



22nd Annual SEC Government-Business Forum
on Small Business Capital Formation

FINAL REPORT

December 2003

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The SEC hosts the annual Government-Business Forum on Small Business Capital Formation, but does not seek to endorse or edit any of the Forum's recommendations. The recommendations are solely the responsibility of the Forum participants from outside the SEC, who were responsible for developing, voting upon and prioritizing them. The recommendations do not necessarily reflect the views of the SEC, its Commissioners or any of the SEC's staff members.

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INTRODUCTION

Background

As mandated by the Small Business Investment Incentive Act of 1980, the U.S. Securities and Exchange Commission hosts an annual forum that focuses on the capital formation concerns of small business. Called the “SEC Government-Business Forum on Small Business Capital Formation,” this gathering has assembled for 22 years. A major purpose of the Forum is to provide a platform for small business to highlight impediments in the capital-raising process and address their necessity. Each Forum seeks to develop recommendations for governmental or other action to improve the environment for small business capital formation, consistent with other public policy goals, such as investor protection. Prior Forums have published numerous recommendations in the areas of taxation, securities and financial services regulation and state and federal assistance, many of which have been implemented.

The Commission hosted this year’s Forum at the Key Bridge Marriott Hotel in Arlington, Virginia, across the Potomac River from Washington, D.C., on Monday and Tuesday, September 22 and 23, 2003.

Planning and Organization

The SEC’s Office of Small Business Policy in its Division of Corporation Finance, in consultation with the Office of Advocacy of the U.S. Small Business Administration, organized a Planning Committee to provide advice and assistance in organizing this year’s Forum. Consistent with the Forum’s statutory mandate, the Planning Committee’s membership included representatives of federal and state government agencies as well as business and professional organizations concerned with small business capital formation. The members of the 2003 Forum Planning Committee are listed on pages 4 and 5.

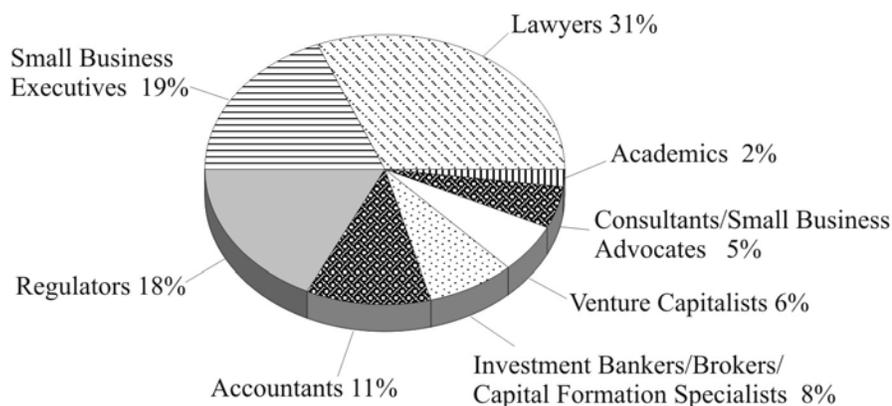
The Planning Committee recommended that this year’s Forum be held in Washington, D.C. and that it remain focused on securities regulation and taxation, as has been the case in recent years. The Planning Committee members also assisted in preparing the agenda and in recruiting speakers and moderators.

Participants

The Office of Small Business Policy worked with members of the Planning Committee in recruiting participants for the 2003 Forum. Both written and e-mail invitations were distributed. The goal was to attract as large a cross-section of the small business community concerned with capital formation as possible. Invitations were sent to participants in previous Forums and to members of numerous business and professional groups and committees concerned with small business capital formation. Groups assisting in recruiting participants included the National Venture Capital Association, National Federation of Independent Business, National Association of Women Business Owners, Financial Executives International, American Society of Corporate Secretaries, National Association of Small Business Investment Companies, U.S. Chamber of Commerce, North American Securities Administrators Association, National Association of Securities Dealers, American Institute of Certified Public Accountants and Section of Business Law of the American Bar Association.

A total of 145 participants attended the 2003 Forum, including 30 speakers, moderators and SEC staff. The occupations of the participants are shown in the following chart.

Occupations of Forum Participants*



* The information in this chart is based primarily on data collected in a survey of participants on the first day of the Forum. When a participant indicated in the survey that he or she had more than one of the designated occupations, the participant was counted as many times as the number of occupations indicated. Participants who were classified as "Regulators," however, were not counted as also being lawyers or accountants. "Regulators" includes employees of the state and Canadian provincial securities regulators and securities self-regulatory organizations; it does not include SEC employees, who were excluded for purposes of calculating the percentages in the chart.

Proceedings

The agenda for the 2003 Forum is reprinted starting at page 6. SEC Commissioner Cynthia A. Glassman provided opening remarks to launch the Forum. Her remarks are presented beginning on page 11. The format for the remainder of the Forum included general session panel discussions, workshops, breakout groups and a final general session. The panel discussions and workshops were designed to stimulate recommendations for governmental and other action to improve the environment for small business capital formation, and to clarify issues. Four breakout groups of approximately 20 participants each met in several sessions over the course of one-and-a-half days. The purpose of the breakout groups was to develop specific recommendations. One breakout group discussed angel investing and venture capital issues. Two others discussed smaller public company issues. The final breakout group discussed tax issues. Participants chose to participate in a specific type of breakout group based on their area of greatest interest. Some participants circulated among a number of breakout groups. At the final general session, a reporter from each of the four breakout groups presented the group's recommendations. The participants then voted on the securities law recommendations and prioritized them using an electronic audience response system with hand-held voting devices. SEC participants were asked to refrain from voting. The recommendations offered by the tax breakout group were presented at the final general session but were not voted upon by the larger group.

In addition to the activities reflected in the formal agenda, some participants in the Forum met with Pamela F. Olson, Assistant Secretary for Tax Policy, U.S. Treasury Department. Participants in the tax breakout groups met with Fred Hartmen, Tax and Finance Counsel, Senate Committee on Small Business and Entrepreneurship; staff of the House Ways and Means Committee, including Greg Nickerson, Chief Tax Counsel, Alex Brill, Senior Tax Economist, and Bob Winters, Special Counsel; and Jim Clark, Chief Tax Counsel, House Small Business Committee. The Office of Advocacy of the U.S. Small Business Administration organized all of these meetings.

PLANNING COMMITTEE

Chairman:

Gerald J. Laporte
Chief, Office of Small Business Policy
Division of Corporation Finance
U.S. Securities and Exchange Commission

Government/Regulatory Representatives

Anthony G. Barone
Special Counsel
Office of Small Business Policy
Division of Corporation Finance
U.S. Securities and Exchange
Commission

Dan Covitz
Economist, Capital Markets
Division of Research and Statistics
Board of Governors of the Federal
Reserve System

Mauri L. Osheroff
Associate Director
Division of Corporation Finance
U.S. Securities and Exchange
Commission

Russell Orban
Assistant Chief Counsel
Office of Advocacy
U.S. Small Business Administration

S. Anthony Taggart
Director, Division of Securities
Department of Commerce
State of Utah
*Corporate Finance Committee Chair,
North American Securities
Administrators Association, Inc.*

Joani Ward
Associate Supervisor
Public Offering Review
Corporate Financing Department
NASD Regulation, Inc.

Barry Wides
Director
Community Development Division
Office of the Comptroller of the
Currency

Representatives of Business and Professional Organizations

Brian T. Borders
Borders Law Group
Washington, D.C.
*Representing National Venture Capital
Association*

Giovanni Coratolo
U.S. Chamber of Commerce
Washington, DC

Christopher W. Frey
Managing Director
CFO Solutions, Inc.
New York, New York
*Representing American Institute of
Certified Public Accountants*

Erin Fuller
Executive Director
National Association of Women
Business Owners
Vienna, Virginia

Bruce Goldberg
PriceWaterhouse Coopers
Philadelphia, Pennsylvania

John J. Huntz
Managing Director
Fuqua Ventures, LLC
Atlanta, Georgia
*Representing National Venture Capital
Association*

Daryl Jackson
Deloitte Touche, LLP
New Orleans, Louisiana

Lee Mercer
President
National Association of Small Business
Investment Companies
Washington, D.C.

Marc Morgenstern
Kahn Kleinman
Cleveland, Ohio
*Representing American Bar Association
Business Law Section Committee on
Small Business*

Bob Shepler
Manager
Government Relations
Financial Executives International
Washington, D.C.

Gregory C. Yadley
Shumaker, Loop & Kendrick
Tampa, Florida
*Representing American Bar Association
Federal Regulation of Securities
Committee
Subcommittee on Small Business Issuers*

FORUM SEC STAFF

Mauri L. Osheroff
Associate Director
Division of Corporation Finance

Office of Small Business Policy Division of Corporation Finance

Gerald J. Laporte, Chief

Anthony G. Barone

Corey A. Jennings

Kevin M. O'Neill

Twanna M. Young

AGENDA

First Day

Monday, September 22, 2003

9:00 a.m. Introductory Remarks Gerald J. Laporte
Chief, Office of Small Business Policy
Division of Corporation Finance
U.S. Securities and Exchange Commission

9:10 a.m. Opening Remarks The Honorable Cynthia A. Glassman
Commissioner
U.S. Securities and Exchange Commission

9:30 a.m. Morning General Session

Panel: Equity Capital Formation for Private and Micro Cap Companies Today

Professor Michael D. Ames
Director, Small Business Institute
California State University – Fullerton

John J. Huntz
Managing Director
Fuqua Ventures, LLC
Atlanta, Georgia

Cynthia I. Pharr
Texas Women Ventures Fund

Professor Jeffrey E. Sohl
Director
Center for Venture Research
Whittemore School of Business
and Economics
University of New Hampshire

11:00 a.m. Breakout Group Meetings:

- **Venture Capital and Angel Investing Breakout Group**
- **Smaller Public Companies Breakout Groups**
- **Tax Breakout Group**

12:15 p.m. Luncheon Speaker Douglass Tatum
Chairman and CEO
Tatum Partners

1:30 p.m. Afternoon General Session

Panel: OTC Equity Securities Markets and Small Business Capital Formation

R. Cromwell Coulson
Chairman & CEO
Pink Sheets, LLC
New York, New York

David A. Haynes
F.T. Ventures
San Francisco, California

Stephen Luparello
Executive Vice President
Market Regulation & U.S. Exchange
Solutions
National Association of Securities Dealers
Washington, D.C.

K. Richard B. Niehoff
President and COO
Mark Securities, Inc.
Pelham Manor, New York

Nancy J. Sanow
Assistant Director
Division of Market Regulation
U.S. Securities and Exchange Commission

3:15 p.m. Workshops

- **Private Placement Workshop**

Alan J. Berkeley, Esq.
Kirkpatrick & Lockhart, LLP
Washington, D.C.

Martin P. Dunn
Deputy Director
Division of Corporation Finance
U.S. Securities and Exchange Commission

- **Workshop on SEC Staff Review of Smaller Public Company Filings**

Tia L. Jenkins
Senior Assistant Chief Accountant
Office of Emerging Growth Companies
Division of Corporation Finance
U.S. Securities and Exchange Commission

Gerard P. O'Connor, Esq.
Foley Hoag, LLP
Boston, Massachusetts

John D. Reynolds
Assistant Director
Office of Emerging Growth Companies
Division of Corporation Finance
U.S. Securities and Exchange Commission

- **Workshop on Credit Capital Formation for Small Businesses**

Ronald E. Bew
Associate Deputy Administrator
Office of Capital Access
U.S. Small Business Administration

Daniel M. Covitz
Economist, Capital Markets
Division of Research and Statistics
Federal Reserve Board

Melissa H. Fischer
Vice President
Bank of America
Washington, D.C.

Barry Wides
Director
Community Development Division
Office of the Comptroller of the Currency

- **Tax Workshop**

Daryl W. Jackson
Director – Tax Services
Deloitte Touche
New Orleans, Louisiana

Russell Orban
Assistant Chief Counsel
Office of Advocacy
U.S. Small Business Administration

4:30 p.m. Breakout Group Meetings:

- **Venture Capital and Angel Investing Breakout Group**
- **Smaller Public Companies Breakout Groups**
- **Tax Breakout Group**

5:30 p.m. Reception

Second Day
Tuesday, September 23, 2003

9:00 a.m. Opening Remarks

The Honorable Thomas M. Sullivan
Chief Counsel for Advocacy
U.S. Small Business Administration

9:30 a.m. Morning General Session

Panel: The Securities Law Regulatory Landscape for Private and Small Cap Companies

Alan L. Beller
Director
Division of Corporation Finance
U.S. Securities and Exchange Commission

Randolph P. Green
Professional Accounting Fellow
Office of the Chief Accountant
U.S. Securities and Exchange Commission

James C.T. Linfield, Esq.
Cooley Godward, LLP
Broomfield, Colorado

Mauri L. Osheroff
Associate Director
Division of Corporation Finance
U.S. Securities and Exchange Commission

10:50 a.m. Breakout Group Meetings:

- **Venture Capital and Angel Investing Breakout Group**
- **Smaller Public Companies Breakout Groups**
- **Tax Breakout Group**

12:45 p.m. Luncheon Speaker The Honorable Donald Manzullo
Chairman
Committee on Small Business
U.S. House of Representatives

2:00 p.m. Final General Session

*Breakout Group Presentations of Recommendations and Voting on
Securities Law Recommendations*

**OPENING REMARKS
OF
COMMISSIONER CYNTHIA A. GLASSMAN**

Government-Business Forum on Small Business Capital Formation

September 22, 2003

Good morning, and thank you, Gerry, for that introduction. It is a pleasure being here this morning to welcome you to the 22nd Annual Government-Business Forum on Small Business Capital Formation. Let me state, at the outset, that the views I express here today are my own and not necessarily those of the Commission or its staff.

I have worked on small business issues throughout my career as an economist in both the public and private sectors. When I spent a year on loan from the Federal Reserve to the Treasury Department's Office of Capital Markets Legislation in 1980, I was staff liaison to the Small Business Advisory Committee. When I returned to the Fed, I worked on a study of commercial bank lending to small businesses and participated on an interagency task force on small business. Under Chairman Paul Volcker, as the Fed's small business economist, I was also responsible for handling calls and complaints from small business owners, and I still haven't forgotten some of the calls I got in the late 70's when the prime rate went over 18%. Needless to say, they weren't very friendly.

When I left the public sector, I continued to work on small business issues as a consultant, focusing on bank lending to small business. In 1996, I testified before Congress on consumer and small business banking issues.

So, I am well aware of the importance of small business to our economy. In preparing my remarks for this morning, I came across some powerful statistics from the Small Business Administration that underscore the impact of small business on the U.S. economy. In 2002, there were nearly 23 million small businesses in the United States. These firms:

- represent more than 99.7% of all employers;
- employ more than half of all private sector employees, including 39% of high-tech professionals such as scientists, engineers and computer engineers;
- generate 60-80% of net new jobs annually; and
- create more than 50% of non-farm private gross domestic product.

The requirement for an annual forum, mandated under the Small Business Capital Formation Act of 1980, reflects Congress' recognition of the importance of small business to our economy as a whole. It provides you an opportunity to hear from and interact with our staff and the staffs of other government agencies on issues that are

important to small business, and it is our opportunity to hear and learn from you. Another means of communication is available to you through the Office of Small Business Policy within the Division of Corporation Finance. The office has rulewriting functions, provides interpretive advice, and acts as the SEC's small business ombudsman. I encourage you to make use of the resources of this special office.

I want to emphasize the important role that those of you who are from small business issuers, and your advisers, can play in the Commission's rulemaking process. It is critical that small business issuers take advantage of the comment process to inform us of your views on the effectiveness of our proposed rules and the special regulatory burdens and compliance costs that are associated with them. The Commission is very sensitive to the impact of its rules on small business, and the more informed we are about the effect of our rules on small business, the more narrowly we can target our rules to achieve our objectives.

As you know, last year the Commission adopted several new rules pursuant to the Sarbanes-Oxley Act of 2002. Even before the enactment of Sarbanes-Oxley, we had begun work on accelerating the filing of quarterly and annual reports, requiring certification of those reports by CEOs and CFOs, and speeding up the disclosure of personal securities trading by corporate insiders. Under Sarbanes-Oxley, we required companies to disclose material off-balance sheet arrangements, added a requirement for listed companies to disclose whether they have a financial expert on their audit committees, and required an annual report assessing the quality of their internal control over financial reporting.

In each of these areas, we tried to be sensitive to the concerns of small business issuers about cost-effectiveness. I'm sure we didn't satisfy everybody, but we did make a number of accommodations.

- Public companies with less than \$75 million in market capitalization were exempted from the accelerated deadlines for quarterly and annual reports.
- Public companies with less than \$25 million in revenues and \$25 million in market capitalization (our definition of "small business issuers") were not required to provide a table of contractual obligations.
- Small business issuers got an extra six months to comply with the new rule requiring disclosure of whether they have an audit committee financial expert on their audit committees.
- Public companies with less than \$75 million in market capitalization got an additional nine months to comply with the new rules requiring a report on internal control over financial reporting.

- Small auditing firms with fewer than five public-company audit clients and ten partners are exempt from the audit partner rotation requirements and the prohibitions on providing non-audit services to public company clients.

Now that the flurry of Sarbanes-Oxley rulemaking has subsided, companies both large and small are in the process of adjusting to the new rules, and the Commission is in the process of assessing the effectiveness of the new rules. We are monitoring whether the rules are achieving our objectives, looking out for unintended consequences and seeing whether any changes to the rules need to be made. I've heard anecdotal evidence that some companies are having difficulty finding directors willing to sit on corporate boards and that finding audit committee financial experts has been a particular problem for small business. As the Sarbanes-Oxley rules get fully implemented, these are issues that we need to monitor.

We've also heard anecdotal evidence we're aware of that some smaller public companies may forego their public reporting status rather than comply with the new Sarbanes-Oxley governance requirements. Of course, good corporate governance and clear and accurate financial reporting are the right objectives, regardless of whether your company is large or small.

But as an economist, I think we need to re-examine whether we are providing the appropriate incentives. We recognize that it is important for small businesses to grow and prosper; our economy needs the new jobs and new products small businesses create. Yet some of you are telling us that we do not make it easy enough for small businesses to raise the capital they need to expand. With some exceptions, we generally expect small businesses to comply with the same regulatory requirements that apply to more established companies. And even when a small business makes it to the public company stage, where capital raising should be easier and cheaper, compliance costs—regulatory as well as financial—may act as a disincentive to expansion. Obviously, if that is happening, that is a serious concern.

However, as always, there is another side of the story that we must consider. A large number of the frauds we see in our enforcement actions are perpetrated by small businesses—and investors in small business deserve the same disclosures and protections as investors in bigger business.

Nevertheless, if we are serious about the need to improve the environment for small business capital formation—and I certainly am—we need to determine our objectives and our priorities for reform from among the many recommendations the forum has made, keeping in mind the importance of investor protection to our mission and your reputations.

As a long-time supporter of small business, I will continue to make sure that we take into account the impact of our rules on small businesses. I hope you have a productive forum and I look forward to seeing the results of this year's discussions.

Thank you very much.

RECOMMENDATIONS*

Set forth below are the recommendations of the 2003 Government-Business Forum on Small Business Capital Formation. The taxation recommendations follow the securities regulation recommendations.

Securities Regulation Recommendations

The securities regulation recommendations are presented in two lists. The proposals on the first list are referred to as the “top ten” recommendations. The lower-ranked proposals are numbered 11 through 26 and are presented in a second list. Both lists are presented in the order of priority established by the Forum participants voting by means of an electronic audience response system. An explanation of the manner of establishing the priorities and the meanings of the average ratings and percentage scores presented after the recommendations may be found after the recommendations, beginning on page 19.

Top Ten Securities Regulation Recommendations

1. The SEC should work with NASAA and the NASD to undertake the following:

- (a) address the regulatory status of finders;**
- (b) facilitate an appropriate role for finders in the capital-raising process;
and**
- (c) clarify the circumstances under which issuers and others can legally compensate finders and other capital formation specialists who meet minimum standards.**

In undertaking this effort, the SEC staff should focus specifically on whether to create an exemption from broker-dealer and/or investment adviser registration requirements for certain finders or instead issue a new regulation enabling these finders to register under a simplified regime aimed at regulating finders engaging in a defined category of activities. Factors that should be considered in crafting such an exemption or regulation should include:

- (a) whether NASD membership should be required;**

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- (b) the form of the application (such as the one proposed by the ABA Task Force Draft Form 1010EZ dated July 9, 2002, referred to as “Form 1010-EZ - Private Placement Broker-Dealer”);**
- (c) lower fees for application and (annual) renewal;**
- (d) appropriate testing requirements;**
- (e) certification as to no “bad boy” disqualifications;**
- (f) no custody of client funds or securities permitted;**
- (g) no minimum net capital requirements;**
- (h) appropriate bonding requirements;**
- (i) explicit recognition that transaction-based remuneration is permitted;**
- (j) no discretionary authority permitted for investments;**
- (k) appropriate record-keeping requirements; and**
- (l) applicable sales practice rules.**

Further to this initiative, the SEC staff should:

- (a) consider the findings and recommendations in the upcoming final report on the subject of finders of the Subcommittee on Small Business Issuers of the Federal Regulation of Securities Committee of the ABA Section of Business Law; and**
- (b) within the next 12 months issue a concept release addressing the adoption of a finder exemption and soliciting comment from the small business community and other interested parties.***

* Recommendation 1 is a combined version of three separate recommendations concerning “finders,” each of which had been reported by a different breakout group. The term “finder” is used to designate a person who assists a securities issuer in locating investors but is not registered as a broker-dealer under the Securities Exchange Act of 1934. The three individual recommendations received the top three average ratings in the voting conducted to establish priority rankings for the securities regulation recommendations, as described beginning on page 19. As a result of these top rankings, the assembly decided to appoint a committee to combine the three finders recommendations into one, and to report the combined recommendation as the highest priority recommendation of the Forum. The committee consisted of Brian T. Borders, Roger V. Davidson and Gerard P. O’Connor. Recommendation 1 is the result of the committee’s efforts. The three original recommendations read as follows:

- (1) The states and the SEC should address the regulatory status of finders in order to facilitate the legitimate role of finders in the small business capital formation process. This should include:

- 2. The SEC should support the efforts of the Public Company Accounting Oversight Board to develop and establish appropriate protocols with respect to compliance with Section 404 of the Sarbanes-Oxley Act for small businesses. (6.84 avg. rating, 81.08%)**
- 3. The SEC Office of Small Business Policy should appoint a committee of Forum participants to work with the SEC and the SBA in following up on the progress of implementing the recommendations made at the Forum. (6.60 avg. rating, 89.36%)**
- 4. Congress should enact another omnibus small business capital formation act with a purpose similar to the Omnibus Small Business Capital Formation Act of 1980. (6.45 avg. rating, 74.41%)**
- 5. One of the SEC Commissioners should be designated to act as a liaison to the small business community. (6.43 avg. rating, 73.33%)**
- 6. The SEC should allow quotation in the pink sheets to be considered equivalent to quotation on the OTCBB for the purpose of enabling issuers to use the current market price as the sales price in a selling shareholder Form SB-2 registration statement. (6.39 avg. rating, 70.83%)**
- 7. The SEC should follow Section 212 of the Small Business Regulatory Enforcement Fairness Act of 1996 in publishing compliance guidelines specifically**

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- (a) an evaluation of the ABA final report on finders and adoption of limited broker-dealer/finders and investment advisor exemptions or at least create a limited regime to regulate their activities; and
 - (b) consider whether broker-dealers, issuers, or investors could effectively function as gatekeepers and legally compensate capital formation specialists who meet minimum standards. (7.46 avg. rating, 82.22%)
 - (2) The SEC should create a limited broker-dealer licensing category for financial intermediaries who are not registered through a broker-dealer firm within the following parameters:
 - (a) NASD membership required;
 - (b) abbreviated application form;
 - (c) lower fees for application and renewal;
 - (d) appropriate testing requirements;
 - (e) applicants must certify that there are no “bad boy” disqualifications;
 - (f) annual renewal of registration;
 - (g) no custody of client funds or securities permitted;
 - (h) no minimum net capital requirements;
 - (i) appropriate bonding requirements;
 - (j) explicit recognition that these persons may accept transaction-based remuneration;
 - (k) no discretionary authority permitted;
 - (l) record-keeping appropriate to the business; and
 - (m) applicable sales practice rules. (7.04 avg. rating, 71.42%)
 - (3) The SEC should issue a concept release addressing the adoption of a “finder” exemption from Broker/Dealer registration requirements where activities customarily associated with brokers (*e.g.*, directed selling efforts) are not present. (6.94 avg. rating, 89.36%)

for small business issuers on all aspects of compliance with the Sarbanes-Oxley Act, and in particular Section 404. (6.34 avg. rating, 89.74%)

8. The SEC should amend Regulation A to:

(a) return the review process to the SEC regional offices;

(b) increase the aggregate dollar limit from \$5 million to \$10 million; and

(c) for those issuers intending to raise over \$5 million, adopt the following financial statement requirements to replace current requirements (issuers seeking \$5 million or less would comply with the current financial statement requirements):

(i) historical financial statements must, at a minimum, be reviewed in accordance with Statements on Auditing Standards No. 71 and be accompanied by an accountant's review report; and

(ii) forecasted financial statements, if forecasts are included, must, at a minimum, be compiled by an independent public accountant and must support the registrant's sources and uses of funds calculations. (6.33 avg. rating, 80.00%)

9. We strongly encourage the SEC to make the issue of DTC settlements and monitoring of short sales a priority matter for resolution. (5.95 avg. rating, 78.57%)

10. The SEC should recommend that the NASD designate in the NASD trading tape either the designation "OTCBB" or an equivalent designation for all companies that report under the Securities and Exchange Act of 1934 and that are current in their reporting to the SEC. (5.94 avg. rating, 70.21%)

Remaining Securities Regulation Recommendations

11. The Division of Market Regulation should establish a small business advocate/contact person to focus specifically on small business issuers and issues. (5.71 avg. rating, 89.58%)

12. The SEC Division of Corporation Finance should increase the number of examiners and reviewers. (5.85 avg. rating, 81.39%)

13. The SEC should accept the new Small Company Offering Registration (SCOR) Form U-7 for use in Regulation A and Form SB-1 filings. (5.37 avg. rating, 77.77%)

14. The restrictions on the use of general solicitation to make offers and sales under Rule 506 to accredited investors should be eliminated or loosened. (69.76%)

15. The SEC should study the economic impact of the Sarbanes-Oxley Act on the liquidity horizon of small businesses. (65.85%)

16. The NASD should change Rule 2460 from a blanket prohibition of payment by issuers to market makers for publication of quotations to a requirement that member firms disclose any payments by an issuer for publication of quotations. (65.62%)

17. If an issuer conducts a Rule 504 offering under Regulation D for federal law purposes and files an offering document with a state having review and prospectus delivery requirements, the SEC and NASAA should allow the issuer to sell shares in other states that have compatible exemptions available and permit unrestricted trading, assuming full compliance with state law. (62.16%)

18. The Commissioners should monitor and adjust as necessary the Commission's resources to maintain the efficiency of the organization, capabilities, and adequacy of its responsiveness to the needs of small businesses. (61.90%)

19. All companies that have a class of securities registered under Section 12(g) of the Securities Exchange Act of 1934 and that are current with their reporting requirements should have a streamlined automatic clearance application process for the OTCBB. (61.90%)

20. The SEC should permit the payment of a nominal fee to market makers for Rule 15c2-11 bulletin board filings with the NASD. (61.53%)

21. In order to facilitate small businesses raising capital while in registration with the Commission, the SEC should establish a new safe harbor rule to permit a concurrent, non-public, exempt private offering by small businesses during periods when the small businesses have filed a registration statement with the Commission for a primary or resale public offering of securities. (60.00%)

22. The definition of accredited investor should not be changed. (60.00%)*

* This recommendation was reported to the Forum assembly at the afternoon general session on the second day of the Forum. Earlier that day, the SEC staff coincidentally had polled the assembly on the subject of the recommendation. The following statement was first read to the assembly and projected on a screen:

The SEC staff is often asked for its sense of how the small business community would react to any proposal to change the standards for individual "accredited investors" in Regulation D. As you may know, the current standards of \$200,000 in annual income and \$1 million in net worth for individual accredited investors were set initially in 1982.

(footnote cont'd)

- 23. The issuer should be the primary party in the application process for quotation on the OTC instead of the market maker. (57.14%)**
- 24. In an attempt to broaden the financial participation by a large portion of the public, the SEC should support efforts at financial literacy with the goal of increasing the investor pool of informed buyers. (51.28%)**
- 25. The SEC should encourage the creation of a second-tier market on national stock exchanges to provide an auction market alternative for small capitalization companies. (38.88%)**
- 26. The SEC should permit a post-effective amendment to be filed on a Form S-4 registration statement with respect to a Rule 419 blank check offering to cover the shares issued to the private company’s stockholders. (37.93%)**

* * * * *

The recommendations above are presented in the order of priority established by means of an electronic audience response system in which the voting participants used hand-held electronic devices to record their preferences. Approximately 40 participants voted. The SEC staff distributed a list of 28 recommendations reported by the three breakout groups that devoted their time to discussing securities regulation recommendations. The breakout groups included an “angel investing and venture capital” group and the two “smaller public company” groups. An SEC staff member read each reported recommendation from the podium during the final general session of the Forum. He then asked the voting participants to indicate, by pressing “yes” or “no” on their voting devices, whether or not the issue was important to the participant. The votes were tallied electronically. Each recommendation was assigned a score consisting of the percentage of voting participants who indicated that the issue was important to them. The scores ranged from a low of 37.93% to a high of 89.74%, and are presented in parentheses following each recommendation. Recommendations 11 through 26 are presented in the order of priority established through this voting and scoring process.

The top ten recommendations are presented in a more refined order of priority. This order was established by having an SEC staff member read the 15 recommendations

The audience then responded to the questions set forth below as follows:

<u>Question</u>	<u>Yes</u>	<u>No</u>
Are you in favor of increasing the income and net worth standards for individual accredited investors to reflect changes in income and wealth since the 1980s?	17% (10 votes)	83% (49 votes)
<u>Question</u>	<u>Yes</u>	<u>No</u>
Are you in favor of substituting an assets under investment test for the income and net worth tests to determine accredited investor status?	17% (10 votes)	83% (48 votes)

that received the highest scores in the first voting exercise and then asking the participants to indicate through their voting devices, on a scale of 1 to 10, how intensely they felt that each of the 15 recommendations warranted implementation. As explained above in the footnote beginning on page 15, three recommendations concerning “finders” received the three highest average ratings in this voting exercise. To obtain the “top ten” proposals, these three recommendations were combined into Recommendation 1, and the recommendations receiving the next nine highest average ratings became Recommendations 2 through 10. The “top ten” recommendations above are presented in the order of priority established through this second voting exercise. The first number appearing in parentheses after each top ten recommendation is the average rating for that recommendation resulting from the second voting exercise. The second number is the percentage score for the recommendation resulting from the first voting procedure. Recommendations 11 through 13, which failed to achieve a top ten rating because they did not receive a sufficiently high average rating in the second voting exercise, are also presented with both of these numbers.

TAXATION RECOMMENDATIONS

The tax breakout group developed and prioritized the following recommendations and presented them to the final general session of the Forum:

Small business is the engine that drives the American economy, and, therefore, warrants specific tax legislation that is appropriate for the particular capital formation and compliance needs of small business. Small business needs a comprehensive “simple” tax system and deserves separate legislation that applies only to small business so that the needs of small business can be thoroughly researched and discussed.

If Congress cannot provide a new, more simple comprehensive tax system, then small business needs the following eight critical priority items to improve the current Internal Revenue Code:

1. Conform individual retirement account (IRA) contribution due dates to all other retirement vehicle plan contribution due dates, namely, the due date of the income tax return, including extensions. See IRC Section 219.

Under current law, IRA contributions must be deposited by April 15th of the following year. As a matter of uniformity with other retirement vehicles, the due date for contributions should be the same as the tax-filing date, including extensions. For many small businesses, the sole proprietor does not have the cash to pay taxes, pay the first quarter’s estimated tax payment, and fund an IRA all at the same time. Therefore, the IRS contribution deadline should be extended to include extensions filed beyond the April 15th due date.

2. Congress should enact a comprehensive review of depreciation rates, limits and class lives. See IRC Sections 179, 139, 167 and 280F.

Small businesses appreciate recent efforts by Congress to increase expensing under Section 179, as well as the new regulations issued by the IRS to exclude certain specially modified trucks and vans from depreciation limits under Section 280F. Notwithstanding, the overall depreciation system is a complicated and confusing area that should be thoroughly reviewed, keeping in mind the costs and benefits to small business.

3. Incentive stock option rules should be amended to include an alternative valuation date identical to the estate tax rule alternative valuation date. See IRC Sections 1014 and 55.

Employee incentive stock options are an important resource to small business to attract and retain talented, experienced staff without cash flow drain. The current law does not impose income tax at the exercise date, as it does with non-qualified options, but does impose an alternative minimum tax. In a volatile marketplace, the choice of whether to hold or sell the stock puts a burden on the employee who wants both to

continue to participate as an owner and protect the value of the company, while at the same time recognizing the value of the employee's labor. The alternative minimum tax is imposed on the "gain," described as the difference between the exercise price and the market price at the transaction date. In many cases, the employee is required by the terms of the option agreement with the corporate issuer to retain the stock after the transaction date. The burden arises when the value of the stock falls after the transaction date. Accordingly, the current law should be amended to provide an "alternative exercise date" for the incentive stock option valuation one year after the transaction date. This would be identical to the "optional valuation date" currently allowed in computing estate valuations.

4. The 50% exclusion of gain on qualified small business stock pursuant to Section 1202 should not be subject to the alternative minimum tax imposed pursuant to Section 55.

The 1993 tax law changes to Sections 1202 and 1045 of the Internal Revenue Code that were designed to attract capital to small businesses were a small first step in leveling access to the capital playing field. They are meaningless, however, without critical changes. Under current law, the gain exclusion benefit of Section 1202 is negated by the operation of the alternative minimum tax imposed by Section 55.

5. The unified estate and gift credit equivalent should be permanently increased to \$5 million per person and adjusted annually for inflation. See IRC Section 6018.

Congress has recognized the unfairness of the estate tax. Unfortunately, the failure to repeal permanently the "death tax" has created uncertainty in the business continuation plans of millions of small business owners. Recognizing that permanent repeal has been difficult and expensive to achieve, the estate tax should be retained but with a unified credit permanently increased to an exemption equivalent of \$5 million per person, indexed for inflation and with no change in stepped-up basis at death rules. Such policies would preserve capital facilitating inter-generational businesses to continue. In the short term, this will also reduce the cost and amount of estate planning.

6. Self-employment health insurance should be universally deductible at the entity level. See IRC Sections 162 and 419.

As a matter of taxpayer equity, the cost of health insurance for all participants should be deductible at the entity level in calculating net income, regardless of whether the entity is a Subchapter C or S corporation, a partnership or a sole proprietorship. Regardless of the entity, all business owners should be treated identically, thereby allowing small business owners to retain more capital.

7. The U.S. Treasury Department should reestablish the Small Business Advisory Committee.

The Secretary's Office of the U.S. Treasury Department should reestablish the Small Business Advisory Committee. This committee has served as an important link between the small business community and the Treasury Department by communicating clearly and directly the tax issues to the Secretary's Office. Further, this committee should be viewed as distinct from the Internal Revenue Service Advisory Council. The Secretary's Small Business Advisory Committee would provide small business input on the policy side of tax laws, as contrasted with the compliance/regulatory issues addressed by the Internal Revenue Service Advisory Council.

8. Meal and entertainment expenses should be 100% deductible by small businesses. See IRC Section 274.

Small business capital is generated from revenue increases and expense reductions, as well as direct capital raising. Access to the providers of capital is often accomplished one-on-one, or person-to-person, over a meal with a small business owner, rather than through costly public offerings and the use of the mass media. Marketing and advertising expenses for small businesses are proportionately less than big businesses' direct marketing, advertising and capital-raising expenses, in part because small businesses use business meals and entertainment in place of more costly marketing and advertising. Therefore, in concurrence with the recommendations of the White House Conference on Small Business, a full exclusion for business meals and entertainment should be allowed for all small businesses under Section 274.

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