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**Letter of Comment Sent to Senator Russell B. Long, Chairman  
Senate Finance Committee Regarding S. 1863, A Bill to Amend the  
Internal Revenue Code with Respect to the Income Tax Treatment  
of Small Business Investment Companies**

American Institute of Certified Public Accountants. Committee on Federal Taxation

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TAX COMMITTEE COMMENTS AND RECOMMENDATIONS

Letter of Comment Sent to Senator Russell B. Long, Chairman  
Senate Finance Committee Regarding S. 1863, A Bill to Amend  
the Internal Revenue Code with Respect to the Income Tax Treatment  
of Small Business Investment Companies

Submitted to the  
Senate Finance Committee

September 22, 1967

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

615 S. FLOWER ST.  
LOS ANGELES, CALIF.

September 22, 1967

The Honorable Russell B. Long, Chairman  
Senate Finance Committee  
Senate Office Building  
Washington, D. C.

Dear Mr. Long:

The committee on federal taxation of the American Institute of Certified Public Accountants supports Federal efforts designed to assist in the initiation, growth and perpetuation of small business. In this context, the committee wishes to express its views on what it believes to be technical deficiencies in S.1863, a bill whose purpose is aiding small business through the medium of Small Business Investment Corporations (SBIC).

Section 4 of the bill deals with the proposed liberalization of the diversification requirements which SBICs must meet in order to qualify for treatment under Subchapter M of the Internal Revenue Code. A limiting provision of this proposal would amend Section 851(f)(2) of the Internal Revenue Code to provide that an SBIC would not be considered to have met the diversification requirements to the extent it had continuously held any security of a particular portfolio company for a period of 10 or more years.

The reason given for this provision is that it will encourage SBICs to maintain sources of funds ready for investment in new ventures. We believe that this limitation could have the effect of discouraging SBICs from making equity investments. The risks are high in many of the situations in which SBICs may become involved. An SBIC would be reluctant to take an equity position if it could retain such position for only 10 years without losing its Subchapter M status because the risks might be present for a longer period. Financial support might have to be withdrawn and disposition made of the equity securities near the end of the 10 year period to avoid the consequences of holding an equity position longer than permitted without penalty.

Section 5 of S. 1863 deals with ordinary losses on SBIC stock. The proposal would amend Section 1242 of the Internal Revenue Code to provide that:

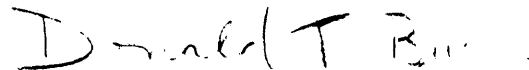
September 22, 1967

1. The amount which can be treated as an ordinary loss in any taxable year would be limited to \$25,000 per taxpayer or \$50,000 in the case of a joint return; and
2. Any amount in excess of such limitations may be carried forward as a capital loss to an unlimited number of successive years and, to the extent so utilized in each such year, may (within the limits above) be treated as an ordinary loss for any taxable year.

This proposal would severely limit the maximum amount of the ordinary deduction that a taxpayer may presently claim under Section 1242 for a loss on SBIC stock. It is difficult then to discern the reasoning behind the inclusion of this provision in a bill to aid small business. Such proposal would act as a deterrent to the investment of private capital in the volume needed to aid small business. It is recommended that no amendment be made to Section 1242.

We would be pleased to amplify any of our views if you feel this would be desirable.

Sincerely,



Donald T. Burns, General Chairman  
Committee on Federal Taxation

cc: Other Members of the  
Senate Finance Committee