

HOUSE TAXATION COMMITTEE MEETING MINUTES
March 18, 1981

A meeting of the House Taxation Committee was held on Wednesday, March 18, 1981 at 8:00 a.m. in Room 102 of the State Capitol. All members were present except Reps. Brand, Harrington, and Vinger, who were absent. HOUSE BILLS 609 and 834, SENATE BILL 377, and SENATE JOINT RESOLUTION 10 were heard.

The first bill to be heard was SENATE BILL 377, sponsored by Sen. Harry Berg. The objective of the bill is to consolidate school finance accounts in the State. It doesn't affect the County portion or the District voted levies. It consolidates the State equalization permissive deficiency accounts into one earmarked revenue account. Benefits will be: (1) improved administration of the fund, (2) greater flexibility, and (3) better budgeting. Currently the Office of Public Instruction is responsible for administration of this financial structure, and they presently have to make numerous transfers among the various accounts. This bill would minimize those transactions. Also, currently it is difficult to determine exact account balances for the future budgetary requirements because of the number of accounts and the transfers between those accounts. Also, the present legal structure of the accounts requires certain actions which can't be reversed once they are done. For example, it is possible to transfer funds to the Permissive Account where they aren't needed and not be able to take them back to the Equalization Account, where they are needed.

He offered an amendment to the bill; see Exhibit "A." Interest from the accounts presently is required to go back to the Permissive Account. This amendment is necessary because the Permissive Account will now become part of the Equalization Account.

Tom Crosser, Governor's Office of Budget and Planning, then rose in support of the bill. He drafted the bill, and worked with the Office of Public Instruction on it. It would simplify their book-keeping records and make internal operations much smoother. He added that the Governor's Office supported the bill.

Bob Stockton, Office of Public Instruction, then rose in support of the bill. Regarding the possibility of having surpluses in one account and deficiencies in another, this has happened, and as a result, a deficiency levy had to be placed. The Legislative Interim Finance Committee had asked for this bill to be drafted.

Dennis Burr, Montana Taxpayers Association, then rose in support of the bill.

There were no OPPONENTS to SB 377; questions were asked. Rep. Nordtvedt asked Mr. Stockton if the bill would in any way change the apparent practice of piling up a surplus in the School Equalization Fund and spending General Fund appropriations.

Mr. Stockton replied that the law presently said that appropriated money should be spent first. Since the money won't have to be transferred to another account at the end of the year, it shouldn't be neces-

sary to use the General Fund appropriation except to take up the slack. He agreed to check up on this to see if the law needed amending in this area.

Rep. Harp wondered if special legislation would be reduced with passage of the bill and Mr. Stockton said he felt it would be reduced.

The sponsor then closed, and the hearing on SB 377 was closed.

HOUSE BILL 609, sponsored by Rep. Jay Fabrega, was then heard. This bill was being heard once more so that additional proponents would be able to testify and explain why the present system wasn't working. Cascade County elected to levy one mill just to support the Economic Growth Council and this is a good indicator of local interest.

John Lopach, Assistant Director of the Economic Growth Council in Great Falls, then rose in support of the bill. This bill's intention is to allow Counties and Cities which desire and need economic development a choice as to the property tax incentives they wish to give to new and expanding manufacturers. The bill provides that the jurisdiction can make the decision whether or not to take advantage of this law.

In his area over the years they have had a significant loss in economic base. In contrast, some other sections of the economy have been prosperous. The same type of situation is occurring in other Cities in the State where there have been slowdowns in the local industries. A positive encouragement needs to be offered to industry.

The Federal government favors cutbacks in federal money to the Cities. This bill is asking for the choice to pick up the burden that the Federal government is implying they should. They don't want to reduce present taxes but simply want to collect new and additional taxes on a graduated basis. There are several problems with existing tax incentives. Basically, there is only one law that will work: MCA 15-6-135. They are asking that this bill be passed and perhaps an amendment be added saying the business cannot use both MCA 15-6-135 and this bill at the same time.

There were no opponents to the bill. Questions were then asked. Rep. Fabrega said that regarding synfuel plants; (1) they could probably take advantage of the present law but if there was a question, he had prepared an amendment to clarify the definition of "manufacturing". If the Committee wanted this amendment also, he would be willing to have it incorporated in the bill, also.

Rep. Sivertsen said he felt a better definition was needed for "construction period." Mr. Lopach wondered if the County assessor couldn't be allowed to determine this. Rep. Sivertsen said that putting the burden on the County assessor would make him subject to

a lot of pressure. Mr. Lopach suggested that the County Commission could have control over the matter, possibly.

Rep. Harp submitted that anyone who had invested a lot of money in an industry would probably try to finish construction as soon as possible.

Rep. Nordtvedt suggested that the break be five years from the date of beginning of construction. Rep. Fabrega suggested language to the effect that not more than two years from the beginning of the construction date of the permit for building, the tax break would begin.

Rep. Bertelsen suggested that the wording on P. 3, line 6 include "tax." Also, an amendment was needed providing that the Department of Revenue would make the determination.

Rep. Fabrega pointed out that the bill only covered the actual building and Montana Power (Resource 89) could come under this bill as far as the building but that would be all.

Rep. Fabrega then closed and the hearing on HB 609 was closed.

HOUSE BILL 834, also sponsored by Rep. Fabrega, was then heard. This is the Small Business Incentive Credit Act. He explained the bill, section by section. A small business investment company or partnership is a source of high risk venture capital and by definition under the Small Business Act, once an SBIC has invested their capital they can borrow three times their capitalization from the Small Business Administration at a reduced rate.

The reason 11 SBIC's have been provided for in the bill is because of the size of the State. The SBIC's in each of the 11 areas would all be allowed a \$1 million capitalization.

A tax credit is provided for investment in the SBIC's. However, the credit has to be spread over several years. In Massachusetts, this approach has been very lucrative.

The long and the short of other State's experiences is not to use General Fund money to lend to high risk businesses; there are political and constitutional problems. The successful approach is giving a tax credit to induce investment. This deletes the need for any bureaucratic involvement. By creating 11 units, individual communities would be getting a chance to try this if there is interest.

John Lopach, Assistant Director of the Economic Growth Council of Great Falls, rose in support of the measure. Just as HB 609 offered an option to local governments, this bill offers the private sector the option and opportunity to create new sources of capital for job creation. For every dollar invested in SBIC's, the State will offer

a tax credit. The bill recognizes that for every dollar invested in SBIC's, \$3 - \$4 will be made available from the Small Business Administration if the minimum investment amount is reached.

The bill says that the company should be located fairly closely to the person borrowing; that is why there are 11 of them in the bill. He presented to the Committee a circular from the National Association of Small Business Investment Companies; see Exhibit "B." He also had a copy of the Small Business Investment Act of 1958; see Exhibit "C." This bill he guaranteed could raise \$500,000 locally; the investors of the money would save \$250,000 in taxes, and that initial investment would bring in at least \$1,500,000 in long term debt from the SBA. During the term of the loans that are out only interest is due back to the SBA. Without prior SBA approval, an SBIC can invest 20% of its capitalization in any one company, so the community could invest \$100,000 of the initial investment in any one local company it wishes to help. SBIC's can also syndicate their investments. A very good borrowing base could therefore be built up. Over the years the community would be rewarded with more jobs, the pride of having made something happen, and having diversified its economic base and cash flow into the economy, and additional tax revenues.

Investors are rewarded with the State tax credit and federal advantages also. Investors are also benefitted because of the SBIC's interest income from their investments.

The SBIC has the right to forego interest in exchange for the right to purchase stock in the companies it has invested in. Therefore, SBIC's often work hard to take the company to public market where they can sell their stock off.

He then distributed a handout prepared by Arthur D. Little, Inc. which described how SBIC's worked; see Exhibit "D."

He then went over what the bill proposed to do. Regarding the Fiscal Note stating that tax receipts would be reduced as much as \$5 million or more during the coming biennium, he submitted that wasn't correct. The highest dollar amount of tax credits available in any one year would be \$1,375,000 because the investors could use only 1/4 of the available tax credit in any one year. In any biennium, therefore, the highest amount available would be about \$2 million, and not \$5.5 million. He had no comment on the other statements in the Fiscal Note. He hadn't realized that the Department of Revenue would want to put the process on computer.

Janelle Fallan, Montana Chamber of Commerce, then rose in support of the bill. The Chamber of Commerce has a Venture Capital Subcommittee, with a board representation of the groups that would be interested in this as members. The private sector approach was taken and they agree with the approach in this bill.

John Fitzpatrick, Western Analysis, Inc., then spoke on behalf of the Chamber of Commerce. Their firm is a member of the Chamber Sub-

committee and involved with businesses in the State. One thing they see as necessary in the State is stimulation of savings and investment. Without this money available for capital investment, industry lags in productivity and this leads to business failures and people out of work. Something like an SBIC can make equity capital available to companies which need updating of their equipment. He pointed out that this bill focused on small businesses. He felt this was appropriate. A questionnaire was put to Montana bankers and many of them responded that they had to turn good business loans down because of lack of equity capital on the part of the people trying to get the money.

One important thing not mentioned in the Fiscal Note is that investment will ultimately bring back revenue to the State in tax dollars. It is important to recognize that there are many different ways the State can participate in economic development. Many proposals put before the Legislature have good features and this bill is a very good approach because the risk is left with the private sector.

Mike Fitzgerald, Montana Trade Commission, then rose in support of the bill.

Dave Goss, Billings area Chamber of Commerce, also rose in support of the bill.

John Cadby, Montana Bankers Association, then spoke. He worked with the Chamber of Commerce in the past 1 1/2 years to find ways to stimulate the State's economy and felt this bill was the best bill of the Session in this area.

There were no OPPONENTS to HB 834. Questions were then asked. Rep. Dozier questioned the statement that no public funds would be involved and submitted that lost tax revenue due to the credit provision would constitute an indirect use of public funds. Mr. Cadby submitted that the yield would exceed the loss in revenue in the initial impact. The aggregate yield to Montana would be greater than the short-term loss from the tax credits would be.

Rep. Bertelsen wanted to know who actually set up the SBIC. Mr. Lopach said community leaders would decide who would be involved in it. A Committee would be formed and investors would be talked to. He saw a coalition of labor unions, bankers, and other businesses in the area, and private high networth individuals getting together with an investment banker and discussing the possibilities. Once the group of shareholders was formed, they would elect the officers. Creation of the shareholders group would be a community effort.

Rep. Bertelsen submitted that the bill might need a Statement of Intent, and the sponsor agreed, and suggested that the Committee develop one to include implementation rules.

Rep. Nordtvedt then gave Mr. John Harmon, owner of Big Bud Tractors

in Havre, permission to testify in support of the bill. His company has needed capital since its inception. It has been very difficult to raise it and he has had to get out-of-State financing to raise additional capital for his company. One of his big problems is because there are no local SBIC's to relate to in getting the money. Out-of-State people find it hard to supervise his company. Home-grown companies are more viable in Montana and out-of State corporations might pull out. He feels comfortable with the ability to create capital for homegrown kinds of industry. In today's economy it is even more difficult to raise capital than ever, and the SBIC is one of the only sources to raise risk capital.

Questions were resumed. Rep. Nordtvedt said that the bill would lead to the paradox of a person with \$100,000 wanting to invest in his own business not being able to get a tax credit unless his money was turned over to the SBIC. He also pointed out that SBIC's didn't give money from "ground 0." The successful business ventures returning a high yield and the high net worth investors end up paying taxes on their earnings.

Rep. Roth asked Mr. Lopach why what the bill was attempting to do couldn't be done through the SBA as it was presently being done. Mr. Lopach replied that the federal government historically had had a problem in the position where it owned equity in a private enterprise. Congress recognized in the 1950's that something needed to be done in the case of borrowing base equity for high risk companies. They said it was not the policy of the government to become directly involved but they could create an incentive for the private sector to take the equity positions in the new companies.

Rep. Williams pointed out that SBIC's could already be created in Montana, and this bill just provided an incentive for that to take place.

Rep. Bertelsen wanted to know if the investors to receive the State credit would also be receiving federal benefits. Mr. Lopach said a tax credit wasn't offered on the federal level, but there were other advantages.

Rep. Bertelsen pointed out that high risk venture capital was usually high interest money and wanted to know if there would be any ceiling on the person receiving the capital. Mr. Lopach said the ceiling was five points above the federal discount rate. Rep. Bertelsen asked him if he saw any problem in that the person who needed the capital was put in a very high interest bracket. Mr. Lopach said the maximum rate was presently 18%, and this could be reduced if the warrant for stock was used to convert the debt to shares.

Rep. Roth asked Rep. Fabrega what the time frame was on repayment and he told her it was a fifteen-year maximum. However, the SBIC in-

vestment is for a minimum of seven years and they get their principal back either by acquiring stock, if the company goes public, or debenture notes.

Rep. Fabrega then closed. He pointed out that the Fiscal Note was too high. One would have to assume that all 11 SBIC's used full funding and were all funded in the first year. He pointed out that jobs would be created from the bill and would generate income tax revenue and the State would also be relieved from having to pay unemployment. He expressed belief that the \$5.5 million from the Fiscal Note would be made up many times over in the years to come. When the State's economic well-being is considered, no price can be put on that. He submitted that this bill was the one measure that really addressed the possibility of economic development by creating new jobs. An SBIC has no reason for being unless it invests in new or expanding ventures.

Rep. Williams was then allowed to ask another question. He wanted to know if the offerings would have to be registered with the Securities Exchange Commission even if they were in the State. Rep. Fabrega said they would have to be.

Rep. Dozier had a question about what would happen if two different SBIC's wished to start up in the same region. Rep. Fabrega said the Department of Revenue would have to address this, but he didn't think it would happen. Mr. Lopach said he didn't see this problem except possibly in the Butte-Anaconda area, and possibly Anaconda would have to be addressed in the bill. Rep. Sivertsen told Rep. Fabrega that if he would like to have the bill amended in this way, to let the Community know. Rep. Fabrega pointed out that this would be increasing the number to 12, and some of them might not get started. He pointed out the purpose of the bill was to provide an incentive and if both Cities could take advantage of this, then they should have the opportunity. The hearing on HB 834 was then closed.

SENATE JOINT RESOLUTION 10, sponsored by Sen. Bill Norman, was then heard. The present IRS ruling says that certain information cannot be divulged relating to alcohol fuel production. Therefore, Montana either has to repeat the process to get the information or they could exchange information with the IRS. The resolution is directed to the Congress and the Bureau Chief of the Bureau of Alcohol, Tobacco, and Firearms asking that the non-confidential information in the IRS file be released to the Department of Revenue so that they would know where and how much alcohol is being produced.

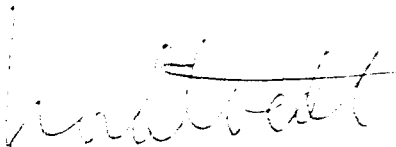
Ellen Feaver, Director of the Department of Revenue, then rose in support of the Resolution as a means of preventing them from having to duplicate the procedure. She felt there was no reason why this information shouldn't be made available.

There were no OPPONENTS to SJR 10. Questions were then asked. Rep. Williams wanted to know where the information would be made available to. Sen. Norman said the second "Whereas" was an inference that the

information be made known to the Department of Revenue; however, this wasn't exactly clear. Rep. Sivertsen asked if the Senate would have any problems with having the Department of Revenue specified and neither Sen. Norman nor Ms. Feaver had any objections to this.

Sen. Norman then closed, and the hearing on SJR 10 was closed.

The meeting was adjourned at 9:50 a.m.



Rep. Ken Nordtvedt, Chairman

da

WITNESS STATEMENT

NAME Harry K. Berg BILL No. 377
ADDRESS 3309 17th Ave S. Gr Falls DATE 3-18-81

WHOM DO YOU REPRESENT _____

SUPPORT OPPOSE _____ AMEND _____

PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

Comments:

Amendment
Senate Bill 377 - Second Reading

1. Page 1, line 24
Following: "years".
Insert: "Interest earned on investment of equalization account funds shall be deposited to the earmarked revenue fund as established in 20-9-343."
2. Page 7, lines 3 through 7.
Following: "years". on line 3
Strike: line 3 through line 7 in their entirety.

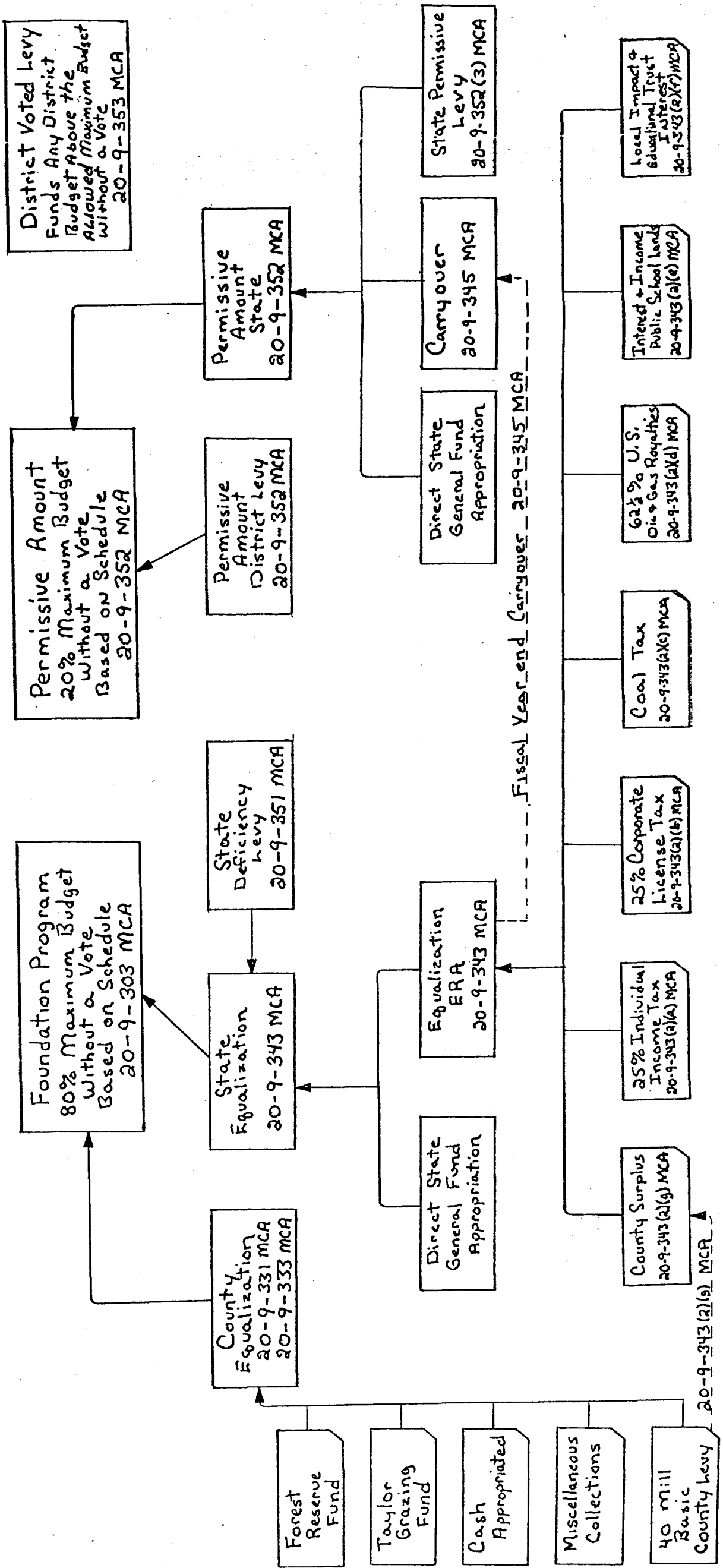
WITNESS STATEMENT

NAME Tom Crosser BILL No. SB377
ADDRESS OBPP DATE 3-18-81
WHOM DO YOU REPRESENT Gov. Office
SUPPORT OPPOSE AMEND

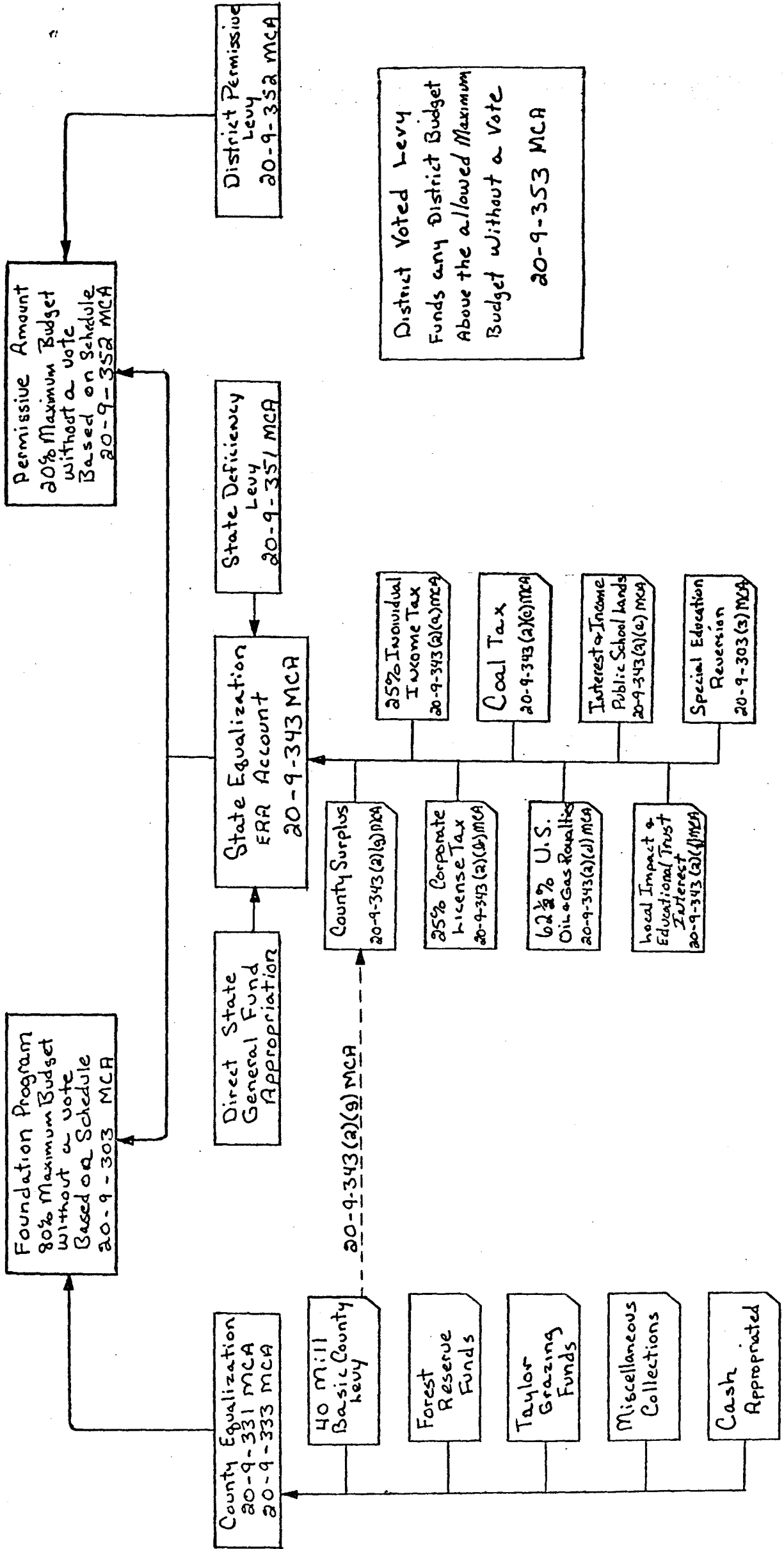
PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

Comments:

Existing Public School Finance Structure 1981



Proposed Public School Finance Structure SB377





N A S B I C

NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

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THE SMALL BUSINESS INVESTMENT COMPANY PROGRAM

What is An SBIC?

A Small Business Investment Company is a privately-organized, privately-capitalized and privately-managed source of venture capital for new and growing independent businesses. SBICs are licensed by the Small Business Administration, and comply with broad investment criteria established by the Small Business Investment Act of 1958 and subsequent SBA regulations. In return for providing equity capital, long-term loans, and management assistance exclusively to new and small businesses, SBICs are permitted to borrow funds from the Federal government at an interest rate slightly above the cost of money to the Federal Treasury.

Similar to SBICs are MESBICs, or Minority Enterprise Small Business Investment Companies. MESBICs utilize the SBIC format to help socially or economically disadvantaged entrepreneurs. Today, there are about 300 SBICs and 100 MESBICs with total assets of about \$1.5 billion.

Why do we need SBICs?

To understand the significance of the SBIC program, one must be aware of the role of small business in our society. We are a nation of small businesses. Independent firms comprise 97% of all unincorporated and incorporated businesses in the U.S. They generate 53% of all business receipts (\$3.3 trillion) and account for 43% of total GNP. Small firms are also the greatest job creators. Department of Labor statistics indicate that of nine million new jobs created between 1969 and 1976, not one was in the largest 1,000 corporations in the country. Six million of these jobs were created by small business and the remaining three million were in various levels of government. In addition, small businesses are innovators. Our economic progress depends upon innovation, and over half of all inventions and innovations introduced into industry since World War II originated in small companies. A National Science Foundation study of the period between 1953 and 1973 concluded that small firms produced 4 times as many innovations per R&D dollar as medium-sized firms, and 24 times as many as the largest firms.

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* EXECUTIVE COMMITTEE

The current economic crisis has many roots, but it is widely agreed that Federal policies which have rewarded consumption rather than savings and investment have contributed to our high rate of inflation and declining productivity. High taxes and excessive government regulation have made it difficult for businesses to accumulate capital to invest in new equipment and ideas. As a result, research and development has decreased, fewer innovations have been incorporated into our industrial systems, and our level of productivity has actually declined in recent years. An article which appeared in the Wall Street Journal noted that while the standard of living in America remains higher than that of any other industrialized country, our levels of capital formation and investment are much lower than those of West Germany, Japan and France. The article concluded that "in the long run, a country's rate of capital formation will largely determine its standard of living."

Heavy tax burdens and regulatory impediments affect the entire business community, but small firms are impacted disproportionately because of their heavy reliance on internally generated funds. Traditional sources of financing, such as banks and public equity markets, have become increasingly inaccessible to small firms in the past decade. The special problems of independent concerns were highlighted during the White House Conference on Small Business, convened in January, 1980. During the conference, over 1,600 delegates submitted 15 priority recommendations for changes in federal policy. It is not surprising that 5 of these were in the area of capital formation. Some small business owners complained that without adequate capital they could be forced to merge with larger corporations or to go out of business altogether. Others said that they would have to seek financing from sources outside of the U.S., underscoring the serious problem of foreign acquisition of small U.S. high technology firms. (A June 14, 1979 report of the Senate Small Business Committee listed a number of high-tech companies in fields such as data processing, advanced electronics, and vehicle and telecommunications electronics in which a controlling or near controlling interest had been acquired by foreign investors).

The venture capital industry has grown and developed in response to the serious need for capital assistance to small firms. Venture capitalists generally seek small firms with better than average growth potential and provide long term loans, equity financing and substantial management assistance. They take a minority ownership position in the company and hope to be rewarded for their risks with capital gains. The Congress, in 1958, realized the importance of establishing an institutional, ongoing source of venture capital. It passed the Small Business Investment Act of 1958 and the SBIC program was created.

How successful has the program been?

In its 21 year history, the SBIC program has been extremely successful, providing over \$3 billion to 40,000 small companies. The National Association of Small Business Investment Companies recently authorized the consulting firm of Arthur D. Little, Inc. to conduct a survey of the economic progress of the companies in which SBICs have invested over the years. Questionnaires were sent to active members of the program, and the data contained in the responses were processed by the accounting firm of Deloitte, Haskins and Sells.

The result of the study were truly impressive. According to key economic impact measures, SBIC-financed companies outperformed other small businesses by a factor of more than 10-1 (see chart). In the area of employment, the figures showed that a permanent job has been created for each \$4,000 of SBIC investment (in contrast to \$25,000 that the government must spend annually to create and maintain a single job). The Federal government has profited from the increased tax revenues generated by SBIC portfolio companies, which are from 150% to nearly 400% as great as those paid by all other small firms. 91% of the growth of these companies has been the result of internal growth, rather than mergers and acquisitions. In addition to the benefits directly attributable to SBIC money, SBIC financing in many cases has enabled the small firm to qualify for additional senior debt, such as bank lending.

Probably no other Federally created project represents as successful a partnership between public and private sectors as does the SBIC program. SBICs are permitted to take advantage of government leverage to provide more financial assistance to promising companies, but every penny of private capital is at risk before the government is exposed to any loss. Since 1958 the government loss on the SBIC program has been less than \$30 million -- an average of \$1.5 million per year. Added to the cost of administration, which is about \$1 million annually, the SBIC program costs the American taxpayers approximately \$2.5 million each year. When considered in light of the tremendous benefits which accrue to the economy as a result of SBIC activity, this is a phenomenally small expense. In 1979 alone, more than 1,670 small concerns received \$280 million from SBICs, and the numbers are growing each year.

How can the program be improved?

SBICs can only fulfill their mandate if an environment exists which is conducive to the welfare of small business. It has been established that small business is the most innovative, job-creative segment of the economy, but in order for it to survive, it must have an adequate supply of venture capital. The 1978 tax bill which reduced the capital gains tax from 49% to 28% has been a tremendous boost to the venture capital industry, and is responsible for a steady increase in the amount of funds committed to private investors since 1978. However, other steps must be taken to encourage venture investment in independent concerns. NASBIC supports a capital gains rollover treatment, which would permit the deferral of taxes on the proceeds of successful investments which are reinvested in other independent enterprises; liberalized corporate tax rates; more rapid capital cost recovery methods and the reinstatement of restricted stock options. It also advocates further liberalization of SEC rules which lessen the ability of small firms to raise capital, and a legislative exemption for publicly-owned SBICs and venture capital firms from the Investment Company Act of 1940. Finally, NASBIC supports all of the recommendations issued by the delegates to the White House Conference on Small Business, particularly those designed to facilitate capital formation.

A COMPARISON OF THE GROWTH OF SBIC PORTFOLIO COMPANIES
WITH THE GROWTH OF ALL SMALL COMPANIES*

Year of Initial Financing:	PRE-1972		1972-1975		1976-1977	
	SBIC PORTFOLIO COMPANIES	ALL SMALL COMPANIES**	SBIC PORTFOLIO COMPANIES	ALL SMALL COMPANIES**	SBIC PORTFOLIO COMPANIES	ALL SMALL COMPANIES**
Employment	384%	29%	155%	19%	48%	8%
Sales	896	76	386	27	81	16
Profits	1,165	144	553	25	52	53
Assets	694	48	188	24	92	13
Federal Corporate Taxes	739	135	652	63	85	57

*For SBIC's, growth rates are measured from the year prior to SBIC financing to the most recent fiscal year. For small companies in general, the comparison is from 1970, 1973 and 1976, to 1978.

**For financial measures, manufacturing corporations with less than \$5 million in assets. For employment, all corporations with less than 100 employees. Percentages for employment and taxes for all small companies for 1978 were estimated based on historical data.

Source: Federal Trade Commission, Quarterly Report of Manufacturing Corporations, U.S. Bureau of the Census, County Business Patterns and Arthur D. Little, Inc., estimates.

SUMMARY OF SECURITIES LAWS APPLICABLE TO SBICs AND PORTFOLIO COMPANIES

1. Small Offerings

Sec. 3(b) of the Securities Act of 1933 authorizes the SEC to exempt from the registration requirements of the Act certain small offerings. Pursuant to this authority, Regulation E provides a short form registration statement for SBICs issuing securities for not more than \$500,000 and Regulation A provides a similar procedure for other issuers up to \$1,500,000.

Rule 242, also promulgated pursuant to Section 3(b) of the Securities Act of 1933, authorizes private sales of securities to be made to "accredited" investors provided that the amount offered does not exceed \$2 million in any six-month period. An "accredited investor" is any person purchasing \$100,000 or more worth of securities or any of a number of institutions listed in the Rule, including SBICs.

2. Private Offerings

Section 4(2) of the 1933 Act exempts from the registration requirements "transactions by an issuer not involving any public offering." Rule 146, construing Sec. 4(2), permits the sale of securities without registration provided generally that: (1) there are not more than thirty-five purchasers; (2) all purchasers are "sophisticated investors" or have professional investment advice; (3) the investors are able to bear the economic risk of the investment; and (4) the investor has access to all information that would normally be required to be included in a registration statement filed by the issuer.

3. Sales of Restricted Securities

Any security acquired other than pursuant to full registration is a "restricted security" and generally cannot be sold except pursuant to Rule 144 under the 1933 Act. Rule 144 provides generally that a restricted security can be sold only after it has been held for a minimum of two years and there is adequate public information available with respect to the issuer. Satisfying those conditions, the sales of such restricted securities are limited in any three-month period to the greater of 1% of the outstanding securities of the same class or the average weekly trading volume over the preceding four weeks prior to the sale. Furthermore, all resale restrictions are lifted after a three-year holding period for stocks traded on a national exchange or listed on NASDAQ; or after a four-year period for securities of reporting companies not so traded provided that the securities are held by a non-affiliate of the issuer.

4. Intrastate Exemption

Sec. 3(11) of the 1933 Act exempts from the registration requirements "any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of said security is a person resident and doing business" within such State or Territory. Rule 147 construes Sec. 3(11) and permits limited resales to persons outside the state of the issuer. This exemption is not available to an SBIC or to any other issuer subject to the Investment Company Act of 1940.

5. Limited Offerings

Rule 240 under the 1933 Act permits an issuer to sell up to \$100,000 of its securities in any twelve-month period without registration under the Act provided: (1) there is no advertising or general solicitation; (2) no commission or other compensation is paid in connection with sales; and (3) the aggregate sales price of all such sales does not exceed \$100,000 in any twelve-month period. Note: Rule 240 is not available to "an investment company registered or required to be registered under the Investment Company Act of 1940."

6. Transactions with Affiliates

Section 17 of the 1940 Act prohibits transactions with affiliates except where the Commission issues an exemptive order after finding that the proposed transaction is reasonable and fair and consistent with the purposes of the Act, principally the protection of investors. "Affiliate" is defined to mean any officer, director, partner or any person directly or indirectly owning, controlling, or holding with power to vote, 5% or more of the outstanding voting securities of a registered investment company or any company in which the registered investment company has a 5% interest. Rule 17a-6 under the 1940 Act exempts SBICs from the exemptive order proceedings provided generally that no affiliated person of the registered SBIC has a private financial interest in the transaction. Rule 17d-1(d)(3) likewise exempts transactions by a registered SBIC and an affiliated bank provided periodic reports are filed on their joint financings of portfolio companies.

7. Capital Structure

Section 18(a)(1) of the 1940 Act provides that a registered investment company shall have an asset coverage of 300% on debt. Section 18(k) of the Act exempts SBICs from this debt-asset coverage requirement provided such debt "shall be held or guaranteed by the Small Business Administration." In addition, Section 18(a)(2) of the 1940 Act provides that a registered investment company having more than one class of stock must have 200% asset coverage on any second class of stock such as preferred. SBICs are not exempt from this requirement.

8. Definition of Investment Company

Section 3(a) of the 1940 Act defines an investment company generally to be any issuer engaged in the business of investing and which owns investment securities having a value exceeding 40% of the value of such issuer's total assets. Section 3(c)(1) excepts from the foregoing definition any issuer whose outstanding securities "are beneficially owned by not more than 100 persons and which is not making and does not presently propose to make a public offering of its securities. . . ." Where a corporation owns 10% or more of the outstanding voting securities of the issuer, then the number of shareholders of that corporation is included in the calculation of the "100 persons. . .", but Rule 3c-2 under the 1940 Act provides that where there is a corporate shareholder in an SBIC, the corporation will be treated as only one shareholder (even if it owns more than 10% of the stock of the SBIC) provided that the value of all securities of SBICs owned by such corporation does not exceed 5% of the value of its total assets.

SUMMARY OF SPECIAL TAX PROVISIONS APPLICABLE TO SBICS AND SHAREHOLDERS

1. Losses of Shareholders

Shareholders of SBICs are permitted to take an unlimited ordinary loss deduction on losses pursuant to sale, exchange or worthlessness of their stock in an SBIC. (Sec. 1242 IRC)

2. Gains and Losses on Investments

Gains and losses on sales of investments evidenced by debt instruments are treated as ordinary gains and losses. Gains and losses on sales of stock in portfolio companies are treated as capital gains and losses, subject to the rules pertaining to holding periods. But a loss on stock received pursuant to the conversion privilege of a convertible debenture is entitled to unlimited ordinary loss treatment (Secs. 582(c) and 1243 IRC).

3. Loss Reserves of SBICs

SBIC bad debt loss reserves on investments in small concerns must generally be based on the individual loss experience of the SBIC. SBICs in existence less than ten years are permitted to use an SBIC industry loss experience average (Sec. 586 IRC).

4. Dividends Received by SBICs

SBICs are allowed a deduction of 100% on dividends received from portfolio small business concerns, rather than the 85% dividends received deduction allowed corporate taxpayers generally (Sec. 243 (a) (2) IRC).

5. Regulated Investment Company Treatment

SBICs which are registered under the Investment Company Act of 1940 can, like mutual funds and other investment companies, "pass-through" (i.e., avoid payment of corporate income tax) their income to shareholders, subject to certain conditions.

The principal requirements are diversification; derivation of at least 90% of the company's gross income from dividends, interest, and gains from the sale or other disposition of stock or securities; and distribution to stockholders of not less than 90% of net income, excluding capital gains (Sec. 851(b) and (c) (8) IRC).

6. Personal Holding Company

SBICs are excepted from the definition of a personal holding company provided no shareholder in the SBIC owns 5% or more of a portfolio concern directly or indirectly (Sec. 542(c) (8) IRC).

7. SBIC Carryback of Net Operating Losses

SBICs are permitted to carry back net operating losses for ten years instead of three years (Sec. 172(b) (1) (F) IRC).

8. Accumulated Earnings Tax

The IRS has by regulation exempted SBICs from the surtax on accumulated earnings, provided the SBIC is in compliance with the Small Business Investment Act and regulations thereunder and is actively engaged in providing financing to small business concerns (Reg. 1.533-1(d)).

9. Pricing Options and Warrants

Where an SBIC and a borrower agree in writing in advance of a financing that the interest rate on the financing without options or warrants would have been not more than 1% per annum greater than the rate on the financing coupled with options or warrants, then IRS will accept such agreed assumed rate of interest and limit original issue discount treatment to this amount (T.D. 6984, 12-23-68; Reg. 1.1232-3(b)(2)(ii)).

95th Congress }
1st Session }

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SMALL BUSINESS INVESTMENT ACT
OF 1958
AS AMENDED

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES
NINETY-FIFTH CONGRESS
FIRST SESSION



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89-695

SMALL BUSINESS INVESTMENT ACT OF 1958

(Public Law 699,¹ as amended)

TITLE I—SHORT TITLE, STATEMENT OF POLICY, AND DEFINITIONS

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SEC. 101. This Act * * * may be cited as the "Small Business Investment Act of 1958".

STATEMENT OF POLICY

SEC. 102. It is declared to be the policy of the Congress and the purpose of this Act to improve and stimulate the national economy in general and the small-business segment thereof in particular by establishing a program to stimulate and supplement the flow of private equity capital and long-term loan funds which small-business concerns need for the sound financing of their business operations and for their growth, expansion, and modernization, and which are not available in adequate supply: *Provided, however*, That this policy shall be carried out in such manner as to insure the maximum participation of private financing sources.

It is the intention of the Congress that the provisions of this Act shall be so administered that any financial assistance provided hereunder shall not result in a substantial increase of unemployment in any area of the country.

SEC. 103. As used in this Act—

DEFINITIONS

(1) the term "Administration" means the Small Business Administration;

(2) the term "Administrator" means the Administrator of the Small Business Administration;

(3) the terms "small business investment company", "company", and "licensee" mean a company approved by the Administration to operate under the provisions of this Act and issued a license as provided in section 301;²

(4) the term "State" includes the several States, the Territories and possessions of the United States,

Definitions,
15 U.S.C. 662.

¹ Approved August 21, 1958.

² This language substituted by section 2(1) of PL 87-841, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 752).

the Commonwealth of Puerto Rico, and the District of Columbia;³

(5) the term "small-business concern" shall have the same meaning as in the Small Business Act;

(6) the term "development companies" means enterprises incorporated under State law with the authority to promote and assist the growth and development of small-business concerns in the areas covered by their operations;

(7) the term "license" means a license issued by the Administration as provided in section 301; ⁴ and

(8) the term "articles" means articles of incorporation for an incorporated body and means the functional equivalent or other similar documents specified by the Administrator for other business entities.⁵

TITLE II—SMALL BUSINESS INVESTMENT DIVISION OF THE SMALL BUSINESS ADMINISTRATION⁶

ESTABLISHMENT OF SMALL BUSINESS INVESTMENT DIVISION

SEC. 201. There is hereby established in the Small Business Administration a division to be known as the Small Business Investment Division. The Division shall be headed by an Associate Administrator who shall be appointed by the Administrator, and shall receive compensation at the rate provided by law for other Associate Administrators of the Small Business Administration.⁷

TITLE III—SMALL BUSINESS INVESTMENT COMPANIES

ORGANIZATION OF SMALL BUSINESS INVESTMENT COMPANIES

SEC. 301. (a) A small business investment company shall be an incorporated body or a limited partnership⁸ organized and chartered or otherwise existing⁹ under State law solely for the purpose of performing the functions and conducting the activities contemplated under

this title, which has succession for a period of not less than thirty years unless sooner dissolved by its shareholders or partners¹⁰ and possesses the powers reasonably necessary to perform such functions and conduct such activities. The area in which the company is to conduct its operations, and the establishment of branch offices or agencies (if authorized by the articles), shall be subject to the approval of the Administration.¹¹

Articles.

(b) The articles of any small business investment company shall specify in general terms the objects for which the company is formed, the name assumed by such company, the area or areas in which its operations are to be carried on, the place where its principal office is to be located, and the amount and classes of its shares of capital stock. Such articles may contain any other provisions not inconsistent with this Act that the company may see fit to adopt for the regulation of its business and the conduct of its affairs. Such articles and any amendments thereto adopted from time to time shall be subject to the approval of the Administration.

(c) The articles and amendments thereto shall be forwarded to the Administration for consideration and approval or disapproval. In determining whether to approve such a company's articles and permit it to operate under the provisions of this Act, the Administration shall give due regard, among other things, to the need and availability for the financing of small business concerns in the geographic area in which the proposed company is to commence business, the general business reputation and character of the proposed owners and management of the company, and the probability of successful operations of such company including adequate profitability and financial soundness. After consideration of all relevant factors, if it approves the company's articles, the Administration may in its discretion approve and issue the company a license for such operation.¹²

(d) Notwithstanding any other provision of this Act, a small business investment company the investment in small business concerns which will contribute to a well-balanced national economy by facilitating ownership in such concerns by persons whose participation in the free enterprise system is hampered because of social

Consideration
by SBA.

¹⁰ "Or partners" added by section 106(b)(3) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

¹¹ Amended by section 11(a) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 756).

¹² New language in second and third sentences substituted by section 11(b)(1) and (2) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 756). Previous sections 301(d) and 301(e) struck out by section 11(b)(3) of PL 87-341. The business reputation of owners and management and the probability of successful operations, including adequate profitability and financial soundness, were added as criteria for approval by section 202 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967. (81 Stat. 269).

"Articles."

15 U.S.C. 671.

15 U.S.C. 681.

³ Amended by section 3 of PL 86-502, the Small Business Investment Act Amendments of 1960, approved June 11, 1960 (74 Stat. 196), to reflect admission of Alaska and Hawaii to the Union.

⁴ This language inserted by section 2(2) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 752).

⁵ This language inserted by section 106(a) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

⁶ For functions under this Act authorized in the Small Business Act as amended.

⁷ Added by section 2 of PL 86-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1359), to provide that the Division be headed by an Associate Administrator in lieu of a Deputy Administrator; to delete the provisions relating to the powers of the Administrator under the Act be exercised through the Small Business Investment Division; and to transfer the administrative and penal provisions to a new section 308(f).

⁸ The phrase "or a limited partnership" added by section 106(b)(1) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

⁹ The phrase "or otherwise existing" added by section 106(b)(2) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

or economic disadvantages may be organized and chartered under State business or nonprofit corporation statutes, and may be licensed by the Administration to operate under the provisions of this Act.¹³

CAPITAL REQUIREMENTS¹⁴

SEC. 302. (a) Each company authorized to operate under this Act shall have a combined private paid-in capital and paid-in surplus¹⁵ in an amount (1) not less than \$150,000, and (2) adequate to assure a reasonable prospect that the company will be operated soundly and profitably, and managed actively and prudently in accordance with its articles.¹⁶

(b) Notwithstanding the provisions of section 6(a)(1) of the Bank Holding Company Act of 1956,¹⁷ shares of stock in small business investment companies shall be eligible for purchase by national banks, and shall be eligible for purchase by other member banks of the Federal Reserve System and nonmember insured banks to the extent permitted under applicable State law; except that in no event may any such bank acquire shares in any small business investment company if, upon the making of that acquisition, the aggregate amount of shares in small business investment companies then held by the bank would exceed 5 percent of its capital and surplus.¹⁸

(c) The aggregate amount of shares in any such company or companies which may be owned or controlled by any stockholder, or by any group or class of stockholders, may be limited by the Administration.

BORROWING POWER

SEC. 303. (a) Each small business investment company shall have authority to borrow money and to issue its debenture bonds, promissory notes, or other obligations under such general conditions and subject to such limita-

¹³ Added by section 2(b) of PL 92-595, the Small Business Investment Act Amendments of 1972, approved October 27, 1972, (86 Stat. 1314).

¹⁴ Heading amended by section 203(b) of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967, (81 Stat. 269).

¹⁵ Section 742 of the Economic Opportunity Act of 1964, as amended provides that funds granted under Title VII which are invested, directly or indirectly, in a SBIC shall be included as private paid-in capital and paid-in surplus.

¹⁶ Section 302(a) substantially rewritten by section 203(a) of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967 (81 Stat. 269), to reflect transfer of SBIC authority to sell subordinated debentures to SBA to section 303(b).

¹⁷ Reference to the Bank Holding Company Act added by section 5 of PL 86-502, the Small Business Investment Act Amendments of 1960, approved June 11, 1960 (74 Stat. 1966), to allow a bank subsidiary of a holding company to invest in an SBIC subsidiary of the same holding company. Section 6 of the Bank Holding Company Act was repealed by section 9 of PL 89-483, approved July 1, 1966, (80 Stat. 240).

¹⁸ The maximum amount of shares a bank may hold in SBICs, formerly set at 2 percent of capital and surplus by section 3(b) of PL 87-341, the Small Business Investment Act Amendments of 1961, (75 Stat. 752) and at 5 percent but not to exceed 49 percent of any class of voting shares by section 204 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967 (81 Stat. 270), is now limited only by the 5 percent provision under section 107 of PL 94-305, approved June 4, 1976. (90 Stat. 663).

tions and regulations as the Administration may prescribe.

(b) To encourage the formation and growth of small business investment companies the Administration is authorized (but only to the extent that the necessary funds are not available to said company from private sources on reasonable terms) when authorized in appropriation Acts, to purchase, or to guarantee the timely payment of all principal and interest as scheduled on, debentures issued by such companies. Such purchases or guarantees may be made by the Administration on such terms and conditions as it deems appropriate, pursuant to regulations issued by the Administration. The full faith and credit of the United States is pledged to the payment of all amounts which may be required to be paid under any guarantee under this subsection. Debentures purchased or guaranteed by the Administration under this subsection shall be subordinate to any other debenture bonds, promissory notes, or other debts and obligations of such companies, unless the Administration in its exercise of reasonable investment prudence and in considering the financial soundness of such company determines otherwise. Such debentures may be issued for a term of not to exceed fifteen years and shall bear interest at a rate not less than a rate determined by the Secretary of the Treasury taking into consideration the current average market yield on outstanding marketable obligations of the United States with remaining periods to maturity comparable to the average maturities on such debentures, adjusted to the nearest one-eighth of 1 per centum, plus such additional charge, if any, toward covering other costs of the program as the Administration may determine to be consistent with its purposes. The debentures shall also contain such other terms as the Administration may fix, and shall be subject to the following restrictions and limitations:

(1) The total amount of debentures purchased or guaranteed and outstanding at any one time from a company which does not qualify under the terms of paragraph (2) of this subsection, shall not exceed 300 percent of the combined private¹⁹ paid-in capital and paid-in surplus²⁰ of such company. In no event shall the debentures of any such company purchased or guaranteed and outstanding under this paragraph exceed \$35,000,000.²¹

¹⁹ The word "private" added by section 2(c)(1) of PL 92-595, the Small Business Investment Act Amendments of 1972, approved October 27, 1972, (86 Stat. 1314).

²⁰ Section 742 of the Economic Opportunity Act of 1964, as amended provides that funds granted under Title VII which are invested, directly or indirectly, in a SBIC shall be included as paid-in capital and paid-in surplus.

²¹ \$15,000,000 substituted for \$7,500,000 by section 2(c)(2) of PL 92-595, the Small Business Investment Act Amendments of 1972, approved October 27, 1972, (86 Stat. 1314).
²² "300" percent substituted for "200" percent, and "\$35,000,000" substituted for "\$15,000,000" by sections 104(a)(1) and (2) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

(2) The total amount of debentures which may be purchased or guaranteed and outstanding at any one time from a company not complying with section 301(d) of this Act, which has investments or legal commitments of 65 per centum or more of its total funds available for investment in small business concerns invested or committed in venture capital, and which has combined private paid-in capital and paid-in surplus of \$500,000 or more shall not exceed 400 per centum of its combined private paid-in capital and paid-in surplus. In no event shall the debentures of any such company purchased or guaranteed and outstanding under this paragraph exceed \$35,000,000. Such additional purchases or guarantees which the Administration makes under this paragraph shall contain conditions to insure appropriate maintenance by the company receiving such assistance of the described ratio during the period in which debentures under this paragraph are outstanding.²²

(3) Outstanding amounts of financial assistance provided to a company by the Administration prior to the effective date of the Small Business Investment Act Amendments of 1967 shall be deducted from the maximum amount of debentures which the Administration would otherwise be authorized to purchase or guarantee under this subsection.

For purposes of this subsection, the term "venture capital" includes such common stock, preferred stock, or other financing with subordination or nonamortization characteristics as the Administration determines to be substantially similar to equity financing.²³

(c)²⁴ Subject to the following conditions, the Administration is authorized to purchase preferred securities, and to purchase, or to guarantee the timely payment of all principal and interest payments as scheduled, on debentures issued by small business investment companies operating under authority of section 301(d) of this Act. The full faith and credit of the United States is pledged

²² Amended by section 2(c)(3) of PL 92-505, the Small Business Investment Act Amendments of 1972, approved October 27, 1972 (86 Stat. 1314) to reduce the minimum capital required from \$1 million to \$500,000 and to increase from \$10 to \$20 million the ceiling on outstanding debentures under this paragraph.

²³ 400 per centum substituted for "300" per centum and "\$35,000,000" substituted for "\$20,000,000" by sections 104(b)(1) and (2) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

²⁴ Section 205 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967 (81 Stat. 270), substantially recast the authority of SBA to purchase the debentures of SBICs and incorporated within this section 303(b) the debenture purchasing authority formerly set out in section 302(a). As amended, section 303(b) increases the capacity of SBICs to borrow from SBA and provides an even greater borrowing capacity for equity-oriented SBICs. Section 10 of PL 92-213, approved December 22, 1971 (85 Stat. 776) amended this section 303(b) debenture purchase authority of SBA by adding the authority to guarantee the timely payment of principal and interest on such debentures but requiring that the authority to purchase or guarantee be exercisable only when specially authorized in appropriation Acts; and by expressly pledging the full faith and credit of the United States to the payment of such guarantees.

²⁵ Added by section 2(d) of PL 92-595, the Small Business Investment Act Amendments of 1972, approved October 27, 1972. (86 Stat. 1314).

to the payment of all amounts which may be required to be paid under any guarantee under this subsection.

The Administration may purchase—

(1) shares of nonvoting stock (or other securities having similar characteristics), provided—
(i) dividends are preferred and cumulative to the extent of 3 per centum of par value per annum;

(ii) on liquidation or redemption, the Administration is entitled to the preferred payment of the par value of such securities; and prior to any distribution (other than to the Administration) the Administration may require the preferred payment of the difference between dividends paid thereon and cumulative dividends payable at a rate equal to the interest rate determined pursuant to section 303(b) for debentures with a term of fifteen years, without interest on such difference;

(iii) the purchase price shall be at par value and, in any one sale, \$50,000 or more; and

Maximum amounts.

(iv) the amount of such securities purchased and outstanding at any one time shall not exceed (A) from a company having combined private paid-in capital and paid-in surplus of less than \$300,000 and licensed on or before October 13, 1971, the amount of combined private paid-in capital and paid-in surplus invested after such date, nor (B) from any company having combined private paid-in capital and paid-in surplus of \$300,000 or more but less than \$500,000 the amount of its combined private paid-in capital and paid-in surplus in excess of \$300,000, nor (C) from any company having combined private paid-in capital and paid-in surplus of \$500,000 or more, the amount of its combined private paid-in capital and paid-in surplus.

The Administration may purchase or guarantee—

(2) debentures subordinated pursuant to subsection (b) of this section (other than securities purchased under paragraph (1) of this subsection (c)), provided—

(i) such debentures are issued for a term of not to exceed fifteen years;

(ii) the interest rate is determined pursuant to sections 303(b) and 317; and

(iii) the amount of debentures purchased or guaranteed and outstanding at any one time pursuant to this paragraph (2) from a company having combined private paid-in capital and paid-in surplus of less than \$500,000 shall

Debentures—
maximum amounts.

not exceed 300²⁵ per centum of its combined private paid-in capital and paid-in surplus less the amount of preferred securities outstanding under paragraph (1) of this subsection, nor from a company having combined private paid-in capital and paid-in surplus of \$500,000 or more 400²⁶ per centum of its combined private paid-in capital and paid-in surplus less the amount of such preferred securities.

(3) debentures purchased and outstanding pursuant to section 303(b) of this section may be retired simultaneously with the issuance of preferred securities to meet the requirements of subparagraph (2) (iii) of this subsection (c).

(4) the Administration may require, as a condition of the purchase or guarantee of any securities in excess of 300²⁷ per centum of the combined private paid-in capital and paid-in surplus of a company, that the company maintains a percentage of its total funds available for investment in small business concerns invested or legally committed in venture capital (as defined in subsection (b) of this section) determined by the Administration to be reasonable and appropriate.

PROVISION OF EQUITY CAPITAL FOR SMALL-BUSINESS CONCERNS²⁸

SEC. 304. (a) It shall be a function of each small business investment company to provide a source of equity capital for incorporated and unincorporated²⁹ small-business concerns, in such manner and under such terms as the small business investment company may fix in accordance with the regulations of the Administration.

(b) Before any capital is provided to a small-business concern under this section—

(1) the company may require such concern to refinance any or all of its outstanding indebtedness so that the company is the only holder of any evidence of indebtedness of such concern; and

(2) except as provided in regulations issued by the Administration, such concern shall agree that it will not thereafter incur any indebtedness without

first securing the approval of the company and giving the company the first opportunity to finance such indebtedness.

(c) [Repealed.]³⁰

(d) Equity capital provided to incorporated small-business concerns under this section may be provided directly or in cooperation with other investors, incorporated or unincorporated, through agreements to participate on an immediate basis.³¹

LONG-TERM LOANS TO SMALL-BUSINESS CONCERNS

SEC. 305. (a) Each company is authorized to make loans, in the manner and subject to the conditions described in this section, to incorporated and unincorporated small-business concerns in order to provide such concerns with funds needed for sound financing, growth, modernization, and expansion.

(b) Loans made under this section may be made directly or in cooperation with other lenders, incorporated or unincorporated, through agreements to participate on an immediate or deferred basis.³²

(c) The maximum rate of interest for the company's share of any loan made under this section shall be determined by the Administration.

(d) Any loan made under this section shall have a maturity not exceeding twenty years.

(e) Any loan made under this section shall be of such sound value, or so secured, as reasonably to assure repayment.

(f) Any company which has made a loan to a small-business concern under this section is authorized to extend the maturity of or renew such loan for additional periods, not exceeding ten years, if the company finds that such extension or renewal will aid in the orderly liquidation of such loan.

AGGREGATE LIMITATIONS

SEC. 306. (a) Without the approval of the Administration, the aggregate amount of obligations and securities acquired and for which commitments may be issued by any small business investment company under the provisions of this Act for any single enterprise shall not ex-

²⁵ Section 206 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967 (81 Stat. 271), repealed section 304(c) which gave to companies receiving equity financing from an SBIC an option to purchase stock in the SBIC. This section added by section 5 of PL 87-341, the Small Business Investment Amendments of 1961, approved October 3, 1961. (75 Stat. 752).

²⁶ This sentence amended by section 6 of PL 87-341, the Small Business Investment Amendments of 1961, approved October 3, 1961 (75 Stat. 753), to substitute "other lenders, incorporated or unincorporated" for "other lending institutions." The sentence agreements to participate in loans on a deferred basis under this subsection, the participation by the company shall not be in excess of 90 per centum of the balance of loan outstanding at the time of disbursement." was repealed by section 105 of PL 305, approved June 4, 1976. (90 Stat. 663).

Assistance :
Limitations :
15 U.S.C. 653

Long-term
loans :
15 U.S.C. 653

Form of loan
direct,
participation
or guarantee

Conditions
of loan.

Equity capital.
15 U.S.C. 654.

²⁷ "300" per centum substituted for "200" per centum by section 104(c)(2) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

²⁸ "400" per centum substituted for "300" per centum by section 104(c)(1) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

²⁹ "300" per centum substituted for "200" per centum by section 104(c)(2) of PL 94-305, approved June 4, 1976. (90 Stat. 663).

³⁰ Prior to its amendment by section 6 of PL 86-502, the Small Business Investment Act Amendments of 1960, approved June 11, 1960 (74 Stat. 196), section 304 authorized SBICs to furnish equity capital only through the purchase of convertible debentures.

³¹ The words "and unincorporated" added by section 2(c) of PL 92-562, the Small Business Investment Act Amendments of 1972, approved October 27, 1972. (86 Stat. 1314).

ceed 20 percent of the combined private³³ paid-in capital and paid-in surplus of such company.³⁴

(b) [Repealed.³⁵ The subsection is set out below to provide a clearer understanding of this entire section.]

[(b) For the purpose of this section, the combined paid-in capital and paid-in surplus of any company licensed prior to January 1, 1968, shall consist of (1) the paid-in capital and paid-in surplus of such company and (2) the following portions of the funds outstanding from the Administration through the issuance of subordinated debentures as of the effective date of the Small Business Investment Act Amendments of 1967, or on January 1 of each of the following calendar years, whichever is less: (A) 100 percent, during 1968; (B) 75 percent, during 1969; (C) 50 percent, during 1970; (D) 25 percent, during 1971; and (E) zero, during 1972 and thereafter.]

(c) With respect to obligations or securities acquired prior to the effective date of the Small Business Investment Act Amendments of 1967, and with respect to legally binding commitments issued prior to such date, the provisions of this section as in effect immediately prior to such effective date shall continue to apply.³⁶

EXEMPTIONS³⁷

SEC. 307. (a) Section 3 of the Securities Act of 1933, as amended (15 U.S.C. 77c), is hereby amended by inserting at the end thereof the following new subsection (c):

“(c) The Commission may from time to time by its rules and regulations and subject to such terms and conditions as may be prescribed therein, add to the securities exempted as provided in this section any class of securities issued by a small business investment company under the Small Business Investment Act of 1958 if it finds, having regard to the purposes of that Act, that the enforcement of this Act with respect to such securities is not necessary in the public interest and for the protection of investors.”

(b) Section 304 of the Trust Indenture Act of 1939 (15 U.S.C. 77ddd) is hereby amended by adding the following subsection (e):

³³ The word “private” added by section 2(f) of PL 92-505, the Small Business Investment Act Amendments of 1972, approved October 27, 1972, (86 Stat. 1314), as amended by section 2(b) of PL 93-350, the Small Business Investment Act Amendments of 1974, approved October 27, 1974, (88 Stat. 1314), and section 2(b) of PL 94-142, the Small Business Investment Act Amendments of 1975, approved October 27, 1975, (89 Stat. 1314), shall apply to the combined paid-in capital and surplus” and “paid-in capital and paid-in surplus” instead of “combined capital and surplus” and adding sections 306(b) and 308(c) section 207 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967 (81 Stat. 271), in effect reduced the limitation for SBICs having subordinated debenture funds and made the change effective on a sliding scale for SBICs already in operation.

³⁴ Repealed by section 2(f) of PL 93-350, the Small Business Investment Act Amendments of 1974, approved October 27, 1974, (88 Stat. 1314).

³⁵ Added by section 20 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967, (81 Stat. 271).

³⁶ The Act provides a specific exemption from the Investment Company Act of 1940 for SBICs, releases them from a 3-to-1 asset coverage requirement in connection with borrowings. The SBICs are prescribed limitations on borrowing by SBICs.

“(e) The Commission may from time to time by its rules and regulations, and subject to such terms and conditions as may be prescribed herein, add to the securities exempted as provided in this section any class of securities issued by a small business investment company under the Small Business Investment Act of 1958 if it finds, having regard to the purposes of that Act, that the enforcement of this Act with respect to such securities is not necessary in the public interest and for the protection of investors.”

(c) Section 18 of the Investment Company Act of 1940 (15 U.S.C. 80a-18) is amended by adding at the end thereof the following:

“(k) the provisions of subparagraphs (A) and (B) of paragraph (1) of subsection (a) of this section shall not apply to investment companies operating under the Small Business Investment Act of 1958.”³⁸

MISCELLANEOUS

SEC. 308. (a) Wherever practicable the operations of a small business investment company, including the generation of business, may be undertaken in cooperation with banks or other investors or lenders, incorporated or unincorporated, and any servicing or initial investigation required for loans or acquisitions of securities by the company under the provisions of this Act may be handled through such banks or other investors or lenders on a fee basis. Any small business investment company may receive fees for services rendered to such banks and other investors and lenders.³⁹

(b) Each small business investment company may make use, wherever practicable, of the advisory services of the Federal Reserve System and of the Department of Commerce which are available for and useful to industrial and commercial businesses, and may provide consulting and advisory services on a fee basis and have on its staff persons competent to provide such services. Any Federal Reserve bank is authorized to act as a depository or fiscal agent for any company operating under the provisions of this Act.⁴⁰ Such companies may invest funds not reasonably needed for their current operations in direct obligations of, or obligations guaranteed as to principal and interest by, the United States, or in insured savings accounts (up to the amount of the insurance) in any institution the amounts of which are

³⁸ See further amendment, section 319 of the Small Business Investment Act, Amendments of 1961, approved October 3, 1961 (75 Stat. 753), to substitute “lenders or

³⁹ The last seven words of this sentence added by section 11(c) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961, (75 Stat. 753).

⁴⁰ The last seven words of this sentence added by section 11(c) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961, (75 Stat. 756).

Cooperation
with banks or
other investors.
15 U.S.C. 63f.

Fees.

Advisory
services.

Investment
of funds.

Exemptions by
the Securities
and Exchange
Commission.

the Government can reasonably expect to incur as a result of such operations during the then current fiscal year.⁴⁵

(2)⁴⁶ In its annual report for the year ending December 31, 1967, and in each succeeding annual report made pursuant to section 10(a) of the Small Business Act, the Administration shall include full and detailed accounts relative to the following matters:

(A) The Administration's recommendations with respect to the feasibility and organization of a small business capital bank to encourage private financing of small business investment companies to replace Government financing of such companies.

(B) The Administration's plans to insure the provision of small business investment company financing to all areas of the country and to all eligible small business concerns including steps taken to accomplish same.

(C) Steps taken by the Administration to maximize recoupment of Government funds incident to the inauguration and administration of the small business investment company program and to insure compliance with statutory and regulatory standards relating thereto.

(D) An accounting by the Bureau of the Budget with respect to Federal expenditures to business by executive agencies, specifying the proportion of said expenditures going to business concerns falling above and below small business size standards applicable to small business investment companies.

(E) An accounting by the Treasury Department with respect to tax revenues accruing to the Government from business concerns, incorporated and unincorporated, specifying the source of such revenues by concerns falling above and below the small business size standards applicable to small business investment companies.

(F) An accounting by the Treasury Department with respect to both tax losses and increased tax revenues related to small business investment company financing of both individual and corporate business taxpayers.

(G) Recommendations of the Treasury Department with respect to additional tax incentives to improve and facilitate the operations of small business investment companies and to encourage the use of their financing facilities by eligible small business concerns.

⁴⁵ Section 308(g) added by section 3(2) of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1356), and redesignated as section 308(g)(1) by section 210 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967, (81 Stat. 271).
⁴⁶ Section 308(g)(2) added by section 210 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967, (81 Stat. 271).

insured by the Federal Savings and Loan Insurance Corporation.⁴¹

(c) The Administration is authorized to prescribe regulations governing the operations of small business investment companies, and to carry out the provisions of this Act, in accordance with the purposes of this Act.⁴²

(d) Should any small business investment company violate or fail to comply with any of the provisions of this Act or of regulations prescribed hereunder, all of its rights, privileges, and franchises derived therefrom may thereby be forfeited. Before any such company shall be declared dissolved, or its rights, privileges, and franchises forfeited, any noncompliance with or violation of this Act shall be determined and adjudged by a court of the United States of competent jurisdiction in a suit brought for that purpose in the district, territory, or other place subject to the jurisdiction of the United States, in which the principal office of such company is located. Any such suit shall be brought by the United States at the instance of the Administration or the Attorney General.

(e) Nothing in this Act or in any other provision of law shall be deemed to impose any liability on the United States with respect to any obligations entered into, or stocks issued, or commitments made, by any company operating under the provisions of this Act.⁴³

(f) In the performance of, and with respect to the functions, powers, and duties vested by this Act, the Administrator and the Administration shall (in addition to any authority otherwise vested by this Act) have the functions, powers, and duties set forth in the Small Business Act, and the provisions of sections 13 and 16 of that Act, insofar as applicable, are extended to the functions of the Administrator and the Administration under this Act.⁴⁴

(g)(1) The Administration shall include in its annual report, made pursuant to section 10(a) of the Small Business Act, a full and detailed account of its operations under this Act. Such report shall set forth the amount of losses sustained by the Government as a result of such operations during the preceding fiscal year, together with an estimate of the total losses which

⁴¹ The last sentence revised by section 5 of PL 88-273, the Small Business Investment Act Amendments of 1963, approved February 28, 1964 (78 Stat. 147), to permit deposits of idle SBIC funds in insured savings accounts.

⁴² The provisions relating to examinations and reports by SBICs were deleted from this section by section 3(f) and added as a new section 310(b) by section 3(2) of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1359, 1360).

⁴³ The last seven words added by section 11(d) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961, (75 Stat. 756). The same section also struck out the previous sections 308(e) and (f) and redesignated this section (formerly (c)) as (e). The former sections 308(e) and (f) were rewritten and expanded by section 9 of PL 87-341 and designated as sections 309, 310, and 311.
⁴⁴ Section 308(f) added by section 3 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1359), and contains the provision transferred from section 201.

Regulations.

Noncompliance.

15 U.S.C. 631.
15 U.S.C. 642.
15 U.S.C. 645.

Annual report,
accounts. 639.
15 U.S.C. 639.

business investment company taking or receiving such interest.⁴⁷

REVOCATION AND SUSPENSION OF LICENSES; CEASE AND DESIST ORDERS⁴⁸

Sec. 309.⁴⁹ (a) A license may be revoked or suspended 15 U.S.C. 687a. by the Administration—

(1) for false statements knowingly made in any written statement required under this title, or under any regulation issued under this title by the Administration;

(2) If any written statement required under this title, or under any regulation issued under this title by the Administrator, fails to state a material fact necessary in order to make the statement not misleading in the light of the circumstances under which the statement was made;

(3) for willful or repeated violation of, or willful or repeated failure to observe, any provision of this Act;

(4) for willful or repeated violation of or willful or repeated failure to observe, any rule or regulation of the Administration authorized by this Act; or

(5) for violation of, or failure to observe, any cease and desist order issued by the Administration under this section.

(b) Where a licensee or any other person has not complied with any provision of this Act, or of any regulation issued pursuant thereto by the Administration, or is engaging or is about to engage in any acts or practices which constitute or will constitute a violation of such Act or regulation, the Administration may order such licensee or other person to cease and desist from such action or failure to act. The Administration may further order such licensee or other person to take such action or to refrain from such action as the Administration deems necessary to insure compliance with the Act and the regu-

⁴⁷ Section 308(h) added by section 204 of PL 93-501, approved October 29, 1974 (88 Stat. 1557). Section 205 of such Act provides "If any provision of this title or the application of such provision to any person or circumstance shall be held invalid, the remainder of the title and the application of such provision to any person or circumstance other than that as to which it is held invalid shall not be affected thereby." Section 206 of such Act provides "The amendments made by this title shall apply to any loan made in any State after the date of enactment of this title, but prior to the earlier of July 1, 1977, or the date which prohibits the charging of interest at the rates provided in the amendments made by this title."

⁴⁸ Heading and sections 309(a), (b), (c), (e), and (f) amended by section 4 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1339), to reflect license revocation authority granted to SBA; delete limitation of grounds for suspension of license for false or misleading statements made for purpose of obtaining license; and to authorize issuance and enforcement of cease and desist orders against individuals as well as licensees.

⁴⁹ Section 309 added by section 9 of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 753). Previous section 309 was repealed by section 11(e) of PL 87-341.

(H) A report from the Securities and Exchange Commission enumerating actions undertaken by that agency to simplify and minimize the regulatory requirements governing small business investment companies under the Federal securities laws and to eliminate overlapping regulation and jurisdiction as between the Securities and Exchange Commission, the Administration, and other agencies of the executive branch.

(I) A report from the Securities and Exchange Commission with respect to actions taken to facilitate and stabilize the access of small business concerns to the securities markets.

(J) Actions undertaken by the Securities and Exchange Commission to simplify compliance by small business investment companies with the requirements of the Investment Company Act of 1940 and to facilitate the election to be taxed as regulated investment companies pursuant to section 851 of the Internal Revenue Code of 1954.

(h) (1) In order to facilitate the orderly and necessary flow of long-term loans and equity funds to small business concerns, as defined in the Small Business Act, if the maximum interest rate permitted by the Small Business Administration exceeds the rate a small business investment company would be permitted to charge in the absence of this subsection, such small business investment company may in the case of business loans in the amount of \$25,000 or more, notwithstanding any State constitution or statute, which is hereby preempted for the purposes of this section, take, receive, reserve, and charge on any such loan, interest at a rate of not more than 5 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve bank in the Federal Reserve district where the small business investment company is located.

(2) If the rate prescribed in paragraph (1) exceeds the rate such small business investment company would be permitted to charge in the absence of this subsection, and such State fixed rate is thereby preempted by the rate described in paragraph (1), the taking, receiving, reserving or charging a greater rate than is allowed by paragraph (1), when knowingly done, shall be deemed a forfeiture of the entire interest which the loan carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person who paid it may recover, in a civil action commenced in a court of appropriate jurisdiction not later than two years after the date of such payment, an amount equal to twice the amount of interest paid from the small

15 U.S.C. 80a-1 et seq.
26 U.S.C. 551.
Small business investment companies, interest charges, limitation.
15 U.S.C. 631 note.

Interest overcharge, forfeiture.

Interest payment recovery.

lations. The Administration may also suspend the license of a licensee, against whom an order has been issued, until such licensee complies with such order.

(c) Before revoking or suspending a license pursuant to subsection (a), or issuing a cease and desist order pursuant to subsection (b), the Administration shall serve upon the licensee and any other person involved an order to show cause why an order revoking or suspending the license or a cease and desist order should not be issued. Any such order to show cause shall contain a statement of the matters of fact and law asserted by the Administration and the legal authority and jurisdiction under which a hearing is to be held, and shall set forth that a hearing will be held before the Administration at a time and place stated in the order. If after hearing, or a waiver thereof, the Administration determines on the record that an order revoking or suspending the license or a cease and desist order should issue, it shall promptly issue such order, which shall include a statement of the findings of the Administration and the grounds and reasons therefor and specify the effective date of the order, and shall cause the order to be served on the licensee and any other person involved.

(d) The Administration may require by subpoena the attendance and testimony of witnesses and the production of all books, papers, and documents relating to the hearing from any place in the United States. Witnesses summoned before the Administration shall be paid by the party at whose instance they were called the same fees and mileage that are paid witnesses in the courts of the United States. In case of disobedience to a subpoena, the Administration, or any party to a proceeding before the Administration, may invoke the aid of any court of the United States in requiring the attendance and testimony of witnesses and the production of books, papers, and documents.

(e) An order issued by the Administration under this section shall be final and conclusive unless within thirty days after the service thereof the licensee, or other person against whom an order is issued,⁵⁰ appeals to the United States court of appeals for the circuit in which such licensee has its principal place of business by filing with the clerk of such court a petition praying that the Administration's order be set aside or modified in the manner stated in the petition. After the expiration of such thirty days, a petition may be filed only by leave of court on a showing of reasonable grounds for failure to file the petition theretofore. The clerk of the court shall immediately cause a copy of the petition to be delivered to the Administration, and the Administration shall

thereupon certify and file in the court a transcript of the record upon which the order complained of was entered. If before such record is filed the Administration amends or sets aside its order, in whole or in part, the petitioner may amend the petition within such time as the court may determine, on notice to the Administration. The filing of a petition for review shall not of itself stay or suspend the operation of the order of the Administration, but the court of appeals in its discretion may restrain or suspend, in whole or in part, the operation of the order pending the final hearing and determination of the petition. The proceedings in such cases in the court of appeals shall be made a preferred cause and shall be expedited in every way. The court may affirm, modify, or set aside the order of the Administration. If the court determines that the just and proper disposition of the case requires the taking of additional evidence, the court shall order the Administration to reopen the hearing for the taking of such evidence, in such manner and upon such terms and conditions as the court may deem proper. The Administration may modify its findings as to the facts or make new findings by reason of the additional evidence so taken, and it shall file its modified or new findings and the amendments, if any, of its order, with the record of such additional evidence. No objection to an order of the Administration shall be considered by the court unless such objection was urged before the Administration or, if it was not so urged, unless there were reasonable grounds for failure to do so. The judgment and decree of the court affirming, modifying, or setting aside any such order of the Administration shall be subject only to review by the Supreme Court of the United States upon certification or certiorari as provided in section 1254 of title 28, United States Code.

(f) If any licensee or other person against which or against whom an order is issued under this section fails to obey the order, the Administration may apply to the United States court of appeals, within the circuit where the licensee has its principal place of business, for the enforcement of the order and shall file a transcript of the record upon which the order complained of was entered. Upon the filing of the application the court shall cause notice thereof to be served on the licensee or other person. The evidence to be considered, the procedure to be followed, and the jurisdiction of the court shall be the same as is provided in subsection (e) for applications to set aside or modify orders. The proceedings in such cases shall be made a preferred cause and shall be expedited in every way.⁵¹

Petition:

⁵⁰ Section 4(e) of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1360), added the clause "or other person against whom an order is issued."

⁵¹ Amended by section 4(f) of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966 (80 Stat. 1360), to provide for enforcement of cease and desist orders against individuals as well as against licensees.

Investigations.

Sec. 310.⁵³ (a) The Administration may make such investigations as it deems necessary to determine whether a licensee, or any other person has engaged or is about to engage in any acts or practices which constitute or will constitute a violation of any provision of this Act, or of any rule or regulation under this Act, or of any order issued under this Act. The Administration shall permit any person to file with it a statement in writing, under oath or otherwise as the Administration shall determine, as to all the facts and circumstances concerning the matter to be investigated. For the purpose of any investigation, the Administration is empowered to administer oaths and affirmations, subpoena witnesses, compel their attendance, take evidence, and require the production of any books, papers, and documents which are relevant to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States. In case of contumacy by, or refusal to obey a subpoena issued to, any person, including a licensee, the Administration may invoke the aid of any court of the United States within the jurisdiction of which such investigation or proceeding is carried on, or where such person resides or carries on business, in requiring the attendance and testimony of witnesses and the production of books, papers, and documents; and such court may issue an order requiring such person to appear before the Administration, there to produce records, if so ordered, or to give testimony touching the matter under investigation. Any failure to obey such order of the court may be punished by such court as a contempt thereof. All process in any such case may be served in the judicial district whereof such person is an inhabitant or wherever he may be found.

Examinations.

(b) Each small business investment company shall be subject to examinations made by direction of the Administration by examiners selected or approved by the Administration, and the cost of such examinations, including the compensation of the examiners, may in the discretion of the Administration be assessed against the company examined and when so assessed shall be paid by such company. Each such company shall be examined at least once each year, except that the Administrator may waive examination in the case of a company whose operations have been suspended by reason of the fact that the company is involved in litigation or is in receivership.⁵⁴ Every such company shall make such reports to the Administration at such times and in such form as the Ad-

⁵³ Section heading amended by section 5 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1360).
⁵⁴ Section 310 added by section 9 of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 755).
^{*} Sentence added by section 208 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967. (81 Stat. 271).

ministration may require; except that the Administration is authorized to exempt from making such reports any such company which is registered under the Investment Company Act of 1940 to the extent necessary to avoid duplication in reporting requirements.⁵⁵

INJUNCTIONS AND OTHER ORDERS

Sec. 311.⁵⁶ (a) Whenever, in the judgment of the Administration, a licensee or any other person has engaged or is about to engage in any acts or practices which constitute or will constitute a violation of any provision of this Act, or of any rule or regulation under this Act, or of any order issued under this Act, the Administration may make application to the proper district court of the United States or a United States court of any place subject to the jurisdiction of the United States for an order enjoining such acts or practices, or for an order enforcing compliance with such provision, rule, regulation, or order, and such courts shall have jurisdiction of such actions and, upon a showing by the Administration that such licensee or other person has engaged or is about to engage in any such acts or practices, a permanent or temporary injunction, restraining order, or other order, shall be granted without bond. The proceedings in such a case shall be made a preferred cause and shall be expedited in every way.

(b) In any such proceeding the court as a court of equity may, to such extent as it deems necessary, take exclusive jurisdiction of the licensee or licensee and the assets thereof, wherever located; and the court shall have jurisdiction in any such proceeding to appoint a trustee or receiver to hold or administer under the direction of the court the assets so possessed.

(c)⁵⁷ The Administration shall have authority to act as trustee or receiver of the licensee. Upon request by the Administration, the court may appoint the Administration to act in such capacity unless the court deems such appointment inequitable or otherwise inappropriate by reason of the special circumstances involved.

CONFLICTS OF INTEREST

Sec. 312. For the purpose of controlling conflicts of interests which may be detrimental to small business concerns, to small business investment companies, to the

⁵⁵ Section 5(2) of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1360), redesignated section 310 as section 310(a) and also added section 310(b). The provisions relating to examinations and reports were previously in section 308(c).
⁵⁶ Section 9 of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (75 Stat. 755), added section 311(a) formerly substantially contained in section 308(e), and section 311(b) authorizing the appointment of a trustee or receiver.
⁵⁷ Section 311(c) added by section 6 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1360).

shareholders or partners of either, or to the purposes of this Act, the Administration shall adopt regulations to govern transactions with any officer, director, shareholder, or partner of any small business investment company, or with any person or concern, in which any interest, direct or indirect, financial or otherwise, is held by any officer, director, shareholder, or partner of (1) any small business investment company, or (2) any person or concern with an interest, direct or indirect, financial or otherwise, in any small business investment company. Such regulations shall include appropriate requirements for public disclosure (including disclosure in the locality most directly affected by the transaction) necessary to the purposes of this section.⁵⁸

REMOVAL OR SUSPENSION OF DIRECTORS AND OFFICERS
OF LICENSEES⁵⁹

15 U.S.C. §87e.

SEC. 313. (a) The Administration may serve upon any director or officer of a licensee a written notice of its intention to remove him from office whenever, in the opinion of the Administration, such director or officer—

(1) has willfully and knowingly committed any substantial violation of—

- (A) this Act,
- (B) any regulation issued under this Act, or
- (C) a cease-and-desist order which has become final, or

(2) has willfully and knowingly committed or engaged in any act, omission, or practice which constitutes a substantial breach of his fiduciary duty as such director or officer,

and that such violation or such breach of fiduciary duty is one involving personal dishonesty on the part of such director or officer.

(b) In respect to any director or officer referred to in subsection (a), the Administration may, if it deems it necessary for the protection of the licensee or the interests of the Administration, by written notice to such officer served upon such director or officer, suspend him from office and/or prohibit him from further participation in any manner in the conduct of the affairs of the licensee. Such suspension and/or prohibition shall become effective upon service of such notice and, unless stayed by a court in proceedings authorized by subsection (d), shall remain in effect pending the completion of the administrative proceedings pursuant to the notice served under subsection (a) and until such time as the Admin-

istration shall dismiss the charges specified in such notice, or, if an order of removal and/or prohibition is issued against the director or officer, until the effective date of any such order. Copies of any such notice shall also be served upon the interested licensee.

(c) A notice of intention to remove a director or officer, as provided in subsection (a), shall contain a statement of the facts constituting grounds therefor, and shall fix a time and place at which a hearing will be held thereon. Such hearing shall be fixed for a date not earlier than thirty days nor later than sixty days after the date of service of such notice, unless an earlier or a later date is set by the Administration at the request of (1) such director or officer and for good cause shown, or (2) the Attorney General of the United States. Unless such director or officer shall appear at the hearing in person or by a duly authorized representative, he shall be deemed to have consented to the issuance of an order of such removal. In the event of such consent, or if upon the record made at any such hearing the Administration shall find that any of the grounds specified in such notice has been established, the Administration may issue such orders of removal from office as it deems appropriate. Any such order shall become effective at the expiration of thirty days after service upon such licensee and the director or officer concerned (except in the case of an order issued upon consent, which shall become effective at the time specified therein). Such order shall remain effective and enforceable except to such extent as it is stayed, modified, terminated, or set aside by action of the Administration or a reviewing court.

(d) Within ten days after any director or officer has been suspended from office and/or prohibited from participation in the conduct of the affairs of a licensee under subsection (b), such director or officer may apply to the United States district court for the judicial district in which the home office of the licensee is located, or the United States District Court for the District of Columbia, for a stay of such suspension and/or prohibition pending the completion of the administrative proceedings pursuant to the notice served upon such director or officer under subsection (a), and such court shall have jurisdiction to stay such suspension and/or prohibition.

(e) Whenever any director or officer of a licensee is charged in any information, indictment, or complaint authorized by a United States attorney, with the commission of or participation in a felony involving dishonesty or breach of trust, the Administration may, by written notice served upon such director or officer, suspend him from office and/or prohibit him from further participation in any manner in the conduct of the affairs of the licensee. A copy of such notice shall also be served upon the licensee. Such suspension and/or prohibition sha-

⁵⁸ Section 312 added by section 6 of PL 88-273, the Small Business Investment Act Amendments of 1963, approved February 28, 1964. (78 Stat. 147). The words "or partner" and "or partners" added by sections 106(f)(1) and (2) of PL 94-305, approved June 4, 1976. (80 Stat. 663).

⁵⁹ Section 313 added by section 7 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1361).

main in effect until such information, indictment, or complaint is finally disposed of or until terminated by the Administration. In the event that a judgment of conviction with respect to such offense is entered against such director or officer, and at such time as such judgment is not subject to further appellate review, the Administration may issue and serve upon such director or officer an order removing him from office. A copy of such order shall be served upon such licensee, whereupon such director or officer shall cease to be a director or officer of such licensee. A finding of not guilty or other disposition of the charge shall not preclude the Administration from thereafter instituting proceedings to suspend or remove such director or officer from office and/or to prohibit him from further participation in licensee affairs, pursuant to subsection (a) or (b).

Hearing and
judicial review.

(f) (1) Any hearing provided for in this section shall be held in the Federal judicial district or in the territory in which the principal office of the licensee is located unless the party afforded the hearing consents to another place, and shall be conducted in accordance with the provisions of chapter 5 of title 5 of the United States Code. After such hearing, and within ninety days after the Administration has notified the parties that the case has been submitted to it for final decision, the Administration shall render its decision (which shall include findings of fact upon which its decision is predicated) and shall issue and cause to be served upon each party to the proceeding an order or orders consistent with the provisions of this section. Judicial review of any such order shall be exclusively as provided in this subsection. Unless a petition for review is timely filed in a court of appeals of the United States, as hereinafter provided in paragraph (2) of this subsection, and thereafter until the record in the proceeding has been filed as so provided, the Administration may at any time, upon such notice, and in such manner as it shall deem proper, modify, terminate, or set aside any such order. Upon such filing of the record, the Administration may modify, terminate, or set aside any such order with permission of the court.

(2) Any party to such proceeding may obtain a review of any order served pursuant to paragraph (1) of this subsection (other than an order issued with the consent of the director or officer concerned, or an order issued under subsection (e) of this section), by filing in the court of appeals of the United States for the circuit in which the principal office of the licensee is located, or in the United States Court of Appeals for the District of Columbia Circuit, within thirty days after the date of service of such order, a written petition praying that the order of the Administration be modified, terminated, or set aside. A copy of such petition shall be forthwith trans-

mitted by the clerk of the court to the Administration, and thereupon the Administration shall file in the court the record in the proceeding, as provided in section 2112 of title 28 of the United States Code. Upon the filing of such petition, such court shall have jurisdiction, which upon the filing of the record shall, except as provided in the last sentence of said paragraph (1), be exclusive, to affirm, modify, terminate, or set aside, in whole or in part, the order of the Administration. Review of such proceedings shall be had as provided in chapter 7 of title 5 of the United States Code. The judgment and decree of the court shall be final, except that the same shall be subject to review by the Supreme Court upon certiorari as provided in section 1254 of title 28 of the United States Code.

(3) The commencement of proceedings for judicial review under paragraph (2) of this subsection shall not, unless specifically ordered by the court, operate as a stay of any order issued by the Administration.

UNLAWFUL ACTS AND OMISSIONS BY OFFICERS, DIRECTORS,
EMPLOYEES, OR AGENTS; BREACH OF FIDUCIARY DUTY ⁶⁰

SEC. 314. (a) Wherever a licensee violates any provision of this Act or regulation issued thereunder by reason of its failure to comply with the terms thereof or by reason of its engaging in any act or practice which constitutes or will constitute a violation thereof, such violation shall be deemed to be also a violation and an unlawful act on the part of any person who, directly or indirectly, authorizes, orders, participates in, or causes, brings about, counsels, aids, or abets in the commission of any acts, practices, or transactions which constitute or will constitute, in whole or in part, such violation.

(b) It shall be unlawful for any officer, director, employee, agent, or other participant in the management or conduct of the affairs of a licensee to engage in any act or practice, or to omit any act, in breach of his fiduciary duty as such officer, director, employee, agent, or participant, if, as a result thereof, the licensee has suffered or is in imminent danger of suffering financial loss or other damage.

(c) Except with the written consent of the Administration, it shall be unlawful—

(1) for any person hereafter to take office as an officer, director, or employee of a licensee, or to become an agent or participant in the conduct of the affairs or management of a licensee, if—

(A) he has been convicted of a felony, or any other criminal offense involving dishonesty or breach of trust, or

(B) he has been found civilly liable in damages, or has been permanently or temporarily enjoined by an order, judgment, or decree of a court of competent jurisdiction, by reason of any act or practice involving fraud or breach of trust; or

(2) for any person to continue to serve in any of the above-described capacities, if—

(A) he is hereafter convicted of a felony, or any other criminal offense involving dishonesty or breach of trust, or

(B) he is hereafter found civilly liable in damages, or is permanently or temporarily enjoined by an order, judgment, or decree of a court of competent jurisdiction, by reason of any act or practice involving fraud or breach of trust.

PENALTIES AND FORFEITURES ⁶¹

15 U.S.C. 687z.

SEC. 315. (a) Except as provided in subsection (b) of this section, a licensee which violates any regulation or written directive issued by the Administrator, requiring the filing of any regular or special report pursuant to section 310(b) of this Act, shall forfeit and pay to the United States a civil penalty of not more than \$100 for each and every day of the continuance of the licensee's failure to file such report, unless it is shown that such failure is due to reasonable cause and not due to willful neglect. The civil penalties provided for in this section shall accrue to the United States and may be recovered in a civil action brought by the Administration.

(b) The Administration may by rules and regulations, or upon application of an interested party, at any time previous to such failure, by order, after notice and opportunity for hearing, exempt in whole or in part, any small business investment company from the provisions of subsection (a) of this section, upon such terms and conditions and for such period of time as it deems necessary and appropriate, if the Administration finds that such action is not inconsistent with the public interest or the protection of the Administration. The Administration may for the purposes of this section make any alternative requirements appropriate to the situation.

JURISDICTION AND SERVICE OF PROCESS ⁶²

SEC. 316. Any suit or action brought under section 308, 309, 311, 313, or 315 by the Administration at law or in

⁶¹ Section 315 added by section 7 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1364).
⁶² Section 316 added by section 7 of PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1364).

equity to enforce any liability or duty created by, or to enjoin any violation of, this Act, or any rule, regulation, or order promulgated thereunder, shall be brought in the district wherein the licensee maintains its principal office, and process in such cases may be served in any district in which the defendant maintains its principal office or transacts business, or wherever the defendant may be found.

SEC. 317.⁶³ Notwithstanding section 303(b), the effective rate of interest after October 13, 1971, during the first five years thereafter of the term of any debenture purchased by the Administration from a small business investment company under authority of section 303(c), shall be the greater of 3 per centum or 3 percentage points below the interest rate determined pursuant to section 303(b). The Administration is authorized to apply interest paid to it by such company for the period from October 13, 1971, to the effective date of this section, without interest thereon, to interest payable after such effective date. No company which has received the benefit of this section may make a distribution (other than to the Administration) unless it has first paid to the Administration an amount equal to the difference between the rate of interest payable to the Administration pursuant to the previous sentence, and the rate of interest which would have been payable pursuant to section 303(b).

SEC. 318. The Administration is authorized to extend the benefits of sections 303(c) and 317 to any small business investment company operating under authority of section 301(d) of this Act, and which is owned, in whole or in part, by one or more small business investment companies, in accordance with regulations promulgated by the Administration.

SEC. 319. Section 18 of the Investment Company Act of 1940, as amended (15 U.S.C. 80a-18), is further amended by amending subsection (k) to read as follows:

“(k) The provisions of subparagraphs (A) and (B) of paragraph (1) of subsection (a) of this section shall not apply to investment companies operating under the Small Business Investment Act of 1958, and the provisions of paragraph (2) of said subsection shall not apply to such companies so long as such class of senior security shall be held or guaranteed by the Small Business Administration.”

⁶³ Added by section 2(g) of PL 92-593, the Small Business Investment Act Amendments of 1972, approved October 27, 1972. (86 Stat. 1314).

Interest
subchapter
15 U.S.C. 687l

Joint owner-
ship companies,
benefits,
15 U.S.C. 687j.

Preferred stock
asset coverage
requirement,
15 U.S.C.
80a-18(k).

10 U.S.C. 687h.

TITLE IV—GUARANTEES

PART A—LEASE GUARANTEES ⁶⁴

AUTHORITY OF THE ADMINISTRATION

SEC. 401. (a) The Administration may, whenever it determines such action to be necessary or desirable, and upon such terms and conditions as it may prescribe, guarantee the payment of rentals under leases of commercial and industrial property entered into by small business concerns to enable such concerns to obtain such leases.⁶⁵ Any such guarantee may be made or effected either directly or in cooperation with any qualified surety company or other qualified company through a participation agreement with such company. The foregoing powers shall be subject, however, to the following restrictions and limitations:

(1) No guarantee shall be issued by the Administration (A) if a guarantee meeting the requirements of the applicant is otherwise available on reasonable terms, and (B) unless the Administration determines that there exists a reasonable expectation that the small business concern in behalf of which the guarantee is issued will perform the covenants and conditions of the lease.

(2) The Administration shall, to the greatest extent practicable, exercise the powers conferred by this section in cooperation with qualified surety or other companies on a participation basis.

(b) The Administration shall fix a uniform annual fee for its share of any guarantee under this section which shall be payable in advance at such time as may be prescribed by the Administrator. The amount of any such fee shall be determined in accordance with sound actuarial practices and procedures, to the extent practicable, but in no case shall such amount exceed, on the Administrator's share of any guarantee made under this part,⁶⁶ 2½ per centum per annum of the minimum annual guaranteed rental payable under any guaranteed lease: *Provided*, That the Administration shall fix the lowest fee that experience under the program estab-

⁶⁴ Lease Guarantees, 15 U.S.C. 692.

⁶⁵ Original title IV, which provided for the conversion of State chartered investment companies and State development companies into SBICs, was repealed by section 11(f) of PL 87-441, the Small Business Investment Act Amendments of 1961, approved October 3, 1961 (75 Stat. 736), and new Title IV, Lease Guarantees, was added by section 316(a) of PL 89-117, the Housing and Urban Development Act of 1965, approved August 10, 1965 (79 Stat. 482). Title heading amended by section 911(a) (1) of PL 91-609, the Housing and Urban Development Act of 1970, approved December 31, 1970. (84 Stat. 1812).

⁶⁶ Section 209 of PL 90-104, the Small Business Investment Act Amendments of 1967, approved October 11, 1967 (81 Stat. 271), extended the lease guarantee program to small business concerns generally by deleting the language which had limited the program to small concerns displaced by federally aided construction or eligible for title IV loans under the Economic Opportunity Act of 1964 (42 U.S.C. 2901 et seq.).

⁶⁷ The reference to "this part" inserted in lieu of "this title" by section 911(a)(2) of PL 91-609, the Housing and Urban Development Act of 1970, approved December 31, 1970. (84 Stat. 1812).

lished hereby has shown to be justified. The Administration may also fix such uniform fees for the processing of applications for guarantees under this section as the Administrator determines are reasonable and necessary to pay the administrative expenses that are incurred in connection therewith.

(c) In connection with the guarantee of rentals under any lease pursuant to authority conferred by this section, the Administrator may require, in order to minimize the financial risk assumed under such guarantee—

(1) that the lessee pay an amount, not to exceed one-fourth of the minimum guaranteed annual rental required under the lease, which shall be held in escrow and shall be available (A) to meet rental charges accruing in any month for which the lessee is in default, or (B) if no default occurs during the term of the lease, for application (with accrued interest) toward final payments of rental charges under the lease;

(2) that upon occurrence of a default under the lease, the lessor shall, as a condition precedent to enforcing any claim under the lease guarantee, utilize the entire period, for which there are funds available in escrow for payment of rentals, in reasonably diligent efforts to eliminate or minimize losses, by releasing the commercial or industrial property covered by the lease to another qualified tenant, and no claim shall be made or paid under the guarantee until such effort has been made and such escrow funds have been exhausted;

(3) that any guarantor of the lease will become a successor of the lessor for the purpose of collecting from a lessee in default rentals which are in arrears and with respect to which the lessor has received payment under a guarantee made pursuant to this section; and

(4) such other provisions, not inconsistent with the purposes of this part,⁶⁷ as the Administrator may in his discretion require.

POWERS

SEC. 402. Without limiting the authority conferred upon the Administrator and the Administration by section 201⁶⁸ of this Act, the Administrator and the Admin-

15 U.S.C. 693.
15 U.S.C. 671.
15 U.S.C. 634.

⁶⁸ The reference to "this part" inserted in lieu of "this title" by section 911(a)(2) of PL 91-609, the Housing and Urban Development Act of 1970, approved December 31, 1970 (84 Stat. 1812).

⁶⁹ This authority referred to is to that now contained in section 308(f) as a result of transfer from former section 201 pursuant to PL 89-779, the Small Business Investment Act Amendments of 1966, approved November 6, 1966. (80 Stat. 1359).

istration shall have, in the performance of and with respect to the functions, powers, and duties conferred by this part, all the authority and be subject to the same conditions prescribed in section 5(b) of the Small Business Act with respect to loans, including the authority to execute subleases, assignments of lease and new leases with any person, firm, organization, or other entity, in order to aid in the liquidation of obligations of the Administration hereunder.

FUND 69

Lease-guarantee fund.
15 U.S.C. 694.

SEC. 403. There is hereby created within the Treasury a separate fund for guarantees which shall be available to the Administrator without fiscal year limitations as a revolving fund for the purposes of section 401. All amounts received by the Administrator, including any moneys, property, or assets derived by him from his operations in connection with section 401, shall be deposited in the fund. All expenses, excluding administrative expenses, pursuant to operations of the Administrator under section 401 shall be paid from the fund.⁷⁰

POLLUTION CONTROL 71

Definitions.
15 U.S.C.
694-1.

SEC. 404. (a) For purposes of this section, the term—
(1) "pollution control facilities" means such property (both real and personal) as the Administration in its discretion determines is likely to help prevent, reduce, abate, or control noise, air or water pollution or contamination by removing, altering, disposing or storing pollutants, contaminants, wastes, or heat, and such property (both real and personal) as the Administration determines will be used for the collection, storage, treatment, utilization, processing, or final disposal of solid or liquid waste.

(2) "person" includes corporations, companies, associations, firms, partnerships, societies, joint stock companies, States, territories, and possessions of the United States, or subdivisions of any of the fore-

⁶⁹ Section 403 rewritten by section 911(a)(3) of PL 91-609, the Housing and Urban Development Act of 1970, approved December 31, 1970 (84 Stat. 1812), to increase the amount of the revolving fund and extend its use to the Surety Bond Guarantees under Part B of Title IV; section 403 rewritten by section 6(a) of PL 93-386, the Small Business Amendments of 1974, approved August 23, 1974 (88 Stat. 742), to establish a separate revolving fund to provide capital for Surety Bond Guarantees under Part B of Title IV. The amount authorized for the section 403 fund was previously set at \$10 million by section 911(a)(3) of PL 91-609, to be shared by the Surety Bond Program and the Lease Guarantee Program under Part A of Title IV. See section 412 for the Surety Bond Program Revolving Fund. "Section 401" was substituted for "this part" by section 103 of PL 94-305, approved June 4, 1976 (90 Stat. 663).

⁷⁰ Section 403 was further rewritten by section 103 of PL 95-89, August 4, 1977. The authorization language was transferred to section 20 of the Small Business Act. SBA is no longer required to pay interest to the Treasury on appropriated funds to be used to pay claims under the Real Estate Lease Guarantee program; the authority to invest idle funds obtained as fees was also eliminated.

⁷¹ Added by section 102 of PL 94-305, approved June 4, 1976 (90 Stat. 663).

going, and the District of Columbia, as well as individuals.

(3) "qualified contract" means a lease, sublease, loan agreement, installment sales contract, or similar instrument, entered into between a small business concern and any person.

(b) The Administration may, whenever it determines that small business concerns are or are likely to be at an operational or financing disadvantage with other business concerns with respect to the planning, design, or installation of pollution control facilities, or the obtaining of financing therefor (including financing by means of revenue bonds issued by States, political subdivisions thereof, or other public bodies), guarantee the payment of rentals or other amounts due under qualified contracts. Any such guarantee may be made or effected either directly or in cooperation with any qualified surety company or other qualified company through a participation agreement with such company. The foregoing powers shall be subject, however, to the following restrictions and limitations:

(1) Notwithstanding any other law, rule, or regulation or fiscal policy to the contrary, the guaranteee authorized in the case of pollution control facilities or property may be issued when such property is acquired by the use of proceeds from industrial revenue bonds which provide the holders interest which is exempt from Federal income tax.

(2) Any such guarantee shall be for the full amount of the payments due under such qualified contract and shall be a full faith and credit obligation of the United States.

(3) No guarantee shall be issued by the Administration unless the Administration determines that there exists a reasonable expectation that the small business concern in behalf of which the guarantee is issued will perform the covenants and conditions of the qualified contract.

(c) The Administration shall fix a uniform annual fee for any guarantee issued under this section which shall be payable at such time and under such conditions as may be prescribed by the Administrator. The fee shall be set at an amount which the Administration deems reasonable and necessary and shall be subject to periodic review in order that the lowest fee that experience under the program shows to be justified will be placed into effect. In no case shall such amount exceed 3½ per centum per annum of the minimum annual guaranteed rental payable under any qualified contract guaranteed under this section. The Administration may also fix such

Guarantees.

Fees.

Periodic review.

uniform fees for the processing of applications for guarantees under this section as the Administrator determines are reasonable and necessary to pay the administrative expenses that are incurred in connection therewith.

(d) in connection with the guarantee of rentals under any qualified contract pursuant to authority conferred by this section, the Administrator may require, in order to minimize the financial risk assumed under such guarantee—

(1) that the lessee pay an amount, not to exceed one-fourth of the average annual payments for which a guarantee is issued under this section, which shall be held in escrow and shall be available (A) to meet rental charges accruing in any month for which the lessee is in default, or (B) if no default occurs during the term of the qualified contract, for application (with accrued interest) toward final payments of rental charges under the qualified contract;

(2) that upon occurrence of a default under the qualified contract, the lessor shall, as a condition precedent to enforcing any claim under the qualified contract guarantee, utilize the entire period, for which there are funds available in escrow for payment of rentals, in reasonable diligent efforts to eliminate or minimize losses, by releasing the property covered by the qualified contract to another qualified lessee, and no claim shall be made or paid under the guarantee until such effort has been made and such escrow funds have been exhausted;

(3) that any guarantor of the qualified contract will become a successor of the lessor for the purpose of collecting from a lessee in default rentals which are in arrears and with respect to which the lessor has received payment under a guarantee made pursuant to this section; and

(4) such other provisions, not inconsistent with the purposes of this section as the Administrator may in his discretion require.

(e) Any guarantee issued under this section may be assigned with the permission of the Administration by the person to whom the payments under qualified contracts are due.

(f) Section 402 shall apply to the administration of this section.

FUND

SEC. 405. There is hereby created within the Treasury a separate fund for guarantees which shall be available to the Administrator without fiscal year limitations as a revolving fund for the purpose of section 404. All amounts received by the Administrator, including any moneys, property, or assets derived by him from his operations in connection with section 404 shall be deposited in the fund. All expenses and payments, excluding

Administrator under section 404 shall be paid from the fund.⁷²

PART B—SURETY BOND GUARANTEES⁷³

DEFINITIONS

Sec. 410. As used in this part—

(1) the term "bid bond" means a bond conditioned upon the bidder on a contract entering into the contract, if he receives the award thereof, and furnishing the prescribed payment bond and performance bond.

(2) the term "payment bond" means a bond conditioned upon the payment by the principal of money to persons under contract with him.

(3) the term "performance bond" means a bond conditioned upon the completion by the principal of a contract in accordance with its terms.

(4) the term "surety" means the person who, (A) under the terms of a bid bond, undertakes to pay a sum of money to the obligee in the event the principal breaches the conditions of the bond, (B) under the terms of a performance bond, undertakes to incur the cost of fulfilling the terms of a contract in the event the principal breaches the conditions of the contract, or (C) under the terms of a payment bond, undertakes to make payment to all persons supplying labor and material in the prosecution of the work provided for in the contract if the principal fails to make prompt payment.

(5) the term "obligee" means (A) in the case of a bid bond, the person requesting bids for the performance of a contract, or (B) in the case of a payment bond or performance bond, the person who has contracted with a principal for the completion of the contract and to whom the obligation of the surety runs in the event of a breach by the principal of the conditions of a payment bond or performance bond.

(6) the term "principal" means (A) in the case of a bid bond, a person bidding for the award of a contract, or (B) the person primarily liable to complete a contract for the obligee, or to make payments to other persons in respect of such contract, and for whose performance of his obligation the surety is bound under the terms of a payment or performance bond. A principal may be a prime contractor or a subcontractor.

⁷² Section 405 was rewritten by section 104 of PL 95-59, August 4, 1977; the authorization language was transferred to section 20 of the Small Business Act; SBA is no longer required to pay interest to the Treasury appropriated funds to be used to pay claims under this program; the authority to invest idle funds was ended.
⁷³ Part B added by section 911 (a) (4) of PL 91-609, the Housing and Urban Development Act of 1970, approved December 31, 1970. (84 Stat. 1812).

(7) the term "prime contractor" means the person with whom the obligee has contracted to perform the contract.

(8) the term "subcontractor" means a person who has contracted with a prime contractor or with another subcontractor to perform a contract.

AUTHORITY OF THE ADMINISTRATION

SEC. 411. (a) The Administration may, in consultation with the Secretary of Housing and Urban Development and upon such terms and conditions as it may prescribe, guarantee and enter into commitments to guarantee any surety against loss, as hereinafter provided, as the result of the breach of the terms of a bid bond, payment bond, or performance bond by a principal on any contract up to \$1,000,000⁷⁴ in amount, subject to the following conditions:

(1) the person who would be the principal of the bond is a small business concern.

(2) the bond is required in order for such person to bid on a contract, or to serve as a prime contractor or subcontractor thereon.

(3) such person is not able to obtain such bond on reasonable terms and conditions without a guarantee under this section.

(4) the Administration determines that there is a reasonable expectation that such person will perform the covenants and conditions of the contract with respect to which the bond is required.

(5) the contract meets requirements established by the Administration for feasibility of successful completion and reasonableness of cost.

(6) the terms and conditions of any bond guaranteed under the authority of this part are reasonable in light of the risks involved and the extent of the surety's participation.

(b) Any contract of guarantee under this section shall obligate the Administration to pay to the surety a sum not to exceed 90 per centum of the loss incurred by the surety in fulfilling the terms of his contract as the result of the breach by the principal of the terms of a bid bond, performance bond, or payment bond.

(c) The Administration shall⁷⁵ administer this program on a prudent and economically justifiable basis and shall fix a uniform annual fee which it deems reasonable and necessary for any guarantee issued under this section,

⁷⁴ 15 U.S.C. 694b. Surety-bond guarantee authority.

⁷⁵ "\$1,000,000" inserted in lieu of "\$500,000" by section 61(n)(3) of PL 93-386, the Small Business Amendments of 1974, approved August 23, 1974. (88 Stat. 742).
⁷⁶ The phrase "administer this program on a prudent and economically justifiable basis and shall" added by section 11(a) of PL 93-386, the Small Business Amendments of 1974, approved August 23, 1974. (88 Stat. 742).

to be payable at such time and under such conditions as may be determined by the Administration. Such fee shall be subject to periodic review in order that the lowest fee that experience under the program shows to be justified will be placed into effect. The Administration shall also fix such uniform fees for the processing of applications for guarantees under this section as it determines are reasonable and necessary to pay administrative expenses incurred in connection therewith. Any contract of guarantee under this section shall obligate the surety to pay the Administration such portions of the bond fee as the Administration determines to be reasonable in the light of the relative risks and costs involved. Within 30 days after the date of enactment of this sentence and at monthly intervals thereafter, the Administration shall publish the cost of the program to the Administration for the month immediately preceding the date of publication. The Administration shall conduct a study of the program in order to determine what must be done to make the program economically sound. Within one year after the date of enactment of this sentence, the Administration shall transmit a report to Congress containing a detailed statement of the findings and conclusions of the study, together with its recommendations for such legislative and administrative actions as it deems appropriate.⁷⁶

(d) The provisions of section 402 shall apply in the Administration of this section.

FUND ⁷⁷

SEC. 412. There is hereby created within the Treasury a separate fund for guarantees which shall be available to the Administrator without fiscal year limitation as a revolving fund for the purposes of this part. All amounts received by the Administrator, including any moneys, property, or assets derived by him from his operations in connection with this part, shall be deposited in the fund. All expenses and payments, excluding administrative expenses, pursuant to operations of the Administrator under this part shall be paid from the fund. Moneys in the fund not needed for the payment of current operating expenses or for the payment of claims arising under this part may be invested in bonds or other obligations of, or bonds or other obligations guaranteed as to principal

⁷⁷ Sentences beginning with "Within 30 days after the date of enactment of," added by section 11(b) of PL 93-386, the Small Business Amendments of 1974, approved August 23, 1974. (88 Stat. 742).

⁷⁸ Section 412 added by section 6(a)(4) of PL 93-386, the Small Business Amendments of 1974, approved August 23, 1974. (88 Stat. 742). Section 412 was rewritten by section 105 of PL 93-89, August 4, 1977; the authorization language was transferred to section 20 of the Small Business Act; SBA is no longer required to pay interest to the Treasury on appropriated funds to be used to pay claims under this program; the authority to invest idle funds was modified.

and interest by, the United States; except that moneys provided as capital for the fund shall not be so invested.⁶

TITLE V—LOANS TO STATE AND LOCAL DEVELOPMENT COMPANIES

15 U.S.C. 695.

Sec. 501. (a) The Administration is authorized to make loans to State development companies to assist in carrying out the purposes of this Act. Any funds advanced under this subsection shall be in exchange for obligations of the development company which bear interest at such rate, and contain such other terms, as the Administration may fix, and funds may be so advanced without regard to the use and investment by the development company of funds secured by it from other sources.

(b) The total amount of obligations purchased and outstanding at any one time by the Administration under this section from any one State development company shall not exceed the total amount borrowed by it from all other sources. Funds advanced to a State development company under this section shall be treated on an equal basis with those funds borrowed by such company after the date of the enactment of this Act, regardless of source, which have the highest priority, except when this requirement is waived by the Administrator.

Sec. 502. The Administration may, in addition to its authority under section 501, make loans for plant acquisition,⁷ construction, conversion or expansion, including the acquisition of land, to State and local development companies, and such loans may be made or effected either directly or in cooperation with banks or other lending institutions through agreements to participate on an immediate or deferred basis: *Provided, however*, That the foregoing powers shall be subject to the following restrictions and limitations:

(1) All loans made shall be so secured as reasonably to assure repayment. In agreements to participate in loans on a deferred basis under this subsection, such participation by the Administration shall not be in excess of 90 per centum of the balance of the loan outstanding at the time of disbursement.

(2) The proceeds of any such loan shall be used solely by such borrower to assist an identifiable

⁶ Section 6(b) of PL 93-386, the Small Business Amendments of 1974, approved August 23, 1974 (88 Stat. 742), provides that: "Unexpected balances of capital previously transferred to the fund pursuant to section 403 of the Small Business Investment Act of 1958 (15 U.S.C. 694), as in effect prior to the effective date of this Act, shall be allocated together with related assets and liabilities, to the funds established by paragraphs (2) and (4) of subsection (a) of this section in such amounts as the Administrator shall determine. In addition, the Administrator is authorized to transfer to the fund established by paragraph (4) of subsection (a) of this section not to exceed \$2,000,000 from the fund established under section 4(c)(1)(B) of the Small Business Act: *Provided*, That section 4(c)(6) and the last sentence of section 4(c)(5) shall not apply to any amounts so transferred."
⁷ The word "acquisition" added by section 108(a) of PL 91-305, approved June 4, 1976, (90 Stat. 663).

small-business concern and for a sound business purpose approved by the Administration.

(3) Loans made by the Administration under this section shall be limited to \$500,000⁸ for each such identifiable small-business concern.

(4) Any development company assisted under this section must meet criteria established by the Administration, including the extent of participation to be required or amount of paid-in capital⁹ to be used in each instance as is determined to be reasonable by the Administration.

(5) No loans, including extensions or renewals thereof, shall be made by the Administration for a period or periods exceeding twenty-five years¹⁰ plus such additional period as is estimated may be required to complete construction, conversion, or expansion, but the Administration may extend the maturity of or renew any loan made pursuant to this section beyond the period stated for additional periods, not to exceed ten years, if such extension or renewal will aid in the orderly liquidation of such loan. Any such loan shall bear interest at a rate fixed by the Administration.¹¹

TITLE VI—CHANGES IN FEDERAL RESERVE AUTHORITY

[Omitted as no longer current.]

TITLE VII—CRIMINAL PENALTIES

(This title amends the U.S. Code to include certain actions by persons affiliated with or dealing with SBIC's as Federal crimes. The provisions have been amended from time to time to include various agencies. Only the pertinent parts of the affected sections, 18 U.S.C. 212, 213, 216, 657, 1006 and 1014, are set out below for information purposes only.)

§ 212. Offer of loan or gratuity to bank examiner.

Whoever, being an officer, director or employee . . . of any small business investment company, makes or grants any loan or gratuity, to any examiner or assistant examiner who examines or has authority to examine such . . . corporation . . . shall be fined not more than \$5,000 or imprisoned not more than one year, or both;

⁸ This limitation was raised from "\$350,000" to "\$500,000" by section 110 of PL 94-305, approved June 4, 1976. (90 Stat. 663).
⁹ Section 742 of the Economic Opportunity Act of 1964, as amended provides that funds granted under Title VII which are invested, directly or indirectly in a local development company shall be included as paid-in capital.
¹⁰ This limitation was raised from 10 years to 25 years by section 10(2) of PL 87-341, the Small Business Investment Act Amendments of 1961, approved October 3, 1961. (77 Stat. 756).
¹¹ Previous limitation on the life of section 502 (June 30, 1961), was repealed by section 26 of PL 87-27, the Area Redevelopment Act approved May 1, 1961. (75 Stat. 63).

and may be fined a further sum equal to the money so loaned or gratuity given.

The provisions of this section and section 218⁸⁴ of this title shall apply to all public examiners and assistant examiners who examine member banks of the Federal Reserve System or insured banks, or National Agricultural Credit Corporations, whether appointed by the Comptroller of the Currency by the Board of Governors of the Federal Reserve System, by a Federal Reserve Agent, by a Federal Reserve bank or by the Federal Deposit Insurance Corporation, or appointed or elected under the laws of any State; but shall not apply to private examiners or assistant examiners employed only by a clearing-house association or by the directors of a bank.

§ 213. Acceptance of a loan or gratuity by bank examiner.

Whoever, being an examiner . . . of small business investment companies, accepts a loan or gratuity from any . . . corporation . . . or organization examined by him or from any person connected therewith, shall be fined not more than \$5,000 or imprisoned not more than one year, or both; and may be fined a further sum equal to the money so loaned or gratuity given, and shall be disqualified from holding office as such examiner . . .

§ 216. Receipt or charge of commissions or gifts for farm loan, land bank, or small business transactions.

Whoever, being an officer, director, attorney or employee of a . . . small business investment company, is a beneficiary of or receives, directly or indirectly, any fee, commission, gift, or other consideration for or in connection with any transaction or business of such association or bank, other than the usual salary or director's fee paid to such officer, director, or employee thereof, and a reasonable fee paid by such association . . . to such officer, director, attorney, or employee for services rendered, shall be fined not more than \$5,000 or imprisoned not more than one year, or both.

Whoever causes or procures any . . . small business investment company, to charge or receive any fee, commission, bonus, gift, or other consideration not specifically authorized, shall be fined not more than \$5,000 or imprisoned not more than one year, or both.

§ 657. Lending, credit and insurance institutions.

Whoever, being an officer, agent or employee of or connected in any capacity with . . . any small business investment company, and whoever, being a receiver of any such institution, or agent or employee of the receiver,

embezzles, abstracts, purloins or willfully misapplies any moneys, funds, credits, securities or other things of value belonging to such institution, or pledged or otherwise intrusted to its care, shall be fined not more than \$5,000 or imprisoned not more than five years, or both; but if the amount or value embezzled, abstracted, purloined or misapplied does not exceed \$100, he shall be fined not more than \$1,000 or imprisoned not more than one year, or both.

§ 1006. Federal credit institution entries, reports and transactions.

Whoever, being an officer, agent or employee of or connected in any capacity with . . . any small business investment company, with intent to defraud any such institution or any other company, body politic or corporate, or any individual, or to deceive any officer, auditor, examiner or agent of any such institution or of department or agency of the United States, makes any false entry in any book, report or statement of or to any such institution, or without being duly authorized, draws any order or bill of exchange, makes any acceptance, or issues, puts forth or assigns any note, debenture, bond or other obligation, or draft, bill of exchange, mortgage, judgment, or decree, or, with intent to defraud the United States or any agency thereof, or any corporation, institution, or association referred to in this section, participates or shares in or receives directly or indirectly any money, profit, property, or benefits through any transaction, loan, commission, contract, or any other act of any such corporation, institution, or association, shall be fined not more than \$10,000 or imprisoned not more than five years, or both.

§ 1014. Loan and credit applications generally; renewals and discounts; crop insurance.

Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, for the purpose of influencing in any way the action of . . . a small business investment company . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution of security therefor, shall be fined not more than \$5,000 or imprisoned not more than two years, or both.

⁸⁴ This section was redesignated as section 213 by section 1(d) of PL 87-849, approved October 23, 1962. (76 Stat. 1125).

SBIC TAX PROVISIONS

INTERNAL REVENUE CODE OF 1954

as amended

(Title 26 of the United States Code)

* * * * *

SEC. 172. NET OPERATING LOSS DEDUCTION.

(a) DEDUCTION ALLOWED.—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) NET OPERATING LOSS CARRYBACKS AND CARRY-OVERS.—

(1) YEARS TO WHICH LOSS MAY BE CARRIED.—

* * * * *

(F)¹ In the case of a financial institution to which section 585, 586, or 593 applies, a net operating loss for any taxable year beginning after December 31, 1975, shall be a net operating loss carryback to each of the 10 taxable years preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 5 taxable years following the taxable year of such loss.

* * * * *

SEC. 243.² DIVIDENDS RECEIVED BY CORPORATIONS.

(a) GENERAL RULE.—In the case of a corporation, there shall be allowed as a deduction an amount equal to the following percentages of the amount received as dividends from a domestic corporation which is subject to taxation under this chapter:

(1) 85 percent, in the case of dividends other than dividends described in paragraph (2) or (3);

¹ Added by section 431(b) of PL 91-172, the Tax Reform Act of 1969, approved December 30, 1969 (83 Stat. 619), and provides loss carryback and carryover benefits to SBICs since they are financial institutions to which section 586 of the Internal Revenue Code applies. ² The provision allowing SBICs a deduction of 100 percent of dividends received from a taxable domestic corporation rather than the 85 percent generally allowed corporate taxpayers was added by section 57(b) of PL 85-566, the Technical Amendments Act of 1958, approved September 2, 1958. (72 Stat. 1645). Amendments have been made to this section since the 1958 Act but have not affected the treatment given to SBIC dividends.

(2) 100 percent, in the case of dividends received by a small business investment company operating under the Small Business Investment Act of 1958; and

* * * * *

SEC. 542. DEFINITION OF PERSONAL HOLDING COMPANY.

(a) GENERAL RULE.—For purposes of this subtitle, the term "personal holding company" means any corporation (other than a corporation described in subsection (c)) if—

* * * * *

(c) EXCEPTIONS.—The term "personal holding company" as defined in subsection (a) does not include—

* * * * *

(8)³ a small business investment company which is licensed by the Small Business Administration and operating under the Small Business Investment Act of 1958 and which is actively engaged in the business of providing funds to small business concerns under that Act. This paragraph shall not apply if any shareholder of the small business investment company owns at any time during the taxable year directly or indirectly (including, in the case of an individual, ownership by the members of his family as defined in section 544(a)(2)) a 5 per centum or more proprietary interest in a small business concern to which funds are provided by the investment company or 5 per centum or more in value of the outstanding stock of such concern.

* * * * *

SEC. 582. BAD DEBITS, LOSSES, AND GAINS WITH RESPECT TO SECURITIES HELD BY FINANCIAL INSTITUTIONS.

* * * * *

(c) BOND, ETC., LOSSES AND GAINS OF FINANCIAL INSTITUTIONS.—

(1)⁴ GENERAL RULE.—For purposes of this subtitle, in the case of a financial institution to which section 585, 586, or 593 applies, the sale or exchange of a bond, debenture, note, or certificate or other

³ Added as paragraph 11 by section 3 of PL 86-376, approved September 23, 1959 (73 Stat. 700), and redesignated as paragraph 8 by section 225(c)(2) of PL 88-372, the Revenue Act of 1964, approved February 26, 1964. (78 Stat. 72). The provision qualifiedly exempts SBICs from the personal holding company surtax. ⁴ Amended by section 433(a) of PL 91-172, the Tax Reform Act of 1969, approved December 30, 1969 (83 Stat. 623), and provides ordinary gain and loss treatment to the sale or exchange of certain securities held by SBICs. Section 433(d) makes this provision applicable to taxable years beginning after July 11, 1969, but authorizes SBICs to elect irrevocably whether it shall apply to their taxable years beginning after July 11, 1969 and before July 11, 1974.

evidence of indebtedness shall not be considered a sale or exchange of a capital asset.

* * * * *

SEC. 586.¹ RESERVES FOR LOSSES ON LOANS OF SMALL BUSINESS INVESTMENT COMPANIES, ETC.

(a) INSTITUTIONS TO WHICH SECTION APPLIES.—This section shall apply to the following financial institutions:

(1) any small business investment company operating under the Small Business Investment Act of 1958, and

(2) any business development corporation.

For purposes of this section, the term "business development corporation" means a corporation which was created by or pursuant to an act of a State legislature for purposes of promoting, maintaining, and assisting the economy and industry within such State on a regional or statewide basis by making loans to be used in trades and businesses which would generally not be made by banks (as defined in section 581) within such region or State in the ordinary course of their business (except on the basis of a partial participation), and which is operated primarily for such purposes.

(b) ADDITION TO RESERVES FOR BAD DEBTS.—

(1) GENERAL RULE.—For purposes of section 166 (c), except as provided in paragraph (2) the reasonable addition to the reserve for bad debts of any financial institution to which this section applies shall be an amount determined by the taxpayer which shall not exceed the amount necessary to increase the balance of the reserve for bad debts (at the close of the taxable year) to the greater of—

(A) the amount which bears the same ratio to loans outstanding at the close of the taxable year as (i) the total bad debts sustained during the taxable year and the 5 preceding taxable years (or, with the approval of the Secretary, a shorter period), adjusted for recoveries of bad debts during such period, bears to (ii) the sum of the loans outstanding at the close of such 6 or fewer taxable years, or

(B) the lower of—

(i) the balance of the reserve at the close of the base year, or

(ii) if the amount of loans outstanding at the close of the taxable year is less than the amount of loans outstanding at the close of the base year, the amount which bears the same ratio to loans outstanding at the close

¹ Added by section 431(a) of PL 91-172, the Tax Reform Act of 1969, approved December 30, 1969 (83 Stat. 618), and made effective by section 431(d) for taxable years beginning after July 11, 1969.

of the taxable year as the balance of the reserve at the close of the base year bears to the amount of loans outstanding at the close of the base year.

For purposes of this subparagraph, the term "base year" means the last taxable year beginning on or before July 11, 1969.

(2) NEW FINANCIAL INSTITUTIONS.—In the case of any taxable year beginning not more than 10 years after the day before the first day on which a financial institution (or any predecessor) was authorized to do business as a financial institution described in subsection (a), the reasonable addition to the reserve for bad debts of such financial institution shall not exceed the larger of the amount determined under paragraph (1) or the amount necessary to increase the balance of the reserve for bad debts at the close of the taxable year to the amount which bears the same ratio (as determined by the Secretary) to loans outstanding at the close of the taxable year as (i) the total bad debts sustained by all institutions described in the applicable paragraph of subsection (a) during the 6 preceding taxable years (adjusted for recoveries of bad debts during such period), bears to (ii) the sum of the loans by all such institutions outstanding at the close of such taxable years.

* * * * *

SEC. 1242.² LOSSES ON SMALL BUSINESS INVESTMENT COMPANY STOCK.

If—

(1) a loss is on stock in a small business investment company operating under the Small Business Investment Act of 1958, and

(2) such loss would (but for this section) be a loss from the sale or exchange of a capital asset.

then such loss shall be treated as an ordinary loss. For purposes of section 172 (relating to the net operating loss deduction) any amount of loss treated by reason of this section as an ordinary loss shall be treated as attributable to a trade or business of the taxpayer.

SEC. 1243.³ LOSS OF SMALL BUSINESS INVESTMENT COMPANY.

In the case of a small business investment company operating under the Small Business Investment Act of 1958, if—

² Added by section 57(a) of PL 85-866, the Technical Amendments Act of 1958, approved September 2, 1958, (72 Stat. 1645). Under Internal Revenue Service Income Tax Regulation 71.1242-1(a), ordinary loss deductions are made clearly available to subsequent purchasers as well as to original investors in SBIC stock.

³ Added by section 57(a) of PL 85-866, the Technical Amendments Act of 1958, approved September 2, 1958, (72 Stat. 1645). Section 304 of the Small Business Investment Act of 1958 was amended in 1960 to permit SBICs, under SBA regulations, to accept securities other than convertible debentures in exchange for equity capital surplus. However, only stock acquired by exercise of the conversion privilege specifically covered by section 1243 of the Internal Revenue Code. (See Footnote 2.)

(1) ^s a loss is on stock received pursuant to the conversion privilege of convertible debentures acquired pursuant to section 304 of the Small Business Investment Act of 1958, and

(2) such loss would (but for this section) be a loss from the sale or exchange of a capital asset, then such loss shall be treated as an ordinary loss.

* * * * *

^s Paragraph (1) amended by section 433(b) of PL 91-172, the Tax Reform Act of 1969, approved December 30, 1969 (83 Stat. 624), to conform to the amendment made to section 582(c) by section 433(a) of PL 91-172, giving ordinary gain and loss treatment to debentures and other evidence of indebtedness. Prior to the change, this section covered the ordinary loss treatment given to both convertible debentures and stock received pursuant thereto.

10/15/81

TAXATION 3/18/81
EXHIBIT "D"

**SUMMARY OF
THE ECONOMIC IMPACT OF THE SMALL BUSINESS
INVESTMENT COMPANY PROGRAM**

**A Study Performed By
ARTHUR D. LITTLE, INC.**

**Data Collection/Processing and
Survey Design Assistance By
DELOITTE HASKINS & SELLS**

INTRODUCTION

The Small Business Investment Act was passed in 1958 to establish a new program to help fill the equity gap which Congress had determined to pose a serious threat to the vitality of our free enterprise economy.

The Small Business Investment Company ("SBIC") program was founded on the premise that a partnership between the Federal Government and the private sector could be effective in meeting a public policy goal. SBICs have always been privately capitalized, privately-managed firms licensed and regulated by the Small Business Administration. The particular genius of the program has been the fact that the private owners of SBICs have been exposed to 100% loss on their capital before the Federal Government has stood to lose a penny.

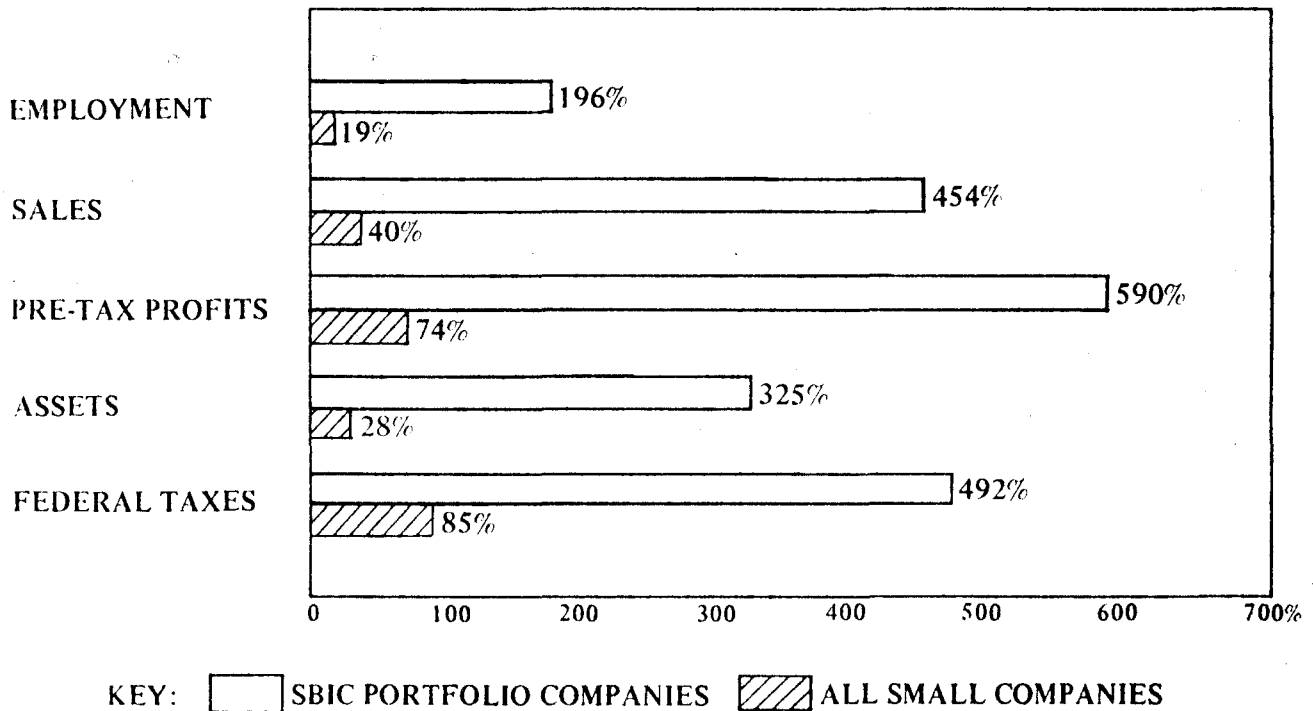
To determine the effectiveness of the SBIC programs, the National Association of Small Business Investment Companies ("NASBIC") sponsored a detailed study that measured the impact of SBIC portfolio companies on the economy. We've summarized the conclusions in this brochure. Copies of the complete report are available from NASBIC. This study was structured and analyzed by the highly respected consulting firm, Arthur D. Little, Inc. The survey was designed and the data were collected and processed by Deloitte Haskins & Sells, the international accounting firm.

The results of this survey prove that this partnership between the Federal Government and the private sector has been extremely effective in bolstering the national economy.

SIGNIFICANT CONCLUSIONS

The results of the NASBIC study accentuate the fact that companies that have received SBIC funds have significantly outperformed other small companies. One need only review the statistics to understand the tremendous impact of SBIC portfolio companies on the nation as a whole. SBIC portfolio companies, as measured by all economic criteria studied, have experienced growth rates that average 8 times as great as those of all small companies (See Figure 1). These statistics alone can serve as a benchmark to demonstrate the compelling success of the SBIC program.

FIGURE 1
AVERAGE GROWTH OF SBIC PORTFOLIO COMPANIES
COMPARED WITH THE AVERAGE GROWTH OF ALL SMALL COMPANIES



The study concludes:

1. Companies financed by SBICs have generated ten times the employment growth of all other small companies (See Figure 1 and 2).
2. These companies produce jobs for \$6,463 of one-time investment, whereas various estimates indicate that the government spends at least \$25,000 to create a job, and that amount must be spent every year.
3. SBICs are empowered to borrow funds at market rates with the government's guarantee. Only \$3,513 of this borrowing creates a job, at no cost to the government.
4. The growth rate of Federal tax payments of companies financed by SBICs is over 5 times that of all small companies.
5. Fully 91% of this impressive performance has come from internal growth, not from mergers and acquisitions.
6. Of all investments made by SBICs, 92% were all or part in the form of equity capital.

FIGURE 2
GROWTH OF SBIC PORTFOLIO COMPANIES VERSUS
GROWTH OF ALL SMALL COMPANIES*

Key Economic Impact Measure	Pre-1972 Through Fiscal 78/79		1972/75 Through Fiscal 78/79		1976/77 Through Fiscal 78/79		1978 Through Fiscal 78/79	
	SBIC Portfolio Companies	All Small Companies	SBIC Portfolio Companies	All Small Companies	SBIC Portfolio Companies	All Small Companies	SBIC Portfolio Companies	All Small Companies
Employment	384%	29%	155%	19%	48%	8%	41%	NA
Sales	896%	76%	386%	27%	81%	16%	68%	NA
Profits Before Taxes	1,165%	144%	553%	25%	52%	53%	63%	NA
Assets	694%	48%	188%	24%	92%	13%	60%	NA
Federal Corporate Taxes	739%	135%	652%	63%	85%	57%	101%	NA

* For SBIC's, growth rates are measured from the year prior to SBIC financing to the most recent fiscal year. For all small companies, the comparison is from 1970, 1973 and 1976 to 1978.

Source: Federal Trade Commission, Quarterly Report of Manufacturing Corporations, U. S. Bureau of the Census, County Business Patterns and Arthur D. Little, Inc., estimates.

The most important conclusion of the entire study is that SBIC investments produce jobs. In the companies studied which have been financed by SBIC funds, a job can be created for an investment of \$6,463 (See Figure 3). This is not an annual expenditure but instead a one-time investment which need not be repeated.

FIGURE 3
EMPLOYMENT INCREASES AND SBIC FINANCING
(Dollar Amounts in Thousands)

<u>Employment Size at Time of Initial Investment</u>	<u>Employment Increase</u>	<u>Total Amount of SBIC Financing</u>	<u>Increase in Employment Per \$1 Million of SBIC Financing</u>
0 employees	13,303	\$ 53,064	251
1-20 employees	3,413	\$ 40,121	85
20-49 employees	5,201	\$ 35,586	135
50-99 employees	5,784	\$ 49,033	118
100 or more employees	<u>19,224</u>	<u>\$125,487</u>	<u>153</u>
TOTAL	46,925	\$303,291	155*

*\$303,291,000 ÷ 46,925 jobs = \$6463 per job.

As of December 31, 1979, the Federal government has lent or guaranteed \$649.7 million of loans to SBICs. SBICs have raised \$557.7 million in private capital (Source: SBA). For every \$3,513 that the government lends or guarantees for the SBIC program, one job is created. The job created does not cost the government anything. In contrast, various estimates indicate that the government must pay at least \$25,000 each year for each job it creates.

SBICs produce other benefits, too. In every criterion studied -- employment, payroll, sales, profits, assets, net worth, taxes, and R&D expenditures -- SBICs have been remarkably successful in creating outstanding performance (See Figure 4).

FIGURE 4
SELECTED INDICATORS OF ECONOMIC PERFORMANCE
(Dollar Amounts in Millions)

	<u>Pre-SBIC Financing</u>	<u>Most Recent Fiscal Yr.</u>	<u>Increase</u>
Employment	34,077	81,055	46,928
Payroll	\$ 243	\$ 752	\$ 509
Sales	\$ 1,136	\$ 4,176	\$ 3,040
Pre-Tax Profits	\$ 18	\$ 206	\$ 188
Assets	\$ 925	\$ 2,760	\$ 1,835
Federal Corporation Taxes	\$ 21	\$ 89	\$ 68
State and Local Taxes	\$ 7	\$ 21	\$ 14
R & D Expenditures	\$ 32	\$ 82	\$ 50
Net Worth	\$ 171	\$ 821	\$ 650

The average growth rate of Federal tax payments of SBIC financed companies is over 5 times that of other small companies. SBIC portfolio companies become substantially more efficient and more profitable than other small companies and, accordingly, produce a significantly increasing share of Federal tax revenues.

Although critics may suspect otherwise, SBIC portfolio companies are independent and grow on their own wits, not financial muscle. Fully 91% of the growth of companies that SBICs finance has come from their own internal development. Only 9% of it comes from acquisition. Furthermore, of all SBIC portfolio companies, 92% received a form of equity funds (See Figure 5). Only 8% of the total funds provided consisted of straight debt.

FIGURE 5
TYPE OF FINANCING RECEIVED BY
SBIC PORTFOLIO COMPANIES
(Dollar Amounts in 000's)

	<u>Total Amount of SBIC Financing</u>	<u>Percent of Total SBIC Financing</u>
Debt Only	\$ 24,617	8%
Equity Only	\$ 46,620	15%
Debt & Equity	<u>\$242,434</u>	<u>77%</u>
TOTAL	\$313,671	100%

SUMMARY

SBICs have had a dramatic impact on the U.S. economy. Companies financed by SBICs have experienced greater employment and government revenue growth rates than other small companies that have not received SBIC funds. SBICs are important to the nation's economic strength. They have played an extremely important role in generating revenues, profits, taxes and jobs in small companies.

Small businesses comprise 97% of all businesses in the United States. They are the backbone of its economy. The success of small businesses has been greatly enhanced by SBICs. Therefore, continued and augmented support of the SBIC program will produce substantial economic benefits to the economy as a whole.

The depth and breadth of the results of SBIC investments can barely be scratched by a short summary and only dented by even so thorough a study as NASBIC has conducted, but the summary conclusion is inescapable - **SBICs provide the nation a service which benefits it as no other group can, by providing jobs and tax revenue without threat of monopoly. That is the function of the SBIC program and that is what it has achieved.**

NATIONAL ASSOCIATION OF SMALL BUSINESS INVESTMENT COMPANIES

**618 Washington Building
Washington, D. C. 20005
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WALTER B. STULTS
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Associate Director

CHARLES M. NOONE
General Counsel

EILEEN M. BIERMANN
Administrative Director

L. ANDREA HATFIELD
Legislative Representative

WITNESS STATEMENT

NAME John Fitzpatrick BILL No. 834
ADDRESS Box 287 Helena DATE 5/18/91
WHOM DO YOU REPRESENT Western Analysis Inc
SUPPORT OPPOSE AMEND

PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

Comments:

WITNESS STATEMENT

NAME

Mike Fitzgerald

BILL No.

H3834

ADDRESS

Suite 415 Pamy Bank

DATE

3-18-81

WHOM DO YOU REPRESENT

Montana Trade Commission

SUPPORT

OPPOSE

AMEND

PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

Comments:

VISITORS' REGISTER

HOUSE Taxation COMMITTEE

BILL SJR 10

Date 7/15/51

SPONSOR Neuman

NAME	RESIDENCE	REPRESENTING	SUPPORT	OPPO
<i>Ellis Jones</i>	<i>Kelley</i>	<i>Dep of Revenue</i>	✓	

IF YOU CARE TO WRITE COMMENTS, ASK SECRETARY FOR LONGER FORM.
PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

MR. SPEAKER:

We, your committee on TAXATION

having had under consideration X HOUSE Bill No. 609

A BILL FOR AN ACT ENTITLED: "AN ACT TO PROVIDE A GRADUATED SCHEDULE FOR THE TAX RATE APPLICABLE TO IMPROVEMENTS ON REAL PROPERTY FOR NEW AND EXPANDING MANUFACTURING INDUSTRY; PROVIDING FOR LOCAL GOVERNMENT APPROVAL; AMENDING SECTION 15-6-134, MCA; PROVIDING AN EFFECTIVE DATE."

Respectfully report as follows: That HOUSE Bill No. 609, introduced (white), be amended as follows:

- 1. Page 3, lines 17 through 21.
 Following: "(1)" on line 17
 Strike: line 17 through "period." on line 20
 Following: line 20
 Insert: "a"
 Following: "construction" on line 21
 Insert: "permit is issued"
- 2. Page 4, line 1.
 Following: "(2)"
 Insert: "(a)"

(Page 1 of 2 pages)

~~XXXX~~

COMMITTEE ON TAXATION AMENDMENTS TO HOUSE BILL 609:

3. Page 4.

Following: line 2

Strike: "each"

Insert: "the"

Following: "or"

Insert: "the"

4. Page 4, line 5.

Following: "for"

Strike: "their"

Insert: "its"

Following: "jurisdiction"

Insert: "and the majority of the electors of the taxing jurisdiction must have approved the resolution at a general election.

(b) The electors may end the tax benefits by majority vote at a general election, but the tax benefits may not be denied an industrial facility that previously received the benefits.

(c) The resolution provided for in subsection (2) (a) shall include a definition of improvements that qualify for the tax treatment that is to be allowed in the taxing jurisdiction.

(3) The taxpayer must apply to the county assessor on a form provided by the department of revenue for the tax treatment allowed under subsection (1). The application by the taxpayer must first be approved by the governing body of the appropriate local taxing jurisdiction, and the governing body must indicate in its approval that the property of the applicant qualifies for the tax treatment provided for in this section. Upon receipt of the form with the approval of the governing body of the affected taxing jurisdiction, the assessor shall make the assessment change pursuant to this section.

AND AS AMENDED
DO PASS

STANDING COMMITTEE REPORT

April 3,

19 81

MR. SPEAKER:.....

We, your committee on TAXATION.....

having had under consideration HOUSE Bill No. 834

A BILL FOR AN ACT ENTITLED: "AN ACT TO ESTABLISH AN INVESTMENT CREDIT AGAINST PERSONAL INCOME TAX OR CORPORATE TAX FOR INVESTMENTS IN SMALL BUSINESS INVESTMENT COMPANIES; AND PROVIDING AN IMMEDIATE EFFECTIVE DATE."

Respectfully report as follows: That HOUSE Bill No. 834,
introduced (white), be amended as follows:

1. Title, lines 4 and 5.
Following: "TO " on line 4
Strike: line 4 through "AGAINST" on line 5
Insert: "EXEMPT CERTAIN CAPITAL GAINS AND DIVIDEND INCOME FROM"
2. Page 1, line 11.
Following: "Investment"
Strike: "Credit"
Insert: "Incentive"
3. Page 1, line 17.
Following: "tax"
Strike: "credits"
Insert: "exemptions"

(Page 1 of 2 pages)

~~REPAY~~

COMMITTEE ON TAXATION AMENDMENTS TO HOUSE BILL 334:

4. Page 2, line 8 through line 9 on page 5.

Following: line 7 on page 2

Strike: Sections 4 through 6 in their entirety

Re-number: subsequent sections

5. Page 5, line 11.

Following: "each"

Strike: "regional"

6. Page 5, line 14.

Following: "investor,"

Strike: "the region of investment,"

7. Page 5.

Following: line 15

Strike: "subsection (2) in its entirety

8. Page 5.

Following: line 23

Insert: "Section 5. Capital gains - dividends exempted. Any capital gains or dividend income realized by an individual or a corporation from an investment in an SBIC organized in accordance with this [act] is exempt from taxation under the provisions of Title 15, chapters 30 and 31."

Re-number: subsequent section

AND AS AMENDED

DO PASS

SEE ATTACHED STATEMENT OF INTENT

STATEMENT OF INTENT ON HOUSE BILL 834:

Section 4 of HOUSE BILL 834 provides the Department of Revenue with rule-making authority relating to Small Business Investment Corporations in Montana. In enacting this legislation, it is the intent of the Legislature that the Department of Revenue will adopt rules that ensure the proper reporting of investments in SBIC's and rules to establish eligibility for the capital gains and dividend treatment allowed by HOUSE BILL 834.

STANDING COMMITTEE REPORT

April 10, 1981

MR. SPEAKER

TAXATION

We, your committee on

having had under consideration SENATE Bill No. 377

A BILL FOR AN ACT ENTITLED: "AN ACT TO SIMPLIFY UTILIZATION OF FUNDS AVAILABLE FOR FINANCING THE FOUNDATION PROGRAM AND PERMISSIVE PORTIONS OF PUBLIC SCHOOL BUDGETS; AMENDING SECTIONS 20-9-345, 20-9-351, AND 20-9-352, MCA."

Respectfully report as follows: That SENATE Bill No. 377

BE CONCURRED IN

DO PASS

Rep. Ken Norstedt, Chairman.