need to hire less people. If I win jobs, I hire more guys. Baltimore City unemployment will be impacted by your decision here.

If you lower my taxes, I will win more jobs. And if you raise my taxes, I will lose more jobs. So I recommend making our tax rates very competitive with our competitors, like lower taxes than France. We should also have lower taxes than Germany, and we do not now. We have higher tax rates than socialized countries, and this is really hurting us.

Mr. RYS. Mr. Greenblatt, again, is exactly right. Seventy-five percent of small business owners are pass-through businesses. This means they are paying their tax at the individual level. Those expiring tax rates—the individual rates, the estate tax, Section 179—are a concern.

We do a monthly small business economic trend survey. We ask small business owners in the survey—and I will say that the survey is at some of its historic lows, especially in terms of lost sales, which is the biggest problem. There is just no business. But we asked the question, is this a good time to invest in your business, and the overwhelming answer was no. The number one reason given for the last—economic conditions.

For the last four months, the number two reason, and it has been in double digits, hovering between 15 and ten percent, is the political climate. Small business owners don't know what the rules of the game are next year. They don't know what their health care costs are going to be. They don't know what their energy costs are going to be. They don't know what their tax costs are going to be.

And they are not seeing a tax increase at the end of next year. They are seeing a tax increase today, because unemployment taxes

are going up. The State of Hawaii increased their unemployment taxes by 1,000 percent. That is not an environment to increase job creation.

Ms. BLACK. What was the number on the unemployment tax increase? I mean, was it some fraction that went up?

Mr. RYS. Well, Hawaii is kind of an odd state because they have had some changes in their unemployment system, but the percent overall is somewhere around 100 percent. But we have seen Maryland announce that they are going to increase their taxes. Maryland is on a schedule. They go from a Schedule A to a Schedule F. They were on Schedule B this year. They are going to move to Schedule F next year to try to replenish their trust fund.

We have got to figure out a way to try to deal with it. I mean, we have got to make sure these unemployment benefits are available, but the people that are paying those benefits are small business owners. So the same people we are saying create a job are the people that are paying for these benefits. So, somehow, we have got to come up with a system that is going to work to address that issue, especially when we are going through such a rough economic patch.

But in terms of the individual rates, it is very important that those are extended and done quickly, being that they expire at the end of next year, for planning purposes. This should just be across the board. You know, we have heard this $250,000 number. We have done some surveys. We have done some research on this. We have asked business owners, how much money do you make, and when we ask business owners with 20 to 250 employees, more than 30 percent of those business owners made $250,000. Those businesses account for more than one-quarter of the American workforce, 28 percent. Between 2001 and 2006, those businesses created two million jobs. If you want to create jobs, make sure those tax rates stay low.

Ms. BRUMFIELD. Well, we will take a moment. Senator Landrieu has just arrived and we would like to have her opening statement.

Chair LANDRIEU. Were you in the middle of anything?

Ms. BRUMFIELD. We were just——

Chair LANDRIEU. Go ahead and continue.

Ms. BRUMFIELD. Okay. I think, Keith, you were next.

Mr. HALL. Thank you. I do agree with these guys, and I know it is very complicated. With all due respect to France and Germany, I would not trade places where I live. Obviously, it is expensive and it is complicated to maintain all the services that this country provides for us, and I am proud, and I know we all have to pay our fair share.

I guess that is the point I want to make as it relates to small businesses, because the individual tax rates—we are talking about pass-throughs—most small businesses, particularly the micro business owners, pay their tax at the individual level. Allowing those provisions to sunset, to go back to a different set of rates, represents a tax increase on small businesses because that is where they pay their taxes.

And I think the idea for small business, the request is, just let small business be on the same playing field with big businesses. Allowing most of these provisions to sunset—we talked about that

AMT provision sunsetting. That is only going to affect the smallest people, not the richer people. The access to the Section 179 deduction, bonus depreciation, all those things provide timing for cash flow investments into small business. The people who have the most difficulty with their cash flow management and determining whether or not to invest in their business are the smallest businesses. Access to capital, decreasing some of the hurdles to getting new capital. Most of those things affect the bigger businesses, not the small businesses.

So allowing all of these things to expire really just continues to be an inequity as it relates to small business compared to big business, and I think that is the key to the individual rates, because that is where we pay our taxes.

Ms. BRUMFIELD. We have a—I am sorry.

Mr. KOENIG. As I mentioned at the outset, representing the restaurant industries, seven out of ten restaurants are single-unit operators, which means we clearly are an industry of small businesses. To the issue that Kathleen asked about, individual rates, clearly, we are hearing from our restaurateurs and entrepreneurs about the uncertainty with regard to the expiration of the individual rates. But again, that almost looks like a long-term problem for them vis-a-vis the expiring tax provisions coming up by the end of the month.

Things of importance for the restaurant industry, which I see we will talk about later, include Section 179, and even more significant than that, a provision on 15-year depreciation for restaurants, retail, and leasehold improvements. If that is allowed to expire at the end of December, we revert back to a 39-year schedule, which in reality just does not measure the economic benefits of putting up a new restaurant. So the rates are very important and we hear about that from our members from a planning standpoint. Obviously, if we can get through being able to extend some of these important provisions that are expiring at the end of 2009, hopefully, we will be able to do the same on the rates in 2010.

Ms. BLACK. Matthew has a follow-up before we move on.

Mr. BERGER. I just wanted to ask about the House's proposal to raise the top marginal tax rate by 5.4 percent to pay for their version of health care legislation. Combined with the expiration of the 2001 tax cuts, that would take the top marginal rate up by 28.7 percent, from the current 35 percent to 45 percent. While it is not clear that this will occur, because there are miles to go before we get to a conference report on the health care legislation, with a 10.2 percent unemployment rate and unemployment expected to be very high for at least the next couple years, what would that do to job creation? Put another way, how would that affect a business on the ground? Drew. Bill.

Mr. GREENBLATT. It is very bad. We compete with——

[Laughter.]

Germany and France and their tax rates are lower than my tax rate. So when I export to Europe or when I export to Asia, I am competing against very ruthless competition who has very low prices. So when you raise my taxes high, I win less jobs. When you cut my taxes, I win more jobs. I have a factory in Baltimore City. I make everything in Baltimore City. If you help me be more com-

petitive, I am going to hire more people in Baltimore City and unemployment will go down and the economy will get stronger. By raising the burden for me, it is very challenging for me to beat the Germans or to beat the Japanese, and I want to.

[Laughter.]

Ms. CALIMAFDE. Could you be a little clearer for us?

[Laughter.]

Mr. BERGER. Bill.

Mr. RYS. I am going to take a little different position than what Mr. Greenblatt did. It is very, very bad, because it isn't just——

[Laughter.]

It is not just the Federal rate and it is not just that 5.4 percent surtax. It is your state taxes. It is your local taxes. It is your property taxes. It is the payroll taxes, the unemployment insurance. You start stacking those and we are starting to talk about an effective tax rate on a pass-through business that is pushing towards 60 percent. That is confiscatory. That is not good tax policy.

And to get to the point of international competition, as well, we have heard this about the—especially in regards to the lower corporate tax rate, reducing it to 25 percent to be more on par with other countries, you know, the second-highest corporate tax rate in the country—but think about what kind of disparity you create if you have a 25 percent corporate rate and a 40 percent or higher individual rate. You are basically telling the successful pass-through business that you are going to pay ten percent more—or more when you start stacking on state taxes and payroll taxes—than what a C Corporation is going to pay. That puts those small businesses in an unfair advantage.

There has been tremendous growth in things like S Corporations and pass-through businesses. In 1978, there were a half-a-million S Corporations and partnerships. There are now three million. We tax more business income at the individual level than we do at the corporate level. A lot of businesses run through those corporate levels.

If you had that kind of disparity in the rates, you are also creating a new planning nightmare, just as we talked about complexity. There was a provision in the code called 341(e), a collapsible corporation. When we talk about complexity, there was a sentence in Section 341(e) that was twice as long as the Gettysburg Address.

[Laughter.]

If you have tax rates that are that disparate between the two, you are going to go back to having to come up and plan that way and come up with 341(e) again to make sure that we don't have that type of planning, dumping the money into a corporation to avoid the higher individual rates. We don't need a tax provision twice as long as the Gettysburg Address.

Mr. HALL. We may be overbudget on the "very"s in front of bad, so I won't use it, but obviously, increasing tax rates make it more difficult to invest in your business. It obviously takes cash flow out from other options, whether that be new infrastructure, new business, or new jobs. So of course, increasing tax rates like that are going to make it more difficult to create jobs, except maybe with the IRS enforcement staff. They could have more jobs there.

The thing that I want to keep reiterating, though, again, I recognize that it is a tough job you guys have in allocating what we are going to pay for and then how to pay for it. That is extremely complicated. Nobody is going to stand up and say, I am for a 45 percent marginal tax rate. But there are choices out there that we are going to have to make and figure out how to pay for it.

The NASE always points out that let us do what we need to do and let us pay for it, but let us make sure that it is fair. One of the things we like to talk about is the equity for our small business—I forget the name of it, but it is S. 725, which basically allows the small guy to deduct their health insurance premiums. Expanding the definition of employee under HRA plans. If we are going to put this health care out there, basically mandate that people have the coverage, the request is, at least let everyone have the opportunity to pay for their premiums pretax, and I think that goes back to if we are going to have to increase taxes, if we are going to have to pay for things, let us at least have the level playing field for small business so that we can have the same opportunity as big businesses do.

Ms. CALIMAFDE. Well, when Keith just said, allowing small business owners to be treated as employees, I couldn't let it go without bringing up the cafeteria plan proposal, where in cafeteria plans, right now, small business owners, whether they are LLC members, partners, Sub-S stock holders, are not allowed to participate in a cafeteria plan, which means that only the larger entities get to provide these really good benefits. A cafeteria plan in the government, you all know what it does. Everybody gets to have one but small business. The smallest of the small businesses does not get to have a cafeteria plan. It makes no sense, particularly when a lot of the state laws are now mandating companies to have cafeteria plans. So I just wanted to jump on what you were saying, and it goes all the way to cafeteria plans, as well.

Ms. BLACK. And that is one thing that we have begun to address in the Senate health care bill. There are a couple of glitches that we are still working through on technical drafting with respect to this issue, but it is something that I know Senator Snowe has worked on at the Senate Finance Committee, and we, as staff, are continuing to work on as we move forward with the health care reform bill.

Ms. CALIMAFDE. I think Senator Snowe has done such a tremendous job in this area, but as you know, there seems to be this thought that small business owners are somehow going to treat a cafeteria plan different than everyone else, which is just—you know, to keep running into this kind of—it is almost discrimination against small business owners, I think, in the tax code, and I don't understand it.

Chair LANDRIEU. Let me just say, that is why we are here, to try to fix as much as we can. We are making great efforts in the health care bill on the table with the help of Senator Snowe to provide robust exchanges and tax credits for health care, because it is one of the issues besides high taxes.

Please explain a little bit more to me about the cafeteria plans and why this has not come up in any of the health care discussions—and maybe it has. Maybe the staff can clarify it. You are

talking about health care benefits for small business. There is a tax provision in this for the smallest of businesses, 25 employees or less. That would be the very small businesses. They are going to get 35 percent off the top in addition to your deduction cost against any health care cost that you would provide. Is that not covering your concern?

Ms. CALIMAFDE. No. Do you want me to answer, Kathleen, or——

Ms. BLACK. Yes, go ahead.

Ms. CALIMAFDE. Okay. You know, the cafeteria plan, I don't know what it is called in the government. What is the name of it? It is the plan where you are allowed to pick and choose between benefits. So if you need more disability, you pick that up. If you need more life insurance, you pick that up. There is usually a Flexible Health Care Spending Account. There may be a Dependent Care Account. So that is under this umbrella cafeteria plan.

Ms. BLACK. At the Federal level, we have got the Federal Thrift Savings Plan, but it is a la carte. It is not really a cafeteria plan in that sense.

Ms. CALIMAFDE. Right. Okay.

Chair LANDRIEU. We don't have a cafeteria. I mean, I am sitting here thinking——

Ms. BLACK. Correct.

Chair LANDRIEU [continuing]. Do I have one——

Ms. BLACK. No.

Chair LANDRIEU [continuing]. And not know about it?

[Laughter.]

I don't think we do.

Ms. BLACK. No.

Chair LANDRIEU. That is what I am saying. I mean, we have a health insurance plan, which is called the Federal Employees Health Benefit Plan.

Ms. BLACK. Yes.

Chair LANDRIEU. And Federal employees in every state have choices, which is what we are trying to accomplish in this health care bill, to provide every small business in America with those same choices, is the idea of this bill. I do know that New York has the most choices, of 34 plans, and Rhode Island has the least number of choices at 14 plans.

So our vision on this health care bill, which looks likely to pass before Christmas, is going to hopefully provide that same sort of opportunity in every state. And if you are a small business of 25 people or less, which is the smallest of the small, we are working right now with Senator Snowe to substantially increase the credit that came out of the Finance Committee on the Senate side. Whether we can achieve that or not, I don't know.

Ms. CALIMAFDE. Senator, what you are talking about——

Chair LANDRIEU. So tell me about——

Ms. CALIMAFDE [continuing]. Is like the huge part of the health care bill and is critically important, and having choices for small business with different insurance companies, insurance reform is critical. The SBCA, for instance, is not in favor of the public option. There are certain things in that bill that get us incredibly nervous.

But we are talking about a piece of that bill. For instance, as a Federal employee, if you don't—does the government pay for the entire health insurance premium?

Ms. BLACK. No.

Chair LANDRIEU. No.

Ms. CALIMAFDE. So the portion that you pay, is that pretax?

Ms. BLACK. Sure.

Ms. CALIMAFDE. Well, then that is your cafeteria plan, and it is that piece that is—for a small business owner, it is not allowed——

Chair LANDRIEU. Paying that piece pretax is what the equity would be?

Ms. CALIMAFDE. That is part of the cafeteria plan and owners are not allowed to——

Chair LANDRIEU. I am going to ask the staff, since this bill is still open. I am going to ask the staff to gather—the joint staff here to help present an idea to Senator Snowe and I that we could get that fixed potentially in this health care bill.

Ms. CALIMAFDE. That would be great.

Chair LANDRIEU. We would like to do that, if we can, because once this bill closes—not that there won't be other health care bills that will allow us to address it—but while we are at it, if you all think this is a big issue, maybe we can take care of this now.

Let us go to Ms. Stewart.

Ms. STEWART. Yes, and in addition to that, too, one thing that you probably should look at in the health care, when it talks about tax credits, as an S Corporation, there are different rules there and when you can take a dollar-for-dollar tax credit versus a C Corporation. And so it may look like if they—with the bill, it may look like it is going to be good for us to be mandated to have these health care plans, but as an S Corporation, I may not get the same benefit as the C Corporations do. So I think that is something that you need to look into, as well.

And again, that goes to the parity issue. As a planner, I have to take a lot of time with my clients to decide if we want to be an S Corporation, if we want to be a C Corporation. We have always gone the S Corporation route because it has been easier for us from a tax perspective. Obviously, if the tax rate is going up, that is not going to be the case. So what that means is they go back to being a C Corporation, which means double tax returns and more expense. Yes, there are good things about the S Corporations because of the benefits that we can get, but if we could have that available to the S Corporations, I think that would solve a whole lot of problems for us as small businesses.

Chair LANDRIEU. The one thing, and then I would like to go to this side for the next question, is the concept of, or part of what is driving this health care bill is based on the testimony of small businesses, is not to put an employer mandate, but to have in its stead an individual responsibility for individuals in the country to have health insurance, because if we don't get more people into the pool, those businesses that do provide insurance just keep paying more and more and more. So the idea is to push as many people into insurance and try to make it as affordable as possible for individuals and small businesses so that you are not out there in a dog-eat-dog market, which is what you are right now, kind of on

your own as a small business, trying to find quality plans that are out of reach and very expensive. That is sort of the concept.

But I am going to ask the staff to look at the differences based on that between S Corporations and C Corporations and see if in some of the amendments that we are filing we couldn't sharpen that up a little bit.

Was it your turn for questions?

Ms. BRUMFIELD. Sure. In the interest of time, we would like to move on to another topic. I think everyone who just spoke in this round mentioned something about planning. So we would like to talk about estate planning and the effects of extending the current rates and exemptions temporarily versus permanently and what effect that would have on small businesses.

Chair LANDRIEU. Nikki, we will get you first.

Ms. STEWART. Again, as I said earlier, as a planner, and I have been doing this for 25-plus years, it is not easy to try to plan for estates with my clients, high-net-worth individuals, because we never—at least for now, we don't know what that rate is going to be. Do we get life insurance to cover it? Do we do all kinds of trusts? What do we do?

I think that, in general, for us as a planning community, it would be a lot easier if we decided to make it a $3.5 million exemption. Then let us make it that and let us leave it at that, because that way, we can plan for 5-, 10-, 15-year dynasties with the families. Otherwise, there is no way that we can decide every year how much life insurance to buy, what kind of trusts. It gets into a lot more complex issues.

So, personally, I don't think—repealing it would be great. I don't think that is going to happen. I do think that we should come to a level that we can all agree on and let us leave it at that and have some consistency.

Chair LANDRIEU. Does anybody else agree or disagree? Go ahead.

Ms. CALIMAFDE. The SBCA largely agrees with that. We had hoped that we could deliver the 30-second sound bite, "repeal estate taxes," which sounds good, and it is much sexier when you get to "kill the death tax." That is really great.

Unfortunately, we have about 100 experts in our organization that actually read tax laws and read tax regulations which causes us not to be able to say the 30-second sound bite, and the reason why is that, when we discovered that carryover basis came into the fore when you repeal estate tax and you lost step-up in basis, and the amount of carryover basis and step-up basis that came in with repeal, we found that, in our estimation, many, many small businesses were better off under the 2009 estate tax law than they would be under repeal. And I think the numbers have now come out to about 70,000 small businesses fall in that category.

Unless you know what a step-up in basis is and a carryover basis and what the estate tax exemption means, it is just mumbo-jumbo. If you know that, you can hone in on it, and what it really means is if a small business owner today has $3.5 million of assets when he or she dies, there is no estate tax and the heirs receive that entire $3.5 million of assets with a step-up basis, which means they get it valued as of date of death. If there is a spouse, that num-

ber—if there is proper estate planning, that number comes up to $7 million.

So you would say, well, repeal should be repealed, except it was written so that carryover basis came in, which meant when an heir received the assets, they received the assets at the value that the owner, the cedent, actually had those assets. So if you are dealing with an 85-year-old, let us say, gentleman who has a dry cleaning store and he has owned it for 50 or 60 years, now somebody has to figure out, well, what did he pay for that dry cleaning store?

And assuming anybody could even find those records—and by the way, this repeal of step-up happened a long time ago and never even came into law because estate planners throughout the country were saying, this is impossible. So by 1980, it was already repealed. So we have gone down this road. We know it doesn't work, but here we are again.

Chair LANDRIEU. I don't think we are going to propose that.

Ms. CALIMAFDE. Good. Good.

[Laughter.]

So it——

Ms. BLACK. Those who don't remember the past are condemned to repeat it.

Ms. CALIMAFDE. Yes——

Chair LANDRIEU. Kent Conrad reminds us enough, so it is not going anywhere.

Ms. CALIMAFDE. Good. Well, I actually have some comments out on the table and it really sets out that a single person with assets of more than $1.3 million and less than $3.5 million is actually better off with extending the 2009 estate tax law permanently. And in the case of a couple, it would be those with assets of up to $4.3 million and less than $7 million do better with the 2009 estate tax law. And those numbers encompass a huge amount of small business owners.

So that is why, when we actually went to the law and read it and were actually shocked to find out what had happened with the carryover basis and the step-up in basis, we are definitely in favor of 2009 extending permanently. But if we had our druthers, that is what we would want this year. Next year, we would want to come back and say, let us bring that $3.5 million and index it. Let us put in portability. Let us strengthen 6166. Let us reunify gift and estate tax. There is a lot more to do, but it is not going to be done on December 3.

If nothing is done, we end up with repeal and then a horrible situation in 2011 with a $1 million exemption. And if you do a one-year extension, we are back to the problem Nikki is talking about where planning—everybody—all these small business owners have to keep this cadre of estate planning attorneys going on, which is just a waste of resources.

Chair LANDRIEU. First of all, let me just comment. I think we are going to be able to work through this over the next year or year and a half. Our problem is we have to come up with something pretty quickly, before the end of this year.

So if you all can—all these comments are wonderful and I really do want to get Bill and Drew to comment on this, but as simply as we could fix it for the next year and then we could come back

and try to do a permanent, very simple, clear fix, so everybody can forward for the next several years or decades understanding what the liability is going to be.

Bill.

Mr. RYS. Well, you know, at NFIB, we have always supported full repeal as the best solution. But short of that, we have supported something along the lines of the Lincoln-Kyl Amendment that was in the budget last year, which was a $5 million exemption and a 35 percent rate. We think that is fairly generous, provides a substantial amount of protection.

But in terms of permanency or certainty, that is a very important thing to keep in mind with this because of the constant need to plan, and as Paula said, the issue of stepped-up versus carryover basis is very important, and I will spare the history lesson, which was 1976. It was repealed in 1978, before it ever got put in place.

But when you think about business, we have a member who I talked to yesterday. They own a farming business out in California. They bought another business in 1971 and that business was started in 1852. There have been a few transactions in the last 157 years. I would assume that it would be difficult to track the basis of those assets, so carryover basis does become difficult, especially when you get to an older business like that.

Chair LANDRIEU. Drew.

Mr. GREENBLATT. This tax is not right. Every year, we pay 35 percent, year in, year out. If I own the company for 20 or 30 years, I will be paying 35 percent year in, year out. And then, when I die, my family has to pay whatever the number is, 40, 50 percent. This is patently wrong. We shouldn't have this tax.

So how do we handle it? We have it now. How do we handle it? Well, we pay premiums. We hire an insurance company. We make an insurance company rich because I don't want to give my wife a $1 million or $2 million tax bill the day I die. I mean, the day I die, hopefully, that will be the biggest issue. But the second biggest issue——

[Laughter.]

Chair LANDRIEU. She might miss you, you know. Might.

Mr. GREENBLATT. So to defend my wife, I have to pay premiums, and I am making an insurance company rich. I am not hiring people in Baltimore City. So this is counterproductive. It is not good for our economy.

Chair LANDRIEU. Okay. Can I take this moment to turn this over to this team for the next question, but to thank you all very much. I am sorry I was a little bit delayed. I had a meeting that went a little over and then a blockage out on the street, which happens occasionally around here. But anyway, I have got to slip out for another meeting, but this will continue until 11:30.

I am very pleased, as the Chair of the committee, to continue, I think, the tradition that Senator Snowe and Senator Kerry both used, to have these informal roundtables to really provide voice for small business. That does really get overlooked, I think, in many instances, sometimes intentionally and sometimes not.

We want to give voice to small business, so as we move to the end of this year for the tax extension, we can give as much relief as possible. And as we look forward to building out of this reces-

sion, we can develop policies that really support and honor the entrepreneurial spirit of these small businesses, of all of you and the people that you represent, the people that we represent, as well.

So I am going to slip out and leave you in the good hands of these very able staffers, and I thank all of you very much.

Ms. BLACK. We will do one more final wrap-up on estate tax and then we will perhaps move on, unless anybody else wants to keep going on estate tax for a little bit.

Ms. CALIMAFDE. Well, I just wanted to mention, Drew, if it is any consolation, you get $7 million under the 2009 estate tax law free of any estate tax. So you might get hit with state estate tax, but at least you get $7 million off the top before you get hit with a dollar of estate tax.

But what I wanted to say was if the choice which I think this year this choice is, a permanent extension of 2009 or a one-year extension of 2009, the permanent extension is only about 8,000-trillion times better than a one-year extension. The one-year extension just sets us up for another fight next year. It sets us up for the 2011 $1 million, 55 percent tax rate with a little five percent bubble sitting in there, so you actually get to 60 percent at some point.

I mean, to me, it is like if there is anything that you all can do to help us get a permanent 2009 estate tax level this year, it would be fabulous, and then let us put in the good fight next year, but at least start with the 3.5 and the 45 percent tax rate rather than running into 2011, where we are going to be fighting against a $1 million, 55 percent tax rate.

Ms. BLACK. Dave.

Mr. KOENIG. I would just say briefly that, as we know, the House is going to take up permanent extension of the estate tax today and likely pass with the parameters of the $3.5 million exemption and a 45 percent rate. While we all agree that a permanent solution is necessary, I know from our organization's standpoint, and I know there is a lot of support in the Senate and even among some members of the House, I would argue that if you are going to do either a permanent or one-year extension, that a better alternative would be the 35 percent rate and the $5 million exemption that has been discussed.

Ms. STEWART. Just one more last comment. Something that Paula said that I didn't speak to, which is very key, is the step-up versus carryover. I can tell you, with my experience, it was an absolute nightmare to go back and try to find what cost basis is on all kinds of things. So just for what that is worth.

And also, I do also agree with her that I think it should be a permanent $3.5 million exemption rather than going to a one-year and then having to start all over again.

Ms. BLACK. And just so that we have this on the record, which then gives us ammunition as we are going out and discussing these issues with our colleagues and our bosses are working with their colleagues, for the nightmare that is a carryover basis situation, if you can't prove what your basis is in a business, what ends up happening? What basis does the inheritor of a business receive?

Ms. CALIMAFDE. Zero.

Ms. BLACK. And you get taxed on the entire amount.

Ms. STEWART. And that is just not fair. I mean, that absolutely—so, yes, you are correct. It would be a zero.

Ms. BLACK. And it is——

Mr. GREENBLATT. And high legal fees.

Ms. BLACK. And huge legal and accounting fees for doing some sort of forensic accounting of what this was worth so that you can try to prove the price for which dear old Granddad bought the business.

Ms. STEWART. And that is a very good point, because what happens is you end up spending so much time and paying so many people to go back through and find all this stuff, and all the legal fees and everything else, the government and everybody else is a lot better off just taking it as a step-up, because it is a lot easier to track from there forward.

Ms. CALIMAFDE. The burden is on the taxpayer to prove basis, and that is why, when repeal went through, it sounded terrific, and it wasn't until folks really read the law that they realized that carryover had taken the place of the step-up.

Ms. BLACK. Right.

Mr. HALL. And obviously, it is complicated. I mean, regardless of where you go, it is still complicated. And to Drew's point, I think the main issue here is providing a permanent answer so that people can plan. If you are covering your potential liability with a health insurance policy and then we wake up one year with dramatically different levels, then do you have to go back and change what your whole plan is? Are we going to have to redo that every year? So providing—regardless of 45 or 35, $5 million or $3.5 million, I think the key is a solution that puts people in a position to be able to plan.

Ms. BLACK. Thank you. It is fabulous to have all of that out there on record, because I don't know that we have had this examination of what is carryover versus stepped-up and it is really important for us to have had this on record.

Mr. BERGER. The only other question I had as we consider the estate tax pertains to marriage and the exemption level. We had a hearing in the Finance Committee not that long ago, and one of the issues that was discussed is what about just making it a straight-up $7 million exemption or a straight-up $10 million exemption so that people don't have to go through the rigmarole of when one spouse dies, then you get the next $3.5 or the next $5 million, down the line. Is that something that is important as you plan, or are other things more critical?

Ms. BRUMFIELD. Paula?

Ms. CALIMAFDE. I just wanted to give someone else a chance. Are you talking about the portability provision——

Mr. BERGER. Yes.

Ms. CALIMAFDE [continuing]. Which is really a great provision. The portability provision would—let us use $3.5 million, but I am hoping one day it will be $5 million, but let us say it is $3.5 million. Each spouse has their own $3.5 million, and if the first spouse doesn't use up all their $3.5 million, the surviving spouse gets to keep whatever they didn't use and apply it to the estate tax assets.

What it really means is that you don't have to have proper estate tax planning, and it means that, if you didn't end up with an ex-

emption trust or a bypass trust in your will, you didn't lose the entire tax credit exemption amount on the first spouse's death. So it is a terrific provision. I was surprised to hear that it has not been deemed much of a revenue loser. I don't know how we got to those numbers, but I was glad to hear that. A terrific provision.

By the way, reunifying gift and estate tax system is really important, as well, because right now, in anticipation of repeal, they pushed the systems apart and you can only make a gift up to $1 million during lifetime, even though you can give away $3.5 million at death, and a lot of small business owners like to give the business away to children during their lifetime rather than waiting until death. So it is an artificial provision and it really is not needed if you don't go to repeal.

Ms. BLACK. Or—and I would love to hear from Mr. Fletcher on this point—it is not just the owner who might give it to children, but an owner giving it to the employees.

Ms. CALIMAFDE. That is absolutely right.

Ms. BLACK. Can you speak to that issue?

Mr. FLETCHER. Yes, I can try.

Ms. BLACK. Okay.

Mr. FLETCHER. Right now, an owner can sell his business to an ESOP and get some tax benefits. But if he is an S Corporation owner, he can't do that, and so that is a problem. There is a bill that has been introduced to fix that, I believe, that would be helpful in that regard.

But what I wanted to speak about was really the consistency part of it and simplicity, because a lot of these small business owners are tied up trying to make a buck. By the time they get down the road that estate planning becomes an issue, they have got a real problem to deal with and they have to do a lot of structuring costs around rearranging the ownership and so forth to try to accommodate that. So if you can make it simpler, it would be a lot easier for them.

Ms. BLACK. Okay.

Mr. RYS. Real quick, I mean, one other thing to keep in mind in this is that the assets that the business is talking about, too, aren't liquid assets. So you are talking about the assets of the business. And when we are talking about the exemption and we are talking about what those rates are and how you plan around it, I mean, if you still get hit with it, it is on the value of the business. So something has to give to pay the tax then. So some of this is an issue of lost productivity when you get to the point of the tax. So we do need to make sure that protection is there.

You know, with the House considering this bill today, it is not indexed for inflation, again, another little AMT time bomb. That is something that ought to be looked at as it is coming back to the Senate, because if this gets tied up next year, and as policy, I think next year we want to definitely push for something more along the lines—I know at least for us, more along the lines of a Lincoln-Kyl type proposal, which does provide more relief and more protection and a bigger exemption and a lower rate. But short of that, if we have got some time on our hands—I mean, it is not really a permanent solution. It is not tied for inflation, because it is changing

every year because inflation is going to change. Who knows where inflation is in a year.

Mr. BERGER. Bill, you actually make a great point on the illiquid assets piece. The current tax code allows certain small businesses to stretch out their payment period. Are those rules something we should look at, too, as we consider the estate tax, or is the panel comfortable with the way those rules are currently constituted?

Ms. CALIMAFDE. I think you are referring to 6166 there——

Mr. BERGER. Yes.

Ms. CALIMAFDE [continuing]. And they need to be straightened up and strengthened, as well. And I think—actually, I believe the Senate Finance Committee had hearings on——

Mr. BERGER. We did.

Ms. CALIMAFDE [continuing]. And I think the 6166 issue was dealt with really well at those hearings, if I recall correctly. But definitely something to look at.

You all may remember the thing called the QFOB, or the Qualified Family-Owned Business. That was an attempt to try to allow small business assets to be exempt from estate tax. But the thing was so complicated, and it suffered, in our opinion, from one huge flaw, which was you didn't know if you made it until you died, which is a terrible way to plan.

So actually John Satagaj, who is over at the Small Business Legislative Counsel, and myself and I know a number of us in the room have tried to come up with some kind of exemption for small business and we just have not been able to do it. So our idea is get the exemption level high enough that you have effectively repealed estate taxes for small business.

Mr. RYS. If I could—I am sorry. It is a business continuity issue, as well. I mean, we want that business. If the son is working in the business, we want that business to stay in the family. We want that to be passed on. That is a smart and resourceful use of resources in this country, and we do it at the corporate level on reorganizations of corporations. We have a whole system set up. They are much more complicated.

I am not suggesting that at all for small business. But making sure that the estate—I mean, the estate tax is sort of the similar side to this. If I decide I want to acquire a larger corporation, I can do that in any number—I can do that, I think, seven different ways and it is a tax-free reorganization. But if I pass the business on to my son, you know, that is not the same situation. So we need to make sure that we have a high enough exemption and we make these planning issues as simple as possible. Short of the tax going away, and I understand the basis issues there, if there is going to be a tax, it shouldn't be something that small business owners have to stay up at night worrying about.

Ms. STEWART. And one more comment on that, as well. The 6166, as everyone is talking about, as well, I do believe that it needs to be strengthened. In addition, small business owners, a lot of all of our assets are in our business. So, again, if it is illiquid and that is what we own, then we need to have some kind of a provision to stretch that out, and 6166, I know, exists, but it does need to be strengthened.

Mr. BERGER. Okay.

Ms. BLACK. Move on to cash flow?

Ms. BRUMFIELD. Sure.

Ms. BLACK. Do you want to start with cash flow?

Mr. BERGER. I just wanted to start the cash flow discussion with Section 179 expensing. On Tuesday, Senator Snowe and Senator Landrieu introduced legislation to extend the Section 179 expensing rules at the $250,000 level permanently, because people need certainty with how much they can expense rather than depreciate.

So my first question to the panel is, do we think that $250,000 is an appropriate level and that it should be made permanent? And part two is, wouldn't levels of investment be lower than they otherwise might be if we let Section 179 fall to $134,000 next year and $25,000 in 2011? And what would the impact of job creation and the overall investment be?

Ms. BRUMFIELD. Any questions?

Mr. HALL. Well, certainly, it would have an impact. This is similar to increase in tax rates we talked about before and it is a cash flow issue. Particularly for small business, it is timing. We are not talking about changing the deduction for an investment in total. We are just moving that investment up to the year of purchase. It is true matching of the investment with the tax benefits which provides financing.

And particularly when you are a small business, even today more than ever, access to capital, financing options are difficult. And if you have a less amount of tax incentive to provide that cash investment, then you are going to have to borrow more money to be able to make that investment in your business, hopefully which increases the number of jobs you have. So decreasing that provision certainly is going to affect somebody's ability to manage the cash flow for an investment, therefore, manage the growth of their jobs.

And back to the same thing we have talked about before, providing some certainty to people so they can plan where they are going, I think is critical. So I think it is definitely a mistake to allow these things to go back to previous levels, and the only thing that can happen is more difficult decisions in investing in the business and lower jobs.

Ms. BLACK. Drew.

Mr. GREENBLATT. This is an important issue because it makes us more efficient. I compete with China, where they pay 30 cents an hour. My guys get paid $20 an hour with health care, 401(k). So the only way I can beat China is if we are more efficient, and the way we get more efficient is if we buy more robots. We have about 15, 17 robots in our factory and the quarter-million dollar expensing is about one robot. So it is not a lot of money. If it could be a half-million or a million bucks, we could invest in more robots and we could fight the Chinese better.

So it is very good for us to have very high expensing so that we can invest more so that our guys are protected, because when we are efficient, we are more viable and we have a better chance of being prosperous and hiring people.

Ms. BLACK. Bill.

Mr. RYS. It is important to extend this and make it permanent, and again, that certainty is an issue. And especially right now, we have seen business owners really sort of sit on the sidelines, as I

mentioned in our surveys. One of the issues we do ask about our capital expenditures, and again, they are at or near historic lows. So business owners are standing back and waiting to see what the playing field looks like. If this goes away, that is clearly a lost incentive to invest. And again, it is a cash flow problem. One in five small business owners have a regular cash flow problem. That is how they finance their businesses.

So making sure these are extended—and Matthew, to your question about would this reduce investment, it is sort of hard to say. These provisions have only been in place for a while and the tax data sort of lags, but if you look at after Section 179 was first put in place in 2003, if you look at the statistics of income data for sole proprietors for 2003, or for 2004, that was the largest increase in depreciation deductions since 1986. So clearly, something happened there, moving that from $25,000 to $100,000. So similarly, if you start to scale that back, I think you are going to see a retrenchment. I mean, the only thing that may be a positive on that is because business has pulled back so far, they may have to make those investments. But making sure that is available, I think is definitely very important.

One other suggestion I would throw out to take a look at is it is qualified equipment. So we are talking, you know, refrigerators, robots—I would like to have a robot in the office——

[Laughter.]

But it doesn't include real property. And I think as maybe a short-term, a one-year thing, looking at how do we give some additional incentives on real property, whether it is the 15-year depreciation schedule or even maybe something along the lines of Section 179 for real property, as one of our members said to me, he said, I am equipment-ed out. He said, I have all I need, but I would like to replace a roof on our office, and he has to depreciate that. So let us find a way where we can shorten those time schedules, as well.

Ms. BLACK. Mr. Fletcher.

Mr. FLETCHER. This is important for two reasons. One, because it is an important source of capital for businesses that are not liquid and they can't get access to money from the bank. So this is very important because it helps reduce that up-front investment. But it is also important from a planning perspective because everybody that makes an investment looks at paying out dollars today versus the future dollars and they are measuring, they are discounting those. And the larger that up-front investment, the more disinclined they are to make the investment. So this helps reduce that up-front cost so it improves the investment returns and so it facilitates that investment decision and allows them to make the investments to hire more people.

Ms. BLACK. David.

Mr. KOENIG. I would agree with what everyone has said, that clearly, we don't want to go back to pre-$250,000 expensing. So we would certainly support a permanent extension, as you mentioned in the legislation that is introduced for Section 179.

But again, as Bill pointed out, that applies to machinery and equipment as opposed to real property, and certainly from the restaurant industry perspective, the issue of depreciation is critical,

and I know that is on our discussion list and we can talk about it now or if you want to wait on that——

Ms. BLACK. Yes, why don't you keep going.

Mr. KOENIG. Okay.

Ms. BLACK. Cash flow, bring it on.

Mr. KOENIG. Sure. Well, in that case, a critical issue for the restaurant industry, the biggest tax issue that we are fighting right now is the short-term extension of the 15-year depreciation provision, and that provision is for restaurant improvements and new construction in addition to leasehold improvements and retail improvements. You know, just from a realistic standpoint, if you look at the foot traffic in the restaurants in this country, it definitely warrants much less of a depreciation schedule than 39 years. I think everyone would agree to that. And Congress in the last few sessions have made some inroads there and we are at the point where we have got an expiring provision for 15 years for such depreciation.

Just to read a couple of figures to you on how this really impacts cash flow, which I think is really the bottom line here—and I have got this in a statement that I submitted for the record, as well—if you look at the average cost to renovate a so-called quick-serve restaurant, i.e., McDonald's, it is approximately $250,000, and for a full-serve, more fine dining restaurant, it is $500,000. Just using a 24 percent effective marginal tax rate for argument purposes, on the $250,000 expenditure, the annual difference in tax savings between the 15-year and the 39-year schedule is approximately $2,500 per year. For the $500,000 renovation, it is about double that, $5,000. And that is just for renovation.

If you look at costs for new construction or rebuilding, the average costs become $700,000 in the quick-serve category and $1.5 million in fine dining. Those numbers are approximately annual savings of about—and this is cash—$7,000 for the quick-serve and about $15,000 for full-service. And again, it is a time value of money, given the 15-year versus 39-year.

Mr. BERGER. So, David, have you done any modeling in terms of job creation or overall levels of investment? Put another way, if we let this lapse, what happens to your industry?

Mr. KOENIG. Well, in 2007, prior to the onset of the recession, the restaurant industry spent about $10 billion in construction of buildings, and that is the most recent figures that we have. Clearly, with the state of the economy in the last two years, those numbers are down. But if you look at Bureau of Economic Analysis statistics, every dollar that is spent in the construction industry generates an additional $2.39 in spending in the rest of the economy. A million dollars spent in the construction industry creates more than 28 jobs in the overall economy.

So if you translate that into the $10 billion spent by restaurants in 2007, that translates into 280,000 jobs. And again, those are 2007 figures. Clearly, the situation now is markedly different than 2007, which I think really necessitates the need to move forward on extending the 15-year depreciation.

Ms. BLACK. One thing I have always wondered about with restaurants or retail space, but more about restaurants, is with a 39-year depreciation period for renovating either the customer space

or, frankly, the back kitchen space. How many restaurants could pass a health code inspection if you didn't update your space every 39 plus years?

Mr. KOENIG. Well, that is a great point, and obviously, fear not, whether it is the 39 years or 15 years, restaurants are not waiting 39 years to renovate.

Ms. BLACK. I am glad to hear that.

Mr. KOENIG. Our research at the NRA shows that most restaurants remodel and update their buildings every six to eight years, regardless of what the tax treatment is, and that is pretty consistent along all segments of the industry.

Ms. CALIMAFDE. Well, I think that is exactly the problem, is that the depreciation schedule doesn't match up with reality. So you are not allowed to take the proper depreciation based on what is really going on. You know, instead of 39 years, it is really eight years. So the real depreciation schedule should have been eight years, not 39.

Mr. KOENIG. That is right, and with this six- to eight-year renovation—and there is a lot of intricacies, as well, between if you are a franchisee, you may—in your contract, it may be required that you have to make renovations even more frequently than this six- to eight-year period. So this is all going on in the context of, as Paula just stated, a totally unrealistic period of 39 years to write off the costs.

So for us, clearly, as we have talked about the estate tax, we have talked about obviously the rates, and those are critical issues, but at least in the short term, before the end of the year, we certainly hope that Congress will not only extend this provision on depreciation, but extend it seamlessly, because clearly, for planning purposes, we don't want to go beyond 2009 and going into January, February, March, saying, well, we think it is going to be extended but we can't be sure.

Ms. BLACK. And one of the things that in the last couple of years has finally come together for restaurant and retail depreciation issues has been a bit of a conundrum over whether it was a leasehold or an owner-owned restaurant. Can you explain that this is now unified?

Mr. KOENIG. That is correct. This provision for 15-year depreciation, as I said, it is not only for restaurant improvements and new construction, but it is also for leasehold improvements and for retail improvements. Its history goes back, I believe to the 107th Congress, where it was just put in place for leasehold improvements and restaurant improvements, and subsequently, it was extended, as these provisions often are, for a short period. Last year, in 2008, the provision was extended to include not only those improvements, but restaurant construction as well as retail improvements. So it is now under an umbrella. It is going forward as hopefully one expiring provision.

NRA leads a coalition of interests that has expanded beyond the restaurant industry to include, you know, the shopping centers, the construction trades, NFIB, the Real Estate Round Table. So we are unified in the approach of we need to extend this for everybody.

Ms. BLACK. And with respect to leaseholds, for how long do restaurateurs sign their leases? How long are national chain restaurant leases or leases for a pad in a shopping center?

Mr. KOENIG. You know, I don't have the specifics on that. I can certainly get back to you. But I imagine it varies. But I think the point is if they are long-term, you have got to be able to factor in over this period of time—whether long-term be three years, five years, ten years—you have got to factor in what your cash flow is going to be during this period. Without the certainty of provisions like the depreciation provision, you can't do that.

Ms. BRUMFIELD. To follow up with that, and Dave, this will actually cross over into what Jose is here to talk about, the New Markets Tax Credit, let us talk about the up-front barrier, the current financial crisis and the inability to access credit before even deciding to purchase something for the restaurant. Let us talk about the ability to access the credit to make those purchases and, as well, for Jose to have those investments in a New Markets Tax Credit.

Mr. KOENIG. I am happy to address the access to credit issue. I will let Jose handle the New Markets Tax Credit.

We had a witness appear yesterday before the Democratic Policy Committee, and they held a hearing on the issue of access to credit and we had a restaurateur from Chicago, Illinois, Ivan Matsunaga, who owns two Connie's Pizza establishments in Chicago, and he is a very successful businessman. The long and short of it is, he has been mandated under his agreement at one of his properties to make the kind of improvements that we are talking about and he is having a very difficult time in securing financing for the renovations. He is not unique. We hear that at the Restaurant Association every single day. That issue is as significant to us right now as this depreciation issue, maybe even more so from a long-term standpoint.

Clearly, your committee has done a lot. There has been legislation out there to increase the amount of SBA guarantees up to, I believe, $5 million. That is helpful. There has been some talk. I believe Senator Warner had sent a letter to the President not too long ago with about 30 or 33 Senators, asking for possible use of excess TARP funds, about $40 or $50 billion to be pooled together to utilize for small business loans. We are grappling with this as an organization and from our members, and clearly, we are not the only segment of the industry that is.

So I don't know what the simple solution is. I don't think there is one. But until our members feel that they have access to capital, expansion or even holding on to properties is going to be difficult.

Mr. VILLALOBOS. And following up on that, the New Markets Tax Credit has been a very effective tool and has been a credit that has been quickly deployed. Prior to the economic crisis and the credit freeze, the New Markets Tax Credit would quite often partner with traditional financing in a junior position. But since the credit freeze, now the New Markets Tax Credit quite frequently is the sole financing source for the qualifying business in a low-income community.

I mean, to date, over $14.3 billion has been invested in over 2,000 businesses across the country, both urban and rural, and as a result of that $14.3 billion, you are talking about—has been used

to rehabilitate over 68 million square feet of real estate projects, create 210,000 construction jobs, and create or maintain over 45,000 full-time jobs.

So the New Markets Tax Credit really has been a critical piece in the current crisis, as I said, because now it really has become one of the few sources of capital available to low-income communities. I know we always talk about how the small business really drives the economic engine of the U.S., and in the communities we serve with the tax credit, it quite often is the only engine. So it really has been critical to try and address the current crisis.

Like I said, it has been quickly deployed over its short history. The Treasury Department through the CD5 Fund has made available $26 billion in credit authority, and you have applications totaling in excess of $200 billion. So it is a credit that is in high demand, and because of the competitive nature, it is quickly deployed. And even though we are seeing the deployment slow down a little in the current economy, it is still being very quickly deployed and, again, a critical source of capital to low-income communities, and at the end of the day, really having a big impact on small business, either by providing direct financing to them or through creating opportunities, if it is a real estate development where there is space at competitive lease rates, it allows a small business to come in and operate at a profit.

Mr. BERGER. Well, obviously, Jose, we couldn't agree more, which is why Senator Rockefeller and Senator Snowe have introduced legislation to make the credit effective for five more years at a rate of $5 billion per year, as well as solve your AMT problem, and we are very grateful that Senator Landrieu just this week decided to cosponsor, as well, and we hope to get that into an extenders package.

But my question is, often around here, you think you can just wait until the last minute to extend expiring tax provisions, and lots of times the incentives actually expire and we extend them retroactively. How does that impact what you are trying to do on the ground and getting a deal done? And how long of an extension are you looking for to give people some certainty that the New Markets Credit is going to endure?

Mr. VILLALOBOS. Well, I mean, from our perspective, we would love a permanent—but the longer the period for the tax credit, the better in terms of authority, because that allows the organization's community development entities to plan and work with the investor market to know that this credit is going to be around for an extended period of time so that everybody can plan accordingly.

Again, the tax credit is such that there is a competitive application process annually and the CD5 Fund has to be able to prepare for that. The organizations, the community development entities, also have to be able to prepare, build a pipeline, and we are talking about projects that oftentimes take a year or more to come to fruition. So you just can't have these things kind of hanging in limbo, waiting to see whether or not the authority is going to be extended.

So, I mean, we fully support Senators Snowe and Rockefeller to do a $5 billion, and currently, at least in the legislation, there is $3.5 billion. We would fully recommend that it be at minimum $5 billion, which would be the current level. And again, when you are

talking about a credit that you have year in and year out and ask of $20 to $30 billion for what is $5 billion, a $5 billion authority is more than reasonable.

Ms. BLACK. Since we represent the Small Business Committee, I would like to draw out a little more information about the New Markets Credit and an aspect that you had already touched on, which is that these projects create a place where small businesses can find a home to find space. In communities struggling to create jobs, does the New Markets Credit Coalition, or TELACU, have information about jobs created in places where there is not so much opportunity, either in the initial construction of places or once businesses do find a home in these projects?

Mr. VILLALOBOS. Well, like I said, the tax credit, because of its competitive nature, you really—one of the keys to being competitive and receiving an allocation authority is to be able to measure your community impacts. So those are being measured not only before the project, but also over the life of the project or the loan, and we are talking financing, if it is debt, seven year interest-only at interest rates that are roughly—you can find easily at two percent in the marketplace right now or other nonconforming terms. It really is nontraditional, nonconforming, below-market interest.

And so you want to track the jobs. You want to track the wages that the individuals are being—and is the employment coming from the low-income community. So you really look to measure the community impacts, not only the economic, but also the social. What type of service is being provided by the project that is being funded? Is it a health center? Is it a charter school? So it is really across the board in terms of the many needs that an underserved community needs.

Ms. BLACK. A follow-on to that? Mr. Fletcher.

Mr. FLETCHER. My comments really aren't around the New Jobs Credit or the New Markets Credit, but it does have to do with access to credit. And since you brought it up, I would like to interject here, if I could, and it has to do with my company is owned by its employees and it has been that way for about seven or eight years.

One of the issues that we have around access to credit, particularly in these times, is we have got assets that we used to use, but we don't use now. But when we converted to an S Corporation seven or eight years ago, they were appreciated in value over their cost. That subject, when you convert to an S Corporation, that creates what is called a built-in gains tax exposure. If you hold the assets for ten years, you can sell those assets without any sort of tax penalty. But if you sell them within that ten-year period, there is a substantial tax penalty on the S Corporation, which really affects the ability to access capital and to redeploy assets in a more effective and efficient way.

Earlier this year, there was a short-term fix provided that shortened that ten-year holding period to seven years, and that is due to expire next year. And so, when you think about access to credit, the ability for companies like ours and others to redeploy assets—and they can't go out and borrow money, but they can sell assets and get funds that way—this is an important thing for you to consider and would be helpful.

Ms. BRUMFIELD. Thank you.

Ms. BLACK. Thank you. Mr. Hall.

Mr. HALL. Kind of the same thing I would add as it relates to access to credit for the smallest businesses. In order to get a conventional loan, you pretty much have to prove that you don't need it, and that is always a difficult thing. So for micro businesses, they typically finance their business with their own credit cards or their savings or take money out of their retirement plans to invest in their business.

Back to the New Markets Tax Credit, those are typically bigger deals that invest in an underserved community, as they talked about. The good news in those type of projects is that typically then provides other small businesses the opportunity for ancillary businesses. The cleaning shop in the same neighborhood, a little restaurant in the same neighborhood, a sandwich shop, the Starbucks, all of those things grow up around that community, which is the whole point for that investment.

Again, the smallest micro businesses, which represents a vast majority of the small businesses—95 percent of small businesses by count are businesses that are self-employed people or under ten employees. So the New Markets Tax Credit really doesn't, from a practical standpoint, reach down to those people. The small business mom-and-pop shops don't do that type of project. But they do do the Starbucks in that neighborhood.

So providing all of these things together, the bonus depreciation, 15-year, extending the Section 179, all of that goes back to providing access to capital cash flow for the small businesses to then also invest in that same community. There is also a Small Business Jump Start Act that is pending. I think that is S. 1402. A small number—I think we are talking about $5 billion here—but this is increasing the deduction for start-up costs from $5,000 to $10,000. Those are the type of small businesses that are going to support that community reinvestment, and I think all of those things together translate into access to capital for small business and I think it is very important.

Ms. BLACK. Thank you.

Ms. STEWART. On that note, as well, I think that if I can throw in a couple of things about women-owned businesses, when you talk about access to capital and access to credit, a lot of our—even if we are not very, very small businesses, most of us as women have had to use our own personal credit lines and those types of things to fund our businesses. It is very difficult when you go to a bank and the bank asks what your husband does to make sure that you can get the loan, and that is a very, very frequent—it sounds like it is funny, but it is really not.

So just in a general sense, all of these things with the credits, with the 179, all of those things help us tremendously. So not that this is the venue for it, but I think the access to capital issue should be addressed, as well.

Ms. BRUMFIELD. Jose.

Mr. VILLALOBOS. Following up on Keith's comments, the tax period, or, I guess, for the New Markets is seven years, so from an operating business loan or access to capital perspective, it is difficult to make a seven-year interest-only loan to a business that needs a line of credit, working capital, or purchase machinery or

equipment. However, we believe, and we have made recommendations to Treasury to create a safe harbor for community development entities that want to make loans to operating businesses so that if they need to repay that loan or make a term that is more in line with the use of the money, say, machinery and equipment, or needs and should be repaid in five years, that as that principal gets repaid, the investor is not at risk of recapture if the money is not redeployed within 12 months, which is the current requirement. So we do have that recommendation pending before Treasury and we believe they have the ability to do that without a legislative fix.

Ms. BRUMFIELD. Bill.

Mr. RYS. Following up on what Keith said, the start-up deduction, I think, would be very beneficial. It is only $5,000 now. Increasing it to $10,000, as Senator Merkley does, there is a bill in the House that Congressman Kratovil has introduced that would increase it to $20,000. These are the costs you spend before you actually open the doors, the advertising, looking for financing, maybe you have a couple of months advance rent you have to pay. Technically, those aren't your business expenses because you haven't started the business. This lets you take those expenses in the first year. If you have more than $5,000, you can deduct it over 15 years. So it is making it a little bit bigger on the front end. I mean, a start-up business needs the money up front, not in the back, so it is very important to do that.

In terms of the credit issue, one issue, and it is especially difficult, is housing and the real estate market. We have done some surveys and we have found just how many small business owners use their mortgages as financing, as part of their business financing, and really that shuffling of personal assets with the business assets, especially when it comes to their homes and how many of those could be underwater right now because of what we see in the housing market. Clearly, it is having a real impact on the viability of businesses to be able to get credit.

As I said, we have done this monthly survey of business owners. Oh, and I should say, on credit, we are actually in the process of doing some research on that, so we should have some new, interesting stuff soon.

Ms. BLACK. Which credit?

Mr. RYS. Just access to credit. When we do these monthly surveys, we ask about the problems of credit, and the one thing that is still sticking out is this lost sales. While credit is certainly a problem and definitely needs to be addressed, we also need to make sure that the balance sheets of these businesses are looking stronger, and that is a much bigger overall economic issue. But until those balance sheets come back, some of these businesses are going to have a harder and harder time getting that credit because it is going to be harder for the banks who are getting squeezed by the regulators to not make a loan that may come back to haunt them later.

So we are kind of stuck in a vicious cycle here and we need to find a way out, and so all these pieces sort of have to fit together, and to sort of bring it all back together, the higher these tax rates

go, the worse those balance sheets are going to look, so let us keep that in mind, too.

Ms. BLACK. Did you have one more comment?

Mr. VILLALOBOS. Well, yes. As I said, we found the New Markets Tax Credit to be just wildly successful beyond our initial dreams and we are part of the, I guess, founding New Markets Tax Credit Coalition member and really it was critical in terms of how can we get additional long-term capital into low-income communities. That really was kind of the concept of the New Markets Tax Credit and working with the Hill and the White House back in the 1990s to try to get this moving. I am definitely very appreciative of everything Senator Snowe has done to support the New Markets Tax Credit.

But given the current economic climate, we definitely want to make sure that the New Markets Tax Credit continues to be on a level playing field with LIHTC and historic and be able to get that AMT relief, but also try to get clarification from the IRS on the passive activity issue so that we can attract and have a wider pool of investors. Right now, because of the AMT and the possible application of the passive losses, we can't go out to individuals or smaller businesses to be able to take advantage of this tax credit. And like I said, it is huge in terms of the impact it has from an economic perspective and ultimately the social and underserved communities.

Ms. BLACK. Finally, of other specific provisions that are going to expire this year including that—for instance, the R&D credit is one, and there are some energy incentives.

Mr. Greenblatt, do you have any experience with the R&D credit?

Mr. GREENBLATT. The R&D credit is extremely critical for us because we, again, are at a massive disadvantage when we compete with China. So the only way we could beat them is if we are more productive and we have really slick engineering. And the only way you do that is by investing in engineers, designers, people that will come up with novel inventions that make it beneficial to go with us, because we are never going to win on price. We are only going to win on quality or custom or some really neat design.

When you have the R&D tax credit unsure or flopping all over the place, we don't have comfort for the investments. And this is the only reason why people come to buy from American companies, is because we have really great ideas. And we need to invest in new research and development all the time, to stay cutting edge, because they are always copying us. If you give us uncertainty in this aspect of business, then it is hard for us to invest in new designers, new software, et cetera.

Mr. BERGER. Drew, apart from the uncertainty, one of the things we keep hearing about from companies is that paperwork burdens make it very hard to make the credit as effective as it could be. Have you guys experienced paperwork issues with the credit?

Mr. GREENBLATT. It is very burdensome and it is very wasteful. To get our initial R&D tax credit was over $9,000, one check for $9,000——

Ms. BLACK. And how much compliance cost?

Mr. GREENBLATT. Well, I mean, every year, every year—my accountant just bundles it, so it is a little bit hard to discern that. My gut is that it is ten percent. It is probably two or three grand a year. It is just so wasteful, okay, because I could spend that money and buy another software station for one of my designers, or I could invest in something that will add values that the customer cares about. The customer doesn't care how much I spend with my accountant.

Mr. BERGER. How do we fix it?

Mr. GREENBLATT. I mean, the vision is that you make everything simpler. I mean, rather than making it—my tax return is, like, 80 or 90 pages long. This is very foolish. I have a simple company and we are a small company. Things should be on a postcard. The way it is done now is a great way to tie us up in knots and we should be the opposite. We should be simple and elegant and reducing everything to its simplest form is critical.

Mr. FLETCHER. Specifically on the cost issue, I can tell you that, not at Appleton but at another company, we had an R&D credit and I think it amounted to about $1 million. We paid over $150,000 to somebody to put together the documentation, and I ended up with a notebook, or two or three notebooks, actually, about this high of——

Mr. GREENBLATT. It's just a total waste.

Mr. FLETCHER [continuing]. Pictures and diagrams and employees' hourly work schedules and the projects that they worked on. So that is what we had in terms of documentation. But worse, that was just the tip of the iceberg, because all my employees had to go out and document what they did every day of the week in terms of R&D projects so that we could try to account for that appropriately to meet the documentation requirements.

Ms. BLACK. Thank you.

Mr. FLETCHER. So it is very inefficient.

Mr. GREENBLATT. And nobody reads this.

Ms. BLACK. Well, unless you get audited, and I don't wish that on anybody.

Ms. CALIMAFDE. I guess I am speaking on the same point but a little bit different, because I definitely agree that the R&D credit, what you have to go through to get it is crazy. But lots of times, things happen over here, and by the time IRS is done with them, they are about 100 times more complicated, and I will throw out an example, which is 409(a) that you all passed because of huge mega-corporations going out of business and the major folks at the top leaving with millions and millions of dollars of nonqualified deferred compensation plans.

Well, most people—then it went over to IRS and IRS sort of went, oh, boy, we get to write tons and tons of regulations about nonqualified deferred compensation plans, and while we are at it, let us extend nonqualified deferred compensation to mean anything that can possibly ever come out after the business closes its doors to an owner, which means that small businesses that don't even know that they are hit by 409(a) are presently in default of 409(a), and this crazy provision, most of the small business advisors don't even know that it applies to their clients.

So there is a smoking gun out there, and I just heard IRS is now going to ramp up their audits on small businesses' compliance with 409(a), and I can tell you, it is an absolute train wreck because I could go around to most small business owners and they would look at me and say, I don't have a nonqualified deferred compensation. They don't. What they have is the ability to get money after they close the doors. That is good enough for 409(a).

So it is the same kind of thing. Even if you do a great job doing the credit, somehow, you have got to—and I don't know the mechanism here, but do it in such a way that IRS then doesn't give us 400 pages of regulations that make it impossible to carry out what should be something fairly simple.

Ms. BRUMFIELD. Yes.

Bill.

Mr. RYS. I can't agree with that more, and whether it is R&D tax credit or a number of other provisions in the code, I think a lot of small business owners may very well be scared away from the R&D tax credit when they see how complicated it is going to be. You may have some very interesting, very good potential out there, but they might walk away from it.

Again, we survey our members all the time, and this isn't just members. This survey was the entire small business population. Tax compliance—the paperwork associated with tax compliance is the most expensive paperwork burden the Federal Government places on small business owners, by far. It is huge. And it is only getting worse.

In the health care bill, we have got this corporate reporting provision which will have small business owners filling out 1099s all year, constantly going back, constantly going forward in terms of trying to figure out, how much did I spend on air travel this year? How much did I spend on restaurants? How much did I spend on telephone services? Business owners are being—and they don't have a finance department. So it is the owner doing this, or in most cases, they just dump it to their accountant and say, give it to me at the end of the year and I will sign it and pay it and whatever, and they move on and they don't know what exactly the cost is. So we really do need to think through those things, especially as they come out of IRS.

Something Paul and I have talked about were the penalties dealing with 6707(a), where if you had a listed transaction, which in many cases was a retirement plan set up for a sole proprietor of a very small, small business, you had to file a form to go with that. But the penalty attached both to the individual form and to the business information return, it is a $100,000 penalty, right, on the individual and $200,000 on the business. So for one year, you have got $300,000 in penalties and you didn't have anywhere near that much in terms of your tax benefit from it. That type of thing needs to be addressed.

Ms. CALIMAFDE. Bill, that is like $300,000 if you are only one member. But, I mean, I have heard of cases where there are, like, three or four children who are minors who have also been caught up to it. So the family is getting a $1 million penalty a year for going into something that they had no idea was a listed transaction, and the promoter never told them it was a listed trans-

action. And then IRS comes in and it turns out that maybe the tax liability is $5,000—and these are real numbers of people out there. And, by the way, this is being targeted to small business almost entirely.

And meanwhile, they have got a $1 million penalty that IRS cannot abate because of the way this was written, and IRS is not crazy about this. They feel really terrible about this situation, because what is happening is you have got small business owners out there, and you can call this a tax issue, but this one has transcended it because you have people who are having heart attacks, families are breaking up because these people haven't made $1 million if you put all of their earnings together for their entire life, and they thought they were doing something that was fine and now they are being held to a standard. So it is bankruptcy, it is financial ruin. I mean, it is a horrible situation, and anything you can do to help out small businesses on 6707(a) is critical.

Mr. RYS. There is a moratorium on moving forward on those penalties until the end of the year, but time is running out, and I know we have heard from members about that. Included in the statute is really no ability to go to court and litigate this without paying the penalty up front, which is just—at $1 million, you just can't do.

Ms. CALIMAFDE. Senator Baucus and Grassley have a bill, but it really doesn't go far enough. It still treats these people, who all they did was didn't disclose something they didn't know about, to a standard where they are deemed to be worse than fraud in the tax area. So it is crazy. But at least it is a start and someone is hearing us.

That wasn't the comment I wanted to make. There was something you had said earlier that really got me, but I forgot already, so——

Ms. BLACK. Mr. Fletcher, there is a tax credit currently in law, an energy provision, and I am wondering if you might chat about that a little while. It is something that Senator Snowe has been very interested in, and that has helped paper companies maintain jobs this year.

Mr. FLETCHER. Thank you for that opportunity. Yes, Appleton and a number of other small paper companies, as well as some large paper companies, have benefitted this year from an alternative fuel mixture credit that was enacted several years ago, or a few years ago, anyway, and that is due to expire at the end of this year. And there has been a lot of discussion around unintended consequences and things of that sort, and yet the paper industry is one of the—was one of the earliest recycling businesses around and it is one of the earliest producers of alternative fuel and continues today to be one of the largest producers of alternative fuel used in its business, both for heat and for electricity, used in its own facility, so they are, like, self-sustaining in the world.

So as a business model, it is something that we all ought to try to support, and yet there are a number of things going on around discussions to extend the Alternative Fuel Mixture Credit in one form or another or some other credits. Because of larger companies that are also able to avail themselves of this credit or these types

of credits, there is some backlash that the smaller companies are inadvertently being made to bear.

So if there is a way to come up with a structure that allows and supports these smaller companies who have problems accessing capital, to afford them the ability to continue to invest in alternative fuel mechanisms to continue to—so it is environmentally friendly, it also makes them to be competitive against the Germans, the Japanese, and the Chinese—increasingly the Chinese sending paper over here—that would be appreciated.

Ms. BRUMFIELD. Jeff, could you speak a little bit about the impact on jobs that your industry has?

Mr. FLETCHER. Yes. For smaller companies, in particular, the way this fuel comes about is that we take wood chips and we soak them in water and chemicals to break the wood apart so that we can take the fiber out and make paper out of it. And then we try to reclaim the chemicals. But then we are left with what is called lignin, and lignin is kind of like glue that holds the fibers together in the wood. Well, that lignin, we recover the chemicals by burning the lignin and the chemicals drop to the bottom of the furnace and the lignin—the heat that we produce produces steam that we pump into the paper machine and it dries the paper. So it is a very interesting, unique, closed-loop process.

So we have been getting a credit for burning these lignins and producing steam, and in some cases, you take the steam and further on produce electricity that you can use to power other aspects of the mill.

Ms. BRUMFIELD. Okay.

Ms. BLACK. There is a Section 45 tax credit for electricity generated from alternative fuels. With that, the credit does not currently apply to thermal heat, so that when you create steam from burning your alternative fuel, you are not eligible for a Section 45 credit.

But you are also not eligible for the Section 45 credit if you use the electricity generated from your alternative energy source, if you use the electricity in your own facility, and that is an issue that Senator Snowe has been working on with Senator Lincoln and Senator Roberts over at the Finance Committee. Would being able to use the electricity on site rather than having to sell it out into the grid be beneficial to your business?

Mr. FLETCHER. Frankly, for us, probably not in terms of—we don't have a generator to produce electricity, so all we do is produce the steam. So Section 45, you are right, there are two aspects of it. One is, in order to qualify for the credit today, you have to produce the electricity and sell it to the utility. And so most of the companies produce the electricity and use it on their own facility and they only sell off the surplus stuff. So the credit has limited application unless you specifically design something that you can say, I am going to sell. But then the returns on that are tough to make.

So if we could find a way to expand that credit to allow for the production of electricity that we use on the site, that would be helpful. It would also take away some of the peak loads that the utilities are feeling so that we relieve the strain on the grid system.

And then for companies like Appleton that don't have generators to produce electricity, just the fact that we produce the steam——

Ms. BLACK. The thermal heat.

Mr. FLETCHER. The thermal heat, that is right—there is a BTU content that otherwise, if we weren't running that pulp mill, if we weren't using that boiler system to recover those chemicals, we would have to produce the thermal heat in some other form or fashion by burning natural gas or coal or something like that.

Ms. BLACK. Exactly.

Paula.

Ms. CALIMAFDE. I just want to take a moment and go back to something Bill kind of went over quickly dealing with the 1099. This is a—I believe it is revenue raiser sitting inside both, I think, both health care bills right now. I think there is a sense that it must be okay, because nobody is talking about it. But I think it is sort of the opposite. I think small business is not aware of what this issue could mean to them, and part of this goes into this whole concept of the tax gap and a lot of the small businesses aren't reporting their income properly, and you can say whatever you want to say about that. But I don't think this 1099 thing is going to do anything to help the tax gap.

But basically, what it is going to require is 1099s. I think it is for every service and property——

Mr. RYS. It is every transaction over $600 for both an incorporated and unincorporated business. Currently, it is only an unincorporated business, but now it will be included to an incorporated business. But it will also include not just services, which is what it is now, but would also include property. So how do you define property? I am assuming it doesn't mean inventory, but that raises a whole set of issues, because if I am a roofer but I have a storefront and I sell shingles as a retail, but I also put those shingles on my building, well, part of it is inventory, part of it is not. So how do you make those distinctions? Where are you going to draw the line?

And you are going to have to constantly keep up and figure out, if I am a landscaper and I buy six bags of dirt at Home Depot and that puts me over $600 at the Home Depot, but it was just one of my guys who was out at the job for the day and said, darn, we need six more bags of dirt, well, did he remember to include however much six bags of dirt cost at Home Depot that he now has to report when he brings it back, and is that going to cause them to fail to report? You know, it is a whole—it is a paperwork thing.

Ms. CALIMAFDE. It sounds to me like the cost of small business, and probably any business, of having to deal with the paperwork load and administrative burden of this, I can't imagine how that wouldn't exceed any possible good that anyone could get out of this. So if you would look at that provision, because as I said, I think the concept is, well, no one is talking about it. I think no one is talking about it like 409(a), because no one knows about it.

Ms. BLACK. And with respect to that, this provision hasn't yet taken effect to require that 1099s get sent to taxpayers. The provision in the health care bill is to apply to C Corporations. It is just not yet effective, correct, for pass-throughs?

Mr. RYS. Well, no. I mean, currently, if you are any sort of business and you get services from an unincorporated business, you report that to the IRS and you report it back to the business, and the purpose behind that is, since there is not generally withholding on the income that the sole proprietor, for example, would hold, that 1099 serves as a back-up for the IRS to be able to say, okay, you have reported this much income. We have got this many 1099s. We can see where your income matches up.

This would expand that universe to now include transactions with corporations. So as today, if I am one of Dave's members and I own a restaurant and I have Verizon come in and put in my telephone services and Internet access and that sort of thing, I don't report that today because Verizon is a C Corporation. But I would report that tomorrow. So that is the distinction.

Ms. BLACK. Got it.

Ms. CALIMAFDE. But I think you are right, Kathleen. The provision that we are talking about in the health care bill, I don't think it becomes effective until 2012. I think there is this concept of a ramp-up time, because, in addition, you have to get the EIN numbers for all these different vendors, and that is the small business' burden to get all those EINs, so——

Mr. RYS. And to add to that, if you don't get the correct number, then you have to—or if you don't get the correct number or you don't know where to send it, because you have to send it to the business that provided the services, if you get an incorrect number or you get no number at all or you don't know where to hold it, you have to withhold 23 percent on the contract. So now you are deputizing the small business owner to basically withhold the money.

It raises $17 billion. My assumption is that the $17 billion is largely that withholding number as small business owners run around trying to figure out, do I have the right lottery numbers here or not, or am I sending—and if you have a franchise, do I send it to the corporate franchise? Do I send it to the owner? Where does it go? So there are a number of just little technical questions that are going to come up for every business owner that has these transactions.

Ms. CALIMAFDE. I mean, do you believe that number? I don't believe that revenue raiser number. I mean, you know. It certainly wasn't offset by the administrative burdens.

Ms. BLACK. If Joint Tax chisels it onto a score sheet, I can assure you, that is what we live with.

Ms. CALIMAFDE. Yes.

Ms. BRUMFIELD. Yes. Sure. Well, we would like to thank everyone——

Ms. BLACK. I am sorry——

Ms. BRUMFIELD. I am sorry.

Dave.

Mr. KOENIG. I am sorry, I will be brief, but there is one expiring provision that I would like to mention——

Ms. BRUMFIELD. Sure.

Mr. KOENIG [continuing]. That hasn't been discussed that is of great importance, not only to the restaurant industry, but to small businesses and really to society. Since 1976, the tax code has al-

lowed traditional C Corporations, and only traditional C Corporations, to get under Section 170 of the code an enhanced deduction to encourage the charitable donation of food inventory. And in 2005, I believe it was, Congress wisely extended that provision to cover all taxpayers, regardless of business form and entity. Like a lot of the other provisions we have talked about earlier, that enhanced deduction provision expires for non-C Corporations at the end of 2009.

And certainly, given the state of the economy and given shortages that have been in the paper recently at food banks, I think it is pretty self-evident that Congress would want to extend that provision. Legislation has been introduced in the Senate, the Good Samaritan Hunger Relief Tax Incentive Extension Act, S. 1313. The lead sponsors are Senators Lincoln, Lugar, and Leahy. This would make that provision permanent for all taxpayers, regardless of C Corporation status or not.

Ms. BLACK. Finishing up on an altruistic end there.

[Laughter.]

Ms. BLACK. Good.

Ms. BRUMFIELD. There we go.

Well, this has been a great roundtable. I would like to thank everyone for participating and all of the attendees for attending. Thank you very much. We will take this information back and do as much work as possible before January 1 to have the results that you all desire. So thank you.

Ms. BLACK. Thank you.

[Whereupon, at 12:04 p.m., the committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

Chair Mary Landireu
Opening Statement for December 3, 2009
Small Business Committee Roundtable
"What is Working: Tax Incentives to Aid Small Business Recovery"

Good morning and thank you for joining us at this roundtable. Today we are here to discuss expiring tax incentives that are critical to small business growth and stability, especially in this tough economic time. But unless Congress acts now a wide range of these tax provisions—from the R&D tax credit to incentives for biodiesel and renewable diesel –will sunset in 28 days.

With an expiration date fast approaching, uncertainty has dampened the recovery for many small businesses. Small businesses, and America, cannot afford to wait, as more small business jobs are lost each day. Our small firms need these measures extended to stay competitive and help create American jobs.

In today's discussion, we will examine the specific importance of a variety of these tax provisions and their impact on small businesses. In

doing so, we will discuss the need for extending provisions, redesigning them, or making some permanent provisions in the tax code.

One tax provision we must not let expire was enacted in the American Recovery and Reinvestment Act (ARRA). The enhanced expensing limits allow small businesses to expense up to $250,000 of the cost of new investments, which enables them to buy vital new facilities and the equipment they need to keep their businesses running.

Because of the substantial savings to small businesses this tax provision has generated in this year alone, yesterday Senator Snowe and I introduced legislation to make permanent the $250,000 expensing limit. By making this enhanced expensing limit permanent, small business owners will have a valuable incentive to make investments in business assets critical to business growth and remaining competitive.

In addition, just this week I joined as a co-sponsor of the New Markets Tax Credit Extension Act, which would extend the New Market Tax Credit for five years and provide $5 billion in annual allocation authority.

The expensing provision and New Markets Tax Credit are just two examples of effective, but endangered, tax provisions. Extending these credits could ease the anxiety associated with last-minute extensions and provide small businesses with the stability they need to plan budgets and attract investment.

Now, more than ever, small businesses need stability and incentives to move forward with getting our economy on track and creating jobs for American workers. By extending and expanding tax measures that we know help small businesses grow, we can give these businesses the certainty they need to make new investments, and the encouragement they need to help grow our economy.

I would now like to recognize my colleagues on the Committee for their statements.

ROUNDTABLE FORMAT

Let me now take a moment to explain the format for the roundtable. We've got a large group so if you would please stand your name placard up long ways to be recognized to speak.

I would like each participant to briefly introduce yourself by stating your name, title, and company or organization you are representing.

The record for this roundtable will be open for two weeks, until December 17th. I encourage you to submit any follow-up materials you feel necessary for the record.

I unfortunately cannot stay due to scheduling conflicts, but in my absence Krystal Brumfield and Caroline Bruckner of my staff and Kathleen Black and Matthew Berger of Senator Snowe's staff will moderate and help lead the discussion.

Now I would like to turn the roundtable over to Krystal.

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Statement of Jeff Fletcher, Corporate Controller, Appleton Papers, Appleton, Wisconsin
December 3, 2009

Introduction

It is a pleasure to be invited to participate in this important roundtable discussion. My name is Jeff Fletcher and I have been the Corporate Controller for Appleton since 2007. Before coming to Appleton, I was the Controller for another family-owned S corporation, this one in the dairy business. Prior to that, I held senior finance officer positions in several small and mid-size companies. I received my CPA immediately after finishing school and spent several years with a large public accounting firm helping clients negotiate the tax code.

Headquartered in Appleton, Wisconsin, Appleton Papers was founded in 1907 as the Appleton Coated Paper Company. Today, Appleton is the world's largest producer of carbonless paper and the only producer of the NCR PAPER* brand of carbonless paper, a product Appleton helped introduce in 1954. Carbonless paper is used to make multipart business forms such as invoices, purchase orders and credit card receipts. Appleton also is a significant producer of thermal paper which is used to provide receipts from ATMs, gas pumps and cash registers. Thermal papers also are used for tickets, tags and labels. Beyond these key products, Appleton also produces security papers and performance packaging products.

In addition to our headquarters, Appleton has significant manufacturing operations in Ohio, Pennsylvania and Massachusetts. Appleton employs approximately 2,400 workers at these facilities and many of our workers, nearly 1,400, are members of the United Steel Workers union.

Appleton is an S corporation and we are a 100 percent employee-owned ("ESOP") company. We are a member of the S Corporation Association and I am here today representing that organization.

S Corporations

I want to first discuss S corporations and ESOPs as important corporate structures that are front and center on many of the tax issues facing Congress.

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Before Congress created S corporations, entrepreneurs had two basic choices when starting a business. They could form a regular C corporation and enjoy the protection of limited liability, but still face two layers of federal tax. Or they could form a partnership or operate as a sole proprietorship, and enjoy just a single layer of tax at the individual level but also sacrifice limited liability and the umbrella of protection it provides.

Neither choice was optimal for small and family-owned businesses. In 1958, Congress created a third option: subchapter S, which merged the single layer of federal tax enjoyed by partnerships with the comprehensive liability protection.

Nearly a half century later, S corporations are the most popular corporate structure in America, with twice as many firms as C corporations. The number of S corporations has increased from less than 500,000 in 1978 to more than four and a half million today. Partnerships have seen similar growth.

The growth of pass-through businesses has had the effect of shifting an increasing amount of business income from the corporate tax code to the individual tax code. This means that tax policy for businesses is increasingly affected by changes to the individual tax code. Much of this income can be attributed to partnerships and S corporations.

Consequently, it is important for policymakers in Washington to be acutely aware of the dynamic between individual tax rates and business income as they consider broad-based tax reform and adjustments to the margin tax rates. The Tax Foundation has reported that nearly 40 percent of the revenue raised by increasing the top two tax rates, and nearly one-third of the revenue from the health care surtax passed by the House, comes from business income. The Joint Committee on Taxation came up with similar estimates.

Thus, speaking for the S Corporation Association, my first recommendation is for tax writers and those advocating on behalf of small and closely-held businesses to recognize the tremendous amount of economic activity taxed by the top income tax rates and, correspondingly, the harm that raising those rates or adding surtaxes on top of those rates would impose on the business community, economic growth and job creation.

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Employee-Ownership

Congress first allowed S corporations to be owned by their employees through employee stock ownership plans ("ESOPs") beginning January 1, 1998. An ESOP is a qualified defined contribution retirement plan that provides employees of a company with retirement savings through their investments in their employer's stock. As a qualified retirement plan, ESOPs are governed by ERISA (Employee Retirement Income Security Act).

The legislation which allowed ESOPs to own S corporations was designed to encourage and expand retirement savings by giving more workers the opportunity to have equity in the companies where they work. In a 2008 University of Pennsylvania study, two leading tax and economic experts found that S corporation ESOPs contribute $14 billion in new savings for their workers each year, beyond the income they would otherwise have earned.

In addition, the study notes that S corporation ESOPs offer their workers greater job stability and increased job satisfaction. The study found that S ESOPs' higher productivity, profitability, job stability and job growth, generate a collective $19 billion in economic value that otherwise would not exist.

Since its formation in 1907, the Appleton business was sold or transferred several times to the point that, in 2001, when the business was again up for sale, Appleton's employees joined together to form an ESOP and purchase Appleton. In the eight years since the acquisition, the value of the employees' investment has increased from $10 per share to nearly $19 per share. In comparison, during that same period the return from the S&P 500 index has been basically zero.

Given the success of this corporate structure for Appleton and many other U.S. companies, we are pleased to see that there is legislation in the House that would expand employee-ownership in S corporations and extend the benefits of this structure to more working Americans. Recently introduced by Congressmen Kind and Blumenauer, H.R. 3586, is a strong bill that we hope will move forward soon. We look forward to seeing similar legislation introduced here in the Senate.

My second recommendation to the Committee is to support employee-ownership as a successful vehicle for making American industry more competitive, while helping to ensure that American workers have the means necessary to enjoy their retirement.

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Response to the Economic Crisis

Like most domestic manufacturers, Appleton has experienced enormous pressure during the economic downturn and taken every possible step to try to avoid layoffs, nevertheless, we have been forced to make a few minimal reductions. This is especially difficult for a company that is 100-percent employee-owned since we know that not only do these reductions impact our workers, they impact their retirement security as well. We are hopeful that we can return to full productivity as the nation and the world recovers from this difficult situation.

However, I want to note two extremely important actions taken by Congress that have been enormously beneficial to Appleton and helped us through these turbulent economic times: reduction in the built-in gains tax, and the energy tax credit related to paper production.

Relief from the built-in gains tax (the so-called BIG tax) has been an S Corporation Association priority for years. BIG applies to appreciated assets that are held by a firm converting to an S corporation. Under BIG, these firms are required to hold these assets for at least ten years or be subject to a punitive level of tax -- first the BIG corporate tax rate of 35 percent, and then all the other applicable federal, state, and local tax rates.

According to government statistics, hundreds of thousands of S corporations nationwide could be sitting on "locked-up" capital that they cannot access or redeploy due to the prohibitive tax implications of BIG. This "lock-in effect" is widespread and results in these businesses being unable to access billions of dollars in assets that could otherwise be used to grow the business and hire new employees.

As closely-held businesses with limited access to the public markets, S corporations have fewer options for raising capital than many of their competitors. In an economy where a one or two percent change in growth can mean the difference between a recession and moderate growth, eliminating that lock-in effect and allowing those assets to become fully productive again could be significant.

Earlier this year, Congress recognized that the inability to access this capital is particularly harmful to S corporations and included temporary BIG relief as part of the first economic stimulus package. We applaud Congress for taking this important step.

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My third recommendation for the Committee is to extend BIG tax relief to ensure firms continue to have access to their own capital. It currently expires at the end of 2010.

Another tax item that has been of particular importance to the paper industry and Appleton is the tax treatment of so-called "black liquor." Senator Snowe, among others, has been a great champion of the paper industry on this issue and we appreciate all her hard work.

In 2007, Congress passed legislation clarifying that alternative liquid fuels derived from biomass were qualified to receive the alternative fuels tax credit initially enacted in 2005. The purpose of the credit, as outlined by the Joint Committee on Taxation at the time of its enactment, was "to encourage the domestic production of alternative fuels and build a domestic industry to continue alternative fuel production."

As it has with other alternative fuel producers, the alternative fuel mixture tax credit is now supporting the paper industry's use of renewable energy. Many papermaking operations produce black liquor, a byproduct of the process that transforms wood into pulp. Paper mills can use the black liquor they generate as a fuel to produce electricity and heat. Using black liquor as a fuel avoids fossil fuel use and, unlike fossil fuel, black liquor is carbon neutral -- its use results in no net increase of carbon dioxide in the atmosphere.

Since the paper industry's use of the alternative fuel credit became public, there have been several efforts to exclude black liquor from the alternative fuel credit or, more recently, the section 40 cellulosic tax credit. Indeed, the House-passed health care reform bill bans black liquor from accessing the section 40 credit, purporting to raise $24 billion in revenue that would be used to offset some of the bill's costs.

While I understand why a tax benefit that size for any particular industry would raise eyebrows, the size of the credit demonstrates the significance of the paper industry in the renewable fuel effort. I would caution Congress not to punish our industry simply because we are one of the largest producers of renewable fuels in the world. The fact that our industry has fully integrated recycling and renewable fuel production into our papermaking process should be a cause for praise, not punishment.

Pulp mills across the United States have been closing as paper makers struggle to stay competitive in this global market. The alternative fuel mixture credit provides pulp manufacturers funds to invest in keeping their alternative fuel processes up-to-date and

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competitive. The purpose of the credit -- to encourage domestic production of alternative fuels -- has no better poster child.

In a related matter, the biomass conversion assistance program (BCAP) administered by the Department of Agriculture, is designed to encourage the production of renewable fuels from biomass. Despite the expansive statutory definitions provided by Congress, the Department of Agriculture appears to be excluding black liquor from qualifying as a renewable fuel. This potentially creates an unlevel playing field among buyers of wood chips. Excluding papermakers from the BCAP could drive up the cost of the wood chips we use to make paper, increasing the likelihood that more firms will shut down their Kraft boilers, import paper pulp from Brazil, and then import and consume fossil fuels to heat the pulp and make the paper.

Given this alternative, several options are available that might be--excuse the expression--more sustainable and fair. One option would be to cap the value of the credit to reduce the total tax benefit to any one company, while making the cost of the tax credit to taxpayers more reasonable. We have been working with a group of paper companies on a proposal along these lines, and I would be happy to provide this proposal to anyone interested.

Another option would be to expand on the approach taken by Senator Lincoln to amend the section 45 production tax credit to include, among other things, the in-house production of electricity and heat.

My fourth recommendation is for the Committee and its members to recognize the leadership of the paper industry in producing renewable fuels, and to embrace either of these approaches.

The fact of the matter is, at least for Appleton, the tax credit has been extremely helpful to our company's bottom line during the economic downturn and has played an important role ensuring our financial stability and viability, which is clearly important to all of our employees!

Conclusion

I would like to thank the Committee and its staff for putting together this roundtable. I know time is short for this legislative session and there remain several major legislative challenges standing between the Congress and Christmas, so I sincerely appreciate being given this opportunity to speak with you and share my recommendations. I am of course happy to take any questions you might have.

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REPRESENTING THE RESTAURANT INDUSTRY
The Cornerstone of the Economy, Career Opportunities and Community Involvement

Written Testimony

Of

Dave Koenig, Director, Tax and Profitability,
National Restaurant Association

For the roundtable

"What Is Working: Tax Incentives to Aid Small Business Recovery"

Before the

U.S. Senate
Committee on Small Business and Entrepreneurship

On behalf of the

National Restaurant Association

Thursday, December 3, 2009

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Chairwoman Landrieu, Ranking Member Snowe, members and staff of the Senate Committee on Small Business and Entrepreneurship, thank you for the opportunity to testify before you today on behalf of the National Restaurant Association. My name is Dave Koenig, Director of Tax and Profitability at the National Restaurant Association. I am here today to ask Congress and this Committee to extend certain expiring tax provisions before the end of the year, such as the 15-year depreciation schedules for leasehold improvements, restaurant improvements and new construction and retail improvements, as well as the charitable deduction for the donation of food inventory. Finally, I ask that Congress increase the business meal deduction from its current level of 50 percent to 80 percent to provide additional stimulus to the economy.

The restaurant industry plays a significant role in this nation's economy. There are 945,000 restaurant and foodservice outlets in this country. Seven out of ten restaurants are single-unit operators, which mean the restaurant industry is an industry of small businesses. Most eating and drinking places, three-quarters of the industry, employ 50 or fewer employees. Restaurants also serve as the conference rooms for many of the self-employed and other small businesses.

This year the restaurant industry is estimated to generate $558 billion in sales, with an overall economic impact of $1.3 trillion. Every dollar spent dining out generates $2.34 in business for other industries. The restaurant industry is one of the nation's largest private employers, employing more than 13 million people, representing more than 9 percent of the nation's job-base. We are truly the cornerstone of this nation's economy.

Extend Leasehold Improvements, Restaurant Improvements and New Construction, Retail Improvements 15-year Depreciation Schedule

The fifteen-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements must be extended before the end of 2009. The fifteen-year depreciation schedule has made significant capital available for restaurant owners to make capital expenditures with the tax savings. Those capital expenditures translate into jobs in the rest of the economy. In addition, a faster, more accurate depreciation schedule has a direct impact on a restaurant's bottom line. By shortening the depreciation schedule, Congress gives operators cash flow to reinvest in their businesses, allowing them to grow restaurant jobs and contribute to the community. In an industry with median profit margins of 3 to 5 percent, every penny counts (See Figure 1).

Even during difficult economic times, restaurateurs are planning capital expenditures to improve or expand their businesses. According to the National Restaurant Association July 2009 Tracking Survey, 42 percent of restaurant operators plan to make a capital expenditure for equipment, expansion or remodeling in the next six months. The ability to plan for these expenditures and know what the tax treatment will be in subsequent years, particularly during these difficult times, is important to those who are making those decisions right now.

Moreover, this provision is an important driver of economic stimulus. Extending the 15 year depreciation schedule for leasehold improvements, restaurant improvements and new construction and retail improvements beyond 2009 will fuel economic activity and create jobs. When restaurants invest in construction and renovations, the impact spreads through the economy. Before the economic downturn, the restaurant industry spent more than $10 billion in

2007 on construction of restaurant buildings. According to the Bureau of Economic Analysis, every dollar spent in the construction industry generates an additional $2.39 in spending in the rest of the economy and every $1 million spent in the construction industry creates more than 28 jobs in the overall economy. That means that restaurant industry construction spending created 280,000 jobs in the overall economy in 2007.

Restaurant Spending on Construction

Year	Billions ($)	Jobs Created In Overall Economy
2004	5.2	145,600
2005	7.4	207,200
2006	6.6	184,800
2007	10.4	280,000

Source: U.S. Census Bureau and National Restaurant Association

In fact, Congress has frequently enacted shorter depreciation schedules to stimulate the economy and create jobs. As far back as the 107th Congress, shorter depreciation schedules for different pieces of the 15 year leasehold improvements, restaurant improvements and new construction, and retail improvement depreciation provision have been included in various economic stimulus and tax extender bills.

It is also important to note that fifteen years, rather than 39 years, is a much more accurate timeframe for depreciation for restaurant buildings. With 133 million Americans patronizing restaurants each day, restaurant building structures experience a daily human assault unlike that borne by any other type of retail building. Restaurateurs must constantly make changes to keep up with the structural and cosmetic wear and tear caused by customers and employees. The heavy use accelerates deterioration of a restaurant building's entrance, lobbies, flooring, restrooms and interior walls. National Restaurant Association research shows that most restaurants remodel and update their building structures every six to eight years.

Extend the Deduction for Charitable Donation of Food Inventory for Small Businesses

The statistics are astounding. Each day, 35 million Americans are at risk of hunger. At the same time, billions of pounds of food are wasted each year. America's restaurants give back to their communities in major ways, the most significant of which is through food donation. According to National Restaurant Association research, 73 percent of restaurants donate food to individuals or charities.

The deduction for charitable donation of food inventory is a critical tool in alleviating hunger and Congress cannot delay its extension any longer. Without the provision, taxpayers get the same tax treatment for throwing out surplus food as they do for giving it to charity. The enhanced deduction encourages donating the food to charity instead, by helping to offset the costs associated with storing and transporting the extra food.

For this tax extender to be effective in encouraging more small businesses, including restaurants, to donate food that would otherwise go to waste, it must be extended before the end of 2009. If Congress were to wait to extend this provision until 2010, it would be ineffective for the period

that it was not in place. The perishable nature of the donated product requires this provision to be in place before such food is produced and goes bad.

Moreover, Congress should make this tax extender permanent for all small businesses as the tax code currently does for C corporations and has for decades. The Good Samaritan Hunger Relief Tax Incentive Extension Act (S. 1313) is sponsored by Senators Lugar (R-IN), Lincoln (D-AR), and Leahy (D-VT) and would expand and make permanent this tax extender provision for small businesses, farmers and ranchers to donate food inventory to charity. The House companion bill (H.R. 3227) is sponsored by Congressmen Levin (D-MI) and Davis (R-KY).

The bill would permanently allow all qualified business taxpayers (not just C corporations) to take a special deduction for contributions of food inventory. In addition, because the need is so great in the current economic environment, the legislation would temporarily allow taxpayers to deduct the full fair market value of food inventory donations.

The National Restaurant Association strongly encourages its members to donate more food, and we recently partnered with Food Donation Connection (FDC) to do just that. Founded by a former restaurant executive, FDC serves as the liaison between the restaurants interested in donating food and the social service agencies adept at getting that food to people in need. FDC helps restaurants develop and implement programs designed to provide an alternative to discarding surplus food, while capitalizing on the economic benefits of those donations through the tax savings. Since 1992, FDC has helped facilitate the donation of over 140 million pounds of food to non-profit, hunger-relief agencies.

I ask members of this Committee and all members of Congress to extend the deduction for charitable donation of food inventory before the end of 2009 by enacting S. 1313, the Good Samaritan Hunger Relief Tax Incentive Extension Act.

Increase the Business Meal Deduction to Stimulate the Economy

The National Restaurant Association strongly urges Congress to provide additional economic relief for this nation's economy and to implement policies that will boost consumer spending. Increasing the business meal and entertainment deduction from 50 percent to 80 percent is a key provision for small businesses. For many small companies the ability to conduct business over a meal is their only means of advertising and marketing their business.

While officially the recession may be ending, the restaurant industry is still reeling from the effects of decreased consumer spending and increased unemployment. Increasing the business meal deduction would encourage consumers to eat out and also benefit small businesses. America's restaurants are small business' conference rooms and the restaurant table is where much business is conducted. Increasing the deduction is a benefit not only to restaurateurs and their employees, but to their guests as well, the small business owner or the self-employed.

Representative Neil Abercrombie (D-HI) has re-introduced H.R. 3333, a bill that would increase the business meal and entertainment deduction to 80 percent for all business meal users. An

increase in the business meal deduction to 80 percent would increase business meal sales by $6 billion and create an $18 billion increase in the overall economy, according to National Restaurant Association research. The impact of the restaurant industry on the nation's economy is considerable and felt in every state (See Figure 2). We service 133 million guests every day. Every dollar spent dining out generates $2.34 in business to other industries, totaling $1.3 trillion in overall economic impact.

Conclusion

I greatly appreciate this opportunity to testify on behalf of the restaurant industry before you today. I strongly urge Congress to extend these important tax provisions before the end of the year.

The restaurant industry needs certainty when it comes to the 15 year depreciation schedule for leasehold improvements, restaurant improvements and new construction and retail improvements as capital expenditures are being considered and planned.

Small businesses, including restaurants, need at minimum the extension of the deduction for charitable donation of food inventory before the end of the year.

Additionally, Congress should consider additional items that will help boost the economy and create jobs like an increase in the business meal deduction to 80 percent.

Thank you for considering the restaurant industry's perspective and ideas regarding tax incentives to assist small businesses during this period of economic recovery.

Figure 1.

Sample Calculations for 15-Year versus 39-Year Depreciation

Total Capital Expenditure on Eligible Property	Annual Depreciation Based on 39-year Schedule	Annual Tax Savings from Depreciation	Annual Depreciation Based on 15-year Schedule	Annual Tax Savings from Depreciation	Annual Difference in Tax Savings Between 15- & 39-Year Schedules
$100,000	$2,532	$608	$6,667	$1,600	$992
$250,000	$6,329	$1,519	$16,667	$4,000	$2,481
$500,000	$12,658	$3,038	$33,333	$8,000	$4,962
$700,000	$17,722	$4,253	$46,667	$11,200	$6,947
$1,000,000	$25,316	$6,076	$66,667	$16,000	$9,924
$1,500,000	$37,975	$9,114	$100,000	$24,000	$14,886
$2,000,000	$50,633	$12,152	$133,333	$32,000	$19,848

Expenditure Scenarios

Rebuild Costs:
Quickservice - $700,000
Fullservice - $1,500,000

Renovate Costs:
Quickservice - $250,000
Fullservice - $500,000

Note: Figures are based on a 24% effective marginal tax rate

Figure 2.

Estimated Impact of Increasing Business Meal Deductibility from 50% to 80%

State	Increase in Business Meal Spending 50% to 80% Deductibility (in millions)	Total Economic Impact In the State (in millions)	Total Employment Impact In the State (number of jobs created)
Alabama	$77	$155	2,464
Alaska	$17	$29	401
Arizona	$118	$235	3,125
Arkansas	$43	$87	1,451
California	$767	$1,797	20,868
Colorado	$114	$264	3,328
Connecticut	$71	$133	1,624
Delaware	$19	$35	402
District of Columbia	$31	$43	254
Florida	$368	$745	9,746
Georgia	$193	$446	5,642
Hawaii	$44	$86	1,154
Idaho	$24	$47	799
Illinois	$256	$610	7,207
Indiana	$117	$241	3,712
Iowa	$47	$95	1,544
Kansas	$46	$92	1,314
Kentucky	$78	$158	2,266
Louisiana	$81	$158	2,374
Maine	$24	$46	709
Maryland	$113	$235	2,750
Massachusetts	$161	$324	3,884
Michigan	$171	$341	5,272
Minnesota	$105	$240	3,270
Mississippi	$41	$78	1,340
Missouri	$115	$256	3,512
Montana	$20	$39	682
Nebraska	$31	$64	1,048
Nevada	$71	$127	1,703
New Hampshire	$29	$53	653
New Jersey	$170	$367	4,139
New Mexico	$37	$66	1,079
New York	$379	$751	8,855
North Carolina	$176	$371	5,435
North Dakota	$11	$20	333
Ohio	$217	$466	6,978
Oklahoma	$60	$127	2,016
Oregon	$82	$169	2,274
Pennsylvania	$212	$478	6,311
Rhode Island	$24	$45	598
South Carolina	$87	$179	2,689
South Dakota	$14	$27	458
Tennessee	$121	$272	3,531
Texas	$477	$1,164	14,109
Utah	$41	$92	1,375
Vermont	$11	$19	288
Virginia	$157	$331	4,155
Washington	$129	$279	3,419
West Virginia	$28	$47	830
Wisconsin	$100	$210	3,399
Wyoming	$10	$16	293

Source: National Restaurant Association estimates, 2009

NEW MARKETS TAX CREDIT COALITION

Testimony of

Jose Villalobos

Senior Vice President of Government Affairs and Business Development

The East Los Angeles Community Union (TELACU)

"What is Working: Tax Incentives to Aid in Small Business Recovery"

United States Senate

Committee on Small Business and Entrepreneurship

December 3, 2009

Thank you Chairman Landrieu and Ranking Member Snowe for the opportunity to participate in today's roundtable discussion on federal tax credits and the impact these credits have on financing small businesses.

My remarks today will focus on the New Markets Tax Credit (NMTC) and how TELACU and other community development entities have effectively used the Credit to provide flexible and patient capital to businesses operating in low income communities across the country.

I wear several hats as a participant in this discussion. I am the Senior Vice President of Government Affairs and Business Development for TELACU which is the largest Community Development Corporation (CDC) and 52nd largest Hispanic business in the United States. With assets in excess of $500 million, TELACU has been rebuilding and enhancing communities by providing valuable products and services—including the creation of new jobs, responsive financial institutions, business expansion, quality affordable housing. and educational opportunities for young people, families and veterans.

I am also representing the New Markets Tax Credit Coalition, a network of more than 150 community development entities and investors committed to using the NMTC to generate investment in businesses and economic development projects in low income communities. TELACU was a founding member of the NMTC Coalition and I currently serve on the Coalition's Executive Committee.

My principal message today is that the New Markets Tax Credit works. The NMTC Program has proven to be an effective tool allowing TELACU to make capital available, both debt and equity, to businesses that are often overlooked by conventional lenders and investors especially during an economic downturn when investors and lenders tend to retreat rather than explore 'new markets. ***I therefore strongly recommend that Congress move to extend the NMTC and maintain the current $5 billion in annual allocation authority.***

I will however offer some suggestions to ensure the NMTC investor market can continue to expand in this economic climate and I will also offer recommendations aimed at increasing NMTC investing in operating businesses.

NMTC Background

The New Markets Tax Credit, authorized in the Community Renewal Tax Relief Act of 2000, was designed to stimulate investment and economic growth in low-income communities that are traditionally overlooked by conventional capital markets. The NMTC does this by providing investors with a seven-year, 39-percent federal tax credit for investments made through investment vehicles known as Community Development Entities (CDEs). These CDEs use the capital raised with the NMTC to finance loans and investments in businesses and economic development projects in low-income areas.

To date, more than $14.3 billion in private capital has been invested in some of the poorest communities in the country thanks to the NMTC.. According to the VDFI Funds most recent data, NMTC investments have been made in more than 2,000 businesses and real estate developments - helping to develop or rehabilitate over 68 million square feet of real estate, create 210,000 construction jobs, and create or maintain 45,000 full time equivalent jobs at businesses in low-income communities.

TELACU's NMTC Investments

TELACU has received 3 NMTC Allocations totaling $120 million and has used the Tax Credit to:

Provide a $7 million, interest only loan at below market rates to help finance the renovation of a shopping center containing approximately 202,000 square feet of commercial space in the city of Azusa. In addition to anchor tenants such as CVS and 99 Cents Only, a number of opportunities were created for small retail businesses offering an array of services and products to the local low income community. The project created 213 permanent jobs and 102 affordable homes.

Finance a $4.2 million loan for the rehabilitation of 4 commercial buildings (1 office and 3 industrial buildings) consisting of 117,418 SF of space located in the City of Commerce. TELACU was able to provide a 2.4% loan (market rate would be approximately 6%). These buildings are located in an area of greater economic distress with median family income of 69.1% and an unemployment rate 2.6 times the national rate. The investment resulted in the creation/retention of 306 jobs. The renovated space is targeted to small business users such as a kidney dialysis center, a manufacturer of leather products, and office space that is divisible to as small as 200 square feet.

As part of its pipeline, TELACU will be using the Tax Credit to finance the construction of two biofuel plants in San Diego that will convert methane gas from the local waste water treatment plant to electricity that will allow the City to reduce its reliance on and use of the electrical grid. This project will be funded early next year and will have a small, minority and women-owned procurement component.

The NMTC at Work

There is substantial evidence that the NMTC has been an effective incentive to encourage private sector investment in low income areas. A recent GAO report found that 88 percent of the NMTC investors surveyed would not have made the investment in the low income community without the Credit and 69 percent of the investors indicated that they had not invested in a low income community project prior to working with NMTC.

It is important to note that CDEs are putting the NMTC to work in communities with poverty rates higher than 30 percent and unemployment greater than one and a half times the national average. This targeting is far beyond the requirements of the law or regulations governing the NMTC program and means that CDEs are working in very poor communities where businesses often face the greatest hurdles in terms of securing capital.

In addition to targeting poorer communities than required by law CDE have historically been able to raise and deploy capital into qualified businesses at a faster rate than required by law or regulation. The law provides a CDE with 5 years to raise qualified equity investments once the CDE is awarded Credits. Not only have CDES been able to fully utilize their NMTC allocations within the 5-year window but according to the CDFI Fund, 2006 and 2007 NMTC Allocatees raised close to half of their equity investments within 1 year of securing their NMTC awards.

The CDFI fund has seen the NMTC investment rate slow some over the last year as the economy has slowed. That said, the Fund reported that CDE receiving allocations in 2008 had raised more than 20 percent of the equity investments within the first year which is well within the 5-year window allowed by law.

In fact research conducted by the NMTC Coalition indicates that the CDEs are on pace to issue something just short of $3 billion in QEIs in 2009. This pace is slightly below past years. CDEs, including TELACU, are reporting that the demand for NMTC financing fro businesses remains strong but it is taking longer to secure investors and therefore taking longer to complete transactions.

Fortunately the NMTC never had the level of investor over-concentration as did Low Income Housing Tax Credits (LIHTC) with its dependency on Freddie and Fannie. However, there is some reliance on money center banks and CDEs are now looking to smaller banks as possible investors in the NMTC. CDEs are also pursuing other sources of debt such as tax increment financing, tax-exempt bond financing and Section 108 loans.

NMTC Recommendations

I submit the following recommendations intended to build on the success of the NMTC and enhance the ability of CDEs to continue building a diverse base of NMTC investors.

Extend the NMTC with $5 billion in annual allocation authority.

The initial $14.3 billion invested in low income communities through the New Markets Tax Credit has bolstered local economies, increased economic opportunity and improved the lives of many Americans. Since implementation, the CDFI Fund has received over $200 billion in applications for $26 billion in available credit authority. The competitive application process places a premium on applicants that commit to invest funds more quickly than required by statute and that can demonstrate the ability to have a positive economic impact on poor communities in terms of financing businesses, community facilities, needed commercial space and jobs.. By all reports the NMTC has succeeded in stimulating new investment and economic growth in low-income communities and we are calling on Congress to extend and expand this valuable program at a time when investment in businesses and community development is critical.

Provide AMT Relief to NMTC Investors and Clarify Passive Activity Rules Relating to NMTC Investors – It is clear that we need diversify the investor base of NMTC. The NMTC Coalition believes this is best facilitated by providing AMT relief to NMTC investor and by clarifying how the NMTC is treated under IRS passive activity rules.

There is a pressing need to provide an exemption to the Alternative Minimum Tax (AMT) for investors in New Markets Tax Credits (NMTC). NMTC has generated over $14.3 billion in investments in low income communities. However, as the taxable income of many banks and corporate entities decline there is growing concern that investors will have less appetite for New Markets as they have less taxable income to offset and other, more attractive options in the credit

marketplace. The Housing and Economic Recovery Act of 2008 provided that the Low Income Housing Tax Credit (LIHTC) (IRC Section 42) and the Historic Rehabilitation Tax Credit (HRTC) (IRC Section 47) can be used to offset AMT liability. A provision to provide NMTC with AMT exemption was contained in the Senate version of economic recovery legislation but dropped in conference. We urge Congress to take action as soon as possible to ensure that AMT relief is provided to NMTC investors in this competitive credit markets. This change is critical if we are to maintain our current investors and attract new ones.

In addition the NMTC Coalition is seeking guidance from the IRS as to how a NMTC investment is treated under current passive activity rules. In order to generate increased interest in the NMTC, the NMTC Coalition has recommend that the IRS consider characterizing the NMTC as a portfolio credit which would open the door to individual investors. Since the NMTC program is designed to spur investment activity, treatment of the NMTC as a portfolio credit in all circumstances would be consistent with the objectives of the NMTC Program.

Establish a safe harbor for NMTC investments made for the sole purpose of financing operating businesses. While there has been a steady increase in the number of non-real estate businesses financed with the NMTC, investors are still reluctant to invest in CDEs that lend or invest in operating businesses for machinery and equipment, working capital, lines of credit, and venture capital using the Credit. The seven-year term of NMTC coupled with reinvestment and 'substantially all' requirements limit a CDE's ability to structure capital that operating businesses need and that is becoming more difficult to secure through conventional lenders. Operating businesses often need financing for loans or investments for terms shorter than the Credit period. However, in cases in which principal is returned or repaid to a CDE during the seven-year Credit period a CDE is required to redeploy that capital within a certain specified time period or risk recapture. The pressure to reinvest principal has given many investors pause and steered them away from CDEs financing operating businesses. Therefore we are recommending that Treasury encourage NMTC investing in operating businesses by establishing a safe harbor that would assure NMTC investors that QEIs used to finance QLICIs in operating businesses will not be at risk of recapture. We think this regulatory change would result in more NMTC investing in CDEs providing patient flexible capital to operating businesses.

I appreciate the opportunity to participate in today's roundtable discussion and I hope there is an opportunity to submit additional testimony, comments and reflections in response to issues that may come up in today's discussion.

December 3, 2009

The Honorable Mary Landrieu
Chair
Senate Committee on Small,
Business and Entrepreneurship
428A Russell Senate Office Building
U.S. Senate
Washington, D.C. 20510

The Honorable Olympia Snowe
Ranking Member
Senate Committee on Small,
Business and Entrepreneurship
428A Russell Senate Office Building
U.S. Senate
Washington, D.C. 20510

Dear Chairwoman Landrieu and Ranking Member Snowe:

On behalf of Associated Builders and Contractors (ABC), a national association with 79 chapters representing 25,000 merit shop construction and construction-related firms with 2 million employees, we appreciate the opportunity to provide our position regarding tax relief in response to the Senate Small Business and Entrepreneurship Committee's hearing entitled, "What Is Working: Tax Incentives to Aid Small Business Recovery." Tax relief is extremely important to the open shop construction industry and small businesses.

One of the greatest obstacles to increased economic growth and higher standards of living is our nation's complex and ever changing tax code. The current tax code disproportionately affects small businesses, which are forced to expend significant time and resources in order to comply with the extensive, complicated and burdensome tax code. Moreover, the tax code impedes small businesses growth by discouraging long term investment due to high capital gains taxes and hinders further job creation with an over reliance on payroll taxes.

ABC supports minimizing the tax burden on American citizens – the construction industry in particular – to help increase the rate of capital formation, economic growth and job creation. ABC specifically advocates capital gains tax cuts, full repeal of the estate tax, Alternative Minimum Tax (AMT) relief, independent contractor clarification, cash accounting clarification, increase the threshold for the completed contract method (CCM), and repeal of look-back accounting requirements for construction firms. ABC also supports extending the 15-year depreciation schedule for leasehold improvements, restaurant improvements and new construction, and retail improvements, which is set to expire at the end of 2009.

Specifically, the estate tax is set to expire in Fiscal Year (FY) 2010 for one year and return to its highest taxable rate of 55 percent in FY 2011. Almost one-third of all small business owners today will be forced to sell outright, or liquidate a significant portion of their company to pay for this unfair tax. Construction companies are frequently small, family-owned businesses and are particularly hit hard by the estate tax burden, since the value of these businesses is not in liquid assets. The estate tax not only jeopardizes the survival of family-owned construction companies, but it also siphons off critical funds used for estate planning costs that could be invested back into the business.

Family-owned businesses are the backbone of our economy and give Americans a sense of pride and accomplishment in our country. In the construction industry, they provide valuable jobs and play an integral role in building communities. ABC believes that these businesses are worth preserving for the next generation. Lessening the tax burden on individuals will encourage small business owners and

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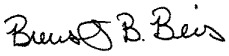
construction companies to reinvest in their businesses, thus expanding the economy. We look forward to working with you to provide tax relief to small businesses.

Sincerely,



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Senior Director, Legislative Affairs