



COMMITTEE ON PRIVATE COMPANY-POLICY

November 17, 2010

Gerald J. Laporte
Chief, Office of Small Business Policy
Division of Corporate Finance
Securities and Exchange Commission
100 F Street NE, Room 3650
Washington, D.C. 20549

Dear Mr. Laporte:

We are providing this statement on behalf of the Committee on Private Company-Policy ("CPC-P") of Financial Executives International ("FEI") in response to the Security and Exchange Commission's ("SEC") Government-Business Forum on Small Business Capital Formation. CPC-P appreciates the opportunity to express our views regarding ways for government to work with privately-held and family owned businesses to improve the environment for small business capital formation.

FEI is a professional association representing the interests of more than 15,000 chief financial officers, treasurers, controllers, tax executives, and other senior financial executives from over 8,000 major companies throughout the United States and Canada. FEI represents both the providers and users of financial information. CPC-P is a national committee that formulates policy for FEI in line with the views of the membership. This statement represents the views of the CPC-P.

Protecting Privately-held and Family Owned Business' Access to Capital: Since the financial market meltdown of 2008, private companies have felt the impacts of significant contraction of liquidity in the traditional financial sector, with the banks having their capital bases severely shrunk and credit standards tightened by the U.S. government and associated oversight agencies. Private companies finance most of their capital needs through after tax cash flow and traditional bank borrowing. When cash flow is reduced or restricted due to increased taxes or tighter lending rules and regulations, it limits private companies from generating jobs, making investments or performing research and development. Additionally, the uncertainty surrounding the existence and reach of certain tax policies prevents private companies from being able to plan and commit capital which stifles growth in an already soft economy.

Therefore, a number of impediments that private companies face when attempting to access capital would be lessened if Congress and the SEC would work to: a) enhance policies that increase access to capital via the development of more competitive U.S. tax policies for privately-held companies that promotes and sustains technological innovation, supports U.S. manufacturing and investment in inventory, encourages savings through business investment, and b) provide reasonable access to traditional banking credit markets by

insuring that policies and regulations are consistently aligned.

FEI supports pro-growth policies and recommends the following principles to assist with privately-held business capital formation:

- ***Enhance the global competitiveness of U.S. companies.*** The U.S. has the second highest corporate tax rate among industrialized countries. A competitive effective corporate income tax rate is needed for the U.S. to remain competitive in the global marketplace and to promote continued U.S. economic growth and job creation.

The relatively high U.S. tax rate creates a long-term competitive disadvantage for U.S.-based businesses. High corporate tax rates make domestic investment less attractive and create a competitive pricing advantage for companies with lower corporate income tax rates. Over time companies in lower effective tax rate environments achieved both higher real wage levels and economic growth rates. We encourage policymakers to lower rates and restore the U.S. corporate tax system to a competitive position.

While many businesses pay their taxes through the corporate tax system, a **significant portion of small and family owned businesses are subchapter "S"** corporations or partnerships, and the owners pay their business taxes on their personal tax return. As a result, provisions of the personal tax code, such as the personal Alternative Minimum Tax (AMT), personal income tax rates and the estate tax have an impact on small businesses. Further, any privately-held business of substance will generate taxable income allocable to its owners plus earned income in excess of the \$200,000/\$250,000 putting them in the highest tax rate classification. In most cases, the allocated tax income less the taxes on such income is retained in the business to meet capital needs. It is important to U.S. job growth to extend the current tax rates enacted in 2001 and 2003 and index the AMT to inflation.

It is also essential to recognize that the current estate tax system penalizes privately-held businesses by creating a material liquidity event at the time of the **owner's** death. This liquidity event causes significant disruption in those businesses with many ceasing to exist and destroying capital and jobs. At a best case basis, capital which could otherwise be used to maintain and grow jobs and produce output is diverted from the business to satisfy the death taxes. We believe the best policy is to fully repeal the estate tax. However, we understand that full repeal of the estate tax may not be possible with current budget deficits, so we support more equitable relief that does not unduly penalize going concerns that wish to survive the death of an owner.

In addition, the Interest Charge Domestic International Sales Corporation (IC-DISC) is an important tax provision that was created by Congress over 20 years ago to improve the competitiveness of U.S. exporters in the global marketplace. The US economy increasingly relies on small exporters for economic growth, and small and closely-held exporters rely upon the IC-DISC tax provision to grow their businesses and employee rosters. Therefore, CPC-P recommends that the IC-DISC provision should be protected in any future tax reform efforts.

- ***Promote and Sustain Technological Innovation.*** Technological developments are an important component of economic growth, productivity and high paying jobs. Tax policy considerations provide a historic opportunity to make permanent the research and development (R&D) tax credit. The credit also should be strengthened by

increasing the Alternative Simplified Credit. The R&D credit spurs innovation and economic growth and creates high-wage American jobs. A permanent extension of the strengthened credit would enhance its incentive value by providing the certainty that would permit companies to factor it into their long range project planning.

- ***Support U.S. Manufacturing and Investment in Inventory.*** The last-in, first-out (LIFO) inventory accounting method has been expressly permitted in the tax law for 70 years and has a solid foundation in financial accounting and economic theory. LIFO encourages companies to maintain and grow their investment in inventory which in turn furthers job creation. Moreover, LIFO accurately reflects income for tax purposes because current revenues are matched against current costs.

The repeal of LIFO as a method of inventory accounting would have an adverse effect on companies in many different industries, including general manufacturing, publishing, retail and textiles. In some cases, companies might be forced to raise significant equity or debt capital in order to maintain their current financial position if LIFO were repealed. We encourage policymakers to preserve LIFO for American businesses that maintain inventories.

- ***Encourage Savings Through Business Investment.*** Business investment is another important driver of economic growth and jobs. However, the lack of available capital has made it increasingly more difficult for privately-held businesses to invest money in their own company. For example, various business leaders have recently floated the idea of providing companies tax credits or a tax holiday over a specified length of time to businesses that make capital investments in the U.S. by building or expanding a new facility. Ideas like this will not only further the value of the capital investment for companies, but it will also create an environment where workers are hired and the economy is stimulated.
- ***Avoid Tax Increases Targeted at Specific Corporate Structures.*** Recently, there was an effort in Congress to require many S corporations to begin paying employment taxes on all active shareholder, non-wage income. Since shareholders in S corporations are taxed even when income is not actually distributed, this provision would have reduced capital available to S corporation owners to create jobs and invest in their businesses. This particular provision is just the latest example of efforts to alter established tax law pertaining to the most popular corporate structure in the U.S. Nearly 62 percent of all business entities are set up as S corporations. Therefore, they are one of the main drivers of job and economic growth. This is why CPC-P recommends that the rules pertaining to S corporations be simplified and greater flexibility be provided to the owners of these vital corporate structures.
- ***Review of Costly and Burdensome Policies.*** Privately-held companies continue to be concerned with the overly prescriptive and costly regulations that are required of them by the U.S. Federal government. A recent example of additional burdensome requirements asked of privately-held companies is the 1099 reporting requirement found in the ***Patient Protection and Affordable Care Act***. CPC-P agrees that finding practical ways to reduce the tax gap and prevent waste, fraud and abuse is beneficial. Nevertheless, the new 1099 reporting requirement is estimated to increase the man-hours spent on complying with the new requirements tenfold. The time and money needed to meet this new requirement diverts resources away from providing additional value to businesses which is needed to grow the economy. Further, we are concerned with the premise behind this reporting requirement that commercial transactions involving the sale and purchase of goods and certain

services are not properly accounted for as gross receipts on the books of the seller. Thus, CPC-P supports the full repeal of the 1099 reporting requirement.

CPC-P also understands the critical needs of privately-held companies to obtain cost-effective professional assistance in: a) raising private capital prior to an initial public offering (IPO), and b) transferring ownership of their businesses via purchases, sales, or exchanges of stock, mergers, and other acquisition structures, in order to continue their growth and create new jobs. As a result, CPC-P supports efforts **undertaken by the American Bar Association ("ABA") and the Alliance of Merger and Acquisitions Advisors ("AM&AA")** to clarify and simplify laws and regulations impacting the securities-related activities of private placement brokers and M&A advisors/intermediaries. CPC-P recommends that the SEC adopt rules as first recommended by the ABA in its Report and Recommendations of the Task Force on Private Placement Broker-Dealers, dated June 20, 2005, and subsequently adopted/recommended by the SEC Government-Business Forums on Small Business Capital Formation of 2006, 2007, 2008 & 2009. Private Placement Brokers (PPB) and M&A Brokers (MAB) are important to small privately-held companies, because current rules pertaining to licensed brokers make the cost of raising pre-IPO capital and mergers and acquisitions too prohibitive for many private companies, effectively disallowing such firms from having access to these important sources of early stage funding.

CPC-P would welcome any opportunity to discuss these proposals or to provide additional information. CPC-P **staff and business leaders from FEI's member companies are available** to speak on any of these issues. If you or your staff should have any questions, feel free to contact Chris Graham, Manager of Government Affairs at 202-626-7809 or cgraham@financialexecutives.org.

Sincerely,



Mark Smetana
Chair
FEI Committee on Private Company-Policy