Committee On Finance
Max Baucus, Chairman

NEWS RELEASE http://finance.senate.gov

For Immediate Release
Tuesday, September 17, 2002

Contacts: Michael Siegel, Lara Birkes
202-224-4515

FACT SHEET
THE "SMALL BUSINESS AND FARM ECONOMIC RECOVERY ACT OF 2002"

On September 17, 2002, the Finance Committee released the Chairman's mark of the "Small Business and Farm Economic Recovery Act." The bipartisan mark, drafted by Chairman Max Baucus and Ranking Member Charles E. Grassley, provides tax relief for the nation's small businesses and agricultural producers. The Finance Committee will mark up this legislation on September 19, 2002.

This bill recognizes the economic realities faced by America's small businesses. While most sectors of the economy have recovered from the economic blows of the past year, small businesses still face significant troubles. Small businesses across the country have seen sales decrease and profits drop. It is essential to ease some of the tax burden faced by small business owners during this difficult time. This bill grants needed tax relief to small businesses, and provides incentives for investment and growth.

Tax provisions. Among the proposals to ease the tax burden on small businesses and agricultural producers are the following:

Section 179 expensing. This provision increases the amount that a small business can immediately deduct ("expense"). Under current law, a small business may expense up to $24,000 in new equipment. The maximum deduction is phased out for investments above $200,000. The Chairman's mark would increase the amount that small businesses can expense to $30,000. This amount would be indexed for inflation for years following 2006. The $200,000 investment limit is indexed in that year also. In 2003, businesses can invest an additional $5,000 in equipment and take a deduction in the year of purchase. This change could save a typical small business as much as $1,200 in 2003.

Leasehold improvements. This provision changes the recovery period for leasehold improvements to more accurately reflect the life of such improvements. Leasehold improvements are improvements to an interior portion of a building that is nonresidential real property. Under current law, the cost of leasehold improvements can be recovered over 39 years. The Chairman's Mark would shorten the period over which the cost of leasehold improvements can be recovered to 25 years.

Tax relief for farmers, fishermen, and ranchers. The Chairman's mark provides a number of tax incentives for farmers, fishermen, and ranchers that were included in the Tax Empowerment and Relief for Farmers and Fishermen Act. The mark establishes tax deductible savings accounts, FFARRM accounts, for farmers, fishermen, and ranchers. It includes a provision to allow farm rental income and Conservation Reserve Program (CRP) payments to be excluded from self-employment income. The mark extends the income averaging to fishermen as well as farmers, and makes it available under the Alternative Minimum Tax (AMT).

S-Corporation reform and simplification. The Chairman's mark includes several provisions relating to subchapter S corporations. The mark increases the number of eligible shareholders to 100. The limit on passive investment income is increased from 25% to 60%. The mark also repeals capital gain as a category of passive income and includes several provisions simplifying subchapter S. These changes modernize the tax rules for S Corporations, which make up 10% of America's small businesses.

Promoting economic development and rural investment. The Chairman's mark would allow for accelerated depreciation for businesses and farms in counties that have experienced rural out-migration. Investments made in these counties would be eligible for a shorter recovery period than provided for in current law. This provision would encourage investment in counties across the nation. The mark also includes modifications to the Work Opportunity Tax Credit (WOTC).

Broadband incentives. The provision establishes a tax credit to encourage the use of broadband technology. It provides a 10 percent investment tax credit for current generation broadband services to subscribers in rural and underserved areas. It also provides a 20 percent credit for next generation broadband services to subscribers in rural areas, underserved areas, and residential subscribers.

Provisions to simplify small business and excise taxes. The Chairman's mark includes provisions to simplify small business taxation, including the expansion of a pilot program for joint state and federal tax filing. It also includes provisions to simplify the excise taxes on alcohol and some sporting equipment.

<u>Offsets</u>. The tax cuts provided in the Chairman's Mark are fully offset by the following provisions:

Provisions to Curtail Tax Shelters. The Chairman's mark includes provisions to strengthen the Treasury Department's existing and proposed administrative enforcement regime, as set forth in S. 2498, which was approved by the Finance Committee on June 18, 2002. The legislation focuses on the role of each of the players involved in abusive tax shelter activity and imposes meaningful sanctions for engaging in conduct that continues to undermine the fairness and integrity of our Federal tax system. The Chairman's mark clarifies the economic substance doctrine, which the courts have developed to deny certain tax motivated transactions their intended tax benefits. The courts generally will deny claimed tax benefits if the transaction that gives rise to those benefits lacks economic substance independent of tax considerations.

Provisions to Discourage Corporate Expatriation. These provisions are based upon the bill, S. 2119, as passed by the Finance Committee on June 18, 2002. The proposal prevents companies from re-incorporating in tax haven countries in order to avoid U.S. taxes.

Provisions Relating to Fair Taxation of Executive Compensation. The Chairman's mark contains three provisions related to executive compensation. The first provision generally provides that funds in an offshore trust will be deemed not to be subject to the claims of creditors, and generally the funds will be taxed. The second provision removes a 1978 moratorium on new regulations and permit Treasury to better define deferred compensation arrangements that merit deferral of taxation and those that should be taxed currently. The final provision increases the withholding rate to the highest marginal tax rate (currently 38.6%) on supplemental pay of over $1 million.