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A Monthly Report on Federal Legislative Matters Affecting CPAs

AICPA
American Institute of Certified Public Accountants

Legislation to Assist Small Business Introduced in Senate; AICPA Pushes for Reform of S Corporation Law

A small business reform bill pushed by the AICPA would assist more than 1.5 million of the nation's small and family-owned S corporations by opening up new sources of investment and simplifying the rules under which they operate. Introduction of the S Corporation Reform Act of 1993, S. 1690, represents more than a year's worth of effort by the AICPA and others to reform subchapter S.

"This is terrific," James A. Woehlke, technical manager for the AICPA's S Corporation Taxation Committee, said about the bill's introduction on November 19, 1993 by Senators David Pryor (D-AR) and John Danforth (R-MO). "It's what we've urged Congress to do, and the critical first step in the legislative process to accomplish reform of the present S corporation laws."

The AICPA, the American Bar Association's (ABA) Committee on S Corporations, and the U.S. Chamber of Commerce, have been collaborating with Senators Pryor and Danforth and their staffs for over a year, Woehlke said. Many of the provisions in S. 1690 were drawn from the reform recommendations developed by the AICPA, the Chamber, and the ABA, he noted.

Senator Danforth said, "Today, S corporation tax returns ... represent more than 42 percent of all corporate returns. Their share of corporate net income is more than 11 percent and their share of corporate assets has nearly doubled from the early 1980s. This rush to subchapter S organization has exposed numerous problems with the current code that would be addressed by the bill."

The last overhaul of subchapter S occurred in 1982, but many unnecessary restrictions on S corporations remain. Subchapter S rules were added to the Internal Revenue Code in 1958 in an attempt to remove tax considerations from small business owners' decisions to incorporate. Needless to say, today's business environment is vastly different from that of 1958. Senator Pryor said, "The financial environment is far more complex, and the 1950's sub S limitations restrict growth opportunities. Frankly, sub S needs an overhaul."

What makes S corporations different from other corporations is that an S corporation's owners report and pay tax on the corporation's income; S corporations rarely pay taxes themselves. Owners of other corporations are taxed twice—first the corporation pays tax on its own income, then its owners pay tax again when the corporate income is distributed as dividends.

Seven other senators are co-sponsors of S. 1690. Importantly, five of them are members of the Senate Finance Committee and represent bi-partisan support on the tax writing panel. They are Senators David L. Boren (D-OK), Orrin G. Hatch (R-UT), Kent Conrad (D-ND), Malcolm Wallop (R-WY), Jim Sasser (D-TN), Mark O. Hatfield (R-OR), and Harlan Mathews (D-TN).

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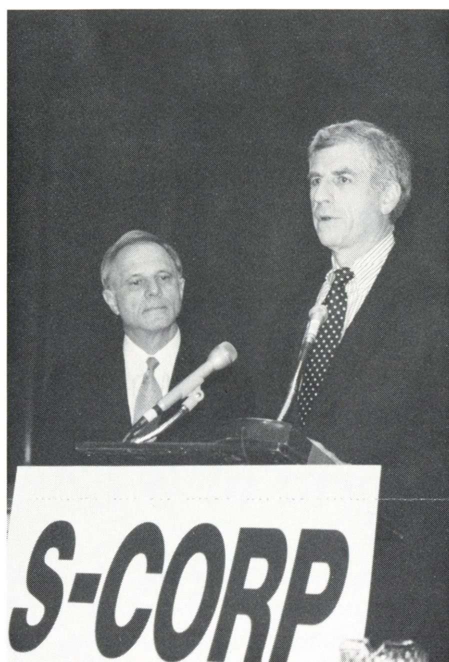
Introduction of Litigation Reform Bill Planned Next Year

FASB Stock Option Proposal Debated; AICPA and SEC Support FASB's Role in Setting Standards

Among S. 1690's provisions are the following:

- Increase the allowable number of shareholders from 35 to 50;
- Aggregate members of one family so they can be counted as one shareholder;
- Permit tax-exempt organizations, such as pension funds (including ESOPs) and charities, to own shares of S corporation stock;
- Expand "safe harbor debt" to permit convertible debt, and permit venture capitalists and lending institutions to hold safe harbor debt;
- Expand the types of trusts that can own S corporation stock;
- Remove tax traps by permitting the Secretary of the Treasury to treat invalid elections as effective and by providing for automatic waivers of certain inadvertent terminations; and
- Change the S corporation laws so that S corporation shareholders are treated the same as owners of regular corporations with respect to fringe benefits.



Senator David Pryor (D-AR), left, and Senator John Danforth (R-MO), right, announced introduction of S. 1690 at a rally of S corporation owners from across the country to kick off introduction of the S Corporation Reform Act of 1993.

***LEGISLATION,** continued from page 1*

Senators Pryor and Danforth consider passage of S. 1690 "doable" as part of a tax bill next year. The fact that the Clinton Administration has already expressed interest in S corporation reform is a significant plus, as is inclusion of a number of the provisions of the bill by the House Ways and Means Committee in H.R. 3419, the Tax Simplification and Technical Corrections Act of 1993 (which, however, was not enacted before Congress adjourned for 1993). However, the road to enactment for tax legislation is never smooth. Some of the provisions in S. 1690 will cost the Treasury money and will have to be offset.

We intend to continue to fight to modernize the rules governing Subchapter S. We will need your help as a Key Person to explain to your members of Congress what S corporations are, how they operate, and why change is needed. As Senator Danforth told the S corporation owners at the November 19 rally, "We depend on your support and energy."

Senator Dodd Plans Introduction of Securities Litigation Reform Bill

Senator Christopher J. Dodd (D-CT), chairman of the Senate Securities Subcommittee, said in a statement in the *Congressional Record* that next year he will introduce legislation to reform our nation's securities litigation system.

The November 20, 1993 statement by Senator Dodd clearly demonstrates that the accounting profession was successful in persuading the Securities Subcommittee at hearings held earlier this year (*Capitol Account* July, 1993 and August 1993) that Congress needs to address the problems connected with litigating securities cases.

The statement by Senator Dodd, and a related one by Senator Pete V. Domenici (R-NM) who is also a member of the Securities Subcommittee, means we've overcome an important obstacle and can move on to the next phase of our campaign—the crafting of legislative language to improve the current securities litigation system for investors and CPAs.

Senator Dodd said, "...It is apparent that the securities litigation system is not working as it should, and needs improvement... Therefore, after the Senate reconvenes in 1994, I intend to introduce legislation to reform the current securities litigation system, particularly with respect to rule 10b-5 class action litigation...While I have not yet developed a bill, my goal will be to make the system more effective in protecting investor interests, while trying to reduce the cost of some securities litigation so it is not an impediment to capital formation."

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SENATOR DODD, continued from page 2

Senator Dodd identified three areas he has targeted for improvement. "First," he said, "we need to strive to screen out frivolous securities cases and coercive settlements...Second, we should find ways to give investors better control over securities class-action cases, and over the lawyers who claim to represent them...Finally, we should strengthen the role of accountants as public watchdogs."

Senator Dodd added that instead of relying on the threat of enormous monetary judgments under joint and several liability to ensure that accountants are doing their job a stronger disciplinary system should be considered. The AICPA couldn't agree more. "Sharpening" the teeth of the profession's self-regulatory apparatus is one of the commitments the AICPA Board of Directors made in its June 1993 report entitled *Meeting the Financial Reporting Needs of the Future*. The Institute already is moving forward to ensure that an improved system is implemented. In the words of the AICPA's new chairman of the board, Dominic A. Tarantino, "It's job one!"

One approach to strengthen the present disciplinary system, Senator Dodd said, could be to create a self-regulatory organization for accountants similar to those used for brokers and dealers that is overseen by the Securities and Exchange Commission.

Concerning a shift to proportionate liability which is advocated by the accounting profession, Senator Dodd said, "...We should consider modifying joint and several liability, so that the liability of defendants will be more closely linked to their relative degree of fault. However, Senator Dodd also emphasized his concern about preserving "adequate redress" for innocent investors.

The accounting profession has a critical stake in the development of legislative language for each of these topics and the AICPA will be making suggestions to the senators and their staffs about how the provisions should be written.

Senator Dodd's public commitment to introduce a bill represents a critical advance in what we recognize will be a long process to achieve reform of the securities litigation system.

FASB Stock Option Proposal Sparks Vigorous Debate; AICPA Supports FASB's Role in Standard Setting Process

The Financial Accounting Standards Board's (FASB) controversial proposal on accounting for employee stock options sparked a vigorous debate at a hearing on the issue by the Senate Subcommittee on Securities on October 21, 1993.

Proponents and opponents of the FASB proposal—which would require companies to charge against their earnings the value of a stock option at the time it is granted—presented strong arguments in support of their positions, and senators traded brisk comments with the witnesses. While Democrat and Republican senators, conservatives and liberals alike, expressed opposition to FASB's proposal, the likelihood of action by Congress to block FASB remains uncertain. Final action by FASB on this proposal is not expected until the end of 1994.

The AICPA and the Securities and Exchange Commission weighed into the debate with letters to Senator Christopher J. Dodd (D-CT), chairman of the Securities Subcommittee, strongly endorsing FASB's current role in the setting of accounting standards.

Legislation pending before the U.S. Congress could "seriously harm" the ability of FASB to continue in its role as the private sector body that sets accounting standards for American businesses, the AICPA said.

The legislation would statutorily mandate financial accounting standards for stock options granted to employees. The AICPA acknowledged that the pending bills do not "propose the wholesale relocation of standard-setting authority to government. But the fact is," the AICPA continued, "that a single significant legislative interference in the objective process followed by the FASB is a major step down a slippery slope to that very result."

All other members of Congress also received a copy of the letter from the AICPA.

The AICPA will be sending comments to FASB on its exposure draft.

Results of Campaign Finance Software Poll Available

Earlier this year the AICPA polled members who have served as campaign treasurers for candidates running for seats in the U.S. Congress to find out what types of computer software they used to manage the campaign's finances.

Nearly 50 percent of the 112 CPAs polled responded, and were almost evenly split between those who used specialized software and those who did not. About 80 percent of the CPAs worked in races for the U.S. House of Representatives. The remainder worked in U.S. Senate campaigns.

The most commonly used specialized programs were Hannibal and Campaign Manager II. The respondents generally were satisfied enough with these programs to recommend them.

The AICPA conducted the poll to assist members who are seeking recommendations about software products for campaign treasurers.

If you would like a copy of the survey results, please write or call Margaret Jarrett at the AICPA's Washington office, 1455 Pennsylvania Avenue, N.W., Washington, D.C. 20004-1081 or 202/434-9274.

Leader of Banking Regulatory Relief Effort Addresses CPAs

Rep. Doug Bereuter (R-NE) addressed the AICPA's Eighteenth Annual National Conference on Banking on November 5, 1993 in Washington, D.C. He is pictured here with John T. Shanahan, chairman of the AICPA Banking Committee, during the question and answer session following his speech.

Rep. Bereuter is a key mover in Congress to provide regulatory relief from the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). He spoke to the more than 600 participants attending the banking conference about his bill, which has broad bi-partisan support in the House of Representatives, to provide such relief to financially sound institutions.

One of the provisions in his bill would remove FDICIA's requirement that an independent auditor report on management's assertion on the effectiveness of the company's internal controls over financial reporting. During the House of Representatives' recent debate over the Community Development Bank bill, the AICPA insisted that the FDICIA requirement remain in the law, but said it would not oppose alteration of FDICIA's requirements that auditors report on compliance with laws and regulations. Ultimately, the House passed the bank bill without repealing any of the auditor attestation requirements under FDICIA. This issue may surface again, however, during Senate consideration of the Community Development Bank bill.

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