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THE SMALL BUSINESS JOBS AND CREDIT ACT

SMALL BUSINESSES STRUGGLE, WHILE CONGRESS SPENDS FREELY

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As small businesses grapple with a sluggish economy, a 9.6-percent unemployment rate, mounting costs from the recently passed health care legislation, and tax hikes that could arrive on New Year's Day, the administration and Congressional Majority have conjured what they consider a solution: a bill with *more* government spending. This time they are creating a new $30-billion small-business loan fund, expanding the size and scope of lending by the Small Business Administration, and providing temporary tax credits chased by permanent tax increases.

The legislation comes even as the administration continues voicing support for an increase in the top two income tax rates, which would hit small businesses filing individually. The firms affected represent more than 50 percent of all small-business income.

Table 1: The Small-Business Jobs and Credit Act (H.R. 5297)

New Spending[a]	**$9.3 billion**
New Taxes	*$14.4 billion*
Tax Credits	*$12 billion*
Net New Taxes	**$2.4 billion**
Revised Deficit Impact	**$6.9 billion**

[a] Estimates Small-Business Lending Fund on a fair-value basis, as determined by the Congressional Budget Office.

A FAMILIAR BAILOUT FUND

The centerpiece of the bill, the Small Business Jobs and Credit Act (H.R. 5297), is its $30-billion Small Business Lending Fund [SBLF]. The fund would allow the Treasury Department to buy stock in the form of preferred shares in financial institutions with assets of $10 billion or less. The banks issuing shares would then be required to remit dividend payments to the Treasury. The fund may appear familiar: it is nearly a mirror-image of the Capital Purchase Program [CPP], the largest initiative of the Troubled Asset Relief Program [TARP]. In its April 2010 report to Congress, the Office of the Special Inspector General for TARP noted: "many of the characteristics of SBLF are the same or very similar" to the CPP, and, "many CPP participants will be able to convert their CPP capital into SBLF capital."[1] The main difference between the two programs is that the SBLF takes a more "command and control" approach to lending: it would reduce dividend payments required by financial institutions based on how much they

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[1] Office of the Special Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, 20 April 2010.

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increase the volume of loans to small businesses. Still, while H.R. 5297 states that the SBLF will be "established as separate and distinct from the Troubled Asset Relief Program," the bill has created a twin of the TARP.

Despite their similarities, H.R. 5297 directs the Congressional Budget Office [CBO] to score the SBLF in a manner inconsistent with TARP. Congress directed the TARP be scored under the guidelines of the Federal Credit Reform Act [FCRA] but adjusted for market risk (also called a fair-value estimate), while H.R. 5297 instructs CBO to determine the cost of SBLF under credit reform *without* an adjustment for market risk.

In preparing its score, CBO notes: "[C]ost estimates made under FCRA do not provide a comprehensive measure of the cost to taxpayers primarily because the FCRA methodology does not include the costs that stem from certain risks involved in lending – risks that private investors would require compensation to bear."[2] While straight FCRA uses Treasury borrowing rates to discount the expected cash flows from government loans or loan guarantees, there are oftentimes additional risks that should be priced-in, especially during times of market stress. In particular, there are currently 829 banks on the FDIC's "problem" list, one signal of the heightened market risk of extending loans to community banks under the SBLF.[3]

In measuring its deficit impact, CBO scores the small-business lending fund in H.R. 5297 as a program that reduces the deficit by $1.1 billion over 10 years. Although the bill directs CBO to use FCRA guidelines, because the preferred stock portion has no requirement that banks repay the loan to Treasury, CBO recorded SBLF outlays and repayments on a *cash* basis, showing transactions in the year they occur (as opposed to a fair-value method that would show the net present value of future cash flows adjusted for market risk).

In contrast, CBO provides a fair-value estimate for the SBLF similar to the approach used to score TARP. **Adjusting for market risk, the small-business lending fund would cost $6.2 billion, $7.3 billion more than the cash estimate.**

The bill creates another bailout fund. In addition to the SBLF, the bill includes another type of fund called the "Small Business Credit Initiative." This would provide $1.5 billion in aid to States in the form of a grant, transferring funds directly to state coffers for programs that provide financing for loans to small businesses.

GROWTH IN THE SBA INSTEAD OF THE PRIVATE SECTOR

H.R. 5297 also expands the size and reach of the Small Business Administration [SBA] – and expands further the growing government role in the lending business. It is part of a continuing

[2] Congressional Budget Office, Cost Estimate of H.R. 5297, the Small Business Lending Fund Act of 2010, 28 June 2010.

[3] In addition, while CBO assumes a negative subsidy rate for the Capital Purchase Program overall (i.e. it makes a profit), this is largely driven by the repayments of financial institutions with larger asset sizes that would not qualify for the SBLF. Almost all banks that have not yet repaid CPP funds are those with assets of $10 billion or less that would qualify for SBLF, which also indicates a heightened risk of lending to that group alone.

trend of increased public sector involvement in credit markets and in managing the economy. As one example, the government, through Fannie Mae, Freddie Mac, or Ginnie Mae, now guarantees almost the entire housing market, standing behind 95 percent of new loan origination.[4] The recently passed financial regulation bill (the "Dodd-Frank" act), calls for at least 250 new Federal rulemakings,[5] putting government regulators behind the reins controlling which banks and individuals get access to capital on Wall Street.

H.R. 5297 includes several provisions to increase loan limits and funding for SBA programs, such as raising the loan limit from $2 million to $5 million – 150 percent – for SBA 7(a) and 504 loans. The bill would also increase the guaranty SBA provides to lenders to 90 percent for 7(a) loans and eliminate fees for all 7(a) and 504 loans through 31 December 2010. In total, the legislation calls for $712 million in new spending directed mainly at SBA programs.

TEMPORARY TAX CREDITS FOR SMALL BUSINESSES, AND A NET TAX INCREASE

Although Senate Republicans proposed a permanent extension of the research and development tax credit, it failed. The bill moved forward with a patchwork of temporary tax credits for small businesses, which many argue would have a minor impact in comparison to the added burden of the expiring 2001 and 2003 individual income tax rates. H.R. 5297's temporary tax credits amount to about $12 billion, but they are outpaced by $14.4 billion in permanent tax increases, leading to a *$2.4 billion net tax increase*, as estimated by the Joint Committee on Taxation [JCT].

Temporary Tax Credits[6] . . .

The largest tax break in the bill is the 1-year extension of bonus depreciation for the purchase of qualified property, which would reduce revenues by about $5.5 billion. In addition, H.R. 5297 contains a provision to temporarily increase the maximum amount of depreciable business assets that can be expensed and expands the definition of eligible property in this category, which would reduce revenues by about $2 billion over the 10-year period.

On top of that, the bill reduces revenue by almost $2 billion by allowing a temporary deduction for health insurance costs in calculating income from self-employment. The bill also provides an exclusion of 100 percent of the gain for investors in small-business stock that hold onto the stock for at least 5 years and purchase the stock before 1 January 2011. This is expected to bring down taxes by about $500 million for those investors.

. . . But Permanent Tax Hikes

In total, the legislation has about $14.4 billion in revenue raisers, which outpace the tax credits. The largest single offset – $5 billion – comes from an unrelated measure: broadening the scope of

[4] Federal Housing Finance Agency, *Conservator's Report on the Enterprises' Financial Performance, Second Quarter 2010.*

[5] "The Uncertainty Principle," *The Wall Street Journal*, 14 July 2010.

[6] Revenue estimates from the Joint Committee on Taxation's *Technical Explanation of the Tax Provisions in Senate Amendment 4594 to H.R. 5297*, 16 September 2010.

rollovers from elective deferral plans, which include individual retirement plans and employer plans, into Roth designated accounts. (Because income transferred into the Roth IRA is included in taxable income, the provision raises revenues over a 10-year period, even though gains in Roth IRA accounts are not subject to capital gains taxation in future years.)

Also inserted as a revenue increase is a controversial provision to expand penalties associated with the 1099 reporting requirement created as part of the health care legislation. This would raise about $2.5 billion, and is seen as especially burdensome for small businesses grappling with the filing requirement.

Additional revenue raisers include other unrelated provisions, such as limiting the cellulosic biofuel producer credit and enacting rules to expand the domestic tax base of income from guarantees.

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