

Congress of the United States
Washington, DC 20515

September 6, 2012

The Honorable Timothy Geithner
Secretary of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Geithner:

We understand that the Department of the Treasury's (Department) Office of Tax Analysis released a report dated August 2011 and titled *Methodology to Identify Small Businesses and Their Owners* (Report).¹ As the Chairman of the House Committee on Small Business and the Ranking Member of the Senate Committee on Small Business and Entrepreneurship, we have serious concerns about the legal authority, justification and purported use of these new definitions.

The Report states that it offers a "revised methodology"² to identify small businesses and their owners for policymakers.³ However, those policymakers are never identified, and as Chairman of the House Committee on Small Business, we were never approached regarding the need for new definitions. In addition, the Department does not appear to have legal authorization to establish such definitions.

The Small Business Act⁴ provides the federal government's definitions of small businesses. The Report notes that "[c]urrently, a consensus does not exist regarding the specific attributes that distinguish small businesses from other firms."⁵ To the contrary, since 1953, the Small Business Act⁶ has provided the federal government's definitions of small businesses.

In fact, under the Act, it is specifically within the purview of the Small Business Administration (SBA) to define a small business. The Act states that "[U]nless specifically authorized by statute, no federal department or agency may prescribe a size standard for categorizing a business as a small business unless the proposed standard: i) is proposed after an opportunity for public notice and comment; ii) provides for determining: I) the size of a manufacturing concern as measured by the manufacturer's average employment based on the concern's pay periods for the preceding 12 months; II) the size of a business concern providing services on the basis of average gross receipts of the business over a period of not less than 3 years; III) the size of other business concerns on the basis of data over a period of not less than 3 years; IV) other appropriate factors; and iii) the approval of the Administrator."⁷

¹ OFFICE OF TAX ANALYSIS, DEPARTMENT OF THE TREASURY, *METHODOLOGY TO IDENTIFY SMALL BUSINESSES AND THEIR OWNERS*, TECHNICAL PAPER 4, (AUGUST 2011).

² *Id.* at 1.

³ *Id.* at 1-2.

⁴ 15 U.S.C. § 631 *et seq.* (2011).

⁵ *Id.* at 2.

⁶ 15 U.S.C. § 631 (2011).

⁷ 15 U.S.C. § 632(a)(2) (2011).

The Report states that it does not “compare the definitions used in this paper to those used by other governmental agencies, such as the Small Business Administration (SBA).”⁸ It goes on to state that “In general, the small business definition used by Treasury and the SBA will differ because they are based on different data sources and concepts and are used for different purposes.” In fact, under the Act, no federal department or agency may determine a size standard unless the conditions of the Act listed above are met. The Report further states that “[t]he definitions used by SBA identify firms that are eligible to receive certain government grants and assistance and is generally considered to be a relatively broad measure.”⁹ In a footnote, the Report notes that “[t]o identify small firms eligible for its programs, the SBA uses industry-specific size standards that are based on sales or number of employees.”¹⁰ However, no matter what the purpose of the federal department or agency, under the Act, the SBA definitions must be used, unless the tax code provides otherwise. Under regulations promulgated by the SBA, federal agencies or departments may use size standards different from those in the Act, but only in very limited circumstances and with written justification to, and the approval of, the SBA.¹¹

The Report claims that the new definitions were developed as a tool for policymakers.¹² If the Department had concerns regarding the existing definitions, it is puzzling why those concerns were not raised with either the SBA or the Congressional committees of jurisdiction. Did policymakers receive the Report? If, as the Report says, there is no consensus on the attributes of a small business,¹³ the Department could have worked with policymakers from the SBA, the committees with legislative jurisdiction and the Joint Committee on Taxation to reconcile the definitions. Interestingly, the SBA is currently in the process of revising all size standards, yet no comments on this issue have been filed with SBA by Treasury. Furthermore, the Report did not contain any recommendations for policymakers to act upon; it merely put forward a new definition. Is it the Department’s recommendation that the Report’s definition be the sole definition of small business for the purposes of Internal Revenue Code?

The Report appears to encourage the further use of its definition, stating that “[A]lthough our methodology is but one approach that could be used to more accurately identify small business owners, we find that our basic conclusions are not sensitive to the tests that we apply.”¹⁴ The Report then goes on to suggest that its definitions should be used to “define the characteristics that distinguish a small business so that the impact of targeted tax provisions can be modeled appropriately.”¹⁵ We are concerned about the effect of the Report’s definition on current policy discussions, and believe it is not helpful to inject yet another definition into an already muddled field. It appears that a great deal of staff time and resources were used to prepare the Report. Exactly how much funding and how many staff hours were expended on the Report, and what purpose was envisioned for it? Are the IRS, the Department and others in the Administration using this methodology to determine how many small business owners would be affected by tax increases for individual taxpayers earning over \$200,000 and families earning over \$250,000?

⁸ OFFICE OF TAX ANALYSIS, DEPARTMENT OF THE TREASURY, *supra* note 1, at 2.

⁹ *Id.* at 3.

¹⁰ *Id.*

¹¹ 13 C.F.R. §121.903 (2011).

¹² OFFICE OF TAX ANALYSIS, DEPARTMENT OF THE TREASURY, *supra* note 1, at 22.

¹³ *Id.* at 2.

¹⁴ OFFICE OF TAX ANALYSIS, DEPARTMENT OF THE TREASURY, *supra* note 1, at 22.

¹⁵ *Id.*

At a time of economic and regulatory uncertainty, when small businesses, our nation's most prolific job creators, are struggling to keep their doors open, the Department's development of an arbitrary new definition adds unnecessary confusion and complexity. That is something that these entrepreneurs surely do not need. We look forward to your prompt response.

Sincerely,



Sam Graves
Chairman
House Committee on Small Business



Olympia J. Snowe
Ranking Member
Senate Committee on Small Business
and Entrepreneurship

cc: Eric M. Thorsen, Inspector General, U.S. Department of the Treasury