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| **Record Group/Collection:** | George H.W. Bush Presidential Records |
| **Collection/Office of Origin:** | Science and Technology Policy, Office of (OSTP) |
| **Series:** | Bromley, D. Allan, Files |
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| **OA/ID Number:** | 62037 |
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**Folder Title:**
Industry - Small High-Tech Business [1992]

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THE WHITE HOUSE

WASHINGTON

January 8, 1992

MEMORANDUM FOR ROGER B. PORTER, ASSISTANT TO THE PRESIDENT FOR ECONOMIC AND DOMESTIC POLICY

THROUGH: D. ALLAN BROMLEY, THE ASSISTANT TO THE PRESIDENT FOR SCIENCE AND TECHNOLOGY DAB.

FROM: J.S. BROZ, WHITE HOUSE FELLOW (OSTP) JB

SUBJECT: STIMULATING SMALL HIGH-TECHNOLOGY BUSINESSES

Background:

OSTP has conducted a thorough assessment of the state of the U.S. small, high-technology business sector. The data show that small high-tech enterprises are extremely important to the economy and can be an effective tool in regaining a high level of international competitiveness. For example, small high-tech businesses are far more innovative and generate more commercial products per employee and per R&D dollar than their larger counterparts, and are a major source of technological change. Further, our research shows that individual ("angel") investors play a surprisingly important role in the start-up of small high-tech businesses, and that these investors are by no means always "wealthy"-- in fact nearly 1/3 of them earn under $60,000 annually. These individual investors are extremely tax-sensitive and there is currently strong evidence of shortages in both angel and professional venture capital at the seed and start-up levels. A revision in gains tax treatment has been identified as the single most important factor in improving capital formation for small business and high technology industries.

Current Situation:

The Democrats are now on-record with a gains tax cut; Bill S. 1932 (Bumpers) is a capital gains tax cut proposal that is directed toward small and growing businesses and is gaining wide bi-partisan support (45 Senate sponsors to date; 11-Republicans). Clinton has also endorsed a similar gains tax plan. It is a targeted proposal providing incentives for venture and seed capital investments that apply only to the purchase of corporate stock. It focuses exclusively on investments that put capital into the hands of entrepreneurs, and is "graded" in the sense that it encourages retaining the stock by lowering the maximum gains rate as the investment holding time increases.

2951

THE WHITE HOUSE

WASHINGTON

September 28, 1992

MEMORANDUM FOR D. ALLAN BROMLEY

FROM: J. FRENCH HILL

SUBJECT: Report on Small High Tech Companies

I have had the opportunity to read your report entitled *A Profile of Small High Technology Business in the United States* and find it is a good contribution to the subject. I have a handful of comments I would like to share.

- Page six, second paragraph, you state: ...the total disbursement of venture money has declined by nearly 80% from 1987 to the present. My question is, isn't the amount raised less also? Also, please see the attached two articles on increasing venture funds. Don't forget this is a cyclical business. Recent IPOs have replenished capital stocks.

- Page seven, first paragraph. I question whether concerns about U.S. competitiveness are growing. The Administration has (and is) developing policies to enhance our continued competitiveness.

- Page eleven, fifth paragraph. Note the misspelling of "dollar" in line 10.

- Page eleven, sixth paragraph. "...in the Federal government... in line three needs clarification. What do you have in mind here?

- Page nineteen, the second paragraph and sixth line where you state "...the computer software sector has the lowest percentage of exporting firms." I would make mention of copyright protection issues. Could it also not be counted fully due to software being sold <u>with</u> hardware in an export market?

- Page twenty, the word "Economic" in the name of the second source, listed at the bottom of the chart, is misspelled. Also, I don't believe Clyde Prestowitz is a particularly good source for a Bush Administration document.

- Page twenty-one, line ten after "...high technology firms." After "firms", please add "as they are the largest foreign direct investors overall."

- Page thirty-one, last paragraph on line five. I think the sentence would be better worded by saying "number" instead of "numbering".

- Page thirty-four, first paragraph and page thirty-five, first paragraph. Note that the figures I've highlighted do not match.

- Also on page thirty-five, insert "capital" between "high" and "gains" under the first bullet in the box.

- Page thirty-six, paragraph three. Substitute "millionaire" for "wealthy" in the first line. In the second line, begin with "Approximately" or spell out "32%".

- Also on page thirty-six at the bottom, I would not use the tag lines highlighted in the chart. Again, at the bottom of the chart, where the word "wealthy" appears, substitute "millionaires". Remember, income over around $60,000 is in top two percent.

- Page thirty-seven, first paragraph. The last sentence needs clarification. Who wouldn't be?

- Page thirty-eight, fourth paragraph. Insert "type of" in the third line between "same" and "technology". In line four of same paragraph, substitute "increase" for word, "hike".

- Also on page thirty-eight, referring to the chart, note that venture capital is a cyclical business and always has been. The chart offers only a very narrow picture. Show more history.

- Page thirty-nine, delete "Despite this important contribution..." on down. See highlighted area.

- Page forty. Insert "capital" between "Adverse" and "gains" under the first bullet, and again between "high" and "gains" in the next line.

- Page forty. Under the third bullet, first line, delete the first line through recessionary and insert "Economic Conditions: The sluggish". Also delete "and gloomy outlook".

- Page forty, in the last paragraph. Substitute "Some" for "Other", change "investments" to "investors" and insert after "investors" "engaged in their primary business of". Substitute "may" for "probably" and insert "be" between "not" and "doing".

- Page forty-four, last four paragraphs. Please update text for actual legislation.

- Page fifty-one, second paragraph. Debt financing is always hard for "young firms" -- especially high-tech firms with few, if any, hard assets.

- Page fifty-two. Difficulties are cyclical.

- Page fifty-three, paragraph four. When listing agency, put commonly used initials afterward if you will be referring back to those agencies using initials. Also, when discussing overregulation, mention the President's regulatory moratorium and the Council on Competitiveness' efforts.

- Page fifty-four. Delete everything here since you mention this on page fifty-six in the conclusion.

- Page fifty-six, the second paragraph, last line. Development of incubators and research parks should be encouraged by what method?

THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release September 23, 1992

**Encouraging Entrepreneurial Capitalism: Strengthening Small Businesses**

FACT SHEET

President Bush announced today a comprehensive program for strengthening our Nation's small businesses, including a five-year, $20 billion initiative to reduce capital costs directly and to reduce the paperwork burdens that fall heavily on small businesses.

The initiative includes:

- Reducing the lowest corporate tax rate for small businesses from 15 percent to 10 percent;
- Increasing the current equipment expensing limit from $10,000 to $25,000;
- Eliminating capital gains taxes on newly-issued small business stock;
- Permitting the immediate write-off of up to $2,500 of the front-end costs of starting a new business; and
- Simplifying the tax laws so that most small businesses can file their returns on one or two pages.

## I. Helping Small Businesses Get Started

The Administration has proposed tax policies and innovative programs to give incentives for entrepreneurship.

### A. Expanding Tax Incentives to Start Small Businesses

- Reducing Capital Gains.

Today the President proposed to eliminate the capital gains tax on small business start-ups. Under the President's proposal, capital gains earned from qualified investments held for five years in certain small business corporations would qualify for a 50 percent exclusion. In addition, for each additional year the investment is held, the exclusion is increased by ten percent. Investments held for ten years or more will be exempt from capital gains taxation. The proposal would cover investments in small businesses with up to $10 million in assets or receipts.

- Expensing Start-Up Costs.

  The President also proposed to permit the immediate write-off of up to $2,500 of the initial costs of organizing a new business. (Under current law, allowable business start-up expenditures must be capitalized and amortized over at least five years.) Direct expensing of a portion of these costs will reduce the cost of capital necessary to start a business.

  The new write-off provisions would be applicable to expenditures made after December 31, 1992 to start up a business that has less than $500,000 in sales in its first full year of operation.

B. **Providing Additional Assistance to Entrepreneurs**

- Facilitating Equity Investments.

  The President recently signed legislation authorizing the SBA to guarantee new equity-type investments in Small Business Investment Companies (SBICs). The SBICs would, in turn, use the proceeds to make equity investments in small businesses.

- Providing Micro-Loans.

  The Small Business Administration (SBA) is implementing a $45 million program to offer unsecured micro-loans of up to $25,000 to small businesses.

## II. Helping Small Businesses Reduce the Cost of Capital

President Bush today proposed a five-point initiative to reduce the cost of capital and simplify the tax code for small businesses. In addition to reducing or eliminating the capital gains tax on newly-issued small business stock and permitting the immediate write-off of up to $2,500 of the initial costs of starting a small business, the President proposed to:

A. <u>Reduce the corporate tax rate for small businesses from 15 percent to 10 percent</u>. The President proposed to reduce the tax rate on the first $50,000 of a corporation's taxable income from 15 percent to 10 percent. The proposed new corporate tax rate would become effective on January 1, 1993.

B. <u>Increase the current expensing limit from $10,000 to $25,000</u>. Under current tax law, a small business may deduct up to $10,000 of the cost of business or income-producing equipment in the year it is placed in service. The President proposed to increase the maximum allowable deduction from $10,000 to $25,000. This $25,000 maximum would be reduced for each dollar of eligible equipments' cost above $200,000. Thus, no expense deduction would be allowed when the cost of eligible equipment exceeds $225,000.

C. <u>Simplify the tax laws so that most small businesses can file their returns on one or two pages</u>. This includes:

- **AMT Relief for Business Tax Preferences**

Under the President's proposal, certain business preferences and adjustments arising from qualifying small corporations (including adjustments for depreciation, depletion, intangible drilling costs and other expenses) would no longer be subject to alternative minimum tax. In addition, active participants in qualifying unincorporated businesses would not be required to include these preferences and adjustments in determining their individual AMT.

- **Inflation-adjusted inventory accounting rules**

Taxpayers with gross receipts under $10 million could elect to use an inflation-adjusted FIFO (First In, First Out) method of accounting for inventory. Inventories would be indexed using inflation adjustment factors based on an overall price index, such as the Consumer Price Index, to eliminate the effects of inflation from the determination of taxable income.

- **Exemption from uniform capitalization rules**

The President's proposal exempts taxpayers with gross receipts under $10 million from the uniform rules governing capitalization of direct and indirect costs associated with the production of property. In addition, very small producers (those with gross receipts under $1 million) would be required to capitalize only direct costs attributable to production activities, and could expense all indirect costs associated with their production activities. This will permit small businesses to avoid making costly and burdensome cost allocations solely for the purpose of computing tax liability.

- **Exemption from long-term contract rules**

Under current law, taxable income from long-term contracts is determined under the percentage of completion method (PCM) of accounting.

The President proposes to expand the current exemption from the PCM requirements to any long-term contract being performed by a contractor with average gross receipts under $10 million.

- **Pension rule simplification**

The President proposed several changes to simplify pension rules and expand pension options for small businesses, including:

-- **Permitting small businesses with less than 100 employees that have no pension plan to sponsor a Small Business Model Retirement Plan for its employees.** An employer who sponsors a Small Business Model Retirement Plan must contribute one percent of pay to an account for each participating employee.

Employees could elect to defer a portion of his or her compensation to the account, up to a maximum of $3,000. To encourage employees to elect deferrals, the employer must make a matching contribution to the first 3 percent of compensation that an employee elects to defer, plus 50 percent of elective deferrals representing between 3 percent and 5 percent of the employee's compensation.

-- **Repealing certain family aggregation rules** that apply for pension plan purposes;

-- **Permitting certain tax-exempt employers** (including trade associations and credit unions) **to adopt Section 401(k) retirement plans** for their employees; and

-- **Eliminating the special aggregation rules that apply to retirement plans for self-employed individuals.**

## III. Helping Small Businesses Get Access to Credit

A. Providing Assistance Through the SBA.

- In 1992 the Administration provided a record $6 billion in loan authority to permit the SBA to guarantee small business loans.

- Under the New England Lending and Recovery Project, the SBA restructures small business loans held by the FDIC as a result of bank failures.

B. Encouraging Bank Lending.

- The Administration has worked with bank regulators and conducted extensive meetings with bankers, examiners, and borrowers nationwide to increase the availability of funds. Earlier this month, Treasury Secretary Brady met with top banking industry executives to encourage a strong focus on small business lending.

- The Administration has also worked with bank regulators in issuing over 30 regulatory changes to increase credit availability.

C. Opening Up Equity Markets to Small Business.

The President's regulatory review and moratorium has led to a series of small business initiatives by the Securities and Exchange Commission, including:

- Allowing issuers of "seed capital" offerings to issue up to $1 million per year in securities and be exempt from SEC registration requirements;

- Raising from $1.5 million to $5 million the ceiling on Regulation A limited public offerings, using simplified disclosure procedures; and

- Fostering investment by mutual funds in small businesses.

D. Providing Disaster Assistance.

More than $2 billion in loan authority has been provided this fiscal year to help small businesses recover from the effects of devastating natural disasters, including Hurricanes Andrew and Iniki and the Los Angeles riots. The SBA has streamlined the application process.

## IV. Helping Small Businesses Expand Employment and Increase Productivity

A. Supporting Innovative Research.

The Administration supports or has proposed a number of measures to increase investment in research and development, including:

- Making the Research & Experimentation tax credit permanent; and
- Doubling the percentage of Federal R&D budget that is set aside for small business under the Small Business Innovation Research (SBIR) program from 1.25 percent to 2.5 percent.

  Today President Bush directed agencies participating in the SBIR program to implement a Commercialization Assistance Project. The project will place participating small businesses in contact with established companies to improve the skills necessary to access credit.

B. Improving the Quality of Our Workforce.

The President has proposed to revolutionize American education through his America 2000 program, and to streamline, expand and improve the accountability of Federal job training programs.

C. Reforming Our Legal System.

President Bush has proposed and supported legislation to reform our civil justice system, particularly in the areas of product liability and tort law, to encourage early settlement of disputes, adopt the "Loser Pays" rule to require the loser to pay the winner's legal fees in certain circumstances, and to limit excessive punitive damage awards.

D. Expanding and Opening Foreign Markets.

The Small Business Administration and the Department of Commerce have provided information, counseling, training and financing to thousands of small businesses who seek to export their products to new markets overseas.

E. Creating Enterprise Zones

President Bush has proposed to create enterprise zones in inner cities and rural areas that suffer from a lack of economic opportunities for their residents. A number of tax incentives would be provided ~~for~~ enterprise zone workers, investors and businesses, including an employee wage credit, expensing of certain stock investments, and an exclusion of most capital gains.

## V. Clearing Away the Regulatory Maze

The Administration has announced several reforms that will reduce the costs and burdens imposed on small businesses in complying with the Federal tax system.

A. Reducing the Costs of the Payroll Tax System.

Several initiatives will reduce administrative costs for the more than 3.5 million small employers who must report employment taxes, including:

- Permitting up to 75 percent of all employers to make payroll tax deposits once a month, and to make those deposits electronically;
- Creating a new simplified Federal employment tax form for small businesses;
- Establishing a single wage reporting system to eliminate duplicate filing of Form W-2 and other payroll tax information; and
- Allowing employers to verify employees' tax identification numbers by telephone.

B. Reduce Other Tax-Related Burdens.

Additional reforms will allow:

- Deductibility of Preparation Fees. On April 1, 1992, the IRS released a ruling allowing more than 16 million sole proprietors, including farmers, to deduct business-related tax preparation fees as a business expense rather than as a limited itemized deduction.

- Joint Federal-State Filing. The IRS is working with States on a pilot program for the joint electronic filing of Federal and State tax returns. In 1992, the IRS implemented this program State-wide in South Carolina and on a more limited basis in six other States. The IRS expects to add additional States during the coming year.

- Educational Initiatives for Small Businesses. In the past year, the IRS has informally contacted over 150,000 small businesses having difficulty complying with Federal tax deposit requirements. The IRS is now working with these taxpayers, outside the formal audit and enforcement context, to address compliance concerns.

## VI. Helping Small Businesses Provide for Their Workers

Small businesses need help in providing benefits that will give their employees economic security. These benefits include:

A. Affordable Health Care.

Eighty five percent of workers and dependents without health insurance work for firms with fewer than 100 employees. The President's Comprehensive Health Reform Plan would:

- Allow small employers to form Health Insurance Networks to give small employers the purchasing clout of a large group;

- Require insurers to offer insurance to all small groups if they sell health insurance to any small groups. Insurers would also be required to offer insurance to all members of the group and could no longer exclude particular individuals who the insurer thought would have high medical expenses;

- Ensure affordable insurance rates for small groups with one or more very sick individuals, initially through rate limitations and, over time, through risk-pooling; and

- Permit the self-employed to deduct 100 percent of their health care insurance premiums as opposed to the 25 percent they currently are permitted to deduct.

B. Tax Incentives for Family Leave Policies.

President Bush has proposed to provide tax credits to businesses with fewer than 500 employees that adopt non-discriminatory leave policies related to childbirth, adoption or serious family health problems. The employer would be eligible for a tax credit equal to 20 percent of the cash wages that the employer provided (or would have provided) to the employee during the period of family leave, up to a maximum of $20 of credit per business day and a maximum of $1,200 of credit per employee per year. The employer must continue to provide health benefits and other employment protections and benefits to employees on family leave.

C. Retirement Security.

- In July 1992, the President signed legislation increasing pension portability and enhancing retirement security for workers who change jobs by permitting workers to rollover their accrued pension benefits directly into another retirement plan or an Individual Retirement Account.

- The President also proposes to:

  -- Reduce and simplify the administrative requirements for pension plans offered by small employers to encourage them to extend coverage to those not currently covered;

  -- Permit tax-exempt institutions and state and local governments to establish 401(k) retirement savings plans for their employees; and

  -- Simplify the rules for administering 401(k) plans and repealing special tax breaks that discourage retirement savings.