

TWENTY-SIXTH ANNUAL

SEC Government-Business
Forum on
Small Business
Capital Formation



FINAL REPORT

September 24, 2007
Washington, DC

2007 Annual SEC Government-Business Forum
on Small Business Capital Formation

FINAL REPORT

Published June 2008

The SEC hosts the annual Government-Business Forum on Small Business Capital Formation, but does not seek to endorse or modify 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 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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SUMMARY OF PROCEEDINGS

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 every year since 1982. A major purpose of the Forum is to provide a platform for small business to highlight perceived unnecessary impediments in the capital-raising process and address whether they can be eliminated or reduced. Each Forum seeks to develop recommendations for governmental and private actions to improve the environment for small business capital formation, consistent with other public policy goals, including investor protection. Prior Forums have published numerous recommendations in the areas of securities and financial services regulation, taxation and state and federal assistance, many of which have been implemented.

The 2007 Forum, the 26th, convened at the SEC’s headquarters at 100 F Street, N.E., Washington, D.C., on Monday, September 24, 2007.

Planning and Organization

Consistent with the Commission’s statutory mandate in the Small Business Investment Incentive Act of 1980, the Commission’s Office of Small Business Policy, Division of Corporation Finance, invited other federal and state government agencies and leading small business and professional organizations concerned with capital formation to participate in planning the 2007 Forum. The individuals who participated in planning the Forum, and their professional affiliations, are listed on pages 4 and 5.

The planning group 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 members of the planning group also assisted in preparing the agenda and in recruiting speakers and moderators.

Participants

The SEC’s Office of Small Business Policy worked with members of the planning group to identify participants for the 2007 Forum. Invitations were sent to participants in previous Forums and to members of various business and professional organizations concerned with small business capital formation. The SEC issued two press releases to inform the public about the time, date and location of the Forum. The press releases publicized the fact that the Forum would be webcast live over the Internet.

* The SEC is required to conduct the forum annually and to prepare this report under 15 U.S.C. 80c-1 (codifying section 503 of Pub. L. No. 96-477, 94 Stat. 2275).

Approximately 100 participants attended this year's Forum in person, including 11 roundtable panelists, moderators and SEC staff. The video webcast of the Forum received 567 hits on the day of the Forum, indicating that many individuals participated by watching or listening over the Internet. To date, the archived video webcast of the Forum has received an additional 383 hits.

Proceedings

The agenda for the 2007 Forum is reprinted starting at page 6. The Forum began with opening remarks from SEC Chairman Christopher Cox, which are reprinted starting on page 8. Chairman Cox's remarks were followed by two morning roundtable discussions. SEC Commissioner Paul S. Atkins gave the luncheon address.

This year's Forum gave participants a unique opportunity to discuss and provide comments and recommendations on six securities law rule proposals approved by the Commission at an open meeting on May 23, 2007.* All of the proposals were designed to facilitate capital formation by small businesses. All were pending before the SEC at the time of the Forum.

The afternoon proceedings included breakout group meetings. Four breakout groups met simultaneously, one on securities offerings by private companies, another on securities regulation of smaller public companies, a third on private placement and M&A broker-dealers, and the last on tax issues affecting small businesses.

The breakout group on securities offerings by private companies discussed and made recommendations on three of the six proposals involving small business capital formation pending before the SEC at the time. The three proposals were those proposing revisions to the limited offering exemptions in SEC Regulation D, changes to the process for filing and information requirements of SEC Form D, and a new exemption for compensatory employee stock options from registration under Section 12(g) of the Securities Exchange Act of 1934. This breakout group continued the discussions of the first morning roundtable, which also focused on these three rule proposals. Brian T. Borders and Marc H. Morgenstern moderated this breakout group.

* These releases included: (1) *Revisions of Limited Offering Exemptions in Regulation D*, Release No. 33-8828 (Aug. 3, 2007) [72 FR 45116 (Aug. 10, 2007)] (proposing release not yet acted upon); (2) *Electronic Filing and Simplification of Form D*, Release No. 33-8814 (Jun. 29, 2007) [72 FR 37376 (July 9, 2007)] (proposing release), *adopted*, Release No. 33-8891 (Feb. 6, 2008) [73 FR 10592 (Feb. 27, 2008)]; (3) *Exemption of Compensatory Employee Stock Options from Registration under Section 12(g) of the Securities Exchange Act of 1934*, Release No. 33-56010 (July 5, 2007) [72 FR 37608 (July 10, 2007)] (proposing release), *adopted*, Release No. 34-56887 (Dec. 3, 2007) [72 FR 69554 (Dec. 7, 2007)]; (4) *Smaller Reporting Company Regulatory Relief and Simplification*, Release No. 33-8819 (July 5, 2007) [72 FR 39670 (July 19, 2007)] (proposing release), *adopted*, Release No. 33-8876 (Dec. 19, 2007) [73 FR 934 (Jan. 4, 2008)]; (5) *Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3*, Release No. 33-8812 (Jun. 20, 2007) [72 FR 35118 (Jun. 26, 2007)] (proposing release), *adopted*, Release No. 33-8878 (Dec. 19, 2007) [72 FR 73534 (Dec. 27, 2007)]; and (6) *Revisions to Rules 144 and 145*, Release No. 33-8813 (Jun. 22, 2007) [72 FR 36822 (July 5, 2007)] (proposing release), *adopted*, Release No. 33-8869 (Dec. 6, 2007) [72 FR 71546 (Dec. 17, 2007)].

The breakout group on securities regulation of smaller public companies discussed and made recommendations on the other three rule proposals involving small business capital formation pending before the SEC at the time. Those proposals covered regulatory relief and simplification for smaller reporting companies, revisions to the eligibility requirements for primary securities offerings on Forms S-3 and F-3, and revisions to Rules 144 and 145. This breakout group continued the discussions of the second morning roundtable, which focused on these three rule proposals. Gerard P. O'Connor moderated this breakout group.

Kristina A. Fausti and Joshua S. Kans, both SEC staff members from the Office of Chief Counsel of the Division of Market Regulation, moderated the first hour of the breakout group on private placement and M&A broker-dealers. Shane B. Hansen and Gregory C. Yadley then assumed moderator responsibilities for that breakout group.

Marc Lumer and Michael Trokey moderated the fourth breakout group, which discussed tax issues affecting small business.

The discussions of the four breakout groups resulted in draft recommendations on federal securities and tax law topics. The moderators of the four securities law breakout groups presented their draft recommendations at a final assembly of all the Forum participants as the last matter of business on September 24. The assembly discussed and approved all the draft recommendations.

After September 24, the five securities regulation breakout group moderators, Brian T. Borders, Shane B. Hansen, Marc H. Morgenstern, Gerard P. O'Connor, and Gregory C. Yadley, compiled a final list of 12 recommendations based on the discussions in their respective breakout groups and the final assembly. These recommendations are presented beginning on page 11. The recommendations of the tax breakout group were compiled by the group's moderators, Marc Lumer and Michael Trokey, and are set forth starting on page 14.

Records of Proceedings

Video recordings of Chairman Cox's opening remarks at the 2007 Forum and of the two morning roundtable sessions of the Forum are available for viewing from a link on the SEC's web site to <http://www.connectlive.com/events/sec092407/>. A transcript of the morning sessions is available in the official Record of Proceedings of the Forum, which can be found on the SEC's web site at <http://www.sec.gov/info/smallbus/2007gbforumproceedings.pdf>.

PLANNING GROUP

Moderator

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AGENDA

2007 SEC Government-Business Forum
on Small Business Capital Formation
Washington, D.C.
September 24, 2007

9:00 a.m. Call to Order
Gerald J. Laporte, Chief, Office of Small Business Policy,
SEC Division of Corporation Finance

Introductory Remarks
John W. White, Director, SEC Division of Corporation Finance

Opening Remarks
SEC Chairman Christopher Cox

9:15 a.m. Roundtable on Securities Offerings by Private Companies

Moderators:
Gerald J. Laporte, Chief, Office of Small Business Policy
SEC Division of Corporation Finance

Marc H. Morgenstern, Managing Partner, Blue Mesa Partners (San Francisco,
California)

Panelists:
Steven E. Bochner, Partner, Wilson Sonsini Goodrich & Rosati (Palo Alto,
California)

Lance R. Lange, Director, Robert W. Baird & Co. (Milwaukee, Wisconsin)

Gregory C. Yadley, Partner, Shumaker Loop & Kendrick LLP (Tampa,
Florida)

10:45 a.m. Break

11:00 a.m. Roundtable on Securities Regulation of Smaller Public Companies

Moderators:
Steven E. Bochner, Partner, Wilson Sonsini Goodrich & Rosati (Palo Alto,
California)

John W. White, Director
SEC Division of Corporation Finance

Panelists:

Phil Clough, Managing General Partner, ABS Capital Partners (Baltimore, Maryland)

R. Cromwell Coulson, Chairman and CEO, Pink Sheets, LLC (New York, New York)

Gerard P. O'Connor, Partner, Foley Hoag LLP (Boston, Massachusetts)

Anna T. Pinedo, Partner, Morrison & Foerster LLP (New York, New York)

Byron Roth, Chairman and Chief Executive Officer, Roth Capital Partners, LLC (Newport Beach, California)

12:30 p.m. Break

12:45 p.m. Luncheon

Speaker: SEC Commissioner Paul S. Atkins

2:15 p.m. Breakout Group Discussions to Develop Recommendations

- Private Placement and M&A Broker-Dealer Breakout Group
- Securities Offerings by Private Companies Breakout Group
- Securities Regulation of Smaller Public Companies Breakout Group
- Tax Issues Breakout Group

3:30 p.m. Break

3:45 p.m. Continuation of Breakout Group Discussions

4:45 p.m. Plenary Session to Develop Next Steps

Moderators:

Gerald J. Laporte, Chief, Office of Small Business Policy
SEC Division of Corporation Finance

Gregory C. Yadley, Partner
Shumaker, Loop & Kendrick, LLP (Tampa, Florida)

5:30 p.m. Networking Reception

**OPENING REMARKS
OF
CHAIRMAN CHRISTOPHER COX**

SEC Government-Business Forum on Small Business Capital Formation

September 24, 2007

Thank you, John [White, Director of the SEC Division of Corporation Finance], for that kind introduction. And welcome, all of you, to the SEC's annual Forum on Small Business Capital Formation. I want to welcome all of you who are here with us in the auditorium at the SEC's Headquarters in Washington, and I especially want to welcome all of you who are watching on the web at sec.gov.

This is an outstanding opportunity for entrepreneurs, and the many professionals who work with small business, to help the SEC fulfill our statutory mission of promoting capital formation. In addition to significant participation from the public, we've benefited from representation by the Government Accountability Office, the Federal Reserve, and state securities regulators—and in particular from the Small Business Administration.

Thanks to the good work that's being done on behalf of small business at the SBA, we have a good idea of just how important today's topics are to our nation's economy. For starters, small business is where all the job creation is. Small firms represent 99.7% of all employer firms in the United States. And they employ half of the entire labor force in the private sector. Of all the net new jobs created in our country, small business generated between 60% and 80% during every single year over the last decade.

But that's not all. It may seem that globalization is being driven by large multinational companies, but in fact small business is leading the way when it comes to America's export economy. According to the SBA's most recent figures, small business makes up 97% of all identified exporters—and produces over 28% of the nation's export value.

Small business is also responsible for the lion's share of America's technology leadership. Innovative smaller firms produce 13 times more patents per employee than large firms. And when it comes to inventions, it isn't just quantity but quality that characterizes small business. Smaller firms' patents are twice as likely as large firms' patents to be among the top 1% most cited. So we shouldn't be surprised that small business employs over 40% of all the high-tech workers in the United States, and seems always to get more bang for the buck.

But despite all of this exciting news about the contribution that small businesses are making to the world's greatest economy and to America's global business leadership, there is another, less encouraging side to the story. And that's the government—which, as a matter of policy, is dedicated to supporting small business and all of the job creation and innovation for which it's responsible—is often getting in the way when it comes to regulation.

That's because the cost of regulation falls heaviest on smaller companies. And not surprisingly, the very smallest companies—which are often the most innovative—are always the very hardest hit. Here's a telling statistic that provides good reason for us to be meeting here today: the very smallest firms—those with less than 20 employees—spend 45% more per employee than larger firms to comply with federal regulations.

And it isn't just capital raising that imposes regulatory burdens. It's all of the rules and paperwork and legal costs that every federal department and agency imposes. So even though we at the SEC aren't responsible for most of those costs, we've got to be cognizant that every incremental regulation we impose is added to the vast maze of federal rules and regulations that every entrepreneur has to navigate. Since our statutory charter is not to minimize the damage our rules might cause, but rather affirmatively to promote and encourage capital formation, we have our work cut out for us. We'll have to be so good here at the SEC that we not only need to make a positive difference for small business, but we also must make up for all the red tape that those other agencies inflict.

I know that everyone here today is enthusiastic about that mission. All of us are committed to scrubbing the SEC's rules to avail ourselves of every opportunity to help nurture small offerings, and to give life to the dreams of enterprising Americans.

As we do that, every one of us at the Commission will do well to heed the advice of the famous 19th century French economist Frederic Bastiat—the advice that every small business person intuitively understands: "If you wish to prosper, let your customer prosper." For us, that means that if we wish our nation's capital markets and our economy to prosper, and to benefit from lower costs of capital, we've got to let small business prosper.

The last quarter century has been a golden era for small business. With our help, that success will spread even further—extending medical breakthroughs, technological innovations, and a higher standard of living to ever greater numbers of the world's people.

So let's get to work right away on lowering the cost of capital formation.

This morning's agenda will feature two roundtable discussions. The first will focus on recent SEC rule proposals relating to private companies—including recent initiatives to make Regulation D and Form D more user-friendly to small business, and to help private companies with stock option plans avoid unintentionally becoming public companies.

The second roundtable will consider the Commission's suite of recent proposals concerning smaller public companies. This will include a discussion of our recent initiatives on Rule 144, Form S-3, and merging Regulation S-B into Regulation S-K.

John White and the impresarios of Corporation Finance have assembled a stellar cast for today's production. The Forum luncheon will feature remarks by SEC Commissioner Paul Atkins, than whom there is no greater champion of small business. Our panelists for the roundtable on securities offerings by private companies will be Steven Bochner, who is a partner at Wilson Sonsini Goodrich & Rosati in Palo Alto; Lance Lange, who is a director of

Robert W. Baird & Company, in Milwaukee; Gerald Laporte, the Chief of the Office of Small Business Policy here at the SEC, who will also serve as one of our co-moderators; Marc Morgenstern, Managing Partner of Blue Mesa Partners in San Francisco, who will also be a co-moderator; and Gregory E. Yadley, who is a partner at Shoemaker, Loop & Kendrick in Tampa. The panelists for the roundtable on smaller public companies will include Phil Clough, Managing General Partner of ABS Capital Partners in Baltimore; Cromwell Coulson, who is Chairman and CEO of Pink Sheets, LLC, in New York; Gerard O'Connor, a partner at Foley Hoag in Boston; Anna Pinedo, a partner at Morrison & Foerster in New York; and of course John White, the SEC's Director of the Division of Corporation Finance, who will be our third co-moderator.

The afternoon program will feature breakout sessions, including one devoted to the role of broker-dealers and finders in private placements. These breakout groups are going to be particularly important, because they're going to help formulate specific recommendations for the SEC to consider as we work to meet our obligation to encourage capital formation.

This is an exciting program, an outstanding group of experts, and a vitally important mission. So to all of you who are dedicated to this mission, thank you for being here—and thank you for what you do every day to help create jobs, nurture innovation, and improve life for every human being on our planet. All of us at the SEC are proud to be your partners.

RECOMMENDATIONS*

Set forth below are the recommendations of the 2007 Government-Business Forum on Small Business Capital Formation. The recommendations of the tax issues breakout group follow the recommendations of the securities regulation breakout groups.

Recommendations of Securities Regulation Breakout Groups

The following 12 securities law recommendations were developed in three breakout groups on securities regulation on the afternoon of September 24, 2007. Five breakout group moderators worked together after that date to compile the recommendations and edit them for clarity and to eliminate overlaps.[†] These recommendations are not presented in any particular order of priority. All of these recommendations, other than those developed by the private placement and M&A broker-dealer breakout group, address issues raised in the six “small business” rule proposing releases approved by the Commission on May 23, 2007.[‡]

Securities Offerings by Private Companies Breakout Group

1. We support the Commission’s Section 12(g) rule proposal and recommend that it be clarified to ensure that employee option holders are not considered within the definition of holders of record for purposes of the limitation under Exchange Act Section 12(g), which requires an issuer with 500 or more holders of record of a class of equity securities and total assets in excess of \$10 million at the end of its most recent fiscal year to register that class of equity securities with the Commission.
2. We support application of uniform disqualification provisions regarding all offerings seeking to rely on Regulation D.
3. We support the Commission’s proposal to shorten the integration safe harbor in Regulation D from six months to 90 days.
4. We support addition of the proposed \$750,000 investment-based test as an alternative means of qualifying as an “accredited investor,” as defined in Rule 501 of Regulation D.
5. We support the Commission’s proposed new Rule 507 of Regulation D establishing a new exemption permitting limited advertising. We recommend that the Commission

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[†] The five moderators were Brian T. Borders, Shane B. Hansen, Marc H. Morgenstern, Gerard P. O’Connor and Gregory C. Yadley.

[‡] These releases are identified in the footnote on page 2.

give serious consideration to making proposed Rule 507 available to “private pooled investment vehicles,” as described in the Regulation D release (*i.e.*, venture capital, private equity and hedge funds).

Private Placement and M&A Broker-Dealer Breakout Group

6. We recommend that the Commission take the lead in adopting rules, in coordination with the states, to create a limited federal registration exemption and simplified system of state registration and regulation for M&A and business brokers who act as intermediaries and advisors in the purchase and sale of existing businesses.
7. We recommend that the Commission adopt rules recommended by the 2005 Private Placement Broker-Dealer Task Force Report of the American Bar Association to facilitate capital raising by small business owners, as well as prospective buyers, to fund small businesses.
8. We recommend that “private placement brokers” be allowed to raise capital through private placements of an issuer’s securities with one or more “accredited investors” in amounts per issuer of up to 10 percent of the investor’s net worth (excluding their primary residence), with full written disclosure of the broker’s compensation, and in aggregate amounts of up to at least \$10 million per issuer, periodically adjusted for inflation.

Securities Regulation of Smaller Public Companies Breakout Group

Comments on Proposed Revisions to Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3

9. Eliminate the Proposed 20 Percent of Public Float Ceiling on Form S-3/F-3 for Primary Registrations by Smaller Reporting Companies.

Recommendation: We recommend that the SEC eliminate the proposed 20 percent of public float limitation on the number of shares that may be offered during any 12-month period on Form S-3 or F-3 by a company that does not meet the \$75-million public float test. If the SEC continues to believe that there should be some upper limit on the number of shares that may be offered by such companies, we recommend that the SEC increase the share limit to 33 percent of a company’s total market capitalization during any 12-month period.

Rationale: The emphasis should be on the quality and availability of the disclosure to investors, and not on an arbitrary limitation on capital that a growing company needs. Though dilution is a valid concern for investors in fast-growing emerging companies, the proposed limitation does not prevent dilution, but merely complicates and makes more costly the critical capital-raising process.

10. Expand the Availability of Form S-3 Resale Registration to Unlisted Reporting Companies.

Recommendation: We recommend that the SEC make Form S-3 available for resales by shareholders of unlisted reporting companies that meet the registrant requirements set forth in General Instruction I.A. to Form S-3. Specifically, in General Instruction I.B.3. of Form S-3, delete the phrase, “if securities of the same class are listed and registered on a national securities exchange or are quoted on the automated quotation system of a national securities association.”

Rationale: We note that the Commission has proposed to permit unlisted smaller reporting companies to register primary offerings on Form S-3. We believe that, if the disclosure available for unlisted smaller reporting companies justifies the use of Form S-3 for a primary offering, then there is no reason to prohibit the same companies from using the form for secondary offerings. Forcing unlisted smaller reporting companies to conduct secondary shelf offerings on registration statements that do not incorporate by reference future Exchange Act filings adds time and cost to capital-raising transactions and does not improve the quality or quantity of disclosure or enhance investor protection.

Comments on Proposed Revisions to Rules 144 and 145

11. Simplify Rule 144 Tolling Provisions.

Recommendation: We recommend adopting a simplified rule that will avoid the need to track the number of days that a holder has hedged and will provide a meaningful benefit for investors that do not hedge. Specifically, we recommend that the SEC revise the rule to provide that non-affiliate holders of restricted securities who do not establish, or increase, a put-equivalent position in the shares at any time during the first six months after acquiring the securities will be permitted to sell under Rule 144 after six months, as proposed. Non-affiliate holders who do establish, or increase, a put-equivalent position in the shares at any time during the first six months of the holding period would be subject to a one-year holding period. After the six-months or one-year holding period, the non-affiliate holder would be free to sell restricted shares pursuant to the revised rule.

Rationale: In the proposed rule, the staff proposes to reinstate the provision tolling the holding period under Rule 144 for periods during which the holder is engaged in hedging activities. We believe that this approach is overly complicated and could have the effect of making more costly and time-consuming the process of “de-leveraging” restricted securities through the ordinary process, which involves factual representations by the holder made to the law firm issuing the Rule 144 opinion to the issuer’s transfer agent. However, the group also supported the provision’s intent to protect against manipulation by holders of restricted securities who do not take an investment position of the type contemplated by Rule 144.

12. Improve the Quality of and Access to Public Information about Non-Reporting Companies.

Recommendation: We recommend that the SEC revise Rule 144(c)(2) to:

- Require non-reporting issuers themselves, instead of market participants, to be responsible for making available the current public information under Rule 144(c)(2) as a condition to shareholders utilizing the Rule 144 safe harbor for resales of restricted securities;
- Consider enhancing the content and the currency of the issuer information required for such issuers to satisfy the requirements of Rule 144(c)(2); and
- Establish one or more third-party (*i.e.*, out of the issuer’s control) repositories for such information so that it is more dependably accessible to investors.

Rationale: Rule 144(c)(2) provides that the “current public information” requirement under Rule 144 for issuers who are not reporting companies may be satisfied if “there is publicly available” the information required by certain subsections of Exchange Act Rule 15c2-11. However, it is not necessarily the responsibility of the issuer to provide or update this information. In practice, this rule does not result in meaningful disclosure being available to investors on a timely basis. In keeping with the spirit of the other comments of this group, we believe that the focus should be on the quality and availability of information.

Recommendations of Tax Issues Breakout Group

The tax issues breakout group developed the following recommendations.

1. Relief from alternative minimum tax.

Issue: Should relief be given to individuals from the alternative minimum tax?

Discussion: Yes, but if the tax is too costly to eliminate, relief should be given to small business owners. Most small businesses are organized as sole proprietorships, S-corporations, LLC’s, and partnerships. In these forms, earnings are taxed to the owner’s personal tax return, regardless of whether or not the cash “flows through” to them. These taxpayers already face a greater tax burden because of payroll taxes imposed on what is essentially business gain. Business earnings that flow through to the owner’s personal tax return decrease and possibly eliminate both personal exemptions and itemized deductions. We believe the alternative minimum tax represents an impediment to capital formation.

Recommendation: If Congress cannot eliminate the alternative minimum tax, then Congress should increase both the alternative minimum tax exclusion and the threshold for the phase-out of the exclusion. The provision should be indexed to inflation.

2. Timely completion of permanent unified gift and estate tax.

Issue: Should the temporary estate provisions be reviewed and should a new unified gift and estate tax have expanded exclusions?

Discussion: Small businesses are typically owned by one or a few individuals. Succession planning is omnipresent in all businesses, and in small businesses it becomes eventually as important as operations. Currently these businesses face an uncertain future regarding the taxability of the assets that will be transferred to the succeeding generations. Additionally, current provisions that provide for a difference between the lifetime gift and estate tax exclusions make planning awkward and discourage pre-death transition. Finally, current exclusions are not adequate to protect the orderly transition of businesses from one generation to the next.

Recommendation: Congress should act immediately to implement a permanent estate and gift tax law. The law should provide a \$5 million lifetime gift and estate tax exclusion, which should be indexed for the effects of inflation.

3. Mandatory corporate income tax e-filing.

Issue: Should corporate size be the determining criteria for mandatory corporate income tax e-filings, and should e-filing remain mandatory in the face of system inadequacies?

Discussion: There are many benefits in efficiency and effectiveness generated from electronic filing of income tax returns. All tax professionals support e-filing as the preferential method for filing an increasingly growing number and types of returns. Many corporations are comfortable with electronic communications. However, corporate income tax filers now face mandatory e-filing based on business size (\$10,000,000) and not on complexity. During the most recent season, practitioners were confronted with a series of inadequacies in the transmission and receiving systems for certain schedules. Filers were given 20 additional days to file, but they were not in control of the problem and mailing a traditional return was no longer an option.

Recommendation: The Treasury Department should allow optional traditional filing of corporate tax returns:

1. if the size of the company is equal to or less than \$50,000,000, or
2. where a valid attempt was made to file electronically and at that time it was not possible to e-file the return, or
3. if the State where the entity has its headquarters does not allow or cannot accept e-filings.

4. Accrual of tax liabilities under conditions of uncertainty.

Issue: Should the standards for accruing uncertain tax positions vary depending on the type of tax?

Discussion: FIN 48 *Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109* regarding the accrual of uncertain income tax provisions marked a change in the way business recognized liability for income tax. Previously, the liability to pay any tax was accrued when the amount was certain and the likelihood was probable as provided in SFAS 5 *Accounting for Contingencies*.

Under the current rule, sales, property, payroll, business permit, and minimum franchise taxes remain under the previous standard. Many small companies face greater uncertainties in these areas than in income tax. Income liability is now computed assuming that the tax authority will audit the business and that it will discover all uncertain tax provisions. Given these assumptions, businesses must now compute the amount that the company will pay based on a most likely scenario. While this system is cumbersome and requires estimation of the relative negotiating skills of the taxpayer and the tax authority, it meets conservatism principles and the fair value criteria.

Recommendation: The SEC and FASB should evaluate the current inconsistency between FIN 48 and SFAS 5 and provide some coordinated guidance and relief for private companies in their tax reporting.

5. The current income tax law is overly complex, burdensome, ineffective and costly to administer.

Issue: Should Congress replace the current income tax system with a system that is simple and more direct?

Discussion: The U.S. income tax system is a cumulative patchwork of revenue raising, economy encouraging, and social action promoting provisions. The inadequacies of the current system are known and subject to continuous discussion by the public and Congress. Many attempts have been made to fix the system without success. A change would benefit both taxpayers and government alike. Raising the required revenue in a fair, efficient, direct, and simple manner should be the goal.

Recommendation: Congress should work with the President to research, debate and enact a simple comprehensive nationwide tax, based on some standard other than income (*e.g.*, sales or value added). The tax should provide an ongoing, lower cost, and more efficient method of tax collection than the current income tax system.

6. Section 404 of SOX.

Issue: Should implementation of Section 404(b) of the Sarbanes-Oxley Act of 2002 be delayed until there is clear guidance on audit scaling for smaller companies and a thorough review and discussion of the relationship of cost to benefit?

Discussion: Smaller public companies are now in the process of evaluating and testing their internal controls over the financial reporting process. Such companies have long been required to comply with U.S. Generally Accepted Accounting Principles, as well as SEC rules and regulations. Neither disclosure nor accounting principles will be affected with implementation of Section 404 of SOX and, accordingly, investors will not see any changes in these areas. It has been widely accepted that implementation of Section 404 of SOX for smaller companies as compared to its implementation for large companies was somewhat inefficient and excessively expensive due to differing interpretations of Section 404 of SOX made by management, consultants and auditors.

Recommendation: The implementation of the audit requirements of Section 404 of SOX on smaller public companies should be delayed until the PCAOB and the SEC have a clearer understanding and can assess the new rules on scaling, the Section 404 audit, and the cost of management's evaluation of the financial reporting process.

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