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SUBCOMMITTEE HEARING ON REGULATORY BURDENS ON SMALL FIRMS: WHAT RULES NEED REFORMS?

SUBCOMMITTEE ON REGULATIONS, HEALTHCARE, AND TRADE COMMITTEE ON SMALL BUSINESS UNITED STATES HOUSE OF REPRESENTATIVES

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SUB COMMITTEE HEARING ON REGULATORY BURDENS ON SMALL FIRMS: WHAT RULES NEED REFORM?

Wednesday, July 30, 2008

U.S. HOUSE OF REPRESENTATIVES,
Subcommittee on Regulations,Healthcare, and Trade,
Committee on Small Business,

WASHINGTON, DC.

The Subcommittee met, pursuant to call, at 10:06 a.m., in Room 1539, Longworth House Office Building, Hon. Charlie Gonzalez [chairman of the Subcommittee] Presiding.

Present: Representatives Gonzalez and Westmoreland.

Chairman GONZALEZ. Good morning, everyone. My apologies for being late. This hearing on the Regulatory Burdens of Small Firms: What Rules Need Reforms? is now called to order. I am going to start off with an opening statement so that everybody understands the procedure. I make an opening statement. The ranking member will make an opening statement. Other members can submit opening statements in writing. They will be filed and then we will proceed with the testimony of the first panel comprised of three witnesses, and I will give you instructions at that time.

I am still trying to catch my breath. I actually came up from the basement. And at my age I shouldn't have done that. The stairs are killers. I am very interested in the results of a recent survey of small business owners conducted by Suffolk University and released by the American Management Services . The poll found that 63 percent of respondents believe that the Federal Government is doing nothing to help small businesses. 64 percent believe that the administration and the SBA specifically aren't doing enough for small businesses. This poll reflects the current challenging climate in which many small owners struggling to stay afloat may find themselves today.

The volatile costs of gasoline, the ever-increasing cost for health care and the crumbling housing market are negatively impacting small businesses. Tough times like these highlight the Federal Government's responsibility to make sure we are not placing undue burdens on the small business community. Under the best of circumstances, operating a small business is an enormous undertaking.

For many entrepreneurs business begins and ends at their desk, and there are never enough hours in any given day. The last thing these men and women need is to be bogged down by excessive paperwork. But unfortunately, complex Federal regulations have al-

ready created a time-consuming logistical nightmare for countless small businesses throughout our country. Many government regulations use one-size-fits-all policies that often fail to account for small business needs. Consequently, small firms end up bearing a disproportionate share of the Federal regulatory burden. Despite having tighter profit margins, they are forced to pay more to comply with government rules than their corporate counterparts.

This discrepancy is so great, in fact, that small enterprises spend 45 percent more on regulatory compliance than big businesses. That adds up to $2,400 in additional fees per employee. And when it comes to various other regulations, the differences are greater still. Some of these rules can cost small businesses as much as 364 percent more to comply. One specific regulation, tax reporting, is 67 percent more expensive.

In other words, we are forcing small businesses with limited capital to pay more than big businesses with deep pockets. In an attempt to address this inequity, Congress passed the Regulatory Flexibility Act way back in 1980, which requires government agencies to consider the effects of their policies in small businesses. But after three decades, it has fallen short of accomplishing its original goal. This is because Reg Flex tends to be inconsistent in its application.

For example, there is no uniform method of practicing Section 610 which, if properly employed, would stem the inequities currently facing small firms. Section 610 requires Federal agencies to periodically review rules, and gauge their impact on small businesses. But while it is a good requirement in its design, it has not been applied consistently. Recognizing Reg Flex's shortcomings, this committee has already taken steps to improve this system.

Last December, we passed H.R. 4458, which will significantly overhaul the regulatory process. Among other provisions, the bill introduced by Mr. Brad Ellsworth of this committee provides an important clarification to Section 610.

In that same vein the Small Business Administration launched the regulatory review and reform initiative, or r3, last year. This rule promises to improve the Reg Flex system by identifying and addressing its ineffective policies. It will also allow entrepreneurs to raise their own concerns and suggest targeted reforms. R3 has the potential to be an invaluable resource for small firms. It will not only give them a voice in the Federal regulation process, but it will also address some of their most significant challenges. For example, SBA's Office of Advocacy hopes to use this rule to simplify tax policies for at-home businesses. R3 promises to confront this issue, along with other concerns, head on.

As we will discuss today, many Federal compliance policies are outdated and unnecessarily complex. Small business owners should not have to put hours of their time towards untangling these regulations because, as this committee and our entrepreneurs well know, such time would be better spent on conducting business as usual.

In today's hearing, we will look at the effects of regulatory burdens on small firms. We will also explore potential solutions, such as the Small Business Regulatory Improvement Act, and the r3 program. I want to thank all of the witnesses in advance for their

testimony. The committee is pleased they could join us today. And we look forward to their insight on these issues.

[The statement of Chairman Gonzalez can be found in the appendix at page 25.]

Chairman GONZALEZ. At this time, it is my privilege to yield to the ranking member, Mr. Westmoreland, for his opening statement please.

Mr. WESTMORELAND. Thank you, Mr. Chairman. Let me just say, I really appreciate the chairman having these hearings. He and I have talked. And I come from a small business background. I was in the real estate building development business. And I certainly understand Federal regulations on small business. And as the chairman and I have talked, we have come up with a different subject matter that we want to have a hearing on. And I really do thank him for this.

When I was elected to serve in Congress, I was issued a mandate by my constituents to reduce the impact of Federal Government on our daily lives. And after 4 years, I don't know that I might have failed in that because I can't think of anything we have reduced in the last 4 years. I am all too aware of the feeling that our own government is working against us. This us-versus-them belief is held in small businesses all across this country. And honestly, I cannot blame anyone for thinking that because most small business people, Mr. Chairman, work 18 to 20 hours a day just trying to keep their small business in business and they really don't have time to keep an eye on the government and what the government is doing to try to revamp or reorganize their business to make the government, I guess, seem like they have a responsibility.

Recent government estimates place the cost of complying with Federal regulations at $1.1 trillion. That averages out to about $10,000 per household, and I don't know how much per small business. But we are here today to constructively address what we already know. Excess Federal regulations negatively impact America.

I think Washington has made a few good steps. However, they have been baby steps. President Bush's executive order directing Federal agencies to place more emphasis on the economic impact of regulatory proposals is a good idea. However, I feel that it missed an opportunity by not addressing the loopholes in the Regulatory Flexibility Act. The executive order also stops short of preventing agencies from using narrow interpretations of Reg Flex in order to ignore their congressionally imposed responsibilities.

SBA's Office of Advocacy is to be commended for its proactive approach to reducing this burden on small business. The r3 program is another step towards this goal. Involving stakeholders in the process of pinpointing rules that merit review makes good sense. However, the combination of Federal agencies' distaste for transparency and the Office of Advocacy's lack of authority to force those agencies to consider reforming unnecessary regulations creates an environment where very little can be accomplished.

To be clear, I am not waving a white flag at this issue. Everyone in this room has a vested interest in seeing small businesses grow and thrive in a global marketplace. In order for that to happen, we must work to increase American competitiveness by reforming and removing the regulations that restrict growth. This is a top priority

for me and our Nation's businesses. And the question is, is it a priority for the agencies in Washington? I welcome these distinguished guests, witnesses, panelists. And I want to thank you for your willingness to come here and testify and take some tough questions. And again, Mr. Chairman, thank you for holding this hearing.

Chairman GONZALEZ. Thank you very much, Mr. Westmoreland.

[The statement of Mr. Westmoreland can be found in the appendix at page 27.:]

Chairman GONZALEZ. Believe me, I appreciate your cooperation and that of your staff. And I always want to start off by acknowledging the fine work of the staff of the Small Business Committee, and the subcommittee especially, but on both sides and that is majority staff and minority staff. They worked really hard putting the memo together and giving us some great explanations and background.

A special thanks to the witnesses I have already expressed. The way this will work is each witness will be given 5 minutes to make their statement. You have your written testimony, which will be made a part of the record. So if you can just summarize it in those 5 minutes, it doesn't seem like enough time, but we will follow up with questions. And since it is just the ranking member and myself at this point, we will have plenty of time for you to expand and to elaborate on some of the statements you would like to make.

PANEL I - PARTICIPANTS IN ORDER ARE: HON. SUSAN DUDLEY, ADMINISTRATOR, OFFICE OF INFORMATION AND REGULATORY AFFAIRS, OFFICE OF MANAGEMENT AND BUDGET; HON. THOMAS SULLIVAN, CHIEF COUNSEL FOR ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION; CHRIS WAGNER, DEPUTY COMMISSIONER, SMALL BUSINESS/SELF EMPLOYED DIVISION, INTERNAL REVENUE SERVICE, UNITED STATES DEPARTMENT OF TREASURY

Chairman GONZALEZ. And I will be introducing the witnesses as they testify. The first witness is the Honorable Susan E. Dudley. Susan E. Dudley was appointed in April 2007 to serve as the administrator of the Office of Information and Regulatory Affairs at the Office of Management and Budget. From 1998 through January 2007, Ms. Dudley served at the Mercatus Center at George Mason University, where she directed the regulatory studies program from 2003 to 2006. Welcome. And we look forward to your testimony.

STATEMENT OF HON. SUSAN E. DUDLEY

Ms. DUDLEY. Thank you for inviting me, Chairman Gonzalez and Ranking Member Westmoreland. I appreciate the opportunity to discuss the Office of Information and Regulatory Affairs, or OIRA as we call it, our efforts to ensure that the Federal Government understands the impact of regulations on small businesses, considers cost-effective regulatory alternatives for small businesses, and looks for ways to reform regulations to lower burdens on small business without sacrificing important public protections.

Small entrepreneurs are the engine of economic growth in America. They represent over 99 percent of employers and provide 60 to 80 percent of net new jobs. Yet as you pointed out in your opening

remarks, Mr. Chairman, they bear disproportionate regulatory and paperwork burdens. OIRA, along with SBA's Office of Advocacy and other Federal regulatory agencies, is working both to minimize unnecessary burdens and also to help America's small businesses comply with regulatory and reporting requirements.

Since OMB began to keep records in 1981, Federal agencies have published over 120,000 Federal rules in the Federal Register. Operating under Executive Order 12866, which was issued by President Clinton in 1993, OIRA coordinates interagency review of the most significant of these rules prior to publication. We estimate that the average yearly cost of the new major regulations issued between 2001 and 2006 is about 47 percent less than over the previous 20 years, and yet the average yearly net benefits of new regulation has increased substantially.

While we are working to ensure that new regulations are cost effective based on projections of what their impact will be, most existing Federal rules have never been systematically evaluated to understand their actual benefits and costs. Given the number of existing regulations on the books, it would be valuable to understand which of them are working as intended and which could benefit from reform. One tool to do this is Section 610 of the Reg Flex Act as you both have discussed. The Office of Advocacy's recent guidance to agencies on conducting 610 analyses should make this promising tool more valuable. The comprehensive approach envisioned by Section 610 has advantages but it also may not target regulations in most need of reform.

In some cases, businesses and consumers have adjusted to regulations that have been in place such that they are no longer binding. In an effort to identify regulations most in need of reform, both OIRA and the Office of Advocacy have solicited nominations from the public for regulations that are unduly burdensome, outdated or have resulted in unintended consequences.

In response to our 2004 request for nominations, the public made 189 recommendations, focussing on regulations that largely affect the manufacturing sector. Working with the relevant agencies, the Office of Advocacy and the Department of Commerce, we selected 76 of these for priority consideration and action. To date, agencies have completed approximately 70 percent of the 2004 manufacturing reforms, and we plan on providing a comprehensive update on the status of these reforms in our 2008 draft report to Congress. We have also followed with interest the Office of Advocacy's r3 initiative, which I am sure Tom Sullivan will talk more about. Several of Advocacy's top 10 are similar to nominations OIRA has received. And we are working together with agencies to pursue these reforms.

OIRA also has authority, under the Paperwork Reduction Act and the Small Business Paperwork Relief Act, to reduce existing burdens on small businesses. These statutes give OIRA and agencies responsibility for eliminating unnecessary, duplicative, and unjustified paperwork burdens, particularly on small entities.

In addition to seeking public comment and OMB approval of initial collections of information, agencies must seek and obtain extensions of OMB approval at least once every 3 years. This provides

a vehicle for ensuring that existing paperwork burdens are re-examined on a regular basis.

Finally, let me note several E-Gov initiatives that, while not reducing the number of regulations and paperwork burdens on small businesses, are designed to simplify and streamline compliance. Business.gov is a one-stop shop where businesses can locate the government compliance guides and forms they deal with on a regular basis, thereby reducing the effort needed to comply with government regulations. Business owners have self-reported saving over 3 million hours so far this year alone by using this portal. The Business Gateway Initiative also promotes data harmonization to reduce the complexity of reporting processes and improve the reuse and distribution of information across Federal, State and local agencies. And we plan to release a comprehensive analysis, including several case studies shortly by mid August. Thank you.

Chairman GONZALEZ. Thank you very much. Appreciate that and look forward to some questions and some responses from you.

[The statement of Ms. Dudley can be found in the appendix at page 28.]

Chairman GONZALEZ. The next witness is the Honorable Thomas M. Sullivan. Mr. Sullivan is the chief counsel for the Office of Advocacy at the U.S. Small Business Administration. Prior to joining the SBA, he worked as executive director of the National Federation of Independent Business Legal Foundation. Mr. Sullivan, as head of the Office of Advocacy, is charged with independently advancing the views, concerns and interests of small businesses before Congress, the White House, Federal regulatory bodies and State policymakers. Mr. Sullivan.

STATEMENT OF HON. THOMAS M. SULLIVAN

Mr. SULLIVAN. Thank you, Mr. Chairman, Representative Westmoreland. Good morning, thank you for allowing me to appear before the committee. My name is Tom Sullivan. I am the chief counsel for Advocacy. And because my office is independent within this Small Business Administration, the views expressed here don't necessarily reflect the position of the administration or the SBA. This testimony was not circulated for comment through OMB. My job is to try and remove regulatory barriers that stifle small businesses' ability to create jobs, drive innovation, and build communities. The main tool used by the Office of Advocacy to accomplish this is the Regulatory Flexibility Act. Section 610 of that Act requires agencies to periodically review the rules that are on the books and consider revising them to reflect modern conditions in order to ease the burden on small business.

GAO reports, law review articles, this committee and others have pointed out that government has not done very well in streamlining, downsizing or modernizing existing Federal rules and regulations. To try and address this problem, last year my office launched the small business regulatory review and reform r3 initiative. It is designed in part to improve compliance with Section 610 and further the goals of periodic review. Through r3's public rule reform nomination process, small businesses and their rep-

resentatives can point out existing agency rules they feel should be reviewed and revised.

Last year small business stakeholders nominated over 80 rules for review and reform. 10 of those nominations were chosen for the top rules for review and reform this February. Now we are working with agencies to respond to those calls for reform. My office will post online agency responses to the top 10 reform nominations next month, and we will update that progress report every 6 months. When the Office of Advocacy started to receive suggestions last year for rules that should be reviewed and reformed, we evaluated them to see one, whether the rule being nominated has ever been reviewed before for its impact on small business.

Two, whether technology, economic conditions or other factors have changed since the rule was originally drafted. Three, whether the rule imposes duplicative requirements. Four, whether that rule could reasonably be reformed to better accomplish its intended objectives with less burden on small business.

And lastly, we evaluated the overall importance of the rule to small business and communities. Let me be clear to the subcommittee, just because a rule that was not nominated for reform does not mean that my office ignores it. Rather, the nominations that were not chosen as the top 10 rules for reform have given my office valuable insight into how we prioritize the regulatory issues of concern for small business. Three weeks ago, we kicked off our request for nominations for next year and we have already received about a dozen suggestions. I believe that the r3 program will be an important tool for keeping agencies' attention focused on Section 610 of the Reg Flex Act and improving the quality of reviews of existing regulations. Given the importance of periodic reviews of current rules, Congress, my office and Small Business have a common interest in the long-term success of r3. Thank you, Mr. Chairman. And I would be happy to answer questions.

Chairman GONZALEZ. Thank you very much, Mr. Sullivan.

[The statement of Mr. Sullivan can be found in the appendix at page 52.]

Chairman GONZALEZ. Our next witness is Mr. Chris Wagner, who is deputy commissioner of the Small Business Self-Employed Division in the Internal Revenue Service. Mr. Wagner has held numerous positions and enforcement functions in the IRS. He also served as the Deputy National Taxpayer Advocate. Welcome, Mr. Wagner, and you may begin your testimony.

STATEMENT OF CHRIS WAGNER

Mr. WAGNER. Good morning, Chairman Gonzalez and Ranking Member Westmoreland. My name is Chris Wagner, and I am the deputy commissioner for Internal Revenue Service Small Business/Self Employed Division. I appreciate the opportunity with talk to you today about the IRS's efforts to reduce burdens for small businesses. The small business self-employed division is made up of 26,000 employees who serve about 57 million taxpayers, roughly about 1/3 of the tax-paying population. This consists of 9 million small business corporations and partnerships with assets of $10 million or less, 41 million self-employed and supplemental income

earners, and 7 million other taxpayers who file employment, excise, estate, gift and fiduciary tax returns. Because the employees within my division work directly with small business men and women, they understand the critical roles small business plays in our Nation's economy. Small businesses represent more than 99 percent of all employers and employ half of all private sector workers. While my division at the IRS does enforce the tax laws against small businesses, we also have an obligation to assist them in understanding and complying with the tax law.

This taxpayer service aspect of what we do is critical because we know that some level of noncompliance reflects a lack of understanding by small businesses of their true tax obligations. This lack of understanding is often a function of complexity of the Tax Code and the burden associated with complying.

One of these areas that affects small businesses, and an area of prime interest to the members of this subcommittee, is the home office deduction. In 1976, Congress passed legislation providing very limited circumstances in which an individual, or an S corporation taxpayer, may take a deduction for an office in the home. Much has changed in the past three decades. And due to technological advancements and other significant changes to business environment, many more small businesses are now able to operate effectively out of the home. In fact, according to the Small Business Administration, home-based businesses represent over 50 percent of all small businesses. This evolution makes the benefit of claiming a business deduction for an office in the home even more valuable to small business taxpayers.

However, because of the complexity involved in claiming the deduction, we believe a number of small businesses that are eligible to claim deductions do not. The IRS has looked extensively at this issue and explored ways to simplify the computations required to claim the office in the home deduction. We concluded that reducing burden on business taxpayers with home office expenses could best be accomplished through a legislative change. One of the challenges we identified was the statutory requirement to recapture depreciation.

Homeowners claiming deductions for an office in their personal residence are required to recapture depreciation allowed or allowable when selling their home. In other words, whether depreciation is claimed or not, additional computations are necessary and a tax liability occurs when the home is sold. Despite the fact that we are unable to simplify the home office deduction, we continue to work with small businesses, helping them understand their obligations and how to claim the deduction. Here are a few ways that we work with the public and third-party stakeholders to help small businesses comply with their obligations. We have posted information on our Web site, IRS.gov, providing links to specific publications with information on the home office deduction.

We work with partners such as the Small Business Administration, State and local government agencies and community organizations to provide small business tax workshops and other educational seminars which include information on home office deduction. We have produced educational materials to supplement forms and publications such as the virtual small business tax workshop,

which can be viewed online at IRS.gov or ordered as a DVD. An entire chapter of the workshop is devoted to the home office expense. We issued a home office deduction fact sheet that is used in outreach and is available on IRS.gov in both English and Spanish.

Mr. Chairman, my written statement discusses in greater detail many of the things we are doing to reduce the burden on small businesses as well as the steps we are taking in terms of outreach and education. I appreciate the opportunity to be here this morning to elaborate on a few of those issues. Thank you, and I will be happy to respond to any questions.

Chairman GONZALEZ. Thank you very much, Mr. Wagner.

[The statement of Mr. Wagner can be found in the appendix at page 70.]

Chairman GONZALEZ. And I will lead off with a question for each member of the panel. And I will start off with the administrator of the Office of Information and Regulatory Affairs. And you referred to it as OIRA?

Ms. DUDLEY. Yes.

Chairman GONZALEZ. OIRA. I am trying to figure out when we actually look at the regulatory scheme and its impact on small businesses. Now we can do it before the regulation is adopted and of course then once it is implemented and its effect. Your office, if I understand it, actually comes in at all stages of this, but I think it is really important—that you come in before the adoption of regulation—can you explain that quickly to me? And how in the world can you really do that, I mean, with the complexity and the enormity of the Federal Government today?

Ms. DUDLEY. Under President Clinton's executive order, my office reviews—and what we do, we conduct an interagency review. So we would engage Tom Sullivan's office as well as other agencies on all regulations both before they are proposed in the Federal Register, and again before they are issued in final form. All regulations there are classified as significant. So of the 120,000, I would say probably a little over 20,000 of those went through the interagency review that we coordinate. And we review them—do you want more details on how—

Chairman GONZALEZ. I am just wondering, the percentages that are reviewed subject to review or whatever, are there any changes that actually occur as a result of the review? And this is not criticism of anyone. I just know that there is only so much time in a day. You only have so much in the way of staff. The ability to actually accomplish that particular task. I mean, how realistic is that? And in accomplishing that task, how many of these regulations actually get sent back for tweaking, review, total overhaul and such?

Ms. DUDLEY. Usually when I am sitting in the seat, I am getting criticized for changing too many regulations.

Chairman GONZALEZ. That is a good criticism.

Ms. DUDLEY. I can actually give you statistics on that. Because when we conclude review—there are four options; withdrawn by the Agency, consistent with the executive order with changes, so that means changes that took place as a result of the interagency review; consistent without change; or returned to the agency. And

we have statistics on how many are in each of those categories. I will be happy to give you that.

Chairman GONZALEZ. Yeah. If you would. And I think in some measure—and it is good to actually share that with many individuals or small businesses that may be in contact with—and saying look, we do have someone out there. And this is not about fixing blame. And I think Mr. Westmoreland and I are together on this. This is about fixing the problem. And as a matter of fact, Mr. Sullivan's initiative and everything came to light as a result of another hearing we had.

Now let's say it is ongoing. Now you come in after the fact. We have the regulation out there, and we are talking about 610 and such. How do you function even in that particular environment? What is the best vehicle? How do you actually do that? How do you perform?

Ms. DUDLEY. Our focus has been primarily on the new regulations. And so I think that is where you would see the greatest effect on the regulations. But as you say, it is complicated. We don't know what the real impacts will be. And it is important to look at the regulations that are in place. To do that, we have sought recommendations from the public for over several years. And what we are doing is, in response to those recommendations, we are going back to the agencies. We have done something similar to what Tom's r3 does: identify priority regulations for reform, gone back to agencies, and are working with those agencies on completing those reforms, I hope before I leave office.

Chairman GONZALEZ. Thank you very much. Which leads me right into what Mr. Sullivan has been doing because I think all eyes are probably on your office, Mr. Sullivan for guidance. Because you are basically in charge of being this advocate for all these small businesses. Someone is just going to assume you are the one that should be keeping pulse on what is going on out there and identifying. So I do want to commend you for the 3r initiative that you took. I think that is a great vehicle. And that is what I would like to do is maybe concentrate my questions on a couple of things about—and for the benefit of the audience, we were having another hearing in which Mr. Sullivan was testifying on the Regulatory Flexibility Act.

And I was suggesting that we should have some sort of a site, you know, ask Nydia or complain—and meaning Nydia, not out of disrespect, but actually a great deal of affection and admiration. Chairwoman Nydia Velazquez. She is the chair of the Small Business Committee, and you would just go in on the Internet and you would file your biggest grievance against some regulation. So Mr. Sullivan informed me, he says, well, we already have that. Nydia was very happy to hear that it would not be her Web site or whatever.

Mr. Sullivan, we are identifying vehicles. How do we get this input from the small business community? So you have something here. But in our discussions in the office the other day, I think one of the concerns, of course, is one that we do something. And that is what we are doing here and that we act on it. And you all will have your own recommendations but also about continuity. So let's say during your tenure and during Ms. Dudley's tenure, and who

knows what 2009 holds other than it is going to be a new administration, and maybe we can be of assistance to make sure there is some continuity regardless of change and regardless whether it is a McCain administration or an Obama administration. There are great changes.

So what are your views on vehicles such as 3r? What else can we do to identify those regulatory schemes that really do need some reform from the ground up? What can we do within the agencies and departments, that they meet their own responsibilities in that regard? And then about continuity.

Mr. SULLIVAN. Thank you, Mr. Chairman. I think primarily to make the regulatory review and reform initiative work, it will depend, in large part, on the oversight mechanism here in the House and also in the Senate. The administration can work as aggressively as possible. But without the type of oversight insistence that this committee is looking over agencies' shoulders to make sure they are sensitive to the burden on small business, it won't work very well.

The r3 initiative, even though I am very proud of it taking place under my leadership, is an acknowledgement that there has been a law on the books for 28 years that hasn't worked very well. And we are excited that working with that law, the Regulatory Flexibility Act has progressed enough to have this type of initiative. But we are still in the infancy about looking at, how do we take the existing $1.1 trillion regulatory burden and how do we streamline, downsize and modernize it to lessen its impact on the small business community?

So I think the simple answer to your question is, this type of initiative will depend very much on the vigilance of this Oversight Committee to make sure that agencies, when asked by the small business community—and please keep in mind, I am simply a megaphone for that small business community. My job is to connect Main Street with government agencies and hopefully have those agencies have a better result. To the extent that this committee makes it clear to those agencies that you are looking over their shoulders to make sure that when Main Street small businesses voice their concerns, they are heard and responded to will go very far in making the r3 initiative a success.

Chairman GONZALEZ. And I apologize. It is r3. And again, I just commend you for that effort. But I think it is important that you have advocates on this committee. And hopefully we will be back for the 111th Congress so that we can be making those recommendations regardless of who may be in charge at that point in time. One last question is, it is important though to deliver. And that is that we heard, not only heard and that it was credible and a legitimate complaint and that there are changes. I think a surefire way to frustrate your effort is if we don't respond. So that is imperative, is it not?

Mr. SULLIVAN. Yes, Mr. Chairman. You have recognized really what GAO has recognized as a failing of the implementation of Section 610. The Government Accountability Office, GAO, did a review recently and said that over the period of 5 years, agencies had actually conducted 1,300 610 reviews. And that seems like a great number. The problem is that many small businesses and folks in

the small business community are first unaware that these reviews happened. To the extent that there are positive outcomes of these reviews, I don't think that those have been adequately explained or described on how they benefit a small business's bottom line. So this r3 initiative, the regulatory review and reform initiative, is also in part to help agencies, to say, you know, the credibility of the Office of Advocacy, our relationship with small businesses is at an all-time high. Let us use that credibility to make your reviews of rules and regulations worthwhile.

And to the extent that you do something positive, then let's amplify that positive so that a small business owner knows that it affects their bottom line. Because the disconnect that exists between reviews or the lack of reviews, according to GAO, is harming the 610 implementation.

So we are hopeful that this initiative long term gives agencies the ability to seek approval of reforms that they take and not hide it from public comment from small business comment.

Chairman GONZALEZ. Thank you very much, Mr. Sullivan. And a question to Mr. Wagner. Obviously, one of the top 10 was the home office deduction. And you have covered it and such. And there can be a difference of opinion here. I mean, and the IRS may have already responded to Mr. Sullivan. He may already be posting their response. And I think that response may be, this will take a legislative fix as opposed to regulatory. And we can maybe have a difference of opinion on that. And we will probably let Ways and Means figure that one out for us.

How often do you come to that conclusion as you review some sort—is review the IRS Code and the regulations that accompany the enforcement of the Code as requiring a legislative fix as opposed to a regulatory fix because obviously legislative takes a lot longer.

Mr. WAGNER. Correct. It really depends on the law. Quite often we are able to make adjustments as we put out regulations. But actually, the laws that we are given in the Internal Revenue Code are really very detailed. So most of the regulations we put out are interpretative regulations.

We are just kind of interpreting what is in the Code itself. So there are times that we are able to do things through regulation and we do apply regulations when we can. But there are times when we are limited by the Code or other sections of the Code from doing something. In the case of the office in the home deduction, that is kind of where we are with that particular issue.

Chairman GONZALEZ. Mr. Wagner, I am going to read something that staff actually prepared regarding—after they reviewed some materials from the IRS. And you said in your statement that regulations promulgated by IRS are not subject to review under Reg Flex, Regulatory Flexibility Act, because the Agency is only allowed to consider the administrative impact, the administrative impact of compliance with a regulation, not the tax burden itself.

So you are making this distinction. You are saying well, sure, it is going to cost a small business a whole lot of money because they conduct all their business out of that spare room in their house. But our regulation can be so complex, it can't comply. So they don't go ahead and attempt to get the deduction. But the bottom line for

them is, yeah, it is their bottom line. It does impact them. But what you are saying, there is a distinction between the administrative compliance cost and the consequence of the tax burden.

Mr. WAGNER. Right. Because when you look at the actual Code itself, the law itself, if that is causing the burden, if we make adjustments in the regulations that add to the burden that is caused by the tax law itself, then that is what we would consider. So we are saying the administrative burden that we add through the regulations is what we would consider under the reform, the Regulation Flexibility Act.

Chairman GONZALEZ. And I understand that. And I think in the discussions it may be esoteric. But to the small business, it is that bottom line. It is a burden because the regulation does not allow them to take advantage of the deduction which obviously does affect their livelihoods.

Thank you very much for your responses. And thank you, Mr. Westmoreland, for your patience. And I recognize Mr. Westmoreland, the ranking member, for his questions.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

Ms. Dudley, in your opening statement, you talked about the 2007 OMB report to Congress. What was the cost between 2001 and 2006? And what was the cost over the previous 20 years? You mentioned that there was a 47 percent deduction. And you may not have those figures now. But I think that that would be interesting to actually have those figures.

Ms. DUDLEY. I will get them to you. I don't have them right here, but I will get them to you.

Mr. WESTMORELAND. Also the other question is, you mentioned—and yet the average yearly net benefits of new regulation has increased substantially. Can you explain what one of those might be?

Ms. DUDLEY. What one of those regulations might be?

Mr. WESTMORELAND. Uh-huh. That has got a positive net benefit to somebody.

Ms. DUDLEY. Our report to Congress lists the regulations of the previous years. And so it lists the costs and benefits. For the most part, we try to make sure every regulation we issue does have net benefits unless otherwise constrained by law. There are some statutes that say you can't really consider those factors. But to the extent that agencies are allowed to consider them, we work with them to try to make sure they do.

Mr. WESTMORELAND. Okay. But do you have any examples of what those might be? Could you get some examples? I mean, and show me kind of how you go through and try to determine what the net benefit is, and how that is I guess associated with who the regulation is placed upon.

Ms. DUDLEY. I think that is a very good question because sometimes the benefits accrue to different people than the costs accrue to. So for example environmental regulations will often have very large net benefits. And the benefits are social benefits over several hundred of years whereas the costs may be falling on people, particularly small businesses today. Others, the benefits and costs are borne more by the same people. For example our vehicle fuel efficiency regulations. The benefits are expected to accrue to drivers who will save money in gasoline if they have more fuel-efficient

cars. One thing I should note is on environmental regulations and occupational safety and health regulations, Tom's office under SBREFA, the Small Business Regulatory Enforcement and Fairness Act, gives Tom's office and a small business panel the opportunity to get involved and focus right in on what are the impacts of this on small businesses, even before I see it for review. So it provides for an even earlier stage of review, for those two agencies in particular.

Mr. WESTMORELAND. I am very familiar with both those agencies. And trust me, we will have people wearing bubbles before it is over and they won't be able to work.

The other thing I wanted to comment on you to talk about the flexibility for community drinking water systems. Very familiar with this. In fact, in one of the counties I represent, they basically had to run a water line out there, very expensive for the homeowners because it was a small drinking system. You have in here that it was started in 1996 when an amendment to the Safe Drinking Water Act came up. You talked about the denominator had mentioned that there was really no way—or it had never been found to be unaffordable.

In other words, all the different tests that you had to go through, it was really impossible to prove to the EPA any of these things. And you said that this nomination is similar to a reform recommended by OMB by the public in 2002, which was approximately 6 years after this came out. And then you say, and we are also interested in working with advocacy and EPA to see that this nomination is pursued to completion. It is 2008. It has been 12 years.

Ms. DUDLEY. Yes. And it is a high priority of mine personally and Tom's personally. There are different legal interpretations of how to use the Clean Air Act. And I think it remains to be seen whether we actually see that finished this year. I would like to very much.

Mr. WESTMORELAND. Well, you can understand what the concern might be in trying to look at some of these if it takes you 12 years and you haven't done it yet. I am assuming this has gone through different administrations and so on and so forth. And I think that, in and of itself, is a problem.

Mr. Sullivan, you and I had a great conversation the other day. And I am going to ask you the same question I asked you in my office.

How many regulations have been done away with during your time at the administration?

Mr. SULLIVAN. Mr. Westmoreland, I will give you the same answer, although with a little bit more research that I have had—

Mr. WESTMORELAND. Good. You found one?

Mr. SULLIVAN. I did. I did. First of all, the Regulatory Flexibility Act that my office oversees really does put the responsibility on the Agency to make a final decision. And I think that is important for the Committee to absorb, is that I tried to lead agencies to the right place. I tried to give advice on how their actions will impact small business. And with respect to Section 610, I try to give advice on how their existing rules may be out of date and how to reform them to help small business. But ultimately it is their decision.

And we use every tool possible to convince agencies to do good for small business.

I would have to say in direct response to that question, we are not always successful. And because of that, we don't have very many rules that we have done away with. However, since I have been chief counsel for advocacy—or in the last several years there have been a few notable rules that do show Washington, D.C.'s sensitivity to how regulations impact small business.

The first is one that I worked on extensively when I was with NFIB and that was the ergonomics regulation that was passed under the last administration. My predecessor, Jerry Glover, was courageous in standing up and telling his own administration that that was not good for small business. And he did not prevail. However, thanks to Congress and the President, they overturned that rule. So that is one. But it did take an act of Congress.

One that is a little bit more recently, and I do view as EPA's responsiveness to small business concerns, was several years ago they were considering requiring every pollution report to be filed electronically. And small businesses were very concerned that this would cost close to $40,000 to update their computer systems, receive training, and they pleaded with then-Governor Whitman. Governor Whitman was the head of EPA at the time. They said, you know this may be a good idea at some point when the technology highway is such that every small business has the exact software, exact computer systems. Maybe this will make sense and maybe it will be an efficient way to submit pollution reports. But right now it will devastate us.

And we presented that material to the Environmental Protection Agency. And because of her leadership, they withdrew the rule. So that is one that I am very proud of. And with this r3 initiative, we were looking for other rules that may be duplicative or out of date that we can also work with the small business community and agency leaders to say, maybe we don't need that rule anymore.

Mr. WESTMORELAND. And Mr. Sullivan, that is the NP—the national—the pollution?

Mr. SULLIVAN. The actual rule that they were thinking of doing, it has a long acronym that is pronounced CROMERR, but it has to do with record keeping on a whole slew of different environmental reports that are required. It is not restricted to one particular Clean Water Act—

Mr. WESTMORELAND. Because there is a national permit that you now have to get for storm water run-off. Even though cities and counties and States have a permitting process, you now have to have a national?

Mr. SULLIVAN. Yes. Yes. Mr. Westmoreland, you and I did talk about a rule that this administration did take a leadership position on. And it was the Environmental Protection Agency's construction and development rule. And there was a different EPA administrator at the time. But when small businesses, and in particular your former livelihood, the home builders and others said, you cannot require—you should not require another Federal form to be sent to Washington, D.C. that is basically already required at a local level.

The home builders believed that sending that other Federal form to Washington would not make the rivers and streams cleaner. And the head of EPA agreed and did not go ahead with the proposed rule at the time. There was legal action. And now the Environmental Protection Agency is under a court order to come back again with a similar approach. And my office is working very hard with EPA, once again, to make sure that the views of small business enter into the process so that what comes out of EPA reflects a sensitivity to small business.

Mr. WESTMORELAND. Thank you, sir. And Mr. Wagner, just a couple questions for you.

In your statement, you had the burden reduction form 13285A. Do you know how many of these Burden Reduction Act, I guess, processes have actually been adopted by the IRS, how many have been submitted and how many have been adopted? I can imagine what some of the submissions you have got were. But do you know how many have been adopted?

Mr. WAGNER. I do not know the exact number of how many have been adopted. But I know we have had a lot of good suggestions come through and we have adopted but I don't have the actual number.

Mr. WESTMORELAND. One of the things that the Chairman mentioned was the home office deduction. And I know a lot of people that just quit doing it just to keep from being audited or called upon by the IRS. Does the IRS have any proactive—in other words, if they see a certain number of things that are being filed wrong or incorrectly, are they proactive in looking at that administratively to see if there needs to be some type of clarification or change when so many people are doing something wrong or improperly or seem not to understand it?

Mr. WAGNER. We do a lot in the area of outreach and education on a lot of issues that we have in the IRS. So we are always looking for areas that we see that people are making mistakes on. This area particularly happens to be one, the office in home deduction. Looking at the data we have, they get it wrong about half the time. About half the time they get it correct, the other half they are either claiming too much or claiming too little on the office in the home deduction. Taxpayers let us know if there is an area that we need to look at to see if we can make some improvements.

First of all, we knew there was a burden in this particular area, plus we get a lot of feedback through a lot of different organizations, external stakeholders even people who are claiming the deduction are telling us it is difficult to claim this deduction, to calculate it. That is why we looked at it and have spent a lot of time trying to figure out how can we do a better job at making this less burdensome. And we have spent much time looking at it extensively. And that is how we came to the conclusion that for this to really be addressed properly, to really reduce the burden on taxpayers, it would take a legislative change to do that. That is how we got the conclusion. That is an example.

Mr. WESTMORELAND. One final question, Mr. Chairman. I will make it quick. And this is to all of you. What brings about a rule or regulation change? Does somebody in your office just think of it? Does it come from suggestions? Does it come from a legislative ac-

tion? And I guess it could do all of the above. If it comes from legislative action, is there any consultation with the legislative branch to find out exactly what the legislative intent of the law was versus what some person in your office may think it should be? And I know that is a multipart question. But I would love to hear from each one of you about it.

Ms. DUDLEY. I will start with a quick answer. I think it does come from all three. I would say in order or frequency, it would be legislative change, discussions with the public. And that is largely through the nomination process that OMB has conducted and the r3 process that Office of Advocacy is doing. And then I would say a distant third would be initiatives from within our offices.

Mr. WESTMORELAND. Do you check to see what the real legislative intent was from the legislator or from the Committee, from which it came before you start enacting rules?

Ms. DUDLEY. The agencies that are given the authority from Congress, they would take the lead on that. So our role is to review theirs. So I am not sure of the extent to which that is done. I assume it is done but I don't know.

Mr. SULLIVAN. Congressman Westmoreland, I also agree with Susan Dudley that changes to regulation do come from all three places, legislative agency activity and from small businesses and their association representations here in Washington, D.C.

But I believe and it has been my experience as the chief counsel that the more agencies rely on small businesses to help them get it right, the better off they are. I see time and time again when a small business owner who is also the plant manager, who is also the accountant, who is also the H.R. manager, when they sit down with OSHA, when they sit down with Department of Labor, when they sit down with EPA and say, you know you may have gotten this proposal wrong, here is how I would do it. The discussion that is not adversarial at that point makes remarkable changes to the outcome. And I will give you one example of how a regulatory change does happen.

Bill Farren was a small business owner, very successful gas station owner from Pine Bluff, Arkansas, and in the 1980s he got very upset that he had to fill out a Federal form that told his local fire chief that he had gas on the premises.

Now because Mr. Farren was so aggravated by this, he decided to tell his Members of Congress, he told my predecessor, he told the Chair and ranking members of the Small Business Committee, he told the head of the Environmental Protection Agency, Carol Browner, that this rule should be done away with. And because of the tenacity of that small business owner, the rule was eventually changed and done away with. And many times, Congressman Westmoreland, that is what it takes.

Mr. WESTMORELAND. Sure.

Mr. WAGNER. I am not the expert to speak on this for the IRS. Our Chief Counsel is the one who really should be talking about this. But I would say that we definitely do get recommendations from all three areas that you just talked about.

Mr. WAGNER. But also, we do look at the legislative intent. As a matter of fact, that is one of the discussions we had about this particular issue for the office in the home deduction. We came to

the conclusion it would take legislation to correct this. We looked at the legislative intent of Congress when they created the exception in 280A. And that is how we came to that conclusion. That is definitely something we consider in our regulations.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

Mr. GONZALEZ. Thank you very much, Mr. Westmoreland. And just one last observation. And that is, I think, Mr. Wagner, when you pointed out that on the home office deduction, that half of the time people get it wrong or something. If that is not a huge red flag. I mean, you can understand people's reluctance. And in my discussion with a dear friend of mine, who is actually a tax court judge, he was explaining to me about exclusive use, the very restrictive standard and how people get tripped up. You know, did you ever, you know, do anything on that computer or that television for one second? Did you watch ESPN for 5 minutes? And boom, you are in trouble.

I think there are some—and I know there is going to be a disagreement whether we can do it through regulation or a legislative act, we need to be providing that. I mean, with the Internet out there, we are really talking about micro-businesses now. Small businesses we understand, but within that definition are just thousands and thousands of micro-businesses. And which lends itself, obviously, to operating out of someone's home. We have to accommodate at that or else we shouldn't have that deduction. But I think it is a fair deduction for, again, proper use, when properly used.

But I want to thank all three witnesses. And at this time you are dismissed. And hopefully, we will see you again. And thank each of you for your service, and we will go ahead and set up for the next panel. We are going to resume the hearing. And I am going to make an assumption, Mr. Sullivan is here, and I realize the other witnesses may not be able to—from the previous panel, because of scheduling, may not be able to stay and listen to the testimony. I assure the witnesses of the second panel we have representatives from those agencies.

So your testimony is very important not just for the information you provide members of the committee, but also those very agencies that we have been discussing and their actions. Again, I will be introducing the witnesses right before they testify. Instructions to the witnesses again, green light means you have the 5 minutes. When the yellow light comes on, that is 1 minute. And then red, that is the end of your 5 minutes. But please understand your full statements are made part of the record. And further, we will have time for questions and answers.

PANEL II - PARTICIPANTS IN ORDER ARE: MR. PAUL RENKER, PRINCIPAL, RENKER EICH PARKS ARCHITECTS, ON BEHALF OF THE AMERICAN INSTITUTE OF ARCHITECTS; MR. PETE VAN DE PUTTE, DIXIE FLAG MANUFACTURING COMPANY, ON BEHALF OF THE NATIONAL FEDERATION OF INDEPENDENT BUSINESS; MR. SCOTT SCRIBNER, PLANO, TEXAS, ON BEHALF OF THE NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED; AND MR. LON SANTIS, MANAGER TECHNICAL SERVICES, INSTITUTE OF MAKERS OF EXPLOSIVES

Chairman GONZALEZ. And again, just like the other witnesses, you may be able to elaborate on some of the information you wish to provide us. The first witness is Mr. Paul Renker. Mr. Paul Renker is the principal of Renker Eich Parks Architects in St. Petersburg, Florida. His firm specializes in educational facilities and historic restoration. Mr. Renker is testifying on behalf of the American Institute of Architects. Founded in 1857, AIA is the leading association for licensed architects, with more than 83,000 members. Welcome, Mr. Renker.

STATEMENT OF PAUL RENKER

Mr. RENKER. Good morning, Mr. Chairman and Ranking Member Westmoreland and members of the Subcommittee. I am Paul Renker. I am an architect, small business owner, and a member of the American Institute of Architects. Thank you for inviting me to discuss the Federal procurement regulation that has been identified under the SBA's r3 initiative as being burdensome on small businesses that contract with the Federal Government. Commonly referred to as the retainage clause, the Federal Acquisition Regulation rule for fixed-price architectural-engineering services allows Federal agencies to impose a 10 percent withholding, or retainage, on fees. This 10 percent can be hell until the full construction of a project.

This retainage clause presents an unnecessary burden to nearly 230,000 small A/E firms who contract with the Federal Government. It is a strong deterrent for small firms for three reasons. First, 10 percent is higher than the amount withheld under many other types of service contracts. For small design firms with a very small profit margin, having 10 percent of their fee held back for what could be years greatly restricts their cash flow.

Secondly, A/E firms typically complete the major portion of their work in the design phase, long before construction is complete. This leaves design firms short of 10 percent of the payment amount for a substantial period of time. The result, as the chairman of the American Council of Engineering Companies Small Firms Council recently said, is an interest free loan to the Federal agencies at the small firms' expense.

Third, a 10 percent retainage requirement is not necessary in order to protect the taxpayers. There are common methods of determining whether performance of A/E services has been satisfactory long before payment of services or completion of construction. Furthermore, the withholding is counter to the Brooks Act, which establishes the qualifications-based selection process, or QBS, for A/E firms.

QBS ensures that only the most competent and capable firms, those with a proven track record of good performance, are selected for design contracts with Federal agencies, even before they negotiate potential fees. I would like to take a few moments to relate our firm's first experience with a Federal project. Through the QBS process, our firm was chosen and awarded a contract to design a new Job Corps Center for the Department of Labor in St. Petersburg, Florida.

This was a small business award, and we are very happy and proud to be selected. We started fee negotiations in June of 2006. We received our first payment for services approximately 220 days from the start of fee negotiations. I mention this because our firm, as a small business, has to staff and plan for large projects such as this. This resulted in our firm incurring costs and expenses for salaries and overhead for 220 days without compensation. We were forced to borrow money to maintain our salaries and expenses. When compensation was received, 10 percent was withheld, further impacting our cash flow. We understand that the intent of the 10 percent retainage is to protect the interests of the government and the taxpayers and to help ensure they receive services equal to or greater for what they paid.

However, this is already addressed under the system in which architects and engineers provide services. The Department of Labor contract we signed includes a handbook and detailed description of services and deliverables required for payment. We are required to submit progress documentation of our work at four key milestones. In each case, professionals hired by the Department of Labor review our work in great detail for compliance with submittal requirements, as well as the design program intent. Only after our submittal is reviewed and approved is our invoice for services accepted and processed for payment.

The 10 percent retainage of our fees was held in increasing amounts over the entire period of our design services. It should be noted that 10 percent is not retained from the contractor's pay requests during construction. We were told we could write a letter requesting the Department of Labor release our retainage for design services. We received our 10 percent retainage approximately 500 days after our contract notice to proceed. As the Small Business Committee is dedicated to opening the Federal marketplace to small businesses, we strongly encourage it to support eliminating the retainage. This will ensure that small A/E firms are able to design the buildings that represent the Federal Government without placing their solvency in jeopardy.

Thank you, Mr. Chairman, and members of the subcommittee for giving me the opportunity to testify today. I would be pleased to answer any questions you may have.

Chairman GONZALEZ. Thank you very much, Mr. Renker.

[The statement of Mr. Renker can be found in the appendix at page 77.]

Chairman GONZALEZ. The next witness is Mr. Pete Van De Putte. Mr. Pete Van De Putte is President and CEO of the Dixie Flag Manufacturing Company in San Antonio, Texas. I have known Pete and his family for a number of years. He is my constituent. And he will be voting on November 4th. I have no idea, and I don't

want to influence at this time. He currently serves on the NFIB Texas Leadership Council. Mr. Van De Putte is here to testify on behalf of NFIB. Founded in 1943, NFIB represents small businesses in Washington and in all 50 State capitals. And I do want to point out that Mr. Van De Putte is married to my wonderful state senator, Leticia Van De Putte. Welcome, Pete.

STATEMENT OF PETE VAN DE PUTTE

Mr. VAN DE PUTTE. Good morning, Chairman Gonzalez, Ranking Member Westmoreland. I am Pete Van De Putte from San Antonio, and I really appreciate the opportunity to be here today. As a member of the NFIB since 1980, I am pleased to offer my testimony. My business, Dixie Flag Manufacturing Company, is a small family business in San Antonio. This year we are proud to be celebrating our 50th year in business. In that 50 years, we have had the privilege to provide jobs to some terrific men and women, and to be the first employment experience for a number of our employees' children.

I come here today not only representing small business owners, but the millions of people who depend on small businesses for their livelihood. At the outset, I want to commend the committee for holding this hearing on the Office of Advocacy's Regulatory, Review and Reform Initiative, or r3, an effort to identify outdated and ineffective Federal regulations. The complexities of Federal regulations are especially onerous to small businesses, so I appreciate the committee's interests in addressing this important topic. NFIB's national membership spans a wide range of small business operations, from one-person enterprises to firms with hundreds of employees.

While there is no one definition of small business, all NFIB members have one thing in common: Their businesses are independently owned. Clearly, we are talking about the truly small businesses in America, businesses whose priorities and abilities to handle regulatory challenges are greatly different from their larger counterparts. Earlier this year, the SBA Office of Advocacy released the 2008 top 10 rules for review and reform. The r3 program strikes right at the heart of one of the major burdens facing America's small business, the cumulative Federal regulatory burden.

Being a small business owner means more times than not you are responsible for everything from ordering inventory to cleaning the toilets and hiring employees to dealing with mandates imposed by Federal, State, and local governments. That is why government regulations and the paperwork they generate should be as simple as possible. The less time a small business spends with government overhead, the more they can spend improving their business, employing more people, and growing the American economy. Unreasonable government regulation, especially paperwork burdens, continues to be a top concern for small business owners like me.

Regulatory costs per employees are the highest for small firms, and our members consistently rank those costs as one of their most important issues. The r3 program plays an important role in regulatory reform, urging agencies to write regulations that are easy to read and understand, and to review the impact each regulation has

on small business. For its part, Congress plays an important oversight role by looking at both new Federal regulations and changing those already on the books.

To keep up with the changing environment, regular evaluation is imperative to find outdated, ineffective, and onerous regulations. With respect to the specific recommendations of the r3 program, one particular provision of particular interest to NFIB members is the standard home office deduction. This issue is of particular interest to me, because my parents started Dixie Flag Manufacturing Company in my bedroom in 1958. Dixie Flag now employs 45 people, but then it was just my dad, my mom, and my grandmother. While the rate of new home-based businesses continues to grow, the existing home office deduction remains burdensome and complicated. It requires a small business owner to determine how much of their house is used for business, and to keep detailed records that substantiate that deduction.

The complicated recordkeeping now required by the IRS to qualify for a home office deduction is a barrier to many who would qualify, but do not have the time and the staff to do the paperwork. That barrier would be removed if a standard deduction for home-based businesses was allowed. NFIB members believe that small home-based businesses should have the option of either a standard home office deduction or using the current system. The standard deduction would allow business owners to claim a deduction he or she is entitled to, reduce the filing burden, and ultimately improve tax compliance.

In conclusion, I appreciate the opportunity to comment on the r3 program and the impact of Federal regulations on small businesses. Along with the other small, independent business owners who make up the membership of the NFIB, I hope that Congress will continue to take significant steps to reduce this burden, and that Federal agencies will adopt the r3 recommendations suggested by SBA's Office of Advocacy. Thank you again for the opportunity to testify. I look forward to answering any questions you might have.

Chairman GONZALEZ. Thank you very much, Mr. Van de Putte.

[The statement of Mr. Van de Putte can be found in the appendix at page 86.]

Chairman GONZALEZ. Our next witness is Mr. Scott Scribner. Mr. Scribner is a realtor from Plano, Texas. He is currently affiliated with Keller Williams Realty. Mr. Scribner is here to testify on behalf of the National Association for the Self-Employed. The NASE represents hundreds of thousands of entrepreneurs and micro-businesses, and it is the largest nonprofit, nonpartisan association of its kind in the United States. And welcome, Mr. Scribner.

STATEMENT OF SCOTT SCRIBNER

Mr. SCRIBNER. Thank you. Chairman Gonzalez, Ranking Member Westmoreland, and members of the subcommittee, I would like to thank you for giving me a chance to speak to you this morning. I applaud the time and energy you spend helping small businesses around the country. Your efforts are appreciated. My name is Scott Scribner, and I have been a member of the National Association for

the Self-Employed for a number of years. Along with my wife Barbara, I own a real estate sales business in Plano, Texas. We have operated the business, primarily from home, for almost 14 years. Before that, I was a commercial banker and president of a small East Texas bank. Our business currently has one full-time employee, but we plan to expand our team in the near future.

My purpose today is to comment on the IRS home office deduction. Since we run the business from our home, we are allowed to deduct expenses related to our home office. The problem we face is the time and complexity in figuring the deduction. And I know that we are not alone. I have talked with many of my peers about this issue, and most everyone agrees either they don't understand the deduction or are afraid that if they take it they increase their chances of an audit.

By way of illustration, this is the home office deduction form 8829. It is only one page, and it looks simple enough until you actually read it. There are 43 line items required just to complete the form. Most of the information needed requires time-consuming effort to complete. For example, line 30 says carryover of casualty losses, while line 32 says allowable excess casualty losses. So I have to know the difference between carryover, excess, and allowable. And I am not even sure I have any casualty losses. There is more, but I think you get the point. I am told on the form 14 different times to see instructions.

Now my wife would be shocked to hear this, but even I read instructions occasionally. And believe me, there are plenty of instructions for the home office deduction. In fact, these are the instructions, all 31 pages worth. So it seems to me that I face a choice. One, spend hundreds of dollars and lost time collecting data, reading 31 pages of instructions and completing the form; two, pay a CPA hundreds of dollars to do it for me; or three, forego the deduction altogether. In my case, I wanted to make sure that my CPA had a great vacation in Hawaii last year, so I chose option two.

Unfortunately, the majority of my fellow self-employed business owners prepare their taxes without professional help. Thus, the time burden and complexity of the home office deduction causes many of them to choose option three and not utilize this tax benefit at all. Like most business owners, I would rather be providing good service to my clients, growing my business, and creating new jobs, not spending time trying to comprehend tax forms and instructions. On the other hand, it seems unfair not to deduct home office expenses. It seems to me there should be a better way. Small business should have a choice. If time and resources allow, let home-based businesses take the traditional deduction, or, if they prefer, how about a standard home office deduction. This provides a way for small business owners to take the home office deduction without negatively impacting their business.

For me, I would choose to take the standard deduction and then get back to work in my business. I am sure many other people feel the same way. The NASE is supporting the Home Office Deduction Simplification Act, H.R. 6214, which would provide a $1,500 standard deduction option for home-based businesses. In addition, House Small Business Committee Chairwoman Velazquez is preparing

legislation that would also include a standard home office deduction.

I encourage Congress to support these bills and help the 52 percent of small businesses who work from their home. Again, I appreciate the chance to be here and to speak about this important topic. Thank you for the passion and energy you put into helping small businesses.

Chairman GONZALEZ. Thank you very much, Mr. Scribner.

[The statement of Mr. Scribner can be found in the appendix at page 90.]

Chairman GONZALEZ. And our next witness, and I hope I get this last name right, is Lon D. Santis. Is that correct? Mr. Santis is Manager of Technical Services of the Institute of Makers of Explosives. He interacts with Federal agencies on issues involving commercial explosives and oversees IME's safety library. The IME was founded in 1913 to provide accurate information and comprehensive recommendations concerning commercial explosive materials. And welcome, Mr. Santis.

STATEMENT OF LON D. SANTIS

Mr. SANTIS. Thank you, Chairman Gonzalez and Ranking Member Westmoreland, for the opportunity to appear before you today. Your interest in MSHA's regulation of explosives is greatly appreciated. MSHA's explosives regulations are inconsistent with national consensus standards and other agencies' regulations. This exposes miners to undue risk and wastes the resources of mining operators and contractors, the vast majority of whom are small businesses.

87 percent of the United States' commercial explosives are consumed in mines, 65 percent in surface coal mines alone. Yet MSHA's surface coal regulations have never been updated since their inception in 1971. In comparison, the National Fire Protection Association's national consensus standard on explosive safety, NFPA 495, has been updated 10 times since 1971. In the last 10 years, I have been in many meetings and discussions with MSHA officials, labor representatives, and mine operators regarding updating these regulations. Despite universal agreement that the regulations need to be updated, MSHA has not been able to get this done.

For the remainder of my testimony, I will touch on the most significant vulnerabilities and burdens created by MSHA's lack of attention to explosives in recent years. First, many of MSHA's explosives regulations are inconsistent with current best practices. Even MSHA's own regulations for coal and metal/nonmetal mines are inconsistent with each other. For example, the surface coal regulations are inconsistent with nearly every other standard with regard to the fundamental concepts of blast site and blast area. These terms should be crystal clear. The blast site is the immediate area around the explosives, where only authorized personnel and equipment should be present during the loading process. Failure to clear the blast area when a blast occurs causes half of the explosive accidents in mines according to MSHA.

Second, MSHA explosive regulations contain outdated and inappropriate references. The definitions for explosives in their regula-

tions are incredibly flawed. The metal/nonmetal regulations refer to nonexistent sections of the U.S. Department of Transportation's DOT regulatory code for definitions of critical terms like detonator, blasting agent and explosive. Likewise, the surface coal regulations refer to different definitions of these terms than DOT. All of MSHA's regulations still use the explosives classification system, class A, B, and C, that was abandoned by DOT in 1992. The regulations also refer to nonexistent sections of the Bureau of Alcohol, Tobacco, Firearms and Explosives (ATF) regulations. They refer to technical standards for blasting agents that were written in 1963.

Third, MSHA's explosives regulations are a barrier to improved technologies, technologies like electronic detonators. Electronic detonators actually represent the second revolution of initiation technology that was missed by the surface coal regulations. To legally and safely use electronic detonators in mines, manufacturers must get MSHA to exempt their brand name product from the regulations. This is a cumbersome process that can take months even for the next generation of a previously approved system. Such a process disadvantages small businesses from entering the electronic detonator market.

Fourth, MSHA's explosives regulations and policy create security vulnerabilities. Through a memorandum of understanding with the ATF, MSHA agrees to enforce Federal explosives laws in underground mines. MSHA's regulations for underground mines have significant security gaps. And to the best of my knowledge, MSHA is not enforcing more stringent ATF rules like those ensuring that only personnel with ATF background checks have possession of explosives underground.

Finally, and very briefly, MSHA has lost its ability to ensure a safe supply of explosives for the Nation's underground coal miners. Mining coal with explosives has become an exclusive niche for small businesses in the underground coal mine community. This loss adversely affects MSHA's ability to conduct accident investigations, field audit quality control testing, and approvals of new and improved explosives. While I have only been able to scratch the surface of the problems with MSHA's explosives regulations here, my written statement and the Small Business Administration's r3 nomination describe to a greater extent each of the points above.

MSHA's failure to update their regulations creates risk where none need exist, and wastes the resources of small businesses. Thank you for this opportunity, and I look forward to answering your questions.

Chairman GONZALEZ. Thank you very much, Mr. Santis.

[The statement of Mr. Santis can be found in the appendix at page 95:]

Chairman GONZALEZ. You are the beneficiary of that initiative, obviously, by Mr. Sullivan. It gave you a vehicle in which to voice those concerns. Mr. Renker, I am going to start off with the questions, obviously, in the order of the witnesses as you all testified. Why the difference on the retainage? And I will tell you now my Association of Building Contractors always complain about, you know, the 5 percent and such. I can only imagine if it was 10 percent. But they are a pretty vocal group. What is the reason for the difference, doubling it?

Mr. RENKER. I wish I knew. I have been an architect for 34 years, and this is the first contract I have ever had retainage on my fees. In every other case we present a product, that product is reviewed and approved, and then we invoice for our services. So, you know, to have a 10 percent retainage was a big surprise to me.

Chairman GONZALEZ. And I am sure it has been asked, I am sure there is an answer out there. What we will do is we will pose the question for you and see if we get a response. Now you would be surprised, we are Members of Congress, right, Mr. Westmoreland, but many times it is the old thing about, you know, they don't wait you out, they will wear you out. So we are familiar with some of that, but we will try to get that response. I just was wondering why the difference. I do want to talk to you about something you may not have touched on completely, and that is the reverse auction, and the fact that it might conflict with the qualifications-based selection process. Can you give me some information from your perspective?

Mr. RENKER. Well, from my perspective, architects and engineers are selected on the QBS system, where we submit our qualifications and the agencies review in depth our qualifications as past performance and select us on the basis of who they feel can do the best job. And at that point we negotiate our fees. The reverse auction process is contrary to that Brooks Act in that they are asking for fees up front, I understand, and then they post them, and whoever is the last one to, you know, the one who is willing to go the lowest, I guess, gets the contract. But I honestly am not personally familiar completely with the reverse auction system.

Chairman GONZALEZ. I think that bears looking into. You know, at what cost? I understand the motivation on a reverse auction. It kind of makes sense in the most simplest of concepts. But in practice, you may not end up accomplishing what you really want to accomplish. There is a lot more than everybody racing to see who is the lowest bidder on this thing.

Mr. RENKER. From an architect/engineer's standpoint, where we provide services that involve health, safety, and welfare of individuals, going on—and I think that is the reason for the QBS system—going on the low price and trying to remove services on that basis just doesn't seem wise.

Chairman GONZALEZ. I sure do thank you, Mr. Renker. Mr. Van De Putte, I know you are going to be in total agreement with Mr. Scribner here regarding the home office deduction and what that means. And I think we have legislation out there that is addressing it. We may have some other legislation that may be spearheaded by the Chair of this full committee, which is, of course, Nydia Velazquez, to whom I referred earlier, and I can tell you you don't have a stronger advocate for small businesses than Chairwoman Velazquez.

And so that is a good sign. And I am hoping that we are going to be able to do something, especially with the tremendous support that we have from Mr. Sullivan's office. Can you think of any other regulation that impacts you that you would say, well, this is on my mind, I think there is ways of streamlining it? And what is the best vehicle for you to make your opinion known as to what is detri-

mental to you in the operation of your business that is not truly necessary in any regulatory scheme?

Mr. VAN DE PUTTE. Yeah, I think there is probably more than we would have time to talk about. I think one of the things that I have come upon, it seems that when you are looking at Federal wage and hour, when you look under the reality of how business operates today and what goes on, their definitions of what is exempt employee, nonexempt employee I don't think necessarily reflects reality.

I once had a run-in with them where I had five employees doing the same thing, and they said because one of those employees had a degree they were a professional, the other four weren't. Which doesn't make an awful lot of sense to me under all sorts of concepts of fairness and equal pay and equal this and that. The fact that the Federal Government would discriminate against somebody because they did or didn't have a degree was surprise to me. But I was told that is the way the regulations run.

And I think that would be one area where the rules are very complicated. And when you are a business owner trying to do things right, and trying to be careful when you are employing people, and you are being fair, again, as a small business owner, when every time I want to do something, the first call I have to make is to the attorney, my attorney, to interpret this rule, and of course, as soon as they pick up the phone the meter starts running. And as small businesses, we don't have staff attorneys. We don't have staff accountants. We have to go out into the marketplace and pay retail.

Chairman GONZALEZ. And again, thank you very much. Mr. Scribner, you have come out with basically, and I wanted to make sure that I touched on this, because we have been able to identify, obviously, problem areas that have come up to the forefront, again, because of what Mr. Sullivan was able to initiate in his own office. The big thing is this thing about this home office deduction. And like I said, just in my over-dinner discussion with a tax judge, he seemed to agree. I mean, you are truly at risk. So we have legislation out there. And I can ask Mr. Van De Putte, too, and I think you also agree in your testimony, Pete, that maybe it would just be a standard deduction. Maybe cut through all this. And if you are audited you are audited, I mean, there is not much anybody can do about things like that. But nevertheless, rather than the strictness of it, that just basically disallows you.

Mr. SCRIBNER. Mr. Chairman, I can speak for myself. I am in a very, what I call a perpetual business, constantly in motion with buyers and sellers and contracts and accounting and legal aspects. And the biggest challenge that I face as a small business person is the ability to try to hold it all together, so to speak. In other words, to have the time to address all of the issues and concerns I need to address to run my business. And that, I think, is the big issue and would be the advantage of the standardized home office deduction. It just is very unwieldy and very time-consuming for me as a small business person to keep up with tracking the various home office expenses and trying to understand those rules. So I think that is the perfect advantage of the standard home office deduction.

And I think that—it is my understanding that 27 percent—only 27 percent of small businesses actually take the deduction. And I think that is because of, you know, a few of the things that I addressed in my comments, the fears that they have about IRS audit and just the overall complication and the time involved in taking the deduction.

Chairman GONZALEZ. The other thing that may not be related to today's hearing, but I wanted to touch on it quickly because of your own background, before you were with Keller Williams, you said you were—was it with a community bank?

Mr. SCRIBNER. Yes, I was in commercial banking for 12 years. I was the CEO of a small East Texas bank.

Chairman GONZALEZ. Because Mr. Westmoreland and I, for a future hearing, we were considering actually bringing in our independent community bankers and seeing what is going on out there in the credit markets, the impact of the regulatory scheme. Because first and foremost, we always think that they truly represent the access to capital within the community.

So again your own experience, we may draw on that, we may call you back and just—there is a reason that you are in real estate today, and I am not saying that you weren't happy as a banker.

Mr. SCRIBNER. I welcome the opportunity.

Chairman GONZALEZ. Mr. Santis, it is very interesting, because you are talking about, obviously, an activity that is very specific to different areas of the country when we are talking about the explosives, the use of them and such. And it is amazing, though, that you pointed out that you haven't had any real updates on regulations and such for a period in excess of 30 years. And technology does move forward. Practices, best practices change and such. What would be the reason for this inactivity? It seems like—and I know there is always staffing. There is always budgetary constraints and such.

But why haven't we moved forward? And the reason for that is that, you know, I believe in regulation. I think we all understand for safety reasons and leveling playing field and all that and standards, reasonable, effective regulation. And these are outdated that we are talking about, these are burdensome, onerous and such. But why do you believe you would have in your particular field such neglect over such an extended period of time?

Mr. SANTIS. Well, I think only MSHA could really give you a full answer. My opinion is that in some respects, we are a victim of our own success in the explosives industry. We have improved technology and products immensely over the years. And explosives accidents are a fairly rare occurrence in mining. But I think as recent experience in mining has shown us, we can go a long period of time without accidents and fatalities, and then suffer mine inundations, mine explosions, massive failures of the mine roof, and then scramble about with how are we going to deal now with this problem that has been thrust in front of us.

And I feel that the explosives area is another potential catastrophe waiting to happen. And the Agency just doesn't seem to recognize that. I think that the Agency may not have as much technical expertise in house to comprehend the problems. And hope-

fully, the r3 initiative will provide some impetus for the Agency to address this critical issue.

Chairman GONZALEZ. Because as Mr. Sullivan pointed out, the follow through with r3, of course, is the response from that particular agency or department. And then looking at it. Again, it is the credibility and legitimacy of the response. Again, thank all the witnesses, and at this time I am going to recognize the ranking member for his questions.

Mr. WESTMORELAND. Thank you, Mr. Chairman. This is a target rich environment. Mr. Renker, talk about the 10 percent retainage. You know, the P word up here sometimes to some people is a bad word. And that would be profit. With the 10 percent retainage, it almost causes not so much of a competitiveness with bidding because when you are bidding and you understand that they are going to have a 10 percent retainage, and I know in a lot of jobs that I have had people that I know that bid, you know, they make three, four, five percent on some of these government contracts. And having a 10 percent retainage, as you spoke before, you know, just kind of—it really hurts your cash flow. And really and truly, it really keeps some people in small businesses from being able to bid on some of these Federal contracts that they would like to bid on, but they cannot suffer that kind of cash flow shortage. Would you say that is a true statement?

Mr. RENKER. Yes, sir.

Mr. WESTMORELAND. Are you aware that I believe starting in 2011, there is going to be an additional 3 percent retainage on Federal contracts?

Mr. RENKER. No, sir, I am not aware of that.

Mr. WESTMORELAND. There is going to be an additional 3 percent withholding for your Federal taxes that will be done on Federal contracts. And so we are only complicating our situation by this. There is several people in the House, I believe Mr. Meek, Mr. Kendrick Meek and myself and others are on a bill to repeal that, to make that not go into effect. And I would hope that the chairman, at some point in time, when we are looking at some regulations, we can look at what that will really do to the cost of how the Federal Government does business.

Also having dealt with architects for a long time, typically on a retainage issue, my experience has been, especially on a government contract, that you cannot get your draw until the architect has actually gone out and inspected and made sure that what he had intended to go in place had actually gone in place, and that the right materials, grades, and so forth were put into place. Is that typically your experience?

Mr. RENKER. Yes, to some degree. In a sense as architects we are not providing the construction product. We provide the design product. And in each case, the Agency that we work for reviews our product, and in great depth and in detail, and only after they review and approve our product, then we are allowed to invoice. And usually with the Federal Government they have been good, once they accept our invoice, they pay us electronically in 30 days. But it is getting that invoice accepted and doing all the work that creates the time lag for us.

Mr. WESTMORELAND. Sure. That is kind of like Mr. Scribner had the instructions for the home deduction.

Mr. RENKER. Yes.

Mr. WESTMORELAND. Mr. Van De Putte, I know Mr. Santis handling explosives is probably under tremendous government regulations. You are in the flag business. How many regulations do you find that are on a flag business? And I am assuming that you make flags. And what type of regulations do you have that causes you the most trouble other than the home deduction?

Mr. VAN DE PUTTE. Well, because we purposely don't use chemicals, we are a sewing operation, we have actually kind of constructed our business so we are not having to deal with some of this. Because the people that I know that are in the business of doing printing, for example, have got all sorts of these EPA hoops they have got to jump through to make that happen.

In our case, it is just the normal course of a business doing business. It is dealing with OSHA and dealing with EPA. Even though we don't use any chemicals, we still have to spend time filling out forms to report the fact that we don't use any chemicals. And wage and hour and IRS. It is just the cumulative burden of everything. I have got one of my highest paid people on my staff spends most of his time dealing with not how to make my business run better, but how to make sure that we are filling out all the forms and doing all of the reporting to the Federal Government just in the normal course of doing business. Whereas the smartest financial guy I have got in my building, if I could turn him loose on helping me to be a more successful business in making and selling flags, we would be a more successful business. But I go in and talk to him about that and he is busy because he has a form he has got to turn in.

Mr. WESTMORELAND. So what you are saying is basically out of fear of more regulations, you haven't expanded your business into some other areas—

Mr. VAN DE PUTTE. Absolutely.

Mr. WESTMORELAND. —that might require you to do chemicals and so forth?

Mr. VAN DE PUTTE. Absolutely.

Mr. WESTMORELAND. And that is pitiful. But the other thing is I notice you have 45 employees.

Mr. VAN DE PUTTE. Uh-huh.

Mr. WESTMORELAND. Don't get to 50.

Mr. VAN DE PUTTE. I am actively working not to.

Mr. WESTMORELAND. If you get to 50 you are going to be under that Family Medical Leave Act, and you are going to have start keeping up with the minutes that your employees take off. So that is a shame that we limit you, because it sounds like starting with your grandmother that business has been very successful. And you certainly have the opportunity to employ more people in San Antonio, Texas, but unfortunately, because of your fear of the regulations and stuff, you are just not going to expand that business. So my apologies to you that we have that kind of effect. Mr. Scribner, you are way too common sense. But Mr. Chairman, I would like unanimous consent that Mr. Scribner be able to submit that IRS form and those 37 pages of instruction—

Chairman GONZALEZ. Without objection.

Mr. WESTMORELAND. —into the record, if you wouldn't mind doing that, because I would like a copy of it. I think I can use that at some later time.

[The information can be found in the appendix at pages 101 and 102.]

Mr. WESTMORELAND. So thank you for coming and for testifying and for standing up for all the self-employed people. Because I think it is in all of us that we all want to be entrepreneurs and want to be self-employed. But one other question I wanted to ask you, you talked about your banking experience and being with a small community bank. And as I go back and look at regulations that this body has passed with unintended consequences, I think Sarbanes-Oxley is one of those unintended consequences about the amount of money that it has cost small banks that are owned by community stockholders that are already audited by the State banking agencies and Federal banking agencies, and yet they have to pay for a third independent completely outside audit.

Mr. SCRIBNER. I think that is exactly right. As a matter of fact, both from my banking perspective and even as a realtor, I see the effects of some of the concerns with a regulation like Sarbanes-Oxley in terms of the requirement to actually have people on staff just to deal with regulations, which again, I think, takes away from the intent of the business, and that is to have as much profit as they possibly can, creating jobs, and stimulating the economy. And having been a banker, it is interesting, my perspective is I was a banker for a long time, and so I saw a lot of small business clients, but it is interesting when you change hats and all of a sudden instead of being the guy giving the money you are the guy trying to make the money. And all of the challenges with respect to additional regulation are hard for a small business person to keep up with.

Mr. WESTMORELAND. Sure. Absolutely. I am looking forward to that hearing that we are going to have on the small banking and small business and how banking affects their business. But thank you for being here.

Mr. SCRIBNER. Thank you.

Mr. WESTMORELAND. Mr. Santis, I know that since I have been in Congress, we have had several terrible accidents that has involved mining and explosions and other things. And sometimes Congress tends to have a knee-jerk reaction rather than sitting down and looking at facts and details and talking to the people that are involved in the business. Do you know of anybody that handles explosives that aren't careful?

Mr. SANTIS. Unfortunately, yes. Aside from accidents that are caused by flying material when the button is pushed, the second most frequent cause of accidents is misuse of the product, someone doing something—

Mr. WESTMORELAND. Would education solve that or more regulation?

Mr. SANTIS. Education helps. But education only reaches a small proportion of our community. The ones that attend seminars and get training are probably not the ones making mistakes. What we see, and especially in the small business community, is that they

rely on the regulation as the ceiling of performance. And that is where they feel they need to operate. So they reach that level and they feel that they are good. Unfortunately, this is not good enough.

Mr. WESTMORELAND. Well, I understand, but I thought you mentioned that the regulations didn't really conform with your best practices of handling explosives.

Mr. SANTIS. That is true. That is true. And fortunately, the vast majority of people in mining operate above the level set by the regulations, demanded by the mine operators, the suppliers of the products and the employees themselves, because there is a considerable self-preservation interest.

Mr. WESTMORELAND. So you are thinking there needs to be more regulation on the mining industry?

Mr. SANTIS. We think the regulations need to be consistent, not necessarily more. The problem comes about through inconsistency and confusion and wasting of resources. Citations for things that are simply not an issue. Those should go away. Those issues, regulations that were written for the use of black powder, for example, which is something we don't do today. They are still on the books.

Mr. WESTMORELAND. I am kind of confused about your statement that education doesn't get to everybody. I am assuming you are saying that regulations do?

Mr. SANTIS. Well, yes.

Mr. WESTMORELAND. And the regulations aren't up to the best practices, so I am confused. If they are not up to the best practices and your people don't get education, then how do they know what the regulations are?

Mr. SANTIS. Oh, the MSHA enforces the regulation. They are aware of what the regulation is. MSHA has training requirements, for example, that the employees must be trained on the regulation. We think that there needs to be consistency in the regulation, which would elevate the level of safety in those operations that operate right at that ceiling.

Mr. WESTMORELAND. And when you say consistency in the regulations, are you talking about the different types of explosive businesses, or what are you talking about consistency?

Mr. SANTIS. Practices. I am talking about practices, differences in practices. For example, a small blasting contractor may blast in a construction site one day, a quarry the next, and a coal mine the next. All three of those performance regulations would be different. And he must adjust his practices and procedures at each one of those sites. And that is a very difficult process. As you pointed out, we are regulated by up to 3,000 entities. And consistency is paramount.

Mr. WESTMORELAND. Yes. So what you are saying is the inconsistency could bring about confusion?

Mr. SANTIS. That is right.

Mr. WESTMORELAND. And more area for something to happen.

Mr. SANTIS. Right. And leaves gaps. When you let something sit since '71, gaps develop.

Mr. WESTMORELAND. Well, Mr. Chairman, that is all the questions I have. I want to thank you for doing this. I look forward to us having some more of these. And as most small businesses, we

are result-oriented. And hopefully, these hearings will have a result.

Chairman GONZALEZ. Well, the follow through is important. Thank you for your participation, as always, Mr. Westmoreland. We are not going to have a regulation-free environment. I think we all understand that. And we probably should not for a lot of the obvious reasons. The importance is the time, the place, the manner of the regulation that doesn't impede, is not a detriment to our citizens. And that is the goal that we all share, whether they be Republican, Democrat, whatever. But we have some really good people that are really invested in this particular endeavor, and we are going to need your help.

So I would like to end the hearing with giving each of the members of the last panel one minute to tell us anything that you think we haven't heard, or that you believe we should walk away with as maybe this one very important message. What would you like us to do? Anything that is on your mind. You have got one minute. And we will start with Mr. Renker.

Mr. RENKER. Okay. I, certainly in my testimony, I mentioned a period of time during negotiations with the government with regard to our fees. Again, we are selected on qualifications and then we negotiate our fees with the government. If you noticed, it took us over a hundred days, almost 115 days to negotiate our contract with the Federal Government, and 200 hours on my part, which are uncompensated hours. And the negotiation process is extremely onerous, and almost caused me to walk away from the contract, quite frankly. They negotiate hourly rates and overhead as if we were a large company, you know, the Bechtels or whatever.

And you know, when we look at my firm, the person who keeps the books on a day-to-day basis is me. And during negotiations, they asked for accounting information that is just not available. And I had to tell them, look, I am sorry, but you can't get blood from a stone. And it dragged on the negotiations for quite a bit. And it made it very, very difficult even to negotiate the contract.

And I would hope that—and we were talking about this maybe for another year or another time, that we look into how the Federal Government negotiates with a small business versus a large business, and maybe make some allowances for that. Thank you very much.

Chairman GONZALEZ. Thank you. Mr. Van De Putte.

Mr. VAN DE PUTTE. I think if there is one thing I would like you to take away, I would like the committee to take away from this is, first of all, something that seems self-evident to us, but doesn't seem to be to the government, is that small business is different from big business.

Small business owners, unless their business happens to be a law office or an accounting office, are usually not lawyers or accountants. They are bakers or they are mechanics or flag makers or they are crafts people who have a passion for what they do and they want to do it and be able to turn that into the ability to make a living and be an entrepreneur.

Unfortunately, we live in a world where, yes, you need regulation, but it is the onerous and the burdensome, redundant regulations that end up making those crafts people and these people who

are artisans and skilled people who want to use their hands, use their ability to make a living and employ people have to become lawyers and accountants or pay gobs of money to lawyers and accountants just to be able to survive. And I think that is where I would hope that the government would understand big business has an incredible advantage because they have, you know, a lineup of lawyers and accountants and lobbyists and everything that they have got to look out for them that are on salary and they are paying all the time. When a small business has to go to this, again, we are having to go out and pay full retail. And it is a very expensive proposition. And so simple rules that a layman can understand would just go a long way. And maybe not 31 pages of instructions.

Chairman GONZALEZ. Thank you very much. Mr. Scribner.

Mr. SCRIBNER. I would like to echo what Mr. Van De Putte says regarding business size. You know, I think as a business gets larger it affords a greater opportunity for specialization within the organization. Micro-business tends not to have that ability. Give you an example, my Keller Williams office, there are 250-plus agents in my office, so there are 250 small businesses generating revenue, paying expenses, helping their clients. And anything that can be done to support simplifying the regulations on these small business people I think is an advantage. Because I observe every day—again, I am in a very perpetual business. And it is all we can do to keep up. Which, you know, we are happy about that.

We have a good business. But I just see the challenges that my colleagues face every day in trying to keep up with regulations, keep up with all of the processes that need to occur in their business. So I think anything that can be done to simplify regulations and help support small business is going to be an advantage.

Chairman GONZALEZ. Mr. Santis.

Mr. SANTIS. Thank you. I would like to commend the Office of Advocacy for this r3 initiative, because I don't think that without it we would have a prayer in getting MSHA to act on this matter. This is a very solvable problem. And one of the things that Mr. Sullivan mentioned in the nomination and selection process were solvable issues. We are dealing with outdated references that could be dealt with in a direct final rule. There is no controversy there. We are dealing with inconsistency within the Agency itself. Certainly the Agency can harmonize within its own departments.

And finally, we have consensus standards that have been established that—the hard work is done. The standards are out there. They just simply need to be incorporated into the regulation. I would encourage this committee to continue to support the Office of Advocacy. And in fact, I think one of the weaknesses that they suffer from is enforceability. From my understanding, Tom can basically cajole agencies into acting. And I hope that we can be successful here, but certainly a bigger stick would be helpful for Mr. Sullivan, I am sure.

Chairman GONZALEZ. Thank you one and all. And I now ask unanimous consent that members will have 5 days to submit a statement and supporting materials for the record. And without objection, it is so ordered. And this hearing is now adjourned.

[Whereupon, at 12:01 p.m., the subcommittee was adjourned.]

NYDIA M. VELAZQUEZ, New York
Chairwoman

STEVE CHABOT, Ohio
Ranking Member

Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building

Washington, DC 20515–0315

STATEMENT
Of the Honorable Charles A. Gonzalez, Chairman
United States House of Representatives, Committee on Small Business
Subcommittee on Regulations, Health Care and Trade:
"Regulatory Burdens on Small Firms: What Rules need reform?"
Wednesday, July 30, 2008, at 10:00 am

I am very interested in the results of a recent survey of small business owners conducted by Suffolk University and released by American Management Services. The poll found that 63 percent of respondents believe that the federal government is doing nothing to help small businesses. 64 percent believe that the Administration and the SBA, specifically, aren't doing enough for small businesses.

This poll reflects the current, challenging climate, in which many small business owners are struggling just to stay-afloat. The volatile cost of gasoline, the ever-increasing cost for healthcare, and the crumbling housing market are negatively impacting small businesses. Tough times like these highlight the federal government's responsibility to make sure we are not placing undue burdens on the small business community.

Under the best of circumstances, operating a small business is an enormous undertaking. For many entrepreneurs, business begins and ends at their desk, and there are never enough hours in the day. The last thing these men and women need is to be bogged down by excessive paperwork. But, unfortunately, complex federal regulations have already created a time consuming, logistical nightmare for countless small businesses owners.

Many government regulations use one-size-fits-all policies, policies that often fail to account for small business needs. Consequently, small firms end up bearing a disproportionate share of the federal regulatory burden. Despite having tighter profit margins, they are forced to pay more to comply with government rules than their corporate counterparts. This discrepancy is so great, in fact, that small enterprises spend 45 percent more on regulatory compliance than big businesses. That adds up to 2,400 dollars in additional fees, per employee. And when it comes to various other regulations, the differences are greater still.

Some of these rules can cost small businesses as much as 364 percent more to comply. One specific regulation--tax reporting-- is 67 percent more expensive. In other words, we are forcing small businesses with limited capital to pay more than big businesses with deep pockets.

In an attempt to address this inequity, Congress passed the Regulatory Flexibility Act, or RegFlex, in 1980. RegFlex requires government agencies to consider the effects of their policies on small businesses. But after nearly three decades, it has fallen short of accomplishing its original goal. This is because RegFlex tends to be inconsistent in its application. For example, there is no uniform method of practicing Section 610, which--if properly employed--would stem the inequities currently facing small firms.

Section 610 requires federal agencies to periodically review rules, and gauge their impact on small businesses. But while it is a good requirement in its design, it has not been applied consistently.

Recognizing RegFlex's shortcomings, this committee has already taken steps to improve the system. Last December, we passed H.R. 4458, which will significantly overhaul the regulatory process. Amongst other provisions, the bill-- introduced by Mr. Ellsworth-- provides important clarification to Section 610.

In that same vein, the Small Businesses Administration launched the Regulatory Review and Reform Initiative, or "r3" last year. This rule promises to improve the RegFlex system by identifying and addressing its ineffective policies. It will also allow entrepreneurs to raise their own concerns and suggest targeted reforms.

R3 has the potential to be an invaluable resource for small firms. It will not only give them a voice in the federal regulation process, but will also address some of their most significant challenges. For example, SBA's Office of Advocacy hopes to use this rule to simplify tax policies for at home businesses. R3 promises to confront this issue, along with other concerns, head on.

As we will discuss today, many federal compliance policies are outdated and unnecessarily complex. Small business owners should not have to put hours of their time towards untangling these regulations. Because as this committee-- and our entrepreneurs-- well know, such time would be better spent on business as usual.

In today's hearing, we will look at the effects of regulatory burdens on small firms. We will also explore potential solutions such as the Small Business Regulatory Improvement Act and the r3 program.

I want to thank all the witnesses in advance for their testimony. The committee is pleased they could join us today and we look forward to their insight on this issue.

U.S. House of Representatives

SMALL BUSINESS COMMITTEE

Subcommittee on Regulation, Health Care and Trade

Wednesday,
July 30, 2008

Opening Statement of Ranking Member Lynn A. Westmoreland

Regulatory Burden on Small Firms: What Rules Need Reforms?

Thank you, Mr. Chairman, for holding this hearing today. I would also like to thank all of the witnesses for their participation.

When I was elected to serve in Congress, I was issued a mandate by my constituents to reduce the impact of the federal government on their daily lives. I am all too aware of the feeling that our own government is working against us. This *us versus them* belief is held in small businesses all across this country and, honestly, I cannot blame anyone for thinking that. Recent government estimates place the cost of complying with federal regulations at $1.1 trillion. That averages out to more than $10,000 per household! We are here today to constructively address what we already know: Excessive federal regulations negatively affect America.

I think Washington has made a few good first steps; however, they have been baby steps. President Bush's executive order directing federal agencies to place more emphasis on the economic impact of regulatory proposals is a good idea. However, I feel that it missed an opportunity by not addressing the loopholes in the Regulatory Flexibility Act. The executive order also stopped short of preventing agencies from using narrow interpretations of Reg-Flex in order to ignore their congressionally-imposed responsibilities.

SBA's Office of Advocacy is to be commended for its proactive approach to reducing this burden on small businesses. The R3 program is another step towards this goal. Involving stakeholders in the process of pinpointing rules that merit review makes good sense. However, the combination of federal agencies' distaste for transparency and the Office of Advocacy's lack of authority to force those agencies to consider reforming unnecessary regulations, creates an environment where very little can be accomplished.

To be clear, I am not waving the white flag at this issue. Everyone in this room has a vested interest in seeing small businesses grow and thrive in a global marketplace. In order for that to happen, we must work to increase American competitiveness by reforming and removing the regulations that restrict growth. This is a top priority for me and our nation's businesses. The question is, is it a priority for Washington?

I welcome these distinguished witnesses, and thank you all for your willingness to testify.

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STATEMENT OF
SUSAN E. DUDLEY
ADMINISTRATOR,
OFFICE OF INFORMATION AND REGULATORY AFFAIRS
BEFORE THE
SUBCOMMITTEE ON REGULATIONS, HEALTHCARE, AND TRADE
OF THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

July 30, 2008

Good morning Chairman Gonzalez, Ranking Member Westmoreland, and distinguished Members of the Subcommittee. I am Susan E. Dudley, Administrator of the Office of Information and Regulatory Affairs (OIRA), in the U.S. Office of Management and Budget (OMB). Thank you for inviting me to testify about analyzing and improving existing small business regulations. I appreciate the opportunity to discuss OIRA's efforts to ensure that the Federal Government takes due account of the impact of regulations on small business, to ensure that Federal Agencies consider cost-effective regulatory alternatives for small business and otherwise comply with the requirements of the Regulatory Flexibility Act, and to ensure that the Government is looking for ways to reform regulations to lower burdens on small business while maintaining important public protections. I am committed to reducing the regulatory and paperwork burdens that America's small businesses confront daily, and I look forward to exploring new approaches to advancing this critically important goal.

Small entrepreneurs are the engine of economic growth in America. Small businesses represent over 99 percent of all employers and provide 60 to 80 percent of new jobs. Yet, research by the Small Business Administration (SBA) Office of Advocacy suggests that small entities disproportionately shoulder regulatory and paperwork burdens. This research indicates that firms with fewer than 20 employees spend 45 percent more per employee than do larger

firms to comply with Federal regulations. OIRA, along with the Office of Advocacy and other Federal regulatory agencies, is working both to minimize unnecessary burdens, and also to help America's small businesses comply with regulatory and reporting requirements.

OIRA and Agency Review of New Regulations

Before discussing OIRA's role in the regulation of small business, I wanted to give you an idea of the staggering number of rules with which businesses must comply. Since OMB began to keep records in 1981, Federal agencies have published over 120,000 final rules in the Federal Register. OMB coordinated interagency review of over 21,000 of these published rules prior to publication. Historically, about 6 percent of the OMB-reviewed rules are considered "major" or "economically significant" rules, primarily because they were estimated to have an economic impact greater than $100 million in any one year.

OMB reviews regulations pursuant to Executive Order 12866, issued by President Clinton in 1993. Executive Order 12866 holds that regulations should be based on an analysis of the costs and benefits of all available alternatives, and that agencies should select from among alternatives the regulatory approach that maximizes net benefits to society, unless otherwise constrained by law. Following this Executive Order, this Administration has developed a principled and transparent regulatory review structure that has achieved results. According to OMB's final 2007 *Report to Congress on the Costs and Benefits of Federal Regulation*, the average yearly cost of the new major regulations issued between 2001 and 2006 is about 47 percent less than over the previous 20 years, and yet the average yearly net benefits of new regulation has increased substantially.

OIRA and Agency Review of Existing Regulation: Solicitations for Regulatory Reform

While we are subjecting new regulations to greater scrutiny, most existing Federal rules have never been systematically evaluated to determine whether they are working as intended and what their actual benefits and costs have been. In practice, it is often difficult to know which regulations are still binding after many years of implementation and adjustment, and which regulations simply represent "sunk costs" for businesses and would no longer benefit from reform. Because of this, OMB decided during President Bush's first term to initiate a program to solicit input from the public as to which existing regulations, guidance documents, and paperwork requirements were most in need of reform. Our February 2004 request for reform nominations[1], with a clear focus on the manufacturing sector of the U.S. economy, was the third such solicitation of reforms undertaken by this Administration[2].

OMB's 2004 manufacturing initiative elicited 189 reform nominations from 46 commenters[3]. OMB evaluated these reform nominations and collaborated with Federal agencies in the development of response plans. OMB also sought evaluations of the recommendations by the Small Business Administration Office of Advocacy and the Department of Commerce's Office of the Assistant Secretary for Manufacturing and Services. In March, 2005, the agencies and OMB determined that 76 of the 189 nominations had potential merit and justified priority consideration and action by the Administration[4]. Actions on these priority reform nominations, which included milestones and deadlines, have ranged from performing a priority investigation

[1] The 2004 solicitation for reform nominations was part of the 2004 draft Report to Congress on the Costs and Benefits of Federal Regulation, which is available at http://www.whitehouse.gov/omb/inforeg/draft_2004_cbreport.pdf

[2] The 2001 and 2002 solicitations for reform nominations were also part of our 2001 and 2002 draft Reports to Congress. More information on all of our reform solicitations, including the 2001 and 2002 reports, and summaries of the public nominations, is available at http://www.whitehouse.gov/omb/inforeg/regpol-reports_congress.html

[3] http://www.whitehouse.gov/omb/inforeg/2004_cb/list_2004cb.html

[4] http://www.whitehouse.gov/omb/inforeg/reports/manufacturing_initiative.pdf

and reporting to OMB in order to determine appropriate next steps, to issuing modernized regulations.

Many of these priority reform candidates were of interest to small entities, and several of them were also included in SBA Advocacy's 2008 Regulatory Review and Reform Initiative (R3) list of "top-10" reforms identified as especially relevant for small business. To date, agencies have completed approximately 70 percent of the 2004 manufacturing reforms, and we plan on providing a comprehensive update on the status of these reforms in the draft 2008 *Report to Congress on the Costs and Benefits of Federal Regulation.*

Small Business Regulatory Reforms

More information on OMB's manufacturing initiative is available at http://www.whitehouse.gov/omb/inforeg/regpol-reports_congress.html, but I would like to illustrate by summarizing three successful small business reforms the Administration has already accomplished, as well as briefly discuss the reform nominations we have in common with the Office of Advocacy.

EPA's National Emission Standards for Hazardous Air Pollutants

In December 2005, EPA issued a final rule[5] permanently exempting certain categories of "non-major" industrial sources that are subject to national emission standards for hazardous air pollutants (NESHAP) from the requirement to obtain an operating permit under title V of the Clean Air Act. The five exempted source categories are dry cleaners, halogenated solvent degreasers, chromium electroplaters, ethylene oxide sterilizers and secondary aluminum smelters. EPA estimated that this final rule will provide regulatory relief for over 38,000 sources, many of which are small businesses.

[5] *Federal Register,* Volume 70, 75319.

EPA's Spill Prevention Control and Countermeasure (SPCC) Requirements Rule

This rule, published in December 2006[6], revised certain requirements in the existing SPCC regulations reducing the regulatory and paperwork burden for smaller facilities that manage or use oil. For example, the revised rules allow these smaller facilities to self-certify their SPCC plan instead of requiring them to use a professional engineer to prepare a SPCC plan for their facility. The rule also modified several other provisions to reduce regulatory burden. EPA estimated that this rule would reduce costs by over $100 million and reduce the associated paperwork burden by roughly 500,000 hours per year. EPA has also proposed further amendments to the SPCC program and expects to complete this rulemaking by the end of the year.

EPA's Toxics Release Inventory (TRI) Burden Reduction Rule

This rule, finalized in December 2006[7], reduces reporting burden on small businesses while still maintaining the practical utility of the TRI data. By raising the release threshold for use of the short Form A from 500 to 2000 pounds, it allows more reporters to use the streamlined form while still retaining full Form R reporting on over 99 percent of releases and other waste management nation wide. In addition, it provides incentives for firms that are slightly above the eligibility threshold to reduce their emissions in order to qualify for the short form.

SBA Advocacy's Regulatory Review and Reform Initiative

As you are no doubt aware, in February of 2008, after significant review and analysis of the 82 nominations received in a public solicitation process similar to the process OMB undertook in 2004, SBA's Chief Counsel for Advocacy selected the top 10 rules for review and potential reform.

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[6] *Federal Register*, Volume 71, 77266.
[7] *Federal Register*, Volume 71, 76932.

In particular, four of the reforms are similar to nominations we received in 2004 and previous reform nomination cycles. Note that Advocacy's approach to these reforms is also similar to OMB's manufacturing reform initiative in that they are not intended to short-circuit the normal notice and comment rulemaking process. In all cases, agencies are asked to reconsider, but not necessarily reform, their regulations in the way suggested by the nomination. If the agency conducts an analysis of the reform idea and concludes the reform cannot be justified, then "completion" of the reform may mean the Administration has decided not to pursue it. We believe, however, that these reforms have potential merit and justify further analysis and review:

Update Mine Safety and Health Administration (MSHA) Rules on the Use of Explosives in Mines to Reflect Modern Industry Standards: The nominator recommended that MSHA update its explosives regulations consistent with current industry standards. The submitter believes the change would both reduce compliance costs and improve safety by providing greater clarity and consistency. This nomination is similar to a reform recommended to OMB as part of the 2002 public nomination process, and we are interested in working with Advocacy and MSHA on this nomination.

Flexibility for Community Drinking Water Systems: The 1996 Amendments to the Safe Drinking Water Act established a process to allow small drinking water systems that cannot afford the treatment technology required to comply with a national primary drinking water standard to use an affordable variance technology instead. For these small system variances to be available for States to issue to small systems, EPA must find that there are no affordable compliance technologies for small systems nationally. EPA must also identify affordable variance technologies that are protective of public health, which may include treatment technologies, treatment techniques, or other means. The drinking water system must then

demonstrate to the State that its specific system cannot afford to comply with the new standard, and that a variance technology will ensure adequate protection of human health. The nominator stated that under EPA's existing guidelines for determining national affordability, no regulation has ever been found to be unaffordable and no small drinking water system has ever been permitted to apply for use of a variance technology. The nominator suggested that EPA consider alternative methods for determining affordability, including using different percentages of median household income in the community. This nomination is similar to a reform recommended to OMB by the public in 2002, and we are also interested in working with Advocacy and EPA to see that this nomination is pursued to completion.

Simplify the Rules for Recycling Solid Waste: The nominator suggested that EPA adopt a definition of solid waste that would eliminate certain forms of recycled materials from being considered "hazardous wastes," allowing them to be recycled more easily. This nomination is similar to a reform identified in 2004 as a priority in the OMB-initiated, government-wide effort to reform regulation in the U.S. manufacturing sector. A final rule on Revisions to the Definition of Solid Waste is currently under OMB review under Executive Order 12866, thus I am not able to discuss the details of the final rulemaking before we conclude review.

EPA Should Clearly Define "Oil" in its Oil Spill Rules: The nominator suggested that EPA adopt a procedure that supports a distinction between materials thought to be oil generated at petroleum refineries, and agricultural product processing materials and chemicals created through processing in chemical production and related industries. Although not directly related to this particular reform, several reforms to the SPCC regulations were identified in 2004 as priorities in the OMB-initiated, government-wide effort to reform regulation in the U.S.

manufacturing sector. OIRA is interest in working with Advocacy and EPA to see that this nomination is pursued to completion.

OIRA and Agency Review of Existing Regulation: Retrospective Regulatory Review

An additional potentially powerful tool for the reform of regulations affecting small businesses is a requirement for agencies to review, within 10 years of issuance, all regulations that have a "significant impact on a substantial number of small entities." This is commonly known as a Regulatory Flexibility Act (RFA) Section 610 review. This requirement applies both to rules that agencies determined at the time of issuance had a significant impact on small entities, as well as to rules where reasonable evidence has surfaced that the rule had a significant impact. The second tier of SBA Advocacy's Regulatory Review and Reform Initiative is to help agencies with their analytical obligations under Section 610, and to this end they released what OIRA considers is excellent guidance on this analysis in the fall of 2007. OIRA also plays a direct role in ensuring that agencies meet their obligation to publish their scheduled 610 reviews in their semi-annual Unified Regulatory Agenda. Last fall, for the first time, all such agenda entries became available in an electronic format that offers users an enhanced ability to obtain and search for information on upcoming regulations.

Other OIRA Activities That Help Small Businesses

The Paperwork Reduction Act of 1980 (PRA) established OIRA within the Office of Management and Budget. The PRA is premised on the principle that the Federal government should not require, or ask, citizens, businesses, organizations, State and local governments, and other public entities to comply with paperwork requirements that are unnecessary, duplicative, or unduly burdensome. Reauthorizations of the Act in 1985 and 1995, and the Small Business Paperwork Relief Act (SBPRA) of 2002, have further enhanced OIRA's role in eliminating

unnecessary, duplicative, and unjustified paperwork burdens, particularly on small entities, and these goals remain high priorities for my office.

The PRA applies very broadly to agency collections of information, which can include reporting, recordkeeping, and third-party disclosure requirements that apply to ten or more persons, businesses, or State, local, or Tribal governments. Currently, there are over 8,500 information collections that have an active OMB approval. Without such OMB approval, agencies cannot implement an information collection. The PRA process for obtaining OMB approval includes public notice and comment procedures that provide an opportunity for the public to suggest ways that agencies can reduce burden (or estimate it more accurately) and improve the usefulness and timeliness of the information collected. After OMB's initial approval of an information collection, agencies must seek and obtain extensions of OMB approval at least once every three years. Consistent with the PRA's goals, OIRA's reviews of agency information collection requests involve an assessment of the "practical utility" of the information to the agency and the associated burden that collecting this information imposes on the public.

The Paperwork Reduction Act and Small Businesses

In conducting our reviews of agency information collection requests, OIRA is particularly sensitive to collections that affect small businesses. Indeed, the PRA's statement of "purposes" identifies as a key PRA goal minimizing the "paperwork burden" on "small businesses."

The PRA also provides specific direction to agencies on how they can minimize the burdens that they impose on small businesses, using approaches such as "(i) establishing differing compliance or reporting requirements or timetables that take into account the resources

available to those who are to respond; (ii) the clarification, consolidation, or simplification of compliance and reporting requirements; or (iii) an exemption from coverage of the collection of information, or any part thereof."

When the PRA was reauthorized in 1995, Congress added a requirement that agencies certify, as part of their requests for OMB approval of an information collection, that the collection "reduces to the extent practicable and appropriate the burden" on small businesses and other small entities. OMB added this certification requirement to the OMB PRA implementing regulations (5 C.F.R. 1320.9(c)). In addition, agency information collection requests submitted to OMB must indicate whether the information collection will have a "significant economic impact on a substantial number of small entities."

The 2002 SBPRA further reinforced the PRA's focus on minimizing small business paperwork burdens by establishing a multi-agency Task Force to address this issue. On June 28, 2003, the SBPRA Task Force submitted its first report to Congress, which included a number of recommendations to streamline the Federal information submission process and reduce small business paperwork burdens. Specifically, the report outlined steps to consolidate information collections, develop a listing of these collections, and allow for electronic submission of forms. One year later, the SBPRA Task Force submitted a second report to Congress that made recommendations concerning the dissemination of information by agencies to facilitate compliance with Federal paperwork requirements. The SBPRA also amended the PRA to require agencies to "make efforts to further reduce the information collection burden for small business concerns with fewer than 25 employees."

Ongoing Efforts to Reduce Small Business Paperwork and Compliance Burdens

Motivated by these statutory requirements, Federal agencies have taken a number of steps over the past several years to reduce the amount of information they collect from small businesses and to ease their compliance burdens, often through the innovative use of information technology. Nonetheless, we have seen government-wide paperwork burdens increase over time, as OMB has documented in its annual Information Collection Budget report (ICB) submitted to Congress pursuant to the PRA. Government-wide PRA burden increased from 8.24 billion hours in FY 2005 to 8.92 billion hours in FY 2006, an increase of more than 8 percent.

A recurring theme of the ICB in recent years has been the very large role played by the Internal Revenue Service (IRS) in the Federal government's information collection activities. Because of the Federal income tax system, the IRS is an important part of the lives of all taxpayers, including businesses large and small. This fact was again reflected in last year's ICB, when OMB reported that IRS was responsible for about 78 percent of the Federal government's total reporting burden on the public in FY 2006.

Despite these broader trends of aggregate burden increases, agencies have been able to achieve some notable burden reduction successes. Let me highlight just a few examples.

Internal Revenue Service: Employer's Annual Federal Tax Program

As reported in last year's ICB, the IRS Office of Taxpayer Burden Reduction recently launched an initiative to reduce burden on small business taxpayers who owe $1,000 or less in Employment Tax (ET) by establishing new rules and processes that will allow them to file their ET returns, as well as pay the ET tax due, on an annual rather than a quarterly basis. As long as these filers remain at $1,000 or less in total Employment Tax they will remain filers of Form 944, the Employer's Annual Employment Tax Return. Those businesses that exceed this

threshold will be subject to the requirement to file Form 941, the Employer's Quarterly Employment Tax Return. By allowing smaller businesses to file annually instead of quarterly, IRS estimated that reporting burdens would drop by almost 30 million hours.

Small Business Administration: The Business Gateway Initiative

SBA's Business Gateway Initiative offers businesses a single access point to Federal regulatory and paperwork compliance resources, including forms and tools. The initiative, which includes Business.gov, Forms.gov, and data harmonization activities, reduces the amount of time and money business owners spend on complying with Federal regulations and associated paperwork so that they can spend more time running their business. Specifically, Business.gov simplifies and improves businesses' ability to locate government compliance guides and forms they deal with on a regular basis, thereby reducing the effort needed to comply with government regulations. Using a voluntary customer satisfaction survey on Business.gov, business owners have self-reported saving over 2.9 million hours (YTD in FY 2008) by using the portal. Since the re-launch of Business.gov in October 2006, business owners have self-reported a total of almost 6.2 million hours saved.

Business.gov is an innovative and search-focused web site where businesses can access up-to-date regulatory and paperwork compliance information and save time doing so. The information available through Business.gov was assembled by reaching across agency silos to make content accessible and relevant to the business community. Business Gateway epitomizes the spirit and intent of the PRA by helping businesses save time getting answers to important questions including: (1) What laws and regulations apply to me?; (2) How do I comply?; and (3) How do I stay in compliance?

The Business Gateway Initiative also promotes "data harmonization," which is defined as the reduction of regulatory reporting burden on citizens and business by reducing the complexity of reporting processes and improving the reuse and distribution of information across Federal, State, and local agencies. Business Gateway supports data harmonization by advocating for and supporting data harmonization solutions.

Business Gateway's seminal data harmonization project is called Single Source Coal Reporting (SSCR). Previously, the coal mining industry submitted highly redundant, paper-based forms to regulators. As of April 2006, they can submit data and pay fees using a single online form, and have it automatically sent to appropriate regulators. Currently, the Federal partners are IRS and the Departments of Labor and Interior; the State partners are Pennsylvania and Virginia. Business Gateway will release a comprehensive analysis on data harmonization by mid-August. The analysis will include five case studies to depict various levels of Federal, State, agency, and industry participation.

OMB and SBA: Compliance Assistance for Small Businesses

Finally, once all these regulatory reforms and paperwork burdens have been vetted and put in place, both OMB and SBA play a key role in helping small businesses simply to understand and comply with their obligations. Specifically, the SBPRA requires Federal agencies to designate one point of contact to act as a liaison between the agency and small business concerns. SBPRA also requires OMB, in conjunction with SBA, to publish on the Internet a list of compliance assistance resources available at Federal agencies for small businesses. In accordance with the SBPRA, Business.gov published a **"Federal Compliance** Contacts" **page which gives the names, phone numbers** and e-mail addresses of individuals at Federal agencies that can help small business answer regulatory and legal questions.

Business.gov also publishes Small Business Guides that include links to Federal, State and local agency resources that help small businesses meet their regulatory requirements. This information is presented together so that if a small business owner does not find the information they are seeking, a "live" person to assist them is readily identifiable.

Conclusion

Let me conclude by reiterating my office's commitment to ensuring that small business, the engine of economic growth in the United States, is not unduly burdened by unnecessary regulation and paperwork. Thank you very much for the opportunity to testify in today's hearing. I would be happy to answer any questions you may have.



Advocacy: the voice of small business in government

Testimony of

The Honorable Thomas M. Sullivan
Chief Counsel for Advocacy
U.S. Small Business Administration

U.S. House of Representatives
Committee on Small Business
Subcommittee on Regulations, Health Care and Trade

Date:	July 30, 2008
Time:	10:00 A.M.
Location:	Room 1539 Longworth House Office Building Washington, D.C.
Topic:	Regulatory Burdens on Small Firms: What Rules Need Reforms?"

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Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government. The Chief Counsel for Advocacy, who is appointed by the President and confirmed by the U.S. Senate, directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. Issues are identified through economic research, policy analyses, and small business outreach. The Chief Counsel's efforts are supported by offices in Washington, D.C., and by Regional Advocates. For more information about the Office of Advocacy, visit http://www.sba.gov/advo, or call (202) 205-6533.

Chairman Gonzalez and Members of the Subcommittee, good morning and thank you for giving me the opportunity to appear before you today. My name is Thomas M. Sullivan and I am the Chief Counsel for Advocacy at the U.S. Small Business Administration (SBA). Congress established the Office of Advocacy (Advocacy) in 1976 under Pub. L. No. 94-305 to advocate the views of small business before federal agencies and Congress. Because Advocacy is an independent entity within the U.S. Small Business Administration, the views expressed by Advocacy here do not necessarily reflect the position of the Administration or the SBA. This testimony was not circulated for comment through the Office of Management and Budget (OMB).

To address the cumulative regulatory burden borne by small business, agencies need to periodically review their existing rules to see how they impact small businesses. Section 610 of the Regulatory Flexibility Act[1] directs federal agencies to review their current rules periodically and consider whether changing circumstances – such as altered market conditions, improved technologies, and new industry practices – have made revisions to the rules necessary. Historically, federal agency compliance with section 610 has been limited. A July 2007 report issued by the Government Accountability Office (GAO) found that federal agencies' reviews of their current rules, including the periodic reviews required under section 610, are neither as useful nor as open to public involvement as they should be.[2]

Accordingly, on August 16, 2007, Advocacy launched the Small Business Regulatory Review and Reform (r3) initiative, designed in part to improve compliance with section 610 and further the goals of periodic reviews. The r3 initiative is a long-term project to help agencies pinpoint existing federal rules that warrant review – and to revise those rules if they are found to be ineffective, duplicative, out of date, or otherwise deficient. Through r3's public rule reform nomination process, small businesses and their representatives can point out existing agency rules that they feel should be reviewed and revised. In the first year since Advocacy began the r3 initiative, small business

[1] 5 U.S.C. § 610. The Regulatory Flexibility Act, Pub. L. 96-354, was enacted in 1980, and was amended by the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. 104-121. The section 610 periodic review requirement has been law since 1980.

[2] Government Accountability Office, *Reexamining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews* (GAO-07-791), pages 35, 43-44 (July 2007).

stakeholders have nominated over 80 rules for review and reform. Ten of those nominations were chosen in February 2008 to be priority rules for review and possible reform. Since February 2008, we have been working with our counterpart agencies to conduct reviews of the ten rules and, where necessary, begin the process of revising those rules. Advocacy is currently accepting additional public nominations from now until December 31, 2008, to be considered as Top 10 candidates for 2009.

Going forward, Advocacy believes that the r3 program will be an important tool for keeping agencies' attention focused on section 610 of the RFA and improving the quality of reviews of existing regulations. For this reason, Congress, the Office of Advocacy, and small business have a common interest in ensuring the long-term success of the r3 program.

Background. Small businesses are extremely important to the U.S. economy. Economic data shows that 99.7% of firms that have employees are small businesses.[3] Small businesses employ over half of the more than 145 million American workers.[4] The small business sector is the primary engine of job creation, growth and innovation.[5] Despite the importance of small business to our country's economic strength, the 2005 Advocacy-funded study by W. Mark Crain, *The Impact of Regulatory Costs on Small Firms*,[6] found that, in general, small businesses are disproportionately impacted by the total federal regulatory burden. The overall regulatory burden was estimated by Crain to exceed $1.1 trillion in 2004.[7] For small firms, employing fewer than 20 employees, the annual regulatory burden in 2004 was estimated to be $7,647 per employee – which is 45 percent

[3] See Office of Advocacy, *Small Business Frequently Asked Questions* available at http://www.sba.gov/advo/stats/sbfaq.pdf.
[4] Small business share of total employment from Office of Advocacy, *Small Business Frequently Asked Questions* available at http://www.sba.gov/advo/stats/sbfaq.pdf. Total employment figure from Bureau of Labor Statistics, June 2008, Employment Situation Summary (www.bls/gov/news.release/empsit.nr0.htm).
[5] See Office of Advocacy, *Small Business Frequently Asked Questions* available at http://www.sba.gov/advo/stats/sbfaq.pdf and *Small Serial Innovators: The Small Firm Contribution to Technical Change* (February 2003) available at http://www.sba.gov/advo/research/rs225tot.pdf.
[6] *The Impact of Regulatory Costs on Small Firms* (September 2005) available at http://www.sba.gov/advo/research/rs264tot.pdf. The 2005 Crain study is the most timely and comprehensive measure of the total cost of regulations on the U.S. economy, reflecting the state of the economy in 2004 and covering virtually every category of regulations impacting small business. The report uses data gathered from numerous sources, including the Office of Management and Budget (OMB), the Organization for Economic Cooperation and Development (OECD), the Council of Economic Advisors, the Census Bureau, and various resource organizations.
[7] *Id.*

greater than the $5,282 per employee burden estimated for firms with more than 500 employees.[8]

For over thirty years, the Office of Advocacy has voiced the concerns of small business over the ever-increasing cumulative federal regulatory burden. During that time, Advocacy has had success in working with federal agencies to evaluate their planned rules and reduce the impacts of these new rules on small businesses while still accomplishing their regulatory objectives.[9]

Unfortunately, persuading federal agencies to periodically evaluate the impacts of their ***existing*** regulations on small business has proven to be a greater challenge. Section 610 of the RFA, enacted in 1980, requires agencies to look at their existing regulations after 10 years to see if they are outdated, ineffective, or duplicative. Agency compliance with section 610's periodic review requirement has varied substantially from agency to agency, with some agencies reviewing few of their current rules. The Government Accountability Office (GAO) released a report in July 2007 which highlighted the need for clearer standards and enhanced public participation in the section 610 review process. The report, *Reexamining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews* is available at: www.gao.gov/new.items/d07791.pdf.

The r3 Initiative. In response to the GAO's findings, the Office of Advocacy developed the r3 initiative to (1) assist agencies and small business stakeholders to better understand and benefit from section 610 reviews of existing rules, and (2) give interested small entities the opportunity to nominate existing agency rules for review and potential reform. The r3 program is meant to encourage agencies to undertake more meaningful section 610 reviews, and to consider tailoring the reviews of existing rules they conduct for other reasons to satisfy the section 610 criteria. Small business stakeholders would also be encouraged to suggest rules that should be reviewed, and reformed if they are found to be outdated, ineffective, or duplicative. The r3 initiative was officially launched on August 16, 2007. Advocacy developed and released a section 610 "best practices"

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[8] *Id.*

[9] *See* Keith Holman, *The Regulatory Flexibility Act at 25: Is the Law Achieving its Goal?*, 33 Fordham Urb. L. J. 1119 (2006).

document in October 2007 to assist agencies in meeting their periodic review obligations under the RFA. This best practices document is included as Attachment A and can also be found at: www.sba.gov/advo/r3. On October 16, 2007, the Office of Advocacy hosted a roundtable to provide representatives from small business associations, government, and academia with the opportunity to learn about r3. We also met with numerous small business groups to inform them about the Initiative and about the process for submitting r3 review nominations. By December 31, 2007, the close of the period for nominations for 2008, Advocacy received a total of 82 nominations for review and potential reform.

The 2008 Top 10 r3 Rules for Review/Reform. After review and analysis of the 82 nominations received, the Chief Counsel for Advocacy selected the following nominations to be the 2008 Top 10 rules for review and reform, listed here in alphabetical order by agency:

Environmental Protection Agency – Update Air Monitoring Rules for Dry Cleaners to Reflect Current Technology. EPA should revise outdated or inaccurate testing requirements so that dry cleaners can have a valid method for demonstrating compliance;

Environmental Protection Agency – Flexibility for Community Drinking Water Systems. EPA should consider expanding the ways for small communities to qualify to meet alternative drinking water standards, provided that the alternative standards are protective of human health and are approved by State authorities;

Environmental Protection Agency – Simplify the Rules for Recycling Solid Wastes. EPA should simplify the rules for recycling useful materials that, because of their current classification, must be handled, transported, and disposed of as hazardous wastes;

Environmental Protection Agency – EPA Should Clearly Define "Oil" in its Oil Spill Rules. EPA should clarify the definition of "oil" in its oil spill program, so that small facilities that store non-petroleum based products are not unintentionally captured by spill program requirements

Federal Aviation Administration – Update Flight Rules for the Washington D.C. Regional Area. FAA and other agencies should review the flight restriction rule for the region surrounding Washington, D.C. to determine whether the rule could be revised to avoid harming small airports within the region;

Federal Acquisition Regulation (FAR) Council – Reduce Duplicative Financial Requirements for Architect-Engineering Services Firms in Government Contracting. The duplicative retainage requirement should be removed or reduced in Architect-Engineering services contracts, as has been done for other services.

Internal Revenue Service – Simplify the Home Office Business Deduction. The IRS should revise their rules to permit a standard deduction for home-based businesses, which constitute 53% of all small businesses;

Mine Safety and Health Administration – Update MSHA Rules on the Use of Explosives in Mines to Reflect Modern Industry Standards. MSHA should update its current rules to be consistent with modern mining industry explosives standards;

Occupational Safety and Health Administration – Update OSHA's Medical/Laboratory Worker Rule. The current rule should be reviewed to determine whether it can be made more flexible in situations where workers do not have potential exposure to bloodborne pathogens; and

Office of Federal Procurement Policy – Update Reverse Auction Techniques for Online Procurement. The current reverse auction techniques should be reviewed to determine whether a government-wide rule is necessary to create a more consistent and predictable online process.

The 2008 Top 10 rules were evaluated on the basis of several factors: (1) whether the rule being nominated has ever been reviewed for its impact on small business, (2) whether technology, economic conditions, or other factors have changed since the rule was originally written, (3) whether the rule imposes duplicative requirements, (4) whether the rule could reasonably be tailored to accomplish its intended objectives without adversely impacting so many small businesses or small communities, and (5) the overall importance of the rule to small business and small communities. Each of the Top 10 rules were chosen on the basis of one or more of these factors. Some of the 82 nominations were rejected because they did not meet Advocacy's nomination criteria (e.g., they would require new legislation or other Congressional action, or the nominator

did not offer any viable alternative to the current rule). Other nominations were not selected as Top 10 rules because Advocacy is already working with agencies to implement the suggested reform or the agency has indicated that the suggested reform is already underway. The nominations that were not chosen as 2008 Top 10 rules have nonetheless given us valuable insight into the regulatory issues of concern to small business, which has helped Advocacy prioritize its current regulatory agenda.

Since February 2008, Advocacy has met with small business stakeholders and agency representatives to underscore the importance of reviewing and reforming the 2008 Top 10 rules. Based on Advocacy's previous experience with similar regulatory reforms, we know that it can take an agency several years to complete the required rulemaking procedures to revise a regulation. We anticipate that some of the 2008 r3 Top 10 rules for review/reform will not be revised within one or even two years. Therefore, it is important that small business stakeholders understand what is happening with their recommended reforms and stay active in the process.

In order to track agencies' progress, the current status of each year's Top 10 rules for review/reform will be tracked and posted on Advocacy's website, www.sba.gov/advo/r3. The updated status of the Top 10 rules will be published on Advocacy's website twice a year. The first status update on the 2008 Top 10 rules will be available this August. Advocacy encourages small businesses and their representatives to follow the progress of the reviews/reforms.

Looking Ahead. On July 7, 2008, Advocacy announced that we are accepting nominations for the next group of rules to be reviewed/reformed. Nominations will be accepted until December 31, 2008. Those nominations will eventually form the basis for the 2009 Top Ten rules for review/reform. The process will continue each year, with nominated rules being selected as Top Ten rules for review and reform.

Going forward, Advocacy believes that the r3 program will be an important tool for keeping agencies' attention focused on section 610 of the RFA and improving the quality of reviews of existing regulations. Given the importance of periodic reviews of current rules, Congress, the Office of Advocacy, and small business have a common interest in the long-term success of r3.

SBA Office of Advocacy
www.sba.gov/advo

Attachment A

Advocacy: the voice of small business in government

Section 610 of the Regulatory Flexibility Act: Best Practices for Federal Agencies

Introduction

Section 610 of the Regulatory Flexibility Act (RFA)[1] requires federal agencies to review regulations that have a significant economic impact on a substantial number of small entities[2] within 10 years of their adoption as final rules. These periodic rule reviews are a mechanism for agencies to assess the impact of existing rules on small entities and to determine whether the rules should be continued without change, or should be amended or rescinded, consistent with the objectives of applicable statutes. Agency compliance with section 610's periodic review requirement has varied substantially from agency to agency since 1980.[3] While some agencies systematically review all of their existing rules, other agencies review few, if any, of their current rules. Agencies also vary considerably in the amount of public involvement they allow, and the amount of information they provide to the public about their reviews.

The Office of Advocacy, an independent office within the U.S. Small Business Administration (Advocacy), has previously given relatively little guidance to agencies on section 610. In 2003, pursuant to the requirements of Executive Order 13,272,[4] Advocacy issued a general guide on how to comply with the RFA, including section 610.[5] The 2003 guide did not, however, address commonly asked questions about section 610, such as the timing and scope of reviews, how the public can be involved, and how agencies should communicate with the public about their reviews. The 2003 guide also did not provide examples of retrospective reviews that were, in Advocacy's view, conducted properly.

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[1] 5 U.S.C. § 610 (2000).

[2] "Small entities" include small businesses that meet the Small Business Administration size standard for small business concerns at 13 C.F.R. § 121.201, small governmental jurisdictions with a population of less than 50,000, and small organizations that are independently owned not-for-profit enterprises and which are not dominant in their field. See 5 U.S.C. §§ 601(3)-(5).

[3] *See, for example,* Government Accountability Office, *Reexamining Regulations: Opportunities Exist to Improve Effectiveness and Transparency of Retrospective Reviews* (GAO-07-791), July 2007; General Accounting Office, *Regulatory Flexibility Act: Agencies' Interpretations Vary* (GAO/GGD-99-55) April 1999. *See also* Michael R. See, *Willful Blindness: Federal Agencies' Failure to Comply with the Regulatory Flexibility Act's Periodic Review Requirement – and Current Proposals to Invigorate the Act*, 33 Fordham Urb. L.J. 1199-1255 (2006).

[4] Exec. Order No. 13,272 § 2(a), 67 Fed. Reg. 53,461 (Aug. 13, 2002) ("Advocacy . . . shall notify agency heads from time to time of the requirements of the [RFA], including by issuing notifications with respect to the basic requirements of the Act . . . .")

[5] Office of Advocacy, *How to Comply with the Regulatory Flexibility Act: A Guide for Government Agencies* (May 2003) available at http://www.sba.gov/advo/laws/rfaguide.pdf.

This best practices document is intended to provide Advocacy's interpretation of section 610 of the RFA and answer common questions about conducting retrospective reviews of existing regulations in a transparent manner. Advocacy intends this document to supplement the 2003 RFA guide; like the 2003 guide, it was developed to meet Advocacy's continuing responsibility under Executive Order 13,272 to "notify agency heads from time to time of the requirements of the [RFA]."[6]

The statutory text of Section 610, 5 U.S.C. § 610

§ 610. Periodic review of rules

(a) Within one hundred and eighty days after the effective date of this chapter, each agency shall publish in the Federal Register a plan for the periodic review of the rules issued by the agency which will have a significant economic impact upon a substantial number of small entities. Such a plan may be amended by the agency at any time by publishing the revision in the Federal Register. The purpose of the review shall be to determine whether such rules should be continued without change, or should be amended or rescinded, consistent with the stated objectives of applicable statutes, to minimize any significant economic impact of the rules upon a substantial number of such small entities. The plan shall provide for the review of all such agency rules existing on the effective date of this chapter within ten years of that date and for the review of such rules adopted after the effective date of this chapter within ten years of the publication of such rules as the final rule. If the head of the agency determines that completion of the review of existing rules is not feasible by the established date, he shall so certify in a statement published in the Federal Register and may extend the completion date by one year at a time for a total of not more than five years.

(b) In reviewing rules to minimize any significant economic impact of the rule on a substantial number of small entities in a manner consistent with the stated objectives of applicable statutes, the agency shall consider the following factors –
    (1) the continued need for the rule;
    (2) the nature of complaints or comments received concerning the rule from the public;
    (3) the complexity of the rule;
    (4) the extent to which the rule overlaps, duplicates or conflicts with other Federal rules, and, to the extent feasible, with State and local governmental rules: and
    (5) the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule.

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[6] Exec. Order No. 13,272 § 2(a), 67 Fed. Reg. 53,461 (Aug. 13, 2002).

(c) Each year, each agency shall publish in the Federal Register a list of the rules which have a significant economic impact on a substantial number of small entities, which are to be reviewed pursuant to this section during the succeeding twelve months. The list shall include a brief description of each rule and the need for and legal basis of such rule and shall invite public comment upon the rule.

Legislative history of the RFA relating to section 610.

Statements made during the 1980 debate on the Regulatory Flexibility Act demonstrate that Congress intended for section 610 to be a mechanism that requires agencies to periodically re-examine the regulatory burden of their rules vis-à-vis small entities, considered in the light of changing circumstances.[7] This view was also reflected in Advocacy's initial 1982 guidance explaining the then-new RFA, which stated that

> The RFA requires agencies to review all existing regulations to determine whether maximum flexibility is being provided to accommodate the unique needs of small businesses and small entities. Because society is not static, changing environments and technology may necessitate modifications of existing, anachronistic regulations to assure that they do not unnecessarily impede the growth and development of small entities.[8]

Put simply, the objective of a section 610 review is like the goal of many other retrospective rule reviews:[9] to determine whether an existing rule is actually working as it was originally intended and whether revisions are needed. Has the problem the rule was designed to address been solved? Are regulated entities (particularly small entities) able to comply with the rule as anticipated by the agency? Are the costs of compliance in

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[7] House Debate on the Regulatory Flexibility Act, 142 Cong. Rec. H24,575, H24,583-585 (daily ed. Sept. 8, 1980) ("At least once every 10 years, agencies must assess regulations currently on the books, with a view toward modification of those which unduly impact on small entities." (Statement of Rep. McDade)) ("[A]gencies must review all regulations currently on the books and determine the continued need for any rules which have a substantial impact on small business." (Statement of Rep. Ireland)). Similarly, the section-by-section analysis of the periodic review provision of S. 299, which became the RFA, notes that the required factors in a section 610 review mirror the evaluative factors in President Carter's Executive Order 12,044, *Improving Government Regulations.* Exec. Order 12,044, 43 Fed. Reg. 12,661 (March 24, 1978). Pursuant to that Executive Order, President Carter issued a Memorandum to the Heads of Executive Departments and Agencies in 1979, further instructing federal agencies: "As you review existing regulatory and reporting requirements, take particular care to determine where, within statutory limits, it is possible to tailor those requirements to fit the size and nature of the businesses and organizations subject to them." President Jimmy Carter, Memorandum to the Heads of Executive Departments and Agencies, November 16, 1979.

[8] Office of Advocacy, *The Regulatory Flexibility Act* (October 1982).

[9] Typical agency-initiated retrospective regulatory reviews include post-hoc validation studies, reviews conducted pursuant to petitions for rulemaking or reconsideration, paperwork burden reviews, and reviews undertaken to advance agency policies.

line with the agency's initial estimates? Are small businesses voicing continuing concerns about the difficulty they have complying with the rule? The section 610 review is an excellent way to address these questions.

Is a section 610 review necessary even if the current rule did not impose a significant economic impact on a substantial number of small entities at the time the rule was promulgated?

In some cases, yes. Even if an agency was originally able to certify properly under section 605 of the RFA that a rule would not have a significant economic impact on a substantial number of small entities,[10] changed conditions may mean that the rule now does have a significant impact and therefore should be reviewed under section 610. For example, there may be many more small businesses that are subject to the rule now than when the rule was promulgated. The cost of compliance with a current rule may have sharply increased because of a required new technology. If there is evidence (such as new cost or burden data) that a rule is now having a significant economic impact on a substantial number of small entities, including small communities or small non-profit organizations, Advocacy believes that the agency should conduct a section 610 review.

Advocacy is aware that some agencies interpret section 610 not to require the periodic review of rules that were originally certified when they were promulgated as having no significant economic impact on a substantial number of small entities. This narrow interpretation of the section 610 review requirements discounts several important considerations. First, evidence of significant current impacts to small entities from an existing rule may call into question the accuracy of the original determination that the rule would have no significant impact. Second, as time passes and the agency (along with regulated small entities) are better able to measure and understand the impacts of a regulation, it benefits the agency to use the periodic review process to update their rules and perform regulatory "housekeeping." Third, limiting section 610 reviews only to rules that were found to have a significant economic impact on a substantial number of small entities at the time of promulgation would severely undercut section 610. EPA and OSHA, for example – which between them determine that at most one or two rules each year will have such an impact – will exclude each of the hundreds of other rules promulgated annually which may now significantly impact small entities from section 610 review. Given the legislative history of section 610, it is very difficult to believe that Congress intended this outcome. Finally, a reading of the plain language of section 610 supports Advocacy's interpretation. If Congress meant to limit periodic reviews, it would have simply required agencies to review rules that <u>had</u> a significant impact, rather than rules which <u>have</u> a significant impact.

An agency may learn about the current impacts of an existing rule through complaints from small entities or petitions for a section 610 or other retrospective review of the rule. If these complaints and/or petitions are founded on reliable cost and impact data, the agency will have a clear indication that small entities are now being impacted by the rule.

[10] *See* 5 U.S.C. § 605(b).

Scope of the review: What should be included?

Once an agency has determined that an existing rule has a significant economic impact on a substantial number of small entities at the present time, the agency's section 610 review should, at a minimum, address each of the five factors listed in section 610(b)(1)-(5):

- Whether or not there a continuing need for this rule, consistent with the stated objectives of the applicable statutes;
- Whether the public has ever submitted comments or complaints about this rule;
- The degree of complexity of this rule;
- Whether some other federal or state requirement accomplishes the same regulatory objective as this rule; and
- The length of time since the agency has reviewed this rule, and/or the extent to which circumstances have changed which may affect regulated entities.

Particular attention should be paid to changes in technology, economic circumstances, competitive forces, and the cumulative burden faced by regulated entities. Has the impact of the rule on small entities remained the same?

Section 610(b) requires an agency to evaluate and minimize "any significant economic impact of a rule on a substantial number of small entities in a manner consistent with the stated objectives of applicable statutes." To accomplish this, agencies may want to use an economic analysis similar to the Initial Regulatory Flexibility Analysis (IRFA) under section 603 of the RFA, taking into account the limitations on data availability and limited agency resources.[11] Agencies have the discretion to place significant weight on other relevant factors, in addition to the types of economic data required by an IRFA. These other factors include an agency's experience in implementing the rule, as well as the views expressed over time by the public, regulated entities, and Congress. With the benefit of actual experience with a rule, the agency and other interested parties should be in a good position to evaluate potential improvements to the rule. Several factors deserve attention here such as the benefits achieved by the regulation, unintended market effects and market distortions, unusually high firm mortality rates in specific industry sub-sectors, and widespread noncompliance with reporting and other paperwork requirements. Thus, a useful review should go beyond obvious measures such as ensuring that regulatory requirements are expressed in plain language and that paperwork can be filed electronically. The analysis should be aimed at understanding and reducing burdens that unnecessarily impact small entities.

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[11] *See* 5 U.S.C. § 603. Indeed, the legislative history of S.299, which became the RFA, notes that "[i]n reviewing existing rules, agencies should follow the procedures described in sections 602-609 [of the RFA] to the extent appropriate." 142 Cong. Rec. H24,575, H24,583-585 (daily ed. Sept. 8, 1980). In the context of a section 610 review, the elements of an IRFA analysis that should be present include: a discussion of the number and types of small entities affected by the rule, a description of the compliance requirements of the rule and an estimate of their costs, identification of any duplicative or overlapping requirements, and a description of possible alternative regulatory approaches. *See also* Office of Advocacy, *How to Comply with the Regulatory Flexibility Act: A Guide for Government Agencies* (May 2003) at 29-40, available at http://www.sba.gov/advo/laws/rfaguide.pdf.

As a matter of good practice, the section 610 analysis should be based on relevant data, public comments, and agency experience. The agency should make use of available data and data supplied by the public, and indicate the sources of the data. To the extent that an agency relies on specific data to reach a conclusion about the continuing efficacy of a rule, the agency should be able to provide that data. The agency should explain its assumptions so that stakeholders can understand its analysis.

Timing of the review: When does the agency have to start and finish?

The language of section 610 specifies that the review should take place within 10 years after the date a rule is promulgated. While agencies need to gain some experience with a rule before undertaking a retrospective review, the review may take place prior to the 10-year mark. If an agency substantially revises a rule after its initial promulgation, it is arguable as to whether the 610 review may be delayed to correspond to the revision date. Advocacy would not likely object to a revision of the date, but agencies should seek input from Advocacy on this point.

Section 610 does not specifically set a limit on the amount of time for a rule review. Some agencies have reported that they spend more than a year on each section 610 review. It is within an agency's discretion to determine how much time it needs to spend on retrospective rule reviews. Advocacy recognizes that section 610 reviews may take more than a year in order to permit adequate time to gather and analyze data, to allow public comment, and to consider those comments in the review. Of course, some reviews could take less time, based on the complexity of the issues and the nature of the regulated industry.

Agencies may wish to take advantage of the opportunity afforded in section 605(c) of the RFA to consider a series of "closely related rules" as one rule for periodic review purposes. An agency can accomplish a comprehensive section 610 review of closely related rules, satisfying the requirements of the RFA while potentially reducing the agency resources required.

How should agencies communicate with interested entities about section 610 reviews they are conducting?

Section 610(c) of the RFA requires agencies to publish in the *Federal Register* a list of the rules they plan to review in the upcoming year. Agencies use the *Unified Regulatory Agenda* for this purpose.[12] This listing requirement is intended to give small entities early notice of the section 610 reviews so that they will be ready and able to provide the agency with comments about the rule under review. As a practical matter, however, agencies often give stakeholders no other information about the ongoing status of a section 610 review, what factors an agency is considering in conducting the review, how

[12] The *Unified Regulatory Agenda* can be accessed at www.reginfo.gov.

comments can be submitted to the agency, or, ultimately, the factual basis on which the agency made its section 610 review findings.

Agencies should communicate with interested entities about the status of ongoing section 610 reviews, as well as those they have completed, to enhance transparency. This information may be most efficiently communicated via an agency website or other electronic media, and should inform interested parties of their ability to submit comments, as well as the agency's commitment to consider those comments. Several agencies already utilize web-based communications as an outreach tool during section 610 reviews.[13]

Insights about an existing regulation received from regulated entities and other interested parties should be a key component of a retrospective rule review. By making the review process transparent and accessible, agencies are more likely to identify improvements that will benefit all parties at the conclusion of the review. Advocacy can help agencies who wish to communicate with small entity stakeholders – by hosting roundtables, working through trade groups, and getting a specific message to a targeted audience. Advocacy is ready to assist agencies in their outreach efforts.

Can other agency retrospective rule reviews satisfy the requirements of section 610?

Yes. Agencies that undertake retrospective rule reviews to satisfy other agency objectives may also be able to satisfy the periodic review requirement of section 610, as long as the rule reviews are functionally equivalent. For example, agencies that evaluated a current regulation pursuant to the Office of Management and Budget's 2002 publicly-nominated rule reform process[14] or OMB's manufacturing rule reform process[15] could qualify as section 610 reviews, if they otherwise met the criteria for section 610 review. Similarly, agencies that undertook retrospective reviews of their regulatory programs because of complaints or petitions from regulated entities could qualify as section 610 reviews – as long as the review includes the minimum factors required by section 610. The best way for agencies to get "credit" for a section 610 review in these circumstances is to communicate adequately with stakeholders, and with Advocacy.

Examples: In Advocacy's view, what are some recent retrospective rule reviews (conducted pursuant to section 610 or otherwise) that have been successful?

- **Federal Railway Administration's Section 610 Review of Railroad Workplace Safety** – On December 1, 2003, the Department of Transportation's

[13] See, e.g., www.osha.gov, www.epa.gov, and www.dot.gov and search for "RFA section 610."
[14] *See* Table 9, "New Reforms Planned or Underway – Regulations" and Table 10, "New Reforms Planned or Underway – Guidance Documents" in *Informing Regulatory Decisions: 2003 Report to Congress on the Costs and Benefits of Federal Regulations and Unfunded Mandates on State, Local, and Tribal Entities* (September 2003) at 26-34; available at www.whitehouse.gov/omb/inforeg/2003_cost_ben_final_rept.pdf.
[15] See Regulatory Reform of the U.S. Manufacturing Sector (2005).

Federal Railroad Administration completed a section 610 review of its railroad workplace safety regulations. After determining that the workplace safety regulations had a significant economic impact on a substantial number of small entities, the FRA examined the rules in light of section 610's review factors. Although the FRA did not recommend any regulatory change as a result of this review, they provided a good description of its analysis of the workplace safety regulations under each review factor and the agency's conclusions. *See* www.fra.dot.gov/downloads/safety/railroad_workplace_safety.pdf.

- **EPA's RCRA Review** - As a result of public nominations for reforms to the Environmental Protection Agency's hazardous waste management program under the Resource Conservation and Recovery Act (RCRA), EPA evaluated the program and identified duplicative requirements, such as forcing filers to submit reports to multiple locations when one location is adequate. By reducing or eliminating these procedures after public notice and comment, EPA enabled regulated entities to collectively save up to $3 million per year while preserving the protections of the RCRA program. The retrospective review was successful because it involved a detailed review of the program's requirements and their costs, based on years of practical experience. The agency considered technical changes such as computerization that have made some of the older paperwork requirements redundant, and found ways to modernize the program to reflect current realities. *See* 71 Fed. Reg. 16,862 (April 4, 2006).

- **OSHA Excavations Standard** – In March 2007, the Occupational Safety and Health Administration (OSHA) completed a section 610 review of its rules governing excavations and trenches. These standards had been in place since 1989, and were designed to ensure that trenches do not collapse on workers and that excavated material does not fall back into a trench and bury workers. In the review, OSHA did a good job of seeking public input on how and whether the rule should be changed. While the agency ultimately decided that no regulatory changes to the standard were warranted, it did determine that additional outreach and worker training would help continue the downward trend of fewer deaths and injuries from trench and excavation work. OSHA concluded that its current Excavations standard has reduced deaths from approximately 90 per year to about 70 per year. *See* 72 Fed. Reg. 14,727 (March 29, 2007).

- **FCC Section 610 Review of 1993-1995 Rules** – In May 2005, the Federal Communications Commission undertook a section 610 review of rules the Commission adopted in 1993, 1994, and 1995 which have, or might have, a significant economic impact on a substantial number of small entities. The FCC solicited public comment on the rules under review, explained the criteria it was using to review the rules, and gave instructions on where to file comments. This approach was transparent because the agency allowed adequate time for comments (three months) and gave interested parties sufficient information to prepare useful comments. *See* 70 Fed. Reg. 33,416 (June 8, 2005).

How can agencies get section 610 assistance from the Office of Advocacy?

The Office of Advocacy is ready to assist agencies that are planning a retrospective review of their regulations, to ensure that the review fully meets the requirements of section 610. Discussions with the Office of Advocacy are confidential interagency communications, and the Advocacy staff is ready to assist you. For more information about this guidance, or for other questions about compliance with section 610, please contact Advocacy at (202) 205-6533.

October 2007

WRITTEN STATEMENT OF CHRISTOPHER WAGNER DEPUTY COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED DIVISION INTERNAL REVENUE SERVICE BEFORE THE HOUSE COMMITTEE ON SMALL BUSINESS SUBCOMMITTEE ON REGULATIONS, HEALTHCARE AND TRADE

July 30, 2008

Good morning, Chairman Gonzalez, Ranking Member Westmoreland, and distinguished members of the Subcommittee. My name is Chris Wagner and I am the Deputy Commissioner of the Internal Revenue Service' Small Business/Self-Employed Division (SB/SE).

The SB/SE organization is made up of 26,000 employees who serve about 57 million taxpayers – roughly one third of the taxpaying population. Our taxpayer base consists of nine million small businesses, including corporations and partnerships with assets of $10 million or less; 41 million self-employed and supplemental income earners; and seven million other taxpayers who file employment, excise, estate, gift, fiduciary and international tax returns.

Small business men and women play a critical role in our nation's economy. Small businesses represent more than 99 percent of all employers and employ half of all private-sector workers. My division at the IRS is focused on serving the small business and self-employed taxpayer community by helping them comply with their tax obligations. Much of this mission is accomplished through education and outreach efforts.

Today, I will discuss some of those efforts, including those related to the home office deduction. But first I will address our compliance with the Regulatory Flexibility Act and the opportunities we provide small businesses and the groups that represent them to influence proposed regulations and to modify regulations after they have been issued.

IRS Compliance with the Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA) is a critical tool which requires Federal agencies to complete and publish a regulatory flexibility analysis when a proposed regulation will have a significant economic impact on a substantial number of small entities. The IRS takes its responsibilities under the RFA very seriously and within the IRS, compliance with the RFA is carried out primarily by

the Office of Chief Counsel, working with the Treasury Department's Office of Tax Policy and Office of General Counsel.

However, for a number of reasons, not the least of which is the nature of the tax laws enacted by Congress, the impact of the RFA on the IRS is not as great as it is on other Federal agencies. Many of the tax laws enacted by Congress are very specific and as such the regulations issued by the IRS to implement those laws tend to be interpretive. In addition, when considering the impact of a tax regulation on small business, we are allowed to consider only the administrative impact of compliance not the burden the tax itself may have on a small entity. As such, most of the regulations issued by the IRS are not subject to review under the RFA.

I should stress that even though specific regulations may not be subject to RFA, small businesses still have the opportunity to review, comment, and influence the outcome of an IRS regulation prior to adoption. In addition to our internal review of the regulations to determine compliance with the RFA, section 7805 of the Internal Revenue Code requires the IRS to send every published Notice of Proposed Rule Making to the Chief Counsel for Advocacy of the Small Business Administration for comment. The IRS considers and responds to all comments made by the Office of Advocacy in the final regulations.

The RFA also requires agencies to review certain regulations after publication. However, again, because of the interpretative nature of most IRS regulations, there are only a very small number of tax regulations that are subject to retrospective review as required by RFA.

However, each year the Treasury Department and the IRS solicit input from the public, including small entities, concerning subjects on which the public would like to see published guidance. Public submissions often include recommendations to revise existing regulations. The cost or difficulty in complying with existing regulations, or a complaint that regulations adversely affect small entities, are potential grounds to amend the regulations.

Those comments and submissions are carefully considered by Treasury Department and the IRS in compiling the annual Guidance Priority Plan, as well as in drafting the text of the regulations themselves.

Efforts to Help Small Businesses and the Self-Employed

The Small Business/Self Employed division of the IRS does not exist just to enforce the law against small business. We have an obligation – in fact a core value – to also assist small businesses understand and comply with the tax law through a series of taxpayer service programs. This taxpayer service aspect of what we do is critical because we know that some noncompliance reflects a lack of understanding by the small business of their true tax obligation.

For example, one of the issues that I know this Subcommittee is very interested in is the home office deduction. I discuss this issue in greater detail later in my statement. However, below are a few of the ways we work with the public and third party stakeholders to help small businesses comply with the home office deduction provisions:

- We have posted information on IRS.gov, such as Tax Topic 509, which provides basic guidelines and links to other resources, including Publication 587, Business Use of Your Home, and Form 8829, Expenses for Business Use of Your Home.

- We work with partners, such as the Small Business Administration, state and local government agencies and community organizations to provide Small Business Tax Workshops and other educational seminars to current and prospective business people throughout the United States. Home office issues are discussed in many of these events by qualified instructors, such as IRS technicians and tax professionals.

- We have produced educational materials to supplement forms and publications, such as the Virtual Small Business Tax Workshop, which can be viewed online at IRS.gov or ordered as a DVD – up to five copies may be ordered for free. An entire chapter of the workshop is devoted to home office expenses.

- We issued Fact Sheet FS-2006-25, Home Office Deduction Reminders, in September 2006. The fact sheet is still used in outreach and is available on IRS.gov in English and Spanish. We are currently working to update the material and expect to reissue the fact sheet this fall.

Burden Reduction

In addition to reaching out and trying to assist small businesses comply with the law, the IRS also has an Office of Taxpayer Burden Reduction (OTBR) which exists, at least in part, to reduce the burden on small entities. Some of the steps take by OTBR to reduce the burden on small business include:

- Form 13285A, Reducing Taxpayer Burden on America's Taxpayers, was created so the public could participate in identifying taxpayer burden reduction. This form provides taxpayers with a process for submitting ideas for consideration directly to the Office of Taxpayer Burden Reduction. The form is available on IRS.gov.

- The Industry Issue Resolution (IIR) program was created to give taxpayers, industry associations, and other interested parties a vehicle for submitting burdensome business tax issues for possible resolution through published or administrative guidance. The goal is to resolve quickly tax issues that are common to a significant number of business

taxpayers by providing targeted guidance on specific tax issues. Under the program, the IRS has issued guidance that has reduced costs, burden, and uncertainty for taxpayers.

- Practitioner and Small Business Forums with national and local level tax professionals and small business associations provide an opportunity for taxpayers to share feedback on burden reduction initiatives before they are implemented. These forums also provide a means for identifying and resolving burden issues and communicating initiatives as they become available.

Completed Projects

Recently we have completed a number of projects that should be of benefit to small businesses:

- **Increased the Business Expense Threshold to $5,000 from $2,500 on Form 1040, Schedule C-EZ** – The threshold for small business taxpayers who file Schedules C or C-EZ for reporting business expenses was raised from $2,500 to $5,000. This enabled approximately 500,000 eligible taxpayers to file a Schedule C-EZ instead of the regular Schedule C.

- **S Corporation Elections** – Implemented Revenue Procedure 2007-62 which provides a simplified method for taxpayers to request relief for a late S corporation election. This now permits taxpayers to file Form 1120S, U.S. Income Tax Return for an S Corporation, and Form 2553, S Corporation Election, simultaneously. The change was effective for taxable years ending on or after Dec. 31, 2007.

- **Extensions to File** – Individuals, including Form 1040 Schedule C filers, are now able to use a redesigned IRS Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, to get an automatic six-month extension of time to file. This replaces the prior two-step process.

- **Form 940 (Employer's Annual Federal Unemployment Tax Return) Redesign** – The Form 940 and Form 940EZ have been combined into one simplified plain language form and have been designed for scanning.

- **Increase the FUTA Minimum Deposit Threshold** – Effective 2005, we increased the threshold for FUTA deposits $100 to $500. The reduced burden for 2.6 million taxpayers per year and eliminated the requirement for taxpayers with eight or less employees from having to make three tax deposits a year. This saved taxpayers who fall under the new threshold from having to make 7.8 million deposits a year.

- **Redesigned Form 941** – Revised in 2005, the new version features and improved layout and employs "plain language" instructions.

- **Form 944** - Beginning in 2006, small business taxpayers can file their Employment Taxes once a year using Form 944, instead of four quarterly Form 941 returns. Currently about 500,000 taxpayers benefit from this program.

- **Outreach** – We launched a campaign in April to help educate new small business owners. The effort will provide first-time Schedule C (Profit or Loss from Business) filers with improved and updated educational materials on a variety of issues including home office deductions.

The Home Office Deduction

One of the issues of interest to this Subcommittee and on which we attempted to relieve the burden on small businesses is the home office deduction. We have received extensive comments on the need to simplify the deduction and we have looked at ways to simplify the deduction so that everyone who is eligible can claim it.

In 1976, Congress passed legislation limiting tax deductions for offices in the home. Internal Revenue Code (IRC) section 280A, enacted in 1976 and revised in 1997, provides the limited circumstances in which an individual or an S corporation taxpayer may take a deduction for an office in the home.

The deductions for home office expenses are generally limited to parts of a home that are exclusively used on a regular basis:

- As a principal place of business for any of trade or business,

- As a place of business used by patients, clients, or customers to meet in the normal course of trade or business, or

- In connection with a trade or business if in a separate structure that is not attached to the home.

Exceptions to these rules apply to space used on a regular basis for storage of inventory or product samples and used for certain daycare facilities.

Changes made by the Tax Relief Act of 1997 expanded the definition of a taxpayer's "principal place of business" to allow more taxpayers to deduct home office expenses. This was a legislative override of a Supreme Court case (Commissioner v. Soliman, 506 U.S. 168 (1993)) that denied a home office deduction to an anesthesiologist who had no place but his home office to perform the administrative duties of his medical practice. Under the change, a taxpayer such as an anesthesiologist , an independent plumber, or a health care worker, whose business is mainly conducted and revenue generated outside the home office, may nonetheless claim the home office deduction if he or she has no other

location in which to conduct the management and administrative duties of the business. This change increased the number of taxpayers eligible for the deduction without affecting the intended unambiguous relationship to business activity.

Due to technological advancements and other significant changes to the business environment since 1976, many more small businesses are now able to operate effectively out of the home. In fact, according to the Small Business Administration, home-based businesses represent over 50 percent of small businesses. This evolution makes the benefit of claiming a business deduction for an office in the home ever more valuable to small business taxpayers.

We have also seen a growth in the use of the office in the home deduction on tax returns with the self-employed business schedule attached from 2.6 million in Tax Year (TY) 2002 to 3.3 million in TY 2006. Even with this increase, there are some indications from Census surveys that a substantial number of taxpayers with home office expenses are not claiming them on tax returns.

One of the reasons that the home office deduction might be underutilized might be that understanding and complying with the rules for deducting home office expenses can be difficult for small business and self-employed taxpayers. The clear intent of the law was to limit deductions of business use of the home to those expenses that have an unambiguous relationship to the business activity as opposed to personal use.

Taxpayers claiming deductions for home office expenses must not only understand the rules for when a business deduction is permitted, but they also must make appropriate computations and keep records to substantiate those deductions. As part of the record keeping, taxpayers must ensure that they do not double deduct expenses related to the home that are already permitted as an itemized deduction on their return, and they must ensure they take appropriate recognition steps if they sell their home.

However, from data collected by the IRS it is clear that many taxpayers do not understand this process.

In August 2007, the IRS conducted an analysis of the National Research Program (NRP) study of Tax Year 2001 individual returns and found that a significant number of taxpayers made errors when claiming home office deductions.

Using the NRP data, we estimate that almost 2.3 million – 1.8 percent – of the timely-filed tax returns for 2001 deducted home office expenses on Schedule C, for a total deduction amount of around $5.8 billion. We further estimate that 33.7 percent of those taxpayers overstated their deduction, 12.8 percent understated their deduction, and only 53.6 percent reported the correct amount.

In other words, almost half the taxpayers claiming a home office deduction made errors. The data does not show whether these errors were unintentional and simply a result of the complexity of the regulations or whether they represented deliberately misreported amounts.

The IRS' Office of Taxpayer Burden Reduction has taken a close look at the home office deduction to determine what options are available to make claiming the deduction easier. The Office explored a number of possible ways to simplify the computations required to claim the business deduction and concluded that reducing burden on business taxpayers with home office expenses may be best accomplished through a legislative change.

One of the problems we identified was the statutory requirement to recapture depreciation. Homeowners claiming deductions for an office in their personal residence are required to recapture depreciation "allowed or allowable" when selling their home – in other words, whether a depreciation deduction is claimed or not. That means additional computations and a possible tax liability when the home is sold, even if they had not included a depreciation deduction on their tax returns.

The IRS will continue to look at this issue, including exploring opportunities to simplify the rules and make Form 8829 easier to use.

It is our aim to find ways to ensure those who work out of their homes and are entitled to take the deduction can do so as accurately and with as little burden as possible.

Thank you, Mr. Chairman. I will be happy to answer any questions you and the other Members of the Subcommittee may have.



THE AMERICAN INSTITUTE OF ARCHITECTS

STATEMENT OF
PAUL RENKER, AIA
RENKER EICH PARKS ARCHITECTS
On Behalf of the American Institute of Architects

"Reform Procurement Rules That Delay Government Payments to Small Architecture and Engineering Firms"

United States House of Representatives
Committee on Small Business
Subcommittee on Regulations, Healthcare & Trade

-

July 30, 2008
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Mr. Chairman, Ranking Member Westmoreland, and members of the Subcommittee — good morning. I am Paul Renker, an architect, small business owner, and member of the American Institute of Architects. Since nearly half of the AIA's members own or work for small firms, we appreciate the work that this Committee does for small businesses.

Thank you for inviting me to discuss two federal procurement regulations that have been identified under the Small Business Administration's (SBA) r3 Initiative as being burdensome on small businesses that contract with the federal government: retainage for architectural and engineering services and reverse auctions.

Commonly referred to as the "retainage clause," the Federal Acquisition Regulation (FAR) rule for fixed-price architectural-engineering services (48 CFR 52.232-10) allows federal agencies to impose a 10-percent withholding, or retainage, on fees for firms providing architectural and engineering services. This rule allows federal contracting officers to withhold 10 percent of the amount owed to A/E firms under the contract until the full construction of a project is complete. The 10-percent withholding for design services is out of line with other federal contract payment regulations, which typically have no withholding fee or a maximum of a five percent withholding.

Earlier this year, as part of the SBA's r3 initiative, the SBA identified the 10-percent retainage clause as one of the Top 10 federal rules in need of reform. This retainage

clause presents an unnecessary burden to nearly 230,000 small A/E firms[1] who contract with the federal government. This is a strong deterrent for those small firms wishing to pursue federal contracts for three reasons.

First, 10 percent is higher than the amount withheld under many other types of service contracts. As the Administrator of the Council on Federal Procurement of Architectural and Engineering Services (COFPAES), of which the AIA is a member, recently testified before this Committee, "10 percent withholding for design services is ... out of line with other federal contract payment regulations which typically have no withholding fee or a maximum of a five percent withholding."[2] For small design firms with very small profit margins and tight cash flows, having 10 percent (or greater) of their fee held back for what could be years is very troubling. The withholding restricts the cash flow of small businesses and in some instances is in addition to any insurance requirements that may be imposed.

Second, A/E firms typically complete the major portion of their work (the design phase of a contract) long before construction is complete, leaving the architectural firm short of 10 percent of the payment amount for a substantial period. The result, as the Chairman of

[1] Small Business Administration Regulatory Review and Reform Initiative Regulatory Review and Reform (r3) Top 10 Rules, 2008- http://www.sba.gov/advo/r3/r3_services08.html#se

[2] Testimony of John M. Palatiello, Administrator, Council on Federal Procurement of Architectural & Engineering Services before the House Committee on Small Business (March 6, 2008).

the American Council of Engineering Companies Small Firms Council recently said, is "an interest free loan to the federal agencies at small firms' expense."[3]

Third, a 10-percent retainage requirement is not necessary in order to protect taxpayers. There are common methods of determining whether performance of architectural services has been satisfactory long before payment for services or completion of construction. Furthermore, the withholding is counter to the Brooks Act (Public Law 92-582), which established the qualifications-based selection (QBS) process for A/E firms. The QBS process ensures that only the most competent and capable firms – those with a proven track record of good performance – are selected for design contracts with federal agencies, even before they negotiate potential fees.

The 10-percent withholding rule is causing significant financial hardships on small A/E firms contracting with the federal government. I would like to take a few moments to relate our firm's first experience with a federal project.

Through the QBS process our firm was chosen and awarded a contract to design a new Job Corps Center for the U.S. Department of Labor in St. Petersburg, FL. This was a small business award, and we are very proud and happy to have been selected.

We started fee negotiations at the beginning of June 2006. We completed fee negotiation and received our notice to proceed approximately 115 days later on September 25, 2006.

[3] Submission of the Chief Counsel, Office of Advocacy, Small Business Administration, to the Office of Management and Budget, March 13, 2008.

We received our first payment for services approximately 105 days after our notice to proceed, or approximately 220 days from the start of fee negotiations. I mention this because our firm, as a small business, has to staff and plan for large projects such as this. This resulted in our firm incurring costs and expenses for salaries and overhead for 220 days without compensation. Our firm was forced to borrow money to maintain salaries and expenses. When compensation was received, 10 percent was withheld, further impacting our cash flow.

We understand that the intent of the 10-percent retainage is to protect the government and taxpayers, to help ensure they receive services equal to or greater than for services paid. However, this is not required under the system under which architects and engineers provide services.

In our case the Department of Labor contract includes a handbook and detailed descriptions of services and deliverables required for payment. We are required to submit progress documentation of our work at 15-percent, 30-percent, 60-percent and 100-percent milestones. In each case we submit our progress documents to other professionals hired by the Department of Labor. These professionals review our work in great detail for compliance with submittal requirements as well as compliance with the design program intent. Only after our submittal is reviewed and approved by the Department of Labor is our Invoice for Services accepted and processed for payment. Once our invoice is accepted, payment is normally made electronically in 30 days. But payment from completion of our work at each submittal was actually 43 days at the15-

percent submittal, 46 days at the 30-percent submittal, 49 days at the 60-percent submittal and 76 days at the 100-percent submittal. As you can see there are already very strong safeguards in place to protect the government and taxpayers without the additional burden of the10-percent retainage.

The 10-percent retainage of our fees was held in increasing amounts over the entire period of design services. After the project was successfully bid we were told that we could write a letter requesting the Department of Labor release our retainage for design services. We received our 10 percent retainage, without interest, approximately 500 days (one year and four-and-a-half months) after our contract notice to proceed.

The 10-percent retainage was started again during construction administration services and to the best of my knowledge will continue for the full duration of construction, or approximately for 527 days. It should also be noted that 10 percent is not retained from the contractor's pay requests.

When this rule was incorporated into the FAR in 1984, the FAR council included a clause that would allow the release of the withheld funds when the design services (the A/E firms' portion of the work) have been satisfactorily completed.[4] In recent years, however, many A/E firms have reported that, as in our case, contracting officers continue to withhold the 10-percent until full construction of the project is complete.

[4] 48 C.F.R. 52.232-10 - "payment may be made in full during any months in which the Contracting Officer determines that performance has been satisfactory."

As noted previously, the SBA has listed the 10-percent retainage requirement for A/E contracts as one of the top ten federal rules for review and potential reform, saying that a "change in this regulation will help increase the cash flow of small A&E firms that contract with the federal government. This change should also encourage more firms to enter the federal procurement market, with concomitant improvements in the quality of services."[5] As the Small Business Committee is dedicated to opening the federal marketplace to small businesses, we strongly encourage Congress to fix this burdensome regulation.

In order to level the procurement playing field, Congress should eliminate the retainage requirement and take steps to ensure that contracting officers make full payment when the design services themselves have been satisfactorily performed rather than when the entire construction project is complete. This will ensure that small A/E firms are able to pursue work with the federal government without placing their businesses' financial stability on the line.

Another issue on the SBA's r3 agenda is reverse auctioning. According to the SBA:

> *In the federal government's procurement system, the live electronic reverse auction technique was designed as a contracting tool to provide contracting officers with flexibility to make contract awards in a timely manner. Bidders who use the technique submit their bids through an online intermediary and are*

[5] Small Business Administration, Office of Advocacy, "Small Business Regulatory Review and Reform Initiative, Regulatory Review and Reform (r3) Top 10 Rules, 2008."

informed of competitors' prices but not their identity. Bidders offer successively lower prices until no lower price is offered. The agency must then decide whether it will make the award. Some current techniques used by contracting officers may have the unintended result of circumventing Federal Acquisition Regulation (FAR) Part 19, which requires agencies to set aside certain dollar threshold contracts for small businesses. The problem exists because no specific FAR regulation instructs contracting officers in how to use the reverse auction tool.[6]

The Office of Advocacy has recommended development of rules that continue to provide contracting officers with the flexibility of reverse auctions while not conflicting with FAR Part 19 small business competition requirements.

The AIA and most other construction entities view reverse auctions as a dangerous concept that induces bidders, in their efforts to be the lowest bidder, to reduce labor and supervision to levels that could endanger safety and lessen quality. In fact, we believe that reverse auctions violate the qualifications-based selection procedures outlined under the Brooks Act (Public Law 92-582) and FAR Part 36.6. Architects and engineers provide a unique service and are not commodities. Because of this, their services cannot be procured in the same manner as office supplies, computers or automobiles, where there is a standard benchmark to compare the products being bid on.

[6] SBA Office of Advocacy, http://www.sba.gov/advo/r3/r3_auction08.html#au

In summary, rules like the ten percent retainage and reverse auctions present considerable roadblocks to small and emerging A/E firms that want to help design and build the buildings that are literally symbols of our nation's vitality, stability and grandeur. We hope that as this Subcommittee continues to explore ways of ensuring that federal procurement laws and regulations provide ample opportunities for small businesses to compete, it also recognizes the unique role that architects and engineers play in ensuring the health, safety and welfare of the millions of people to work in and visit federal facilities every year.

Thank you, Mr. Chairman and members of the Subcommittee, for giving me the opportunity to testify today. I will be pleased to answer any questions you may have.



Testimony by Henry P. Van De Putte
Owner of Dixie Flag Manufacturing Company

House Small Business
Subcommittee on Regulations, Healthcare and Trade
on the date of July 30, 2008
on the subject of

Regulatory Burdens on Small Firms: What Rules Need Reform?

Chairman Gonzalez, Ranking Member Westmoreland and members of the Subcommittee on Regulations, Healthcare and Trade:

I appreciate the opportunity to be here today. As a member of the NFIB since 1980, a former board member, and a founding member of the NFIB Texas Leadership Council, I am pleased to offer my testimony. My business, Dixie Flag Manufacturing Company is a small family business in San Antonio. My parents and my grandmother started the company in my bedroom in 1958, so this year we are proud to be celebrating our 50th year in business. In that 50 years we have had the privilege to provide jobs and opportunities to some terrific men and women and to be the first employment experience for a number of our employees' children. I come here today not only representing small business owners, but also the millions of people who depend on small businesses for their livelihood.

At the outset, I want to commend the Committee for holding this hearing today on the Office of Advocacy's Regulatory Review and Reform Initiative, or R3 -- an effort to identify outdated and ineffective federal regulations. The complexities of the federal regulations are especially onerous to small businesses, so I appreciate that the Committee's interest in addressing this important topic.

INTRODUCTION

NFIB's national membership spans a wide range of small business operations, from one-person enterprises to firms with hundreds of employees. In fact, the average NFIB member employs eight to ten people and has gross receipts of about $500,000 per year.

While there is no one definition of a small business, all NFIB members have one thing in common; their businesses are independently owned. Clearly, we are talking about the truly small businesses—businesses whose priorities and abilities to handle regulatory challenges are greatly different from their larger counterparts.

REGULATORY BURDEN

Earlier this year, the SBA Office of Advocacy released the 2008 Top 10 Rules for Review and Reform, an effort to identify outdated and ineffective federal regulations. Drawn from over 80 rules nominated by small business owners, the recommendations were transmitted to the various federal agencies for further action.

The r3 program strikes right at the heart of one of the major burdens facing America's small business, the cumulative federal regulatory burden. Being a small-business owner means, more times than not, you are responsible for

everything, including ordering inventory, hiring employees and dealing with the mandates imposed by federal, state and local governments. That is why government regulations, and the paperwork they generate, should be as simple as possible. The less time a small business spends with "government overhead," the more they can spend improving their business, employing more people and growing America's economy.

Unreasonable government regulation, especially paperwork burdens, continues to be a top concern for small business owners like me. Regulatory costs per employee are highest for small firms, and our members consistently rank those costs as one of their most important issues.

A recent report commissioned by the SBA estimated the regulatory compliance costs for firms with fewer than 20 employees. Five years ago, that cost averaged $6,975 per employee, per year, but now that figure has risen by nearly 10 percent, to $7,647 per employee, per year. Put another way, for an NFIB member with five employees, regulatory costs now approach a total of nearly $40,000.

The r3 program plays an important role in regulatory reform, urging agencies to write regulations that are easy to read and understand, and to review the impact each regulation has on small business. For its part, Congress plays an important oversight role by looking at both new federal regulations and changing those already on the books. To keep up with the changing environment, regular evaluation is imperative to find outdated, ineffective and onerous regulations.

STANDARD HOME OFFICE DEDUCTION

With respect to the specific recommendations of the r3 program, one provision is of particular interest to NFIB members is the Standard Home Office Deduction. This issue is of particular interest to me because my parents started Dixie Flag Manufacturing Company in my bedroom in 1958. Dixie Flag now employs 45 people, but then it was just my dad, my mom and my grandmother.

Home based businesses are one of the fastest growing segments of our economy, representing 53 percent of all small businesses. Entrepreneurship is especially booming among minority groups. According to the latest U.S. Census Bureau data, the number of minority owned businesses is growing four times faster than all U.S. firms and currently totals more than 3 million companies.

While the rate of new and home-based business continues to grow, the existing home deduction remains burdensome and complicated. It requires a small business owner to determine how much of their house is used for business and to keep detailed records that substantiate the deduction.

The complicated record keeping now required by the IRS to qualify for a home office deduction is a barrier to many who would qualify but do not have the time and staff to do the paperwork. That barrier would be removed if a "standard deduction" for home-based businesses were allowed.

NFIB members believe that small, home-based businesses should have the option of either a standard home office deduction, or using the current system. The standard deduction would allow the business owner to claim a deduction he or she is entitled to, reduce the filing burden, and ultimately improve tax compliance.

In conclusion, I appreciate the opportunity to comment on the r3 program and the impact of federal regulations on small businesses owners. Along with the other small, independent business owners who make up the membership of the NFIB, I hope that Congress will continue to take significant steps to reduce this burden and that federal agencies will adopt the r3 recommendations suggested by SBA's Office of Advocacy.

Thank you again for the opportunity to testify. I look forward to answering any questions you might have.



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Testimony of

Scott Scribner

On behalf of
The National Association for the Self-Employed

"Regulatory Burdens on Small Firms: What Rules Need Reforms?"

House Committee on Small Business
Subcommittee on Regulations, Health Care and Trade

July 30, 2008

I would like to begin by thanking Chairman Gonzalez, Ranking Member Westmoreland and Members of the Subcommittee for the opportunity to speak to you today on an issue that is important to my business as well as to all the home-based entrepreneurs represented by the National Association for the Self-Employed.

My name is Scott Scribner and I've been a member of the NASE for a number of years. Along with my wife Barbara, I own a real estate sales business in Plano, Texas. We're involved mostly in residential sales and investments in the North Texas area. Before that I was a commercial banker and President of a small East Texas bank. Our business currently has one full time employee but we hope to expand our team in the near future. We've operated the business primarily from home thus, I have been contending with the home office deduction for 14 years.

Earlier this year the NASE nominated the home office deduction for the SBA Office of Advocacy's Regulatory Review and Reform (r3) initiative. As you may be aware, after review of over 80 nominated regulations the SBA Office of Advocacy selected the home office deduction as one of their Top 10 Rules for Review and Reform in 2008. I am pleased to see our nation's legislators and the Small Business Administration taking an interest in making this deduction simpler for home-based businesses.

Due to the complexity and time burden of calculating the home office deduction, I quickly turned to an accountant for assistance. However, a majority of my fellow self-employed business owners prepare their taxes without professional assistance and thus, must navigate the home office deduction on their own. Key hurdles faced by the self-employed in taking this deduction are the strict qualifying requirements, the complexity of the form and instructions, and the underlying fear that employing this tax benefit will flag them for review or audit by the IRS.

Micro-business owners face stringent and confusing requirements to qualify for the home office deduction. IRS publication 587, *Business Use of Your Home*, devotes five pages in an attempt to explain and clarify the key requirement for taking the deduction: exclusive and regular use of your home as your principal place of business. While the IRS does its best to make clear what they mean by exclusive and regular, many assumptions are left to the business owner. In addition, the overall qualifying provisions are a bit strict. If I had a storefront or leased office space, there are no penalties for putting personal use items like a television in my place of business or having a family member stop by for a visit and unexpectedly look something up on my computer. Yet because I work from home, the above circumstances could disqualify me from utilizing the home office deduction.

Once a small business owner qualifies for the deduction, he or she then faces the complexity of the IRS form. A self-employed business owner such as I must differentiate between direct and indirect expenses and also between deductible mortgage interest and excess mortgage interest. Some of the expenses are deductible even if the business has a loss and some aren't. Some casualty losses go on line 9 and some go on line 27. I am not a tax expert and confusing questions such as these is what led me to seek professional help.

In addition, the words "see instructions" appear on this one page tax form 14 different times. Those instructions say the form will take an average of 1 hour and 15 minutes to complete. I can tell you from personal experience it takes much longer than that to prepare IRS Form 8829. I believe that the time it takes over the course of the year to manage and maintain the paperwork necessary to prepare the required calculations for the home office deduction has been neglected in the IRS's estimation. This complexity and time burden of the home office deduction is a large deterrent to utilization. Many small businesses who qualify for this important deduction do not take it because it is too onerous to fill out the form.

The lack of clarity present in the requirements to take the deduction and the preparation of the form enhances the concern of the self-employed owner that he or she may do something incorrectly. There is large-scale concern of the subjective nature of this deduction. In a May 2008 survey conducted by the NASE, only 27% of members working from a home office took the home office deduction. The fear of being "red-flagged" by the IRS for review and/or audit was the top reason why qualifying business owners did not utilize the home office deduction.

The question remains: what can we do to improve this regulation for small business? The answer is simple: a standard home office deduction option. Once a self-employed business owner meets the qualifications for the deduction, he or she can choose to itemize and fill out the form in the manner currently advised by the IRS or, the business owner may choose to elect the standard deduction option which provides for a flat-rate deduction. The NASE recommends a standard deduction within the range of $1,500 to $2,500 and indexed annually for inflation. Providing a standard deduction could save many home-based entrepreneurs time and money. In addition, it alleviates confusion surrounding the home office deduction and thus, the concern that the business will be targeted by the IRS.

At present, the Home Office Deduction Simplification Act (H.R. 6214) has been introduced by Rep. John McHugh and would provide a $1,500 standard deduction option for home-based businesses. In addition, House Small Business Committee Chairwoman, Nydia Velazquez, is preparing legislation that would also include a standard home office deduction. I encourage Congress to support these pieces of legislation and help the 52% of small businesses who work from their home.

Please remember that complex and time-consuming tax regulations only make it more difficult for the self-employed community to comply with the tax code. This burden imposed on micro-business is disproportionate to that of larger businesses because smaller firms do not have

accounting and legal departments at their disposal to decipher and comply with the maze of tax regulation. Thus, as a member of the NASE and a home-based entrepreneur, I encourage you to help streamline burdensome regulations like the home office deduction for all of our nation's self-employed.

House Committee on Small Business
Subcommittee on Regulation, Healthcare, and Trade

Regulatory Burdens on Small Firms: What Rules Need Reforms?

July 30, 2008

Statement by Lon D. Santis, Manager of Technical Services
Institute of Makers of Explosives

Thank you Chairman Gonzalez, ranking member Westmorland, and members of the subcommittee for your interest in the Mine Safety and Health Administration's (MSHA) regulation of explosives. Because its regulations are nearly up to four decades old, MSHA's approach is inconsistent with industry standards, national consensus standards, and other agency's regulations. These inconsistencies expose miners to undue risk and waste the resources of mining operators and contractors, the vast majority of whom are small businesses.

The last 22 years of my professional career have been devoted to improving the safety of explosives in the public domain. I received a B.S. and M.S. in Mining Engineering from the University of Pittsburgh in 1985 and 1986. After a short time as a sales representative for an explosives company, I spent 12 years researching explosives safety for the U.S. Bureau of Mines (USBM) and then the National Institutes for Occupational Safety and Health. As such, nearly all that research focused on mine safety. For the last 10 years, I have carried on my "life's work" as the Manager of Technical Services for the Institute of Makers of Explosives.

The IME is the safety and security institute of the commercial explosives industry. Our mission is to promote safety and security through the protection of employees, users, the public and the environment; and to encourage the adoption of uniform rules and regulations in the manufacture, transportation, storage, handling, use and disposal of explosive materials used in blasting and other essential operations. IME member companies produce over 98 percent of the high explosives, and the vast majority of blasting agents and oxidizers. These products are used in every state of the Union and are distributed worldwide.

IME estimates that over 3,000 government entities regulate the civil use of explosives in the United States. It seems like an outrageous number, but these agencies run from the federal level down to municipalities and, at each level, different agencies are often responsible for mining, protecting the environment, security, transportation, or employee safety. These mandates and regulations often overlap. Therefore, consistency, whenever possible, is paramount to small business blasting contractors' ability to comply with the cacophony of regulations that apply to them.

Based on my extensive involvement with or as a member of many national consensus standard setting bodies and my intimate familiarity with the vast set of regulations that impact explosives, the MSHA explosives regulations are unacceptably out-of-step with the times. This is most unfortunate considering that 87 percent of explosives are consumed in mines; 65 percent consumed in surface coal mines alone.[1] The National Fire Protection Association's national consensus standard, NFPA 495, which addresses explosives safety, has been updated 10 times since MSHA's surface coal regulations were apparently cast in stone in 1971.[2]

Since 1999, I have been in many meetings and discussions with MSHA officials and employees at all levels, labor representatives, and mine operators regarding updating these regulations. Despite universal agreement that the regulations need to be updated, MSHA cannot seem to find the will to make it happen.

For the remainder of my testimony, I will describe the most significant vulnerabilities and burdens created by MSHA's lack of attention to explosives in recent years.

Inconsistencies with Current Best Practices

There are many examples where MSHA's regulations are inconsistent with current best practices. Even MSHA's own regulations for coal and metal/nonmetal mines are inconsistent with each other. These inconsistencies expose miners to higher levels of risk than other explosives users and waste the resources of operators.

Perhaps the most glaring inconsistencies exist with the fundamental concepts of "blast site" and blast area." It is hard to imagine a use of explosives where these two concepts should not apply.

MSHA's coal regulations do not recognize the fundamental concept of keeping the "blast site" clear of unauthorized personnel and equipment. MSHA's metal/nonmetal regulations[3] and nearly every other U.S. explosives safety standard are consistent in this regard. Instead of using the standard language, the MSHA surface coal regulations require demarcating "areas" where there are "charged holes."[4] Besides not prohibiting the unsafe act itself, the size of the "area" is not defined. The exact meaning of the term "charged holes" has been a regularly occurring issue of contention between operators, MSHA, labor and IME.

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[1] http://minerals.usgs.gov/minerals/pubs/commodity/explosives/myb1-2006-explo.pdf.
[2] NFPA 495, Explosives Materials Code, 2006 ed.
[3] 30 CFR 56/57.6306(c).
[4] 30 CFR 77.1303(g).

MSHA's coal regulations do not recognize the fundamental concept of clearing the "blast area" before attaching a device capable of firing the shot. MSHA's metal/nonmetal regulations[5] and every other U.S. explosives safety standard are consistent in this regard. Instead of using this well-understood term of art, the MSHA surface coal regulations require clearing personnel from a "blasting area", but does not clearly state when this should take place.[6] The terms "blasting area" and "blast area" are used elsewhere in the coal regulations where the "blast site" would normally be used.[7] This regulation should be crystal clear since MSHA claims that failure to maintain blast area security causes half of the explosives accidents in mines.[8]

IME's written nomination of MSHA's explosives regulations to the SBA's r3 initiative describes 13 more examples of safety gaps in MSHA's explosives regulations for coal mines. I am attaching a copy for the hearing record.

Some of MSHA's regulatory inconsistencies do not necessarily cause safety gaps, but do waste the resources of small businesses. Rules written for the days when black powder was the dominant blasting material are still on the books and enforced by MSHA despite no basis in safety. Storage practices allowed by all other agency regulators in the U.S. are considered illegal by MSHA. Federal Mine Safety and Health Review Commission Chairman Michael Duffy recently described a novel MSHA explosives enforcement action in this area as "regulatory bait and switch."[9]

Outdated References

MSHA does not have a current definition of "explosives" in their regulations. While we support the use of U.S. Department of Transportation (DOT) definitions for the classification of explosives, MSHA's metal/nonmetal regulations refer to nonexistent sections of DOT's regulatory code for its definitions of "detonator", "blasting agent" and "explosive."[10] Likewise, the surface coal regulations have a different definition of "blasting agent" than DOT. Both sets of MSHA regulations still use the explosives classification system (Class A, B and C) abandoned by DOT in 1992. Recently, an Administrative Law Judge kindly described MSHA's definition of blasting agent as being "not helpful" to the case.[11]

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[5] 30 CFR 56/57.6306(e).
[6] 30 CFR 77.1303(h).
[7] 30 CFR 77.1303(gg), (kk), and (ll); and 30 CFR 75.1325(c)(1) and (2), 75.1326(a) and (b)
[8] Verakis, H., "An Examination of Mine Blasting Accidents Over a Quarter of a Century", ISEE, Proceedings of the 32nd Annual Conference on Explosives and Blasting Technique, Jan. 29 – Feb. 1, 2006, Dallas, TX.
[9] http://www.fmshrc.gov/decisions/commission/cent2006-128-11302007.pdf
[10] 30 CFR 56.57.6000
[11] http://www.fmshrc.gov/decisions/alj/ct2006-128.pdf

MSHA's metal/nonmetal regulations also reference nonexistent sections of the Bureau of Alcohol, Tobacco, Firearms and Explosives' (ATF) regulations.[12] A critical error considering that, through a Memorandum of Understanding, MSHA agrees to help carry out ATF's congressional mandate to secure explosives commerce outside of transportation.

The MSHA coal regulations require the mixing and storing of blasting agents to be in compliance with a 1963 USBM standard[13] "or subsequent revisions."[14] The document was revised in 1977 by the USBM[15] but was given a different title than what appears in the regulation, making it virtually impossible to find the document that is currently incorporated by reference into the regulation. This type of perpetual reference circumvents the appropriated rulemaking process and seems to be the very sort of instance Congress intended to avoid by passing the Administrative Procedure Act.[16] Needless to say, bulk explosives technology has changed dramatically since 1963 and 1977. For example, the 1977 document does not address bulk emulsions, a type of blasting agent used extensively today. Dating itself, the 1977 document states that "AN-FO is now supplied mostly premixed", something that occurs rarely today.

Barrier to Improved Technology

Because the outdated regulations do not address the latest explosives products and their applications, small businesses are prevented from incorporating new technology and procedures that will improve safety, security, and operational efficiency. Large companies are also disadvantaged but have more resources and can more easily get around the same regulatory obstacles.

A good example of how the MSHA regulations present an obstacle to the introduction of improved technology by small businesses is the barrier presented to electronic detonators. Electronic detonators did not exist when MSHA's regulations were written and provide a quantum leap in the safety and security of detonators.[17] Since electronic detonators are not addressed by MSHA's regulations, the agency treats them like standard electric detonators. Certain regulations for electric detonators[18] are inappropriate and unsafe for electronic detonators. So to avoid unsafe practices, manufacturers must get MSHA to issue a Program Information Bulletin which exempts

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[12] 30 CFR 56.6131(b)
[13] USBM IC 8179, Safety Recommendations for Sensitized Ammonium Nitrate Blasting Agents, 1963.
[14] 30 CFR 77.1304(a)
[15] USBM IC 8746, Safety Recommendations for Ammonium Nitrate-Based Blasting Agents, 1977
[16] 5 U.S.C. 552 & 1 CFR 51.1(f).
[17] Electronic detonators actually represent the second technology revolution in initiation since the surface coal regulations were written. Shock tube based systems replaced electric detonators in the 1980's and 1990's but are not addressed in MSHA's coal regulations.
[18] 30 CFR 77.1303(e), (y), (z), (nn), and (tt)

their brand-name product from MSHA's electric detonator regulations.[19] This is a cumbersome process that can take months; even for the next generation of a previously approved electronic system. Such a process disadvantages small businesses from entering the electronic detonator market. Compounding the problem is the reluctance of state explosives regulators to depart from MSHA's treatment of electronic detonators.[20]

MSHA's explosives regulations present obstacles to new technology for bulk delivery equipment, recycling used oil, recycling demilitarized explosives, enhanced security, and other explosives applications.

Security Vulnerabilities

The MOU mentioned earlier between MSHA and ATF is needed because it is not practical to train ATF personnel to safely enter and move around in underground mines. Therefore, ATF's responsibilities rest entirely on MSHA's shoulders in underground mines. Apparently, MSHA does not take this responsibility seriously.

MSHA's explosives regulations do not require explosives to always be locked when in storage underground.[21] Also, to the best of my knowledge, MSHA is not providing oversight to ensure that only ATF approved personnel have possession of explosives underground. In my opinion, these two factors create the greatest vulnerability today to the diversion of commercial explosives from legitimate storage or use.

MSHA's regulatory barrier to the use of electronic detonators also inhibits security. Electronic detonators are essentially useless to an unauthorized person since they require a specific, digitally encoded signal to function. On the other hand, standard detonators can function by rudimentary means, of which our adversaries have become most adept. Since nearly 87 percent of explosives are used in mines, MSHA's regulations have hindered the market transition to electronic detonators.

Loss of the Ability to Conduct Safety Audits of Permissible Explosives

MSHA has lost its ability to ensure a safe supply of permissible explosives for the nation's underground coal miners. Permissible explosives are the only type that can be used in an underground coal mine because they have a lower tendency to ignite methane/coal dust mixtures which may result in a mine explosion. Ironically, testing and certifying a class of explosives permitted for used in underground coal mines was the first serious mine safety initiative made by the U.S. government at the turn of the 19th century.

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[19] http://www.msha.gov/regs/complian/PIB/2004/pib04-20.htm
[20] May 7, 2008 e-mail from David Spears, VA Department of Mines, Minerals and Energy to Lon Santis
[21] 30 CFR 57.6160(b)(2)(ii)(5) and 75.1312

While permissible explosives usage has declined during the last century, the market has stabilized. Today, around 2 million pounds of permissible explosives are consumed in the U.S. annually. Mining coal with explosives has become an exclusive niche for small businesses in the underground coal mine community.

The unique properties of permissible explosives can only be evaluated using elaborate tests. MSHA has not conducted these tests for over 10 years, the equipment is in disrepair, and the corporate knowledge needed to conduct the tests is slipping away into retirement.

Despite consuming less than 0.1 percent of the explosives in the U.S., underground coal mines account for 12 percent of the accidents during explosives use.[22] This trend has continued. Most recently, MSHA reported that "On October 23, 2006, a blaster with 25 years of mining experience was fatally injured from the forces of a methane explosion initiated by blasting."[23] MSHA does not have the ability to evaluate whether the explosive products being used at the time met regulatory specifications. Additionally, MSHA has the regulatory authority and responsibility to conduct quality control testing by taking samples from mines and testing them[24] but has not done so for about 15 years. IME believes that such activity is vital to ensuring a safe supply of permissible explosives.

There are only three locations in North America (NA) that manufacture MSHA-approved permissible explosives and only two in the U.S. One of these locations has the only plant in NA that can make permissible dynamite. Plant accidents, shut downs, and other incidents could combine to shut down all or most of the supply of MSHA-approved permissibles. MSHA would have no way to ensure that replacement products meet the same level of safety. Finally, without the ability to test and approve new permissible explosives, future improvements in explosives technology will be kept out of underground coal mines.

Conclusion

We appreciate the opportunity this subcommittee has given us to again attempt to highlight these safety issues and impacts on small businesses. MSHA has failed in its mission as a regulatory agency to keep its rules relevant and in sync with other agency or recognized national consensus standards for safety. In our view, MSHA's inaction has created risk where none need exist. Again, I thank you for this opportunity and I look forward to answering your questions.

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[22] Santis, L. "An Analysis of Recent Accidents During Use of Commercial Explosives", ISEE, Proceedings of the 29th Annual Conference on Explosives and Blasting Technique, Feb. 2-5, 2003, Nashville, TN.

[23] http://www.msha.gov/FATALS/2006/FAB06c42.asp

[24] 30 CFR 15.10

Form **8829**

Department of the Treasury
Internal Revenue Service (99)

Expenses for Business Use of Your Home

▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.

▶ See separate instructions.

OMB No. 1545-0074

2005

Attachment Sequence No. 66

Name(s) of proprietor(s)

Your social security number

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for daycare, or for storage of inventory or product samples (see instructions)	1	
2	Total area of home	2	
3	Divide line 1 by line 2. Enter the result as a percentage	3	%
	• **For daycare facilities not used exclusively for business, also complete lines 4–6.**		
	• **All others, skip lines 4–6 and enter the amount from line 3 on line 7.**		
4	Multiply days used for daycare during year by hours used per day — 4	hr.	
5	Total hours available for use during the year (365 days × 24 hours) (see instructions) — 5	8,760 hr.	
6	Divide line 4 by line 5. Enter the result as a decimal amount — 6	.	
7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 ▶	7	%

Part II Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29, **plus** any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions					8	
	See instructions for columns (a) and (b) before completing lines 9–20.		(a) Direct expenses		(b) Indirect expenses		
9	Casualty losses (see instructions)	9					
10	Deductible mortgage interest (see instructions)	10					
11	Real estate taxes (see instructions)	11					
12	Add lines 9, 10, and 11	12					
13	Multiply line 12, column (b) by line 7			13		14	
14	Add line 12, column (a) and line 13						
15	Subtract line 14 from line 8. If zero or less, enter -0-					15	
16	Excess mortgage interest (see instructions)	16					
17	Insurance	17					
18	Repairs and maintenance	18					
19	Utilities	19					
20	Other expenses (see instructions)	20					
21	Add lines 16 through 20	21					
22	Multiply line 21, column (b) by line 7			22			
23	Carryover of operating expenses from 2004 Form 8829, line 41			23			
24	Add line 21 in column (a), line 22, and line 23					24	
25	Allowable operating expenses. Enter the **smaller** of line 15 or line 24					25	
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15					26	
27	Excess casualty losses (see instructions)			27			
28	Depreciation of your home from Part III below			28			
29	Carryover of excess casualty losses and depreciation from 2004 Form 8829, line 42			29			
30	Add lines 27 through 29					30	
31	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 26 or line 30					31	
32	Add lines 14, 25, and 31					32	
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to **Form 4684,** Section B					33	
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶					34	

Part III Depreciation of Your Home

35	Enter the **smaller** of your home's adjusted basis or its fair market value (see instructions)	35	
36	Value of land included on line 35	36	
37	Basis of building. Subtract line 36 from line 35	37	
38	Business basis of building. Multiply line 37 by line 7	38	
39	Depreciation percentage (see instructions)	39	%
40	Depreciation allowable (see instructions). Multiply line 38 by line 39. Enter here and on line 28 above	40	

Part IV Carryover of Unallowed Expenses to 2006

41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0-	41	
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-	42	

Department of the Treasury
Internal Revenue Service

Publication 587
Cat. No. 15154T

Business Use of Your Home

(Including Use by Day-Care Providers)

For use in preparing
2001 Returns



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Important Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling **1-800-THE-LOST (1-800-843-5678)** if you recognize a child.

Introduction

The purpose of this publication is to provide information on figuring and claiming the deduction for business use of your home. The term ***home*** includes a house, apartment, condominium, mobile home, or boat. It also includes structures on the property, such as an unattached garage, studio, barn, or greenhouse. However, it does not include any part of your property used exclusively as a hotel or inn.

This publication includes information on the following.

- The requirements for qualifying to deduct expenses for the business use of your home (including special rules for storing inventory or product samples).
- Types of expenses you can deduct.

- How to figure the deduction (including depreciation of your home).
- Special rules for day-care providers.
- Selling a home that was used partly for business.
- Deducting expenses for furniture and equipment used in your business.
- Records you should keep.
- Where to deduct your expenses.

If you are an employee, a partner, or you file Schedule F (Form 1040), use the worksheet and its instructions, near the end of this publication, to help figure your deduction. If you file Schedule C (Form 1040), you must use Form 8829, *Expenses for Business Use of Your Home.* The *Schedule C Example* shows how to report the deduction on Form 8829.

The rules in this publication apply to individuals, trusts, estates, partnerships, and S corporations. They do not apply to corporations (other than S corporations). There are no special rules for the business use of a home by a partner or S corporation shareholder.

If you need information on deductions for renting out your property, see Publication 527, *Residential Rental Property.*

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can e-mail us while visiting our web site at **www.irs.gov**.

You can write to us at the following address:

Internal Revenue Service
Technical Publications Branch
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1111 Constitution Ave. NW
Washington, DC 20224

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Useful Items

You may want to see:

Publication

- ❑ **523** Selling Your Home
- ❑ **551** Basis of Assets
- ❑ **583** Starting a Business and Keeping Records
- ❑ **946** How To Depreciate Property

Form (and Instructions)

- ❑ **2106** Employee Business Expenses
- ❑ **2106-EZ** Unreimbursed Employee Business Expenses
- ❑ **4562** Depreciation and Amortization
- ❑ **8829** Expenses for Business Use of Your Home

See *How To Get Tax Help* near the end of this publication for information about getting publications and forms.

Qualifying for a Deduction

To deduct expenses related to the business use of part of your home, you must meet specific requirements. Even then, your deduction may be limited. Use this section and *Figure A* to decide if you can deduct expenses for the business use of your home.

To qualify to claim expenses for business use of your home, you must meet the following tests.

1) Your use of the business part of your home must be:
   a) Exclusive (however, see *Exceptions to Exclusive Use,* later),
   b) Regular,
   c) For your trade or business, AND
2) The business part of your home must be ***one*** of the following:
   a) Your principal place of business (defined later),
   b) A place where you meet or deal with patients, clients, or customers in the normal course of your trade or business, or
   c) A separate structure (not attached to your home) you use in connection with your trade or business.

Additional tests for employee use. If you are an employee and you use a part of your home for business, you may qualify for a deduction for its business use. You must meet the tests discussed above ***plus:***

1) Your business use must be for the convenience of your employer, and
2) You ***do not*** rent any part of your home to your employer and use the rented portion to perform services as an employee.



Whether the business use of your home is for your employer's convenience depends on all the facts and circumstances. However, business use is not considered to be for your employer's convenience merely because it is appropriate and helpful.

Exclusive Use

To qualify under the exclusive use test, you must use a specific area of your home ***only*** for your trade or business. The area used for business can be a room or other sepa-

rately identifiable space. The space does not need to be marked off by a permanent partition.

You do ***not*** meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.

Example. You are an attorney and use a den in your home to write legal briefs and prepare clients' tax returns. Your family also uses the den for recreation. Since the den is not used exclusively in your profession, you ***cannot*** claim a business deduction for its use.

Exceptions to Exclusive Use

You do not have to meet the exclusive use test if either of the following applies.

- You use part of your home for the storage of inventory or product samples (discussed next).
- You use part of your home as a day-care facility, discussed later under *Day-Care Facility.*

Storage of inventory or product samples. If you use part of your home for the storage of inventory or product samples, you can claim expenses for the business use of your home without meeting the exclusive use test. However, you must meet all of the following tests.

- You sell products at wholesale or retail as your trade or business.
- You keep the inventory or product samples in your home for use in your trade or business.
- Your home is the only fixed location of your trade or business.
- You use the storage space on a regular basis.
- The space you use is an identifiably separate space suitable for storage.

Example. Your home is the sole fixed location of your business of selling mechanics' tools at retail. You regularly use half of your basement for storage of inventory and product samples. You sometimes use the area for personal purposes. The expenses for the storage space are deductible even though you do not use this part of your basement exclusively for business.

Regular Use

To qualify under the regular use test, you must use a specific area of your home for business on a continuing basis. You do not meet the test if your business use of the area is only occasional or incidental, even if you do not use that area for any other purpose.

Trade or Business Use

To qualify under the trade or business use test, you must use part of your home in connection with a trade or business. If you use your home for a profit-seeking activity that is not a trade or business, you cannot take a deduction for its business use.

Example. You use part of your home exclusively and regularly to read financial periodicals and reports, clip bond coupons, and carry out similar activities related to your own investments. You do not make investments as a broker or dealer. Since your activities are not part of a trade or business, you cannot take a deduction for the business use of your home.

Principal Place of Business

You can have more than one business location, including your home, for a single trade or business. To qualify to deduct the expenses for the business use of your home under the principal place of business test, your home must be your principal place of business for that trade or business. To determine your principal place of business, you must consider all the facts and circumstances.

Your home office will qualify as your principal place of business for deducting expenses for its use if you meet the following requirements.

- You use it exclusively and regularly for administrative or management activities of your trade or business.
- You have no other fixed location where you conduct substantial administrative or management activities of your trade or business.

Alternatively, if you use your home exclusively and regularly for your business, but your home office does not qualify as your principal place of business based on the previous rules, you determine your principal place of business based on the following factors.

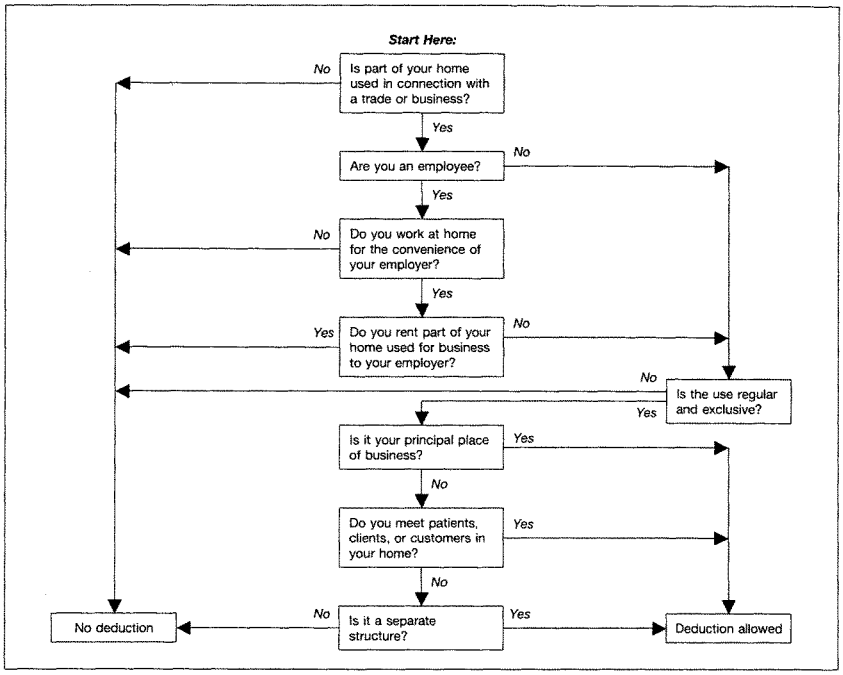
1) The relative importance of the activities performed at each location.
2) If the relative importance factor does not determine your principal place of business, you can also consider the time spent at each location.

If, after considering your business locations, your home cannot be identified as your principal place of business, you cannot deduct home office expenses. However, see the later discussions under *Place To Meet Patients, Clients, or Customers* or *Separate Structure* for other ways to qualify to deduct home office expenses.

Administrative or management activities. There are many activities that are administrative or managerial in nature. The following are a few examples.

- Billing customers, clients, or patients.
- Keeping books and records.
- Ordering supplies.
- Setting up appointments.
- Forwarding orders or writing reports.

Figure A. **Can You Deduct Business Use of the Home Expenses?***



* Do not use this chart if you use your home for the storage of inventory or product samples, or to operate a day-care facility. See *Exceptions to Exclusive Use*, earlier, and *Day-Care Facility*, later.

Administrative or management activities performed at other locations. The following activities performed by you or others will ***not*** disqualify your home office from being your principal place of business.

- You have others conduct your administrative or management activities at locations other than your home. (For example, another company does your billing from its place of business.)
- You conduct administrative or management activities at places that are not fixed locations of your business, such as in a car or a hotel room.
- You occasionally conduct minimal administrative or management activities at a fixed location outside your home.
- You conduct substantial nonadministrative or nonmanagement business activities at a fixed location outside your home. (For example, you meet with or provide services to customers, clients, or patients at a fixed location of the business outside your home.)
- You have suitable space to conduct administrative or management activities outside your home, but choose to use your home office for those activities instead.

Example 1. John is a self-employed plumber. Most of John's time is spent at customers' homes and offices installing and repairing plumbing. He has a small office in his home that he uses exclusively and regularly for the administrative or management activities of his business, such as phoning customers, ordering supplies, and keeping his books.

John does not do his own billing. He uses a local bookkeeping service to bill his customers.

John's home office qualifies as his principal place of business for deducting expenses for its use. He uses the home office for the administrative or managerial activities of his plumbing business and he has no other fixed location where he conducts these administrative or managerial activities. His choice to have his billing done by another

company does not disqualify his home office from being his principal place of business. Because he meets all the qualifications, including principal place of business, he can deduct expenses (to the extent of the deduction limit, explained later) for the business use of his home.

Example 2. Pamela is a self-employed sales representative for several different product lines. She has an office in her home that she uses exclusively and regularly to set up appointments and write up orders and other reports for the companies whose products she sells. She occasionally writes up orders and sets up appointments from her hotel room when she is away on business overnight.

Pamela's business is selling products to customers at various locations throughout her territory. To make these sales, she regularly visits customers to explain the available products and take orders.

Pamela's home office qualifies as her principal place of business for deducting expenses for its use. She conducts administrative or management activities there and she has no other fixed location where she conducts administrative or management activities. The fact that she conducts some administrative or management activities in her hotel room (not a fixed location) does not disqualify her home office from being her principal place of business. Because she meets all the qualifications, including principal place of business, she can deduct expenses (to the extent of the deduction limit, explained later) for the business use of her home.

Example 3. Paul is a self-employed anesthesiologist. He spends the majority of his time administering anesthesia and postoperative care in three local hospitals. One of the hospitals provides him with a small shared office where he could conduct administrative or management activities.

Paul does not use the office the hospital provides. He uses a room in his home that he has converted to an office. He uses this room exclusively and regularly to conduct all the following activities.

- Contacting patients, surgeons, and hospitals regarding scheduling.
- Preparing for treatments and presentations.
- Maintaining billing records and patient logs.
- Satisfying continuing medical education requirements.
- Reading medical journals and books.

Paul's home office qualifies as his principal place of business for deducting expenses for its use. He conducts administrative or management activities for his business as an anesthesiologist there and he has no other fixed location where he conducts administrative or management activities for this business. His choice to use his home office instead of one provided by the hospital does not disqualify his home office from being his principal place of business. His performance of substantial nonadministrative or nonmanagement activities at fixed locations outside his home also does not disqualify his home office from being his principal place of business. Because he meets all the qualifications, including principal place of business, he can deduct expenses (to the extent of the deduction limit, explained later) for the business use of his home.

Example 4. Kathleen is employed as a teacher. She is required to teach and meet with students at the school and to grade papers and tests. The school provides her with a small office where she can work on her lesson plans, grade papers and tests, and meet with parents and students. The school does not require her to work at home.

Kathleen prefers to use the office she has set up in her home and does not use the one provided by the school. She uses this home office exclusively and regularly for the administrative duties of her teaching job.

Kathleen must meet the convenience-of-the-employer test, even if her home qualifies as her principal place of business for deducting expenses for its use. Because her employer provides her with an office and does not require her to work at home, she does not meet the convenience-of-the-employer test and cannot claim a deduction for the business use of her home.

More Than One Trade or Business

Whether your home office is the principal place of business must be determined separately for each trade or business activity. One home office may be the principal place of business for more than one activity. However, you will not meet the exclusive use test for any activity unless each activity conducted in that office meets all the tests for the business use of the home deduction.

Example. Tracy White is employed as a teacher. Her principal place of work is the school. She also has a mail order jewelry business. All her work in the jewelry business is done in her home office and the office is used exclusively for that business. If she meets all the other tests, she can deduct expenses for business use of her home for the jewelry business.

If Tracy also uses the office for work related to her teaching, she would not meet the exclusive use test for the jewelry business. As an employee, Tracy must meet the convenience-of-the-employer test to qualify for the deduction. Because she does not meet this test for her work as a teacher, she cannot claim a deduction for the business use of her home for either activity.

Place To Meet Patients, Clients, or Customers

If you meet or deal with patients, clients, or customers in your home in the normal course of your business, even though you also carry on business at another location, you can deduct your expenses for the part of your home used exclusively and regularly for business if you meet the following tests.

- You physically meet with patients, clients, or customers on your premises.
- Their use of your home is substantial and integral to the conduct of your business.

Doctors, dentists, attorneys, and other professionals who maintain offices in their homes will generally meet this requirement.

Using your home for occasional meetings and telephone calls will not qualify you to deduct expenses for the business use of your home.

The part of your home you use exclusively and regularly to meet patients, clients, or customers does not have to be your principal place of business.

Example. June Quill, a self-employed attorney, works 3 days a week in her city office. She works 2 days a week in her home office used only for business. She regularly meets clients there. Her home office qualifies for a business deduction because she meets clients there in the normal course of her business.

Separate Structure

You can deduct expenses for a separate free-standing structure, such as a studio, garage, or barn, if you use it exclusively and regularly for your business. The structure does not have to be your principal place of business or a place where you meet patients, clients, or customers.

Example. John Berry operates a floral shop in town. He grows the plants for his shop in a greenhouse behind his home. Since he uses the greenhouse exclusively and regularly in his business, he can deduct the expenses for its use, subject to the deduction limit, explained later.

Figuring the Deduction

After you determine that you meet the tests under *Qualifying for a Deduction,* you can begin to figure how much you can deduct. You will need to figure the percentage of your home used for business and the limit on the deduction.

Business Percentage

To find the business percentage, compare the size of the part of your home that you use for business to your whole house. Use the resulting percentage to figure the business part of the expenses for operating your entire home.

You can use any reasonable method to determine the business percentage. The following are two commonly used methods for figuring the percentage.

1) Divide the area (length multiplied by the width) used for business by the total area of your home.
2) Divide the number of rooms used for business by the total number of rooms in your home. You can use this method if the rooms in your home are all about the same size.

Example 1.

- Your office is 240 square feet (12 feet × 20 feet).
- Your home is 1,200 square feet.
- Your office is 20% (240 ÷ 1,200) of the total area of your home.
- Your business percentage is 20%.

Example 2.

- You use one room in your home for business.
- Your home has four rooms, all of about equal size.
- Your office is 25% (1 ÷ 4) of the total area of your home.
- Your business percentage is 25%.

TIP *Use lines 1–7 of Form 8829, or lines 1–3 on the worksheet near the end of this publication, to figure your business percentage.*

Part-Year Use

You cannot deduct expenses for the business use of your home incurred during any part of the year you did not use your home for business purposes. For example, if you begin using part of your home for business on July 1, and you meet all the tests from that date until the end of the year, consider only your expenses for the last half of the year in figuring your allowable deduction.

Deduction Limit

If your gross income from the business use of your home equals or exceeds your total business expenses (including depreciation), you can deduct all your business expenses related to the use of your home. If your gross income from the business use is less than your total business expenses, your deduction for certain expenses for the business use of your home is limited.

Your deduction of otherwise nondeductible expenses, such as insurance, utilities, and depreciation (with depreciation taken last), allocable to the business, is limited to the gross income from the business use of your home minus the sum of the following.

1) The business part of expenses you could deduct even if you did not use your home for business (such as mortgage interest, real estate taxes, and casualty and theft losses, which are allowable as itemized deductions on Schedule A (Form 1040)). These expenses are discussed in detail under *Deducting Expenses,* later.
2) The business expenses that relate to the business activity in the home (for example, business phone, supplies, and depreciation on equipment), but not to the use of the home itself.

If you are self-employed, do not include in (2) above your deduction for half of your self-employment tax.

Carryover of unallowed expenses. If your deductions are greater than the current year's limit, you can carry over

the excess to the next year. They are subject to the deduction limit for that year, whether or not you live in the same home during that year.

Figuring the deduction limit and carryover. If you are an employee or file Schedule F (Form 1040), *Profit or Loss From Farming*, use the worksheet near the end of this publication to figure your deduction limit and carryover. If you file Schedule C (Form 1040), figure your deduction limit and carryover on Form 8829.

Example. You meet the requirements for deducting expenses for the business use of your home. You use 20% of your home for this business. In 2001, your business expenses and the expenses for the business use of your home are deducted from your gross income in the following order.

Gross income from business	$6,000
Less:	
Deductible mortgage interest and real estate taxes (20%)	3,000
Business expenses not related to the use of your home (100%) (business phone, supplies, and depreciation on equipment)	2,000
Deduction limit	$1,000
Less other expenses allocable to business use of home:	
Maintenance, insurance, and utilities (20%)	800
Depreciation allowed (20% = $1,600 allowable)	200
Other expenses up to the deduction limit	$1,000
Depreciation carryover to 2002 ($1,600 – $200) (subject to deduction limit in 2002)	$1,400

You can deduct all of the business part of your deductible mortgage interest and real estate taxes ($3,000). You also can deduct all of your business expenses not related to the use of your home ($2,000). Additionally, you can deduct all of the business part of your expenses for maintenance, insurance, and utilities, because the total ($800) is less than the $1,000 deduction limit. Your deduction for depreciation for the business use of your home is limited to $200 ($1,000 minus $800) because of the deduction limit. You can carry over the $1,400 balance and add it to your depreciation for 2002, subject to your deduction limit in 2002.

More than one place of business. If part of the gross income from your trade or business is from the business use of part of your home and part is from a place other than your home, you must determine the part of your gross income from the business use of your home before you figure the deduction limit. In making this determination, consider the time you spend at each location, the business investment in each location, and any other relevant facts and circumstances.

TIP *If your home office qualifies as your principal place of business, you can deduct your daily transportation costs between your home and another work location in the same trade or business. For more information on transportation costs, see Publication 463,* Travel, Entertainment, Gift and Car Expenses.

Deducting Expenses

If you qualify to deduct expenses for the business use of your home, you must divide the expenses of operating your home between personal and business use. This section discusses the types of expenses you may have and gives examples and brief explanations of these expenses.

Types of Expenses

The part of a home operating expense you can use to figure your deduction depends on both of the following.

- Whether the expense is direct, indirect, or unrelated.
- The percentage of your home used for business.

The following table describes the types of expenses you may have and the extent to which they are deductible.

Expense	Description	Deductibility
Direct	Expenses only for the business part of your home. ***Examples:*** Painting or repairs only in the area used for business.	Deductible in full.* ***Exception:*** May be only partially deductible in a day-care facility. See *Day-Care Facility*, later.
Indirect	Expenses for running your entire home. ***Examples:*** Insurance, utilities, and general repairs.	Deductible based on the percentage of your home used for business.*
Unrelated	Expenses only for the parts of your home ***not*** used for business. ***Examples:*** Lawn care or painting a room not used for business.	Not deductible.

*Subject to the deduction limit, discussed earlier.

TIP *Form 8829 and the deduction worksheet (both illustrated near the end of this publication) have separate columns for direct and indirect expenses.*

Expenses related to tax-exempt income. Generally, you cannot deduct expenses that are related to tax-exempt allowances. However, if you receive a tax-exempt parsonage allowance or a tax-exempt military allowance, your expenses for mortgage interest and real estate taxes are deductible under the normal rules. No deduction is allowed for other expenses related to the tax-exempt allowance.

If your housing is provided free of charge and the value of the housing is tax-exempt, you cannot deduct the rental value of any portion of the housing.

Examples of Expenses

Certain expenses are deductible ***whether or not*** you use your home for business. If you qualify to claim business use of the home expenses, you can use the business percentage of these expenses to figure your total business use of the home deduction. These expenses include the following.

- Real estate taxes.
- Deductible mortgage interest.
- Casualty losses.

Other expenses are deductible ***only*** if you use your home for business. You can use the business percentage of these expenses to figure your total business use of the home deduction. These expenses generally include (but are not limited to) the following.

- Depreciation (covered under *Depreciating Your Home*, later).
- Insurance.
- Rent.
- Repairs.
- Security system.
- Utilities and services.

Real Estate Taxes

To figure the business part of your real estate taxes, multiply the real estate taxes paid by the percentage of your home used for business.

For more information on the deduction for real estate taxes, see Publication 530, *Tax Information for First-Time Homeowners.*

Deductible Mortgage Interest

To figure the business part of your deductible mortgage interest, multiply this interest by the percentage of your home used for business. You can include interest on a second mortgage in this computation. If your total mortgage debt is more than $1,000,000 or your home equity debt is more than $100,000, your deduction may be limited. For more information on what interest is deductible, see Publication 936, *Home Mortgage Interest Deduction.*

Casualty Losses

If you have a casualty loss on your home that you use for business, treat the casualty loss as a direct expense, an indirect expense, or an unrelated expense, depending on the property affected.

1) *Direct expense.* If the loss is on the portion of the property you use ***only*** in your business, use the entire loss to figure the business use of the home deduction.
2) *Indirect expense.* If the loss is on property you use for ***both*** business and personal purposes, use only the business portion to figure the deduction.
3) *Unrelated expense.* If the loss is on property you ***do not*** use in your business, do not use any of the loss to figure the deduction.

If you are filing Schedule C (Form 1040), get Form 8829 and follow the instructions for casualty losses. If you are an employee, a partner, or you file Schedule F (Form 1040), use the worksheet near the end of this publication. You will also need to get Form 4684, *Casualties and Thefts.*

For more information on casualty losses, see Publication 547, *Casualties, Disasters, and Thefts.*

Insurance

You can deduct the cost of insurance that covers the business part of your home. However, if your insurance premium gives you coverage for a period that extends past the end of your tax year, you can deduct only the business percentage of the part of the premium that gives you coverage for your tax year. You can deduct the business percentage of the part that applies to the following year in that year.

Rent

If you rent the home you occupy and meet the requirements for business use of the home, you can deduct part of the rent you pay. To figure your deduction, multiply your rent payments by the percentage of your home used for business.

If you own your home, you cannot deduct the fair rental value of your home. However, see *Depreciating Your Home*, later.

Repairs

The cost of repairs that relate to your business, including labor (other than your own labor), is a deductible expense. For example, a furnace repair benefits the entire home. If you use 10% of your home for business, you can deduct 10% of the cost of the furnace repair.

Repairs keep your home in good working order over its useful life. Examples of common repairs are patching walls and floors, painting, wallpapering, repairing roofs and gutters, and mending leaks. However, repairs are sometimes treated as a permanent improvement. See *Permanent improvements* later under *Depreciating Your Home.*

Security System

If you install a security system that protects all the doors and windows in your home, you can deduct the business part of the expenses you incur to maintain and monitor the system. You can also take a depreciation deduction for the

part of the cost of the security system relating to the business use of your home.

Utilities and Services

Expenses for utilities and services, such as electricity, gas, trash removal, and cleaning services, are primarily personal expenses. However, if you use part of your home for business, you can deduct the business part of these expenses. Generally, the business percentage for utilities is the same as the percentage of your home used for business.

Telephone. The basic local telephone service charge, including taxes, for the first telephone line into your home is a nondeductible personal expense. However, charges for business long-distance phone calls on that line, as well as the cost of a second line into your home used exclusively for business, are deductible business expenses. You can deduct these expenses even if the expenses for the business use of your home do not qualify for the deduction. Deduct these charges separately on the appropriate schedule. Do not include them in your home office deduction.

Depreciating Your Home

If you own your home and qualify to deduct expenses for its business use, you can claim a deduction for depreciation. Depreciation is an allowance for the wear and tear on the part of your home used for business. You cannot depreciate the cost or value of the land. You recover its cost when you sell or otherwise dispose of the property.

Before you figure your depreciation deduction, you need to know the following information.

- The month and year you started using your home for business.
- The adjusted basis and fair market value of your home at the time you began using it for business.
- The cost of any improvements before and after you began using the property for business.
- The percentage of your home used for business. See *Business Percentage*, earlier.

Adjusted basis defined. The adjusted basis of your home is generally its cost, plus the cost of any permanent improvements you made to it, minus any casualty losses or depreciation deducted in earlier tax years. For a discussion of adjusted basis, see Publication 551.

Permanent improvements. A permanent improvement increases the value of property, adds to its life, or gives it a new or different use. Examples of improvements are replacing electric wiring or plumbing, adding a new roof or addition, paneling, or remodeling.

If you make repairs as part of an extensive remodeling or restoration of your home, the entire job is an improvement. You must carefully distinguish between repairs and improvements. You must also keep accurate records of these expenses. These records will help you decide whether an expense is a deductible or capital (added to the basis) expense.

Example. You buy an older home and fix up two rooms as a beauty salon. You patch the plaster on the ceilings and walls, paint, repair the floor, install an outside door, and install new wiring, plumbing, and other equipment. Normally, the patching, painting, and floor work are repairs and the other expenses are permanent improvements. However, since the work gives your property a new use, the entire remodeling job is a permanent improvement and its cost is added to the basis of the property. You cannot deduct any portion of it as a repair expense.

Adjusting for depreciation deducted in earlier years. Decrease the basis of your property by the depreciation you deducted, or could have deducted, on your tax returns under the method of depreciation you properly selected. If you took less depreciation than you could have under the method you selected, decrease the basis by the amount you could have taken under that method. If you did not take a depreciation deduction, decrease the basis by the amount you could have deducted.

If you deducted more depreciation than you should have, decrease your basis by the amount you should have deducted, plus the part of the excess deducted that actually decreased your tax liability for any year.

If you deducted the incorrect amount of depreciation, see *How Do You Correct Depreciation Deductions?* in Publication 946.

Fair market value defined. The fair market value of your home is the price at which the property would change hands between a buyer and a seller, neither having to buy or sell, and both having reasonable knowledge of all necessary facts. Sales of similar property, on or about the date you begin using your home for business, may be helpful in figuring the property's fair market value.

Figuring the Depreciation Deduction for the Current Year

If you began using your home for business before 2001, continue to use the same depreciation method you used in past tax years.

If you began using your home for business in 2001, depreciate the business part as nonresidential real property under the modified accelerated cost recovery system (MACRS). Under MACRS, nonresidential real property is depreciated using the straight line method over 39 years. For more information on MACRS and other methods of depreciation, see Publication 946.

To figure the depreciation deduction, you must first figure the part of the cost of your home that can be depreciated (depreciable basis). The depreciable basis is figured by multiplying the percentage of your home used for business by the smaller of the following.

- The adjusted basis of your home (excluding land) on the date you began using your home for business.

- The fair market value of your home (excluding land) on the date you began using your home for business.

Depreciation table. If 2001 was the first year you used your home for business, you can figure your 2001 depreciation for the business part of your home by using the appropriate percentage from the following table.

MACRS Percentage Table for 39-Year Nonresidential Real Property

Month First Used for Business	Percentage To Use
1	2.461%
2	2.247%
3	2.033%
4	1.819%
5	1.605%
6	1.391%
7	1.177%
8	0.963%
9	0.749%
10	0.535%
11	0.321%
12	0.107%

Multiply the depreciable basis of the business part of your home by the percentage from the table for the first month you use your home for business. See *Table A-7a* in *Appendix A* of Publication 946 for the percentages for the remaining tax years of the recovery period.

Example. In May, George Miller began to use one room in his home exclusively and regularly to meet clients. This room is 8% of the square footage of his home. He bought the home in 1992 for $125,000. He determined from his property tax records that his adjusted basis in the house (exclusive of land) is $115,000. In May, the house had a fair market value of $165,000. He multiplies his adjusted basis (which is less than the fair market value) by 8%. The result is $9,200, his depreciable basis for the business part of the house.

George files his return based on the calendar year. May is the 5th month of his tax year. He multiplies his depreciable basis of $9,200 by 1.605% (.01605), the percentage from the table for the 5th month. The result is $147.66, his depreciation deduction.

Depreciating Permanent Improvements

Add the costs of permanent improvements made before you began using your home for business to the basis of your property. Depreciate these costs as part of the cost of the house as explained earlier. The costs of improvements made after you begin using your home for business (that affect the business part of your home, such as a new roof) are depreciated separately. Multiply the cost of the improvement by the business-use percentage and depreciate the result over the recovery period that would apply to your home if you began using it for business at the same time as the improvement. For improvements made this year, the recovery period is 39 years. For the percentage to use for the first year, see *MACRS Percentage Table for 39-Year Nonresidential Real Property,* earlier. For more information on recovery periods, see *Which Recovery Period Applies?* in chapter 3 of Publication 946.

Day-Care Facility

If you use space in your home on a ***regular*** basis for providing day care, you may be able to deduct the business expenses for that part of your home even though you use the same space for nonbusiness purposes. To qualify for this exception to the exclusive use rule, you must meet the following requirements.

1) You must be in the trade or business of providing day care for children, persons 65 or older, or persons who are physically or mentally unable to care for themselves.
2) You must have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a day-care center or as a family or group day-care home under state law. You do not meet this requirement if your application was rejected or your license or other authorization was revoked.

Figuring the deduction. If you regularly use part of your home for day care, figure what part is used for day care, as explained earlier under *Business Percentage.* If you use that part ***exclusively*** for day care, deduct all the allocable expenses; subject to the deduction limit, as explained earlier.

If the use of part of your home as a day-care facility is regular, but ***not*** exclusive, you must figure what part of available time you actually use it for business. A room that is ***available*** for use throughout each business day and that you regularly use in your business is considered to be used for day care throughout each business day. You do not have to keep records to show the specific hours the area was used for business. You may use the area occasionally for personal reasons. However, a room you use only occasionally for business does not qualify for the deduction.

TIP *To find what part of the available time you actually use your home for business, compare the total time used for business to the total time that part of your home can be used for all purposes. You can compare the hours of business use in a week with the number of hours in a week (168). Or you can compare the hours of business use for the year with the number of hours in the year (8,760 in 2001).*

Example 1. Mary Lake uses her basement to operate a day-care business for children. She figures the business percentage of the basement as follows.

$$\frac{\text{Square footage of the basement}}{\text{Square footage of her home}} = \frac{1,600}{3,200} = 50\%$$

She uses the basement for day care an average of 12 hours a day, 5 days a week, for 50 weeks a year. During the other 12 hours a day, the family can use the basement. She figures the percentage of time the basement is available for use as follows.

$$\frac{\text{Number of hours available for use (12 x 5 x 50)}}{\text{Total number of hours in the year (24 x 365)}} = \frac{3,000}{8,760} = 34.25\%$$

Mary can deduct 34.25% of any ***direct*** expenses for the basement. However, because her ***indirect*** expenses are for the entire house she can deduct only 17.13% of the indirect expenses. She figures the percentage for her indirect expenses as follows.

Business percentage of the basement	50%
Multiplied by: Percentage of time used	× 34.25%
Percentage for indirect expenses	**17.13%**

Mary completes Form 8829 as shown in *Figure B.* In Part I she figures the percentage of her home used for business, including the percentage of time the basement is used.

In Part II, Mary figures her deductible expenses. She uses the following information to complete Part II.

Gross income from her day-care business	$50,000
Expenses not related to the business use of the home	$25,000
Tentative profit	$25,000
Rent	$8,400
Utilities	$850
Painting the basement	$500

Mary enters her tentative profit, $25,000, on line 8. (This figure is the same as the amount on line 29 of her Schedule C.)

The expenses she paid for rent and utilities relate to her entire home. Therefore, she enters them in column (b) on the appropriate lines. She adds these two expenses (line 21) and multiplies the total by the percentage on line 7 and enters the result, $1,585, on line 22.

Mary paid $500 to have the basement painted. The painting is a direct expense. However, because she does not use the basement exclusively for day care, she must multiply $500 by the percentage of time the basement is used for day care (34.25% — line 6). She enters $171 (34.25% × $500) on line 18, column (a). She adds lines 21 and 22 and enters $1,756 ($171 + $1,585) on line 24. Because this is less than her deduction limit (line 15), she can deduct the entire amount. She completes the rest of Part II by entering $1,756 on lines 32 and 34. She then carries the $1,756 to line 30 of her Schedule C (not shown).

Example 2. Assume the same facts as in Example 1 except that Mary also has another room that is available each business day for children to take naps in. Although she did not keep a record of the number of hours the room was actually used for naps, it was used for part of each business day. Since the room was available during regular operating hours each business day and was used regularly in the business, it is considered to be used for day care throughout each business day. The basement and room are 60% of the total area of her home. In figuring her expenses, 34.25% of any direct expenses for the basement and room are deductible. In addition, 20.55% (34.25% × 60%) of her indirect expenses are deductible.

Meals. If you provide food for your day-care recipients, do not include the expense as a cost of using your home for business. Claim it as a separate deduction on your Schedule C (Form 1040). You can never deduct the cost of food consumed by you or your family. You can deduct as a business expense 100% of the cost of food consumed by your day-care recipients and generally only 50% of the cost of food consumed by your employees. However, you can deduct 100% of the cost of food consumed by your employees if its value can be excluded from their wages as a de minimis fringe benefit. For more information on meals which meet these requirements, see *Meals* in Publication 15-B, *Employer's Tax Guide to Fringe Benefits.*

If you deduct the cost of food for your day-care business, keep a separate record (with receipts) of your family's food costs.

Reimbursements you receive from a sponsor under the Child and Adult Food Care Program of the Department of Agriculture are taxable only to the extent they exceed your expenses for food for eligible children. If your reimbursements are more than your expenses for food, show the difference as income in Part I of Schedule C. If your food expenses are greater than the reimbursements, show the difference as an expense in Part V of Schedule C. Do not include payments or expenses for your own children if they are eligible for the program. Follow this procedure even if you receive a Form 1099 reporting a payment from the sponsor.

Sale or Exchange of Your Home

If you sell or exchange your home, you may be able to exclude up to $250,000 ($500,000 for certain married persons filing a joint return) of the gain on the sale or exchange if you meet the ownership and use tests.

Ownership and use tests. To claim the exclusion, you must meet the ownership and use tests. This means that during the 5-year period ending on the date of the sale, you met both the following tests.

1) You owned the home for at least 2 years (ownership test).
2) You lived in the home as your main home for at least 2 years (use test).

Business use during the ownership and use periods. If you used part of your home for business during the ownership and use periods, the exclusion generally applies only to the gain attributable to the personal part of your home.

Depreciation. If you were entitled to take depreciation deductions because you used your home for business, you ***cannot*** exclude the part of your gain equal to any depreci-

Figure B

Form **8829**

Department of the Treasury
Internal Revenue Service

Expenses for Business Use of Your Home

▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.

▶ See separate instructions.

OMB No. 1545-1266

2001

Attachment Sequence No. **66**

Name(s) of proprietor(s): Mary Lake

Your social security number: 412 : 00 : 1234

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples. See instructions		1	1,600
2	Total area of home		2	3,200
3	Divide line 1 by line 2. Enter the result as a percentage		3	50 %
	• **For day-care facilities not used exclusively for business, also complete lines 4–6.**			
	• **All others, skip lines 4–6 and enter the amount from line 3 on line 7.**			
4	Multiply days used for day care during year by hours used per day	4 3,000 hr.		
5	Total hours available for use during the year (365 days × 24 hours). See instructions	5 8,760 hr.		
6	Divide line 4 by line 5. Enter the result as a decimal amount	6 .3425		
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 ▶		7	17.13 %

Part II Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29, **plus** any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions				8	25,000
	See instructions for columns (a) and (b) before completing lines 9–20.		(a) Direct expenses	(b) Indirect expenses		
9	Casualty losses. See instructions	9				
10	Deductible mortgage interest. See instructions	10				
11	Real estate taxes. See instructions	11				
12	Add lines 9, 10, and 11	12				
13	Multiply line 12, column (b) by line 7	13				
14	Add line 12, column (a) and line 13				14	-0-
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	25,000
16	Excess mortgage interest. See instructions	16				
17	Insurance	17				
18	Repairs and maintenance	18	171			
19	Utilities	19		850		
20	Other expenses. See instructions	20		8,400		
21	Add lines 16 through 20	21	171	9,250		
22	Multiply line 21, column (b) by line 7	22		1,585		
23	Carryover of operating expenses from 2000 Form 8829, line 41	23				
24	Add line 21 in column (a), line 22, and line 23				24	1,756
25	Allowable operating expenses. Enter the **smaller** of line 15 or line 24				25	1,756
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15				26	23,244
27	Excess casualty losses. See instructions	27				
28	Depreciation of your home from Part III below	28				
29	Carryover of excess casualty losses and depreciation from 2000 Form 8829, line 42	29				
30	Add lines 27 through 29				30	-0-
31	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 26 or line 30				31	-0-
32	Add lines 14, 25, and 31				32	1,756
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to **Form 4684,** Section B				33	-0-
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶				34	1,756

Part III Depreciation of Your Home

35	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	35	
36	Value of land included on line 35	36	
37	Basis of building. Subtract line 36 from line 35	37	
38	Business basis of building. Multiply line 37 by line 7	38	
39	Depreciation percentage. See instructions	39	%
40	Depreciation allowable. Multiply line 38 by line 39. Enter here and on line 28 above. See instructions	40	

Part IV Carryover of Unallowed Expenses to 2002

41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0-	41	
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-	42	

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ation allowed or allowable as a deduction for periods after May 6, 1997. If you can show by adequate records or other evidence that the depreciation deduction allowed was less than the amount allowable, the amount you cannot exclude is the depreciation allowed.

Basis adjustment. If you used any part of your home for business, you must adjust the basis of your home for any depreciation that was allowable for its business use, even if you did not claim it. If you took less depreciation than you could have under the method you properly selected, you must decrease the basis by the amount you could have taken under that method. If you took more depreciation than you should have under the method you properly selected, you must decrease the basis by the amount you should have deducted, plus the part of the excess deducted that actually decreased your tax liability for any year. For more information on reducing the basis of your property for depreciation, see Publication 551.

More information. This section covers only the basic rules for the sale or exchange of your home. For more information, see Publication 523.

Business Furniture and Equipment

This section discusses the depreciation and section 179 deductions you may be entitled to take for furniture and equipment you use in your home for business or work as an employee. These deductions are available whether or not you qualify to deduct expenses for the business use of your home.

This section explains the different rules for each of the following.

1) Listed property.
2) Property bought for business use.
3) Personal property converted to business use.

Listed Property

If you use certain types of property, called ***listed property,*** in your home, special rules apply. Listed property includes any property of a type generally used for entertainment, recreation, and amusement (including photographic, phonographic, communication, and video recording equipment). Listed property also includes computers and related equipment unless they are used in a qualifying office in your home. If you use your computer in a qualifying office in your home, see *Property Bought for Business Use,* later.

More-than-50%-use test. If you bought listed property and placed it in service during the year, you must use it more than 50% for business (including work as an employee) to claim a section 179 deduction or an accelerated depreciation deduction.

If your business use of listed property is 50% or less, you cannot take a section 179 deduction and you must depreciate the property using the Alternate Depreciation System (ADS) (straight line method). For more information on ADS, see chapter 3 in Publication 946.

Listed property meets the more-than-50%-use test for any year if its qualified business use is more than 50% of its total use. You must allocate the use of any item of listed property used for more than one purpose during the year among its various uses. You cannot use the percentage of investment use as part of the percentage of qualified business use to meet the more-than-50%-use test. However, you do use the combined total of business and investment use to figure your depreciation deduction for the property.

Example 1. Sarah does not qualify to claim a deduction for the business use of her home, but she uses her home computer 40% of the time for a business she operates out of her home. She also uses the computer 50% of the time to manage her investments. Sarah's home computer is listed property because it is not used in a qualified office in her home. Because she does not use the computer more than 50% for business, she cannot elect a section 179 deduction. She can use her combined business/investment use (90%) to figure her depreciation deduction using ADS.

Example 2. If Sarah uses her computer 60% of the time for her business and 30% for managing her investments, her computer meets the more-than-50%-use test. She can elect a section 179 deduction. She can use her combined business/investment use (90%) to figure her depreciation deduction using the General Depreciation System (GDS).

Employee. If you use your own listed property (or listed property you rent) in your work as an employee, the property is business-use property only if you meet the following requirements.

- The use is for your employer's convenience.
- The use is required as a condition of your employment.

"As a condition of your employment" means the use of the property is necessary for you to properly perform your work. Whether the use of the property is required for this purpose depends on all the facts and circumstances. Your employer does not have to tell you specifically to use the property. Nor is a statement by your employer to that effect sufficient.

Years following the year placed in service. If, in a year after you place an item of listed property in service, you fail to meet the more-than-50%-use test for that item of property, you may be required to do the following.

1) Figure depreciation, beginning with the year you no longer use the property more than 50% for business, using the straight line method.
2) Figure any excess depreciation (include any section 179 deduction on the property in figuring excess depreciation) and add it to:

   a) Your gross income, and

b) The adjusted basis of your property.

For more information, see *Recapture of Excess Depreciation* under *Do the Business-Use Limits Apply?* in Publication 946.

Reporting and recordkeeping requirements. If you use listed property in your business, you must file Form 4562 to claim a depreciation or section 179 deduction. Begin with Part V, Section A, of that form.



You cannot take any depreciation or section 179 deduction for the use of listed property unless you can prove your business/investment use with adequate records or sufficient evidence to support your own statements.

To meet the adequate records requirement, you must maintain an account book, diary, log, statement of expense, trip sheet, or similar record or other documentary evidence that is sufficient to establish business/investment use. For more information on what records to keep, see *What Records Must Be Kept?* in chapter 4 of Publication 946.

Property Bought for Business Use

If you bought certain property to use in your business, you can do any one of the following (subject to the limits discussed later).

- Elect a ***section 179 deduction*** for the full cost of the property.
- Take part of the cost as a ***section 179 deduction*** and ***depreciate*** the balance.
- ***Depreciate*** the full cost of the property.

Section 179 Deduction

You can claim the section 179 deduction for the cost of depreciable tangible personal property bought for use in your trade or business. You can choose how much (subject to the limit) of the cost you want to deduct under section 179 and how much you want to depreciate. You can spread the section 179 deduction over several items of property in any way you choose as long as the total does not exceed the maximum allowable. You cannot take a section 179 deduction for the basis of the business part of your home.

You elect the section 179 deduction by completing Part 1 of Form 4562.

More information. For more information on the section 179 deduction, see chapter 2 in Publication 946.

Depreciation

Use Part II of Form 4562 to claim your deduction for depreciation on property placed in service during the year. Do not include any costs deducted in Part I (section 179 deduction).

Most business property used in a home office is either 5-year or 7-year property under MACRS.

- ***5-year property*** includes computers and peripheral equipment, typewriters, calculators, adding machines, and copiers.
- ***7-year property*** includes office furniture and fixtures such as desks, files, and safes.

Under MACRS, you generally use the half-year convention, which allows you to deduct a half year of depreciation in the first year you use the property in your business. If you place more than 40% of your depreciable property in service during the last 3 months of your tax year, you must use the mid-quarter convention instead of the half-year convention. See Publication 946 for an exception for 2001.

After you have determined the cost of the depreciable property (minus any section 179 deduction taken on the property) and whether it is 5-year or 7-year property, use the table, shown next, to figure your depreciation if the half-year convention applies.

MACRS Percentage Table for 5- and 7-Year Property Using Half-Year Convention

Recovery Year	5-Year Property	7-Year Property
1	20.00%	14.29%
2	32.00%	24.49%
3	19.20%	17.49%
4	11.52%	12.49%
5	11.52%	8.93%
6	5.76%	8.92%
7		8.93%
8		4.46%

See Publication 946 for a discussion of the mid-quarter convention and for complete MACRS percentage tables.

Example. During the year, Donald Kent bought a desk and three chairs for use in his office. His total bill for the furniture was $1,975. His taxable business income for the year was $3,000 without any deduction for the office furniture. Donald can elect to do one of the following.

1) Take a section 179 deduction for the full cost of the office furniture.
2) Take part of the cost of the furniture as a section 179 deduction and depreciate the balance.
3) Depreciate the full cost of the office furniture.

The furniture is 7-year property. If Donald does not take a section 179 deduction, he multiplies $1,975, the cost of the furniture, by 14.29% (.1429) to get his depreciation deduction of $282.23.

Personal Property Converted to Business Use

If you use property in your home office that was used previously for personal purposes, you cannot take a section 179 deduction for the property. You can depreciate it,

however. The method of depreciation you use depends on when you first used the property for personal purposes.

If you began using the property for personal purposes after 1986 and change it to business use in 2001, depreciate the property under MACRS.

The basis for depreciation of property changed from personal to business use is the lesser of the following.

1) The adjusted basis of the property on the date of change.
2) The fair market value of the property on the date of change.

If you began using the property for personal purposes after 1980 and before 1987 and change it to business use in 2001, you generally depreciate the property under the accelerated cost recovery system (ACRS). However, if the depreciation under ACRS is greater in the first year than the depreciation under MACRS, you must depreciate it under MACRS. For information on ACRS, see Publication 534, *Depreciating Property Placed in Service Before 1987.*

If you began using the property for personal purposes before 1981 and change it to business use in 2001, depreciate the property by the straight line or declining balance method based on salvage value and useful life.

Recordkeeping



You do not have to use a particular method of recordkeeping, but you must keep records that provide the information needed to figure your deductions for the business use of your home. You should keep canceled checks, receipts, and other evidence of expenses you paid.

Your records must show the following information.

- The part of your home you use for business.
- That you use part of your home exclusively and regularly for business as either your principal place of business or as the place where you meet or deal with clients or customers in the normal course of your business. (However, see the earlier discussion, *Exceptions to Exclusive Use.*)
- The depreciation and expenses for the business part.

You must keep your records for as long as they are important for any tax law. This is usually the later of the following dates.

1) 3 years from the return due date or the date filed.
2) 2 years from the date the tax was paid.

Keep records to prove your home's depreciable basis. This includes records of when and how you acquired your home, your original purchase price, any improvements to your home, and any depreciation you are allowed because you maintained an office in your home. You can keep copies of Forms 8829 or the Publication 587 worksheets as records of depreciation.

For more information on recordkeeping, see Publication 583.

Where To Deduct

Deduct expenses for the business use of your home on Form 1040. Where you deduct these expenses on the form depends on whether you are:

- A self-employed person, *or*
- An employee.

Self-Employed Persons

If you are self-employed and file Schedule C (Form 1040), complete and attach Form 8829 to your return. If you file Schedule F (Form 1040), report your entire deduction for business use of the home, up to the limit discussed earlier (line 32 if you used the worksheet), on line 34 of Schedule F. Write "Business Use of Home" on the dotted line beside the entry.

Deductible mortgage interest. If you file Schedule C (Form 1040), enter all your deductible mortgage interest on line 10 of Form 8829. After you have figured the business part of the mortgage interest on lines 12 and 13, subtract that amount from the total mortgage interest on line 10. The remainder is deductible on Schedule A (Form 1040), lines 10 and 11. If the interest you deduct on Schedule A for your home mortgage is limited, enter the excess on line 16 of Form 8829.

If you file Schedule F (Form 1040), include the business part of your deductible home mortgage interest with your total business use of the home expenses on line 34. You can use the worksheet near the back of this publication to figure the deductible part of mortgage interest. Enter the nonbusiness part of the deductible mortgage interest on Schedule A, lines 10 and 11.

To determine if the limits on qualified home mortgage interest apply to you, see the instructions for Schedule A or Publication 936.

Real estate taxes. If you file Schedule C (Form 1040), enter all your deductible real estate taxes on line 11 of Form 8829. After you have figured the business part of your taxes on lines 12 and 13, subtract that amount from your total real estate taxes on line 11. The remainder is deductible on Schedule A, line 6.

If you file Schedule F (Form 1040), include the business part of real estate taxes with your total business use of the home expenses on line 34. Enter the nonbusiness part of your real estate taxes on line 6 of Schedule A.



If you itemize your deductions, be sure to claim ***only*** *the personal part of your deductible mortgage interest and real estate taxes on Schedule A (Form 1040).* ***Do not deduct any of the business part on Schedule A.*** *For example, if your business percentage on*

line 7 of Form 8829 or line 3 of the worksheet near the back of this publication is 30%, you can claim only 70% of your deductible mortgage interest and real estate taxes as personal expenses on Schedule A.

Casualty losses. If you are using Form 8829, refer to the specific instructions for lines 9 and 27 and enter the amount from line 33 on line 27 of Form 4684, Section B. Write "See Form 8829" above line 27.

If you file Schedule F (Form 1040), enter the business part of casualty losses (line 31 if you use the worksheet) on line 27 of Form 4684, Section B. Write "See attached statement" above line 27.

Other expenses. Report the other home expenses that would not be allowable if you did not use your home for business (insurance, maintenance, utilities, depreciation, etc.) on the appropriate lines of your Form 8829. If you rent rather than own your home, include the rent you paid on line 20. If these expenses exceed the deduction limit, carry the excess over to next year. The carryover will be subject to next year's deduction limit.

If you file Schedule F (Form 1040), include your otherwise nondeductible expenses (insurance, maintenance, utilities, depreciation, etc.) with your total business use of the home expenses on line 34 of Schedule F. If these expenses exceed the deduction limit, carry the excess over to the next year. The carryover will be subject to next year's deduction limit.

Business expenses not for the use of your home. Deduct in full your business expenses that are not for the use of your home itself (dues, salaries, supplies, certain telephone expenses, etc.) on the appropriate lines of Schedule C (Form 1040) or Schedule F (Form 1040). Because these expenses are not for the use of your home, they are not subject to the deduction limit for business use of the home expenses.

Employees

As an employee, you must itemize deductions on Schedule A (Form 1040) to claim expenses for the business use of your home and any other employee business expenses. This generally applies to all employees, including outside salespersons. If you are a statutory employee, use Schedule C (Form 1040) to claim the expenses. Follow the instructions given earlier under *Self-Employed Persons.* The "statutory employee" box within box 13 on your Form W-2 will be checked if you are a statutory employee.

If you have employee expenses for which you were not reimbursed, report them on line 20 of Schedule A. You generally must also complete Form 2106 if either of the following apply.

- You claim any travel, transportation, meal, or entertainment expenses.
- Your employer paid you for any of your job expenses reportable on line 20. (Amounts your employer included in box 1 of your Form W-2 are not considered paid by your employer).

However, you can use the simpler Form 2106-EZ, instead of Form 2106, if you meet the following requirements.

- You were not reimbursed for your expenses by your employer, or if you were reimbursed, the reimbursement was included in box 1 of your Form W-2.
- If you claim car expenses, you use the standard mileage rate.

When your employer pays for your expenses using a reimbursement or allowance arrangement, the payments generally should not be on your Form W-2 if the following rules for an accountable plan are met.

1) You adequately account to your employer for the expenses within a reasonable time.
2) You return any payments not spent for business expenses (excess reimbursements).
3) You must have paid or incurred deductible expenses while performing services as an employee.

If you meet the accountable plan rules and your business expenses equal your reimbursement, do not report the reimbursement as income and do not deduct the expenses.

Adequately accounting to employer. You adequately account to your employer when you give your employer documentary evidence of your travel, mileage, and other employee business expenses, such as receipts, along with an account book, diary, or similar record in which you entered each expense at or near the time you had it.

You also may be treated as adequately accounting to your employer if your employer gives you a per diem or car allowance similar in form to, and not more than, the federal rate and you verify the time, place, and business purpose of each expense. For more information, see the instructions for Form 2106 and Publication 463, *Travel, Entertainment, Gift, and Car Expenses.*

Rental to employer. If you rent part of your home to your employer and you use the rented part in performing services for your employer as an employee, your deduction for the business use of your home is limited. You can deduct mortgage interest, real estate taxes, and personal casualty losses for the rented part, subject to any limitations. However, you cannot deduct otherwise allowable trade or business expenses, business casualty losses, or depreciation related to the use of your home in performing services for your employer.

Deductible mortgage interest. Although you generally can deduct expenses for the business use of your home on line 20 of Schedule A (Form 1040), do not include any deductible home mortgage interest on that line. Instead, deduct both the business and nonbusiness parts of this interest on line 10 or 11 of Schedule A.

If the home mortgage interest you can deduct on lines 10 or 11 is limited by the home mortgage interest rules, you cannot deduct the excess as an employee business expense on line 20 of Schedule A, even though you use part

of your home for business. To determine if the limits on home mortgage interest apply to you, see the instructions for Schedule A or Publication 936.

Real estate taxes. Deduct both the business and nonbusiness parts of your real estate taxes on line 6 of Schedule A. For more information on amounts allowable as a deduction for real estate taxes, see Publication 530, *Tax Information for First-Time Homeowners.*

Casualty losses. Enter the business part of casualty losses (line 31 of the worksheet) on line 27 of Form 4684, Section B. Write "See attached statement" above line 27.

Other expenses. If you file Form 2106 or Form 2106-EZ, report on line 4 the following expenses.

- The business part of your otherwise nondeductible expenses (utilities, maintenance, insurance, depreciation, etc.) that do not exceed the deduction limit.
- The employee business expenses not related to the use of your home, such as advertising.

Add these to your other employee business expenses and complete the rest of the form. Enter the total from Form 2106, or Form 2106-EZ, on line 20 of Schedule A, where it is subject to the 2%-of-adjusted-gross-income limit. If you do not have to file Form 2106 or Form 2106-EZ, enter your total expenses directly on line 20 of Schedule A.

Example. You are an employee who works at home for the convenience of your employer. You meet all the requirements to deduct expenses for the business use of your home. Your employer does not reimburse you for any of your business expenses and you are not otherwise required to file Form 2106 or Form 2106-EZ.

As an employee, you do not have gross receipts, cost of goods sold, etc. You begin with gross income from the business use of your home, which you determine to be $6,000.

The percentage of expenses due to the business use of your home is 20%. You have the following expenses.

Deductible mortgage interest (20%)	$1,500
Real estate taxes (20%)	1,000
Total	$2,500
Expenses not related to business use of the home (100%):	
Supplies	$500
Advertising	1,300
Telephone	200
Total	$2,000
Otherwise nondeductible expenses:	
Maintenance (20%)	$200
Utilities (20%)	350
Insurance (20%)	250
Total	$800
Depreciation (20%)	$1,600

Based on the above expenses, you figure your deduction limit as follows.

Gross income		$6,000
Less:		
Deductible mortgage interest (20%)	$1,500	
Real estate taxes (20%)	1,000	
Expenses not related to business use of the home (100%)	2,000	4,500
Deduction limit		**$1,500**

Your deduction for otherwise nondeductible expenses and depreciation is limited to $1,500. You can deduct all your otherwise nondeductible expenses ($800) and $700 ($1,500 – $800) of your depreciation.

You deduct your expenses for business use of your home on Schedule A (Form 1040) as shown in the following table.

Expense	Amount	Schedule A
Deductible mortgage interest	$1,500	Line 10 or 11*
Real estate taxes	$1,000	Line 6*
Expenses not related to the business use of the home	$2,000	Line 20**
Otherwise nondeductible expenses	$800	Line 20**
Depreciation	$700	Line 20**

*In addition to the 80% nonbusiness part of the expense.
**Subject to the 2%-of-adjusted-gross-income limit.

You can carry over the $900 of depreciation that exceeds the deduction limit to next year, subject to the deduction limit for that year.

Schedule C Example

The filled-in forms for John Stephens that follow show how to report deductions for the business use of your home if you file Schedule C (Form 1040).

Form 4562. The following bold line references apply to Form 4562.

Part I, lines 1–13. John began using his home for business in January of this year. He purchased a new computer and filing cabinet to use in his business. The computer, used 100% for business, cost $3,200. The filing cabinet cost $600. He elects to take the section 179 deduction for both items.

John completes Part I of Form 4562. He enters the cost of both the computer and filing cabinet, $3,800, on line 2 and completes lines 4 and 5. On line 6, he enters a description of each item, its cost and the cost he elects to expense. He completes the remaining lines in Part I.

Part II, line 15c. John converted to business use a desk and chair he had purchased in 1996 for personal purposes. In 1996 he paid $1,500 for them. The fair market value in 2001 is $550. Since the fair market value is less than the cost, his depreciable basis is $550.

In Part II, line 15c, column (c), he enters $550 for the desk and chair. He completes columns (d) through (f). The furniture is 7-year property under MACRS. He uses the *MACRS Percentage Table for 5- and 7-Year Property Using Half-Year Convention* in this publication or *Table A-1* in Publication 946 to find the rate of 14.29% for property placed in service during the first month of the year. He multiplies $550 by 14.29% (.1429) and enters $79 in column (g).

Part II, line 15i. Because this is the first year John used his home for business, he must figure the depreciation on line 15i. On line 15i, column (c), he enters $11,000, the depreciable basis of the business part of his home. (For a discussion on how he figures his depreciation deduction, see *Step 3* under *Form 8829, Part II.)* He enters $271 in column (g).

Part IV, line 21. John totals the amounts on line 12 and line 15 in column (g) and enters the total on line 21. He enters both the section 179 deduction ($3,800) and the depreciation on the furniture ($79) on line 13 of Schedule C. He enters the depreciation on his home ($271) on Form 8829, line 28.

Schedule C. The following bold line references apply to Schedule C.

Line 13. John enters the amount from Form 4562 for his section 179 deduction ($3,800) and the depreciation deduction for his office furniture ($79).

Line 16b. This amount is the interest on installment payments for the business assets John uses in his home office.

Line 25. John had a separate telephone line in his home office that he used only for business. He can deduct $347 for the line.

Lines 28-30. On line 28, he totals all his expenses other than those for the business use of his home, and then subtracts that total from his gross income. He uses the result on line 29 to figure the deduction limit on his expenses for the business use of his home. He enters that amount on line 8 of Form 8829 and then completes the form. He enters the amount of his home office deduction from line 34, Form 8829, on line 30 of Schedule C.

Form 8829, Part I. John uses one room of his home exclusively and regularly to meet clients. In Part I of Form 8829 he shows that, based on the square footage, the room is 10% of his home.

Form 8829, Part II. John uses Part II of Form 8829 to figure his allowable home office deduction.

Step 1. First, he figures the business part of expenses that would be deductible even if he did not use part of his home for business. Because these expenses ($4,500 deductible mortgage interest and $1,000 real estate taxes) relate to his entire home, he enters them in column (b) on lines 10 and 11. He then subtracts the $550 business part of these expenses (line 14) from his tentative business profit (line 8). The result, $25,002 on line 15, is the most he can deduct for his other home office expenses.

Step 2. Next, he figures his deduction for operating expenses. He paid $300 to have his office repainted. He enters this amount on line 18, column (a) because it is a direct expense. All his other expenses ($400 homeowner's insurance, $1,400 roof repairs, and $1,800 heating and lighting) relate to his entire home. Therefore, he enters them in column (b) on the appropriate lines. He adds the $300 direct expenses (line 21) to the $360 total for indirect expenses (line 22) and enters the total, $660, on line 24. Because this amount is less than his deduction limit, he can deduct it in full. The $24,342 balance of his deduction limit (line 26) is the most he can deduct for depreciation.

Step 3. Next, he figures his allowable depreciation deduction for the business use of his home in Part III of Form 8829. The adjusted basis of his home is $130,000, which is less than the fair market value of $160,000. He figures the value of the land to be $20,000. He subtracts the land value from the adjusted basis. He multiplies the result ($110,000) by the percentage on line 7 to get the depreciable basis of the business part of his home ($11,000).

Because he began using the office in January of this year, he uses the *MACRS Percentage Table for 39-Year Nonresidential Real Property* in this publication or *Table A-7a* in *Appendix A* of Publication 946. The depreciation percentage for the first year of the recovery period for assets placed in service in the first month is 2.461%. His depreciation deduction for 2001 (line 40) is $271 (.02461 × $11,000). He enters that amount in Part II on lines 28 and 30. Because it is less than the available balance of his deduction limit (line 26), he can deduct the full depreciation. Since John must also complete Form 4562 for 2001, he enters $271 on line 15i, column (g). See *Form 4562,* earlier.

Step 4. Finally, he figures his total deduction for his home office by adding together his otherwise deductible expenses (line 14), his operating expenses (line 25), and depreciation (line 31). He enters the result, $1,481, on lines 32 and 34, and on Schedule C, line 30.

SCHEDULE C (Form 1040)

Department of the Treasury
Internal Revenue Service

Profit or Loss From Business

(Sole Proprietorship)

▶ **Partnerships, joint ventures, etc., must file Form 1065 or Form 1065-B.**

▶ **Attach to Form 1040 or Form 1041.** ▶ **See Instructions for Schedule C (Form 1040).**

OMB No. 1545-0074

2001

Attachment Sequence No. **09**

Name of proprietor	Social security number (SSN)
John Stephens	465 : 00 : 0001

A Principal business or profession, including product or service (see page C-1 of the instructions): Tax Preparation Services

B Enter code from pages C-7 & 8: ▶ 5 4 1 2 1 3

C Business name. If no separate business name, leave blank: Stephens Tax Service

D Employer ID number (EIN), if any

E Business address (including suite or room no.) ▶ 821 Union Street
City, town or post office, state, and ZIP code: Hometown, IA 52761

F Accounting method: (1) ☒ Cash (2) ☐ Accrual (3) ☐ Other (specify) ▶

G Did you "materially participate" in the operation of this business during 2001? If "No," see page C-2 for limit on losses . ☒ **Yes** ☐ **No**

H If you started or acquired this business during 2001, check here . . . . . ▶ ☐

Part I Income

1	Gross receipts or sales. **Caution.** If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see page C-2 and check here ▶ ☐	1	34,280
2	Returns and allowances	2	- 0 -
3	Subtract line 2 from line 1	3	34,280
4	Cost of goods sold (from line 42 on page 2)	4	- 0 -
5	**Gross profit.** Subtract line 4 from line 3	5	34,280
6	Other income, including Federal and state gasoline or fuel tax credit or refund (see page C-3)	6	- 0 -
7	**Gross income.** Add lines 5 and 6 ▶	7	34,280

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8	250	19	Pension and profit-sharing plans	19	
9	Bad debts from sales or services (see page C-3)	9		20	Rent or lease (see page C-4):		
				a	Vehicles, machinery, and equipment	20a	
10	Car and truck expenses (see page C-3)	10	1,266	b	Other business property	20b	
11	Commissions and fees	11		21	Repairs and maintenance	21	
12	Depletion	12		22	Supplies (not included in Part III)	22	253
13	Depreciation and section 179 expense deduction (not included in Part III) (see page C-3)	13	3,879	23	Taxes and licenses	23	
				24	Travel, meals, and entertainment:		
				a	Travel	24a	310
				b	Meals and entertainment: 512		
14	Employee benefit programs (other than on line 19)	14		c	Enter nondeductible amount included on line 24b (see page C-5): 256		
15	Insurance (other than health)	15	750	d	Subtract line 24c from line 24b	24d	256
16	Interest:			25	Utilities	25	347
a	Mortgage (paid to banks, etc.)	16a		26	Wages (less employment credits)	26	
b	Other	16b	200	27	Other expenses (from line 48 on page 2)	27	267
17	Legal and professional services	17	350				
18	Office expense	18	600				
28	**Total expenses** before expenses for business use of home. Add lines 8 through 27 in columns ▶					28	8,728
29	Tentative profit (loss). Subtract line 28 from line 7					29	25,552
30	Expenses for business use of your home. Attach **Form 8829**					30	1,481
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on **Form 1040, line 12,** and **also** on **Schedule SE, line 2** (statutory employees, see page C-5). Estates and trusts, enter on Form 1041, line 3. • If a loss, you **must** go to line 32.					31	24,071
32	If you have a loss, check the box that describes your investment in this activity (see page C-6). • If you checked 32a, enter the loss on **Form 1040, line 12,** and **also** on **Schedule SE, line 2** (statutory employees, see page C-5). Estates and trusts, enter on Form 1041, line 3. • If you checked 32b, you **must** attach **Form 6198.**					32a ☐ All investment is at risk. 32b ☐ Some investment is not at risk.	

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11334P **Schedule C (Form 1040) 2001**

Form **8829**

Department of the Treasury
Internal Revenue Service

Expenses for Business Use of Your Home

▶ **File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.**

▶ **See separate instructions.**

OMB No. 1545-1266

2001

Attachment Sequence No. **66**

Name(s) of proprietor(s): John Stephens

Your social security number: 465 : 00: 0001

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples. See instructions	1	200
2	Total area of home	2	2,000
3	Divide line 1 by line 2. Enter the result as a percentage	3	10 %
	• **For day-care facilities not used exclusively for business, also complete lines 4–6.**		
	• **All others, skip lines 4–6 and enter the amount from line 3 on line 7.**		
4	Multiply days used for day care during year by hours used per day: 4	hr.	
5	Total hours available for use during the year (365 days × 24 hours). See instructions: 5	8,760 hr.	
6	Divide line 4 by line 5. Enter the result as a decimal amount: 6	.	
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3 ▶	7	10 %

Part II Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29, **plus** any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions				8	25,552
	See instructions for columns (a) and (b) before completing lines 9–20.		**(a)** Direct expenses	**(b)** Indirect expenses		
9	Casualty losses. See instructions	9				
10	Deductible mortgage interest. See instructions	10		4,500		
11	Real estate taxes. See instructions	11		1,000		
12	Add lines 9, 10, and 11	12		5,500		
13	Multiply line 12, column (b) by line 7	13		550		
14	Add line 12, column (a) and line 13				14	550
15	Subtract line 14 from line 8. If zero or less, enter -0-				15	25,002
16	Excess mortgage interest. See instructions	16				
17	Insurance	17		400		
18	Repairs and maintenance	18	300	1,400		
19	Utilities	19		1,800		
20	Other expenses. See instructions	20				
21	Add lines 16 through 20	21	300	3,600		
22	Multiply line 21, column (b) by line 7	22		360		
23	Carryover of operating expenses from 2000 Form 8829, line 41	23		- 0 -		
24	Add line 21 in column (a), line 22, and line 23				24	660
25	Allowable operating expenses. Enter the **smaller** of line 15 or line 24				25	660
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15				26	24,342
27	Excess casualty losses. See instructions	27				
28	Depreciation of your home from Part III below	28		271		
29	Carryover of excess casualty losses and depreciation from 2000 Form 8829, line 42	29				
30	Add lines 27 through 29				30	271
31	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 26 or line 30				31	271
32	Add lines 14, 25, and 31				32	1,481
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to **Form 4684,** Section B				33	
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions ▶				34	1,481

Part III Depreciation of Your Home

35	Enter the **smaller** of your home's adjusted basis or its fair market value. See instructions	35	130,000
36	Value of land included on line 35	36	20,000
37	Basis of building. Subtract line 36 from line 35	37	110,000
38	Business basis of building. Multiply line 37 by line 7	38	11,000
39	Depreciation percentage. See instructions	39	2.461%
40	Depreciation allowable. Multiply line 38 by line 39. Enter here and on line 28 above. See instructions	40	271

Part IV Carryover of Unallowed Expenses to 2002

41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0-	41	
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-	42	

Form **4562**

Department of the Treasury
Internal Revenue Service

Depreciation and Amortization
(Including Information on Listed Property)

▶ See separate instructions. ▶ Attach this form to your return.

OMB No. 1545-0172

2001

Attachment Sequence No. **67**

Name(s) shown on return	Business or activity to which this form relates	Identifying number
John Stephens	Tax Preparation	465-00-0001

Part I **Election To Expense Certain Tangible Property Under Section 179**

Note: *If you have any "listed property," complete Part V before you complete Part I.*

1	Maximum dollar limitation. If an enterprise zone business, see page 2 of the instructions	1	$24,000
2	Total cost of section 179 property placed in service (see page 2 of the instructions)	2	3,800
3	Threshold cost of section 179 property before reduction in limitation	3	$200,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	- 0 -
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see page 2 of the instructions	5	24,000

	(a) Description of property	(b) Cost (business use only)	(c) Elected cost
6	Computer	3,200	3,200
	File Cabinet	600	600

7	Listed property. Enter amount from line 27	7	
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	3,800
9	Tentative deduction. Enter the smaller of line 5 or line 8	9	3,800
10	Carryover of disallowed deduction from 2000 (see page 3 of the instructions)	10	- 0 -
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5 (see instructions)	11	24,000
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11	12	3,800
13	Carryover of disallowed deduction to 2002. Add lines 9 and 10, less line 12 ▶	13	- 0 -

Note: *Do not use Part II or Part III below for listed property (automobiles, certain other vehicles, cellular telephones, certain computers, or property used for entertainment, recreation, or amusement). Instead, use Part V for listed property.*

Part II **MACRS Depreciation for Assets Placed in Service Only During Your 2001 Tax Year (Do not include listed property.)**

Section A—General Asset Account Election

14 If you are making the election under section 168(i)(4) to group any assets placed in service during the tax year into one or more general asset accounts, check this box. See page 3 of the instructions ▶ ☐

Section B—General Depreciation System (GDS) (See page 3 of the instructions.)

	(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
15a	3-year property						
b	5-year property						
c	7-year property		550	7	HY	200DB	79
d	10-year property						
e	15-year property						
f	20-year property						
g	25-year property			25 yrs.		S/L	
h	Residential rental property			27.5 yrs.	MM	S/L	
				27.5 yrs.	MM	S/L	
i	Nonresidential real property		11,000	39 yrs.	MM	S/L	271
					MM	S/L	

Section C—Alternative Depreciation System (ADS) (See page 5 of the instructions.)

16a	Class life				S/L	
b	12-year			12 yrs.	S/L	
c	40-year			40 yrs.	MM	S/L

Part III **Other Depreciation (Do not include listed property.)** (See instructions beginning on page 5.)

17	GDS and ADS deductions for assets placed in service in tax years beginning before 2001	17	
18	Property subject to section 168(f)(1) election	18	
19	ACRS and other depreciation	19	

Part IV **Summary** (See page 6 of the instructions.)

20	Listed property. Enter amount from line 26	20	
21	**Total.** Add deductions from line 12, lines 15 and 16 in column (g), and lines 17 through 20. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	21	4,150
22	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs	22	

For Paperwork Reduction Act Notice, see page 9 of the instructions. Cat. No. 12906N Form **4562** (2001)

Worksheet To Figure the Deduction for Business Use of Your Home

Use this worksheet if you file Schedule F (Form 1040) or you are an employee or a partner.

PART 1—Part of Your Home Used for Business:

1)	Area of home used for business		1) _____
2)	Total area of home		2) _____
3)	Percentage of home used for business (divide line 1 by line 2 and show result as percentage)		3) _____ %

PART 2—Figure Your Allowable Deduction

4)	Gross income from business (see instructions)			4) _____
		(a) Direct Expenses	(b) Indirect Expenses	
5)	Casualty losses	5) _____	_____	
6)	Deductible mortgage interest	6) _____	_____	
7)	Real estate taxes	7) _____	_____	
8)	Total of lines 5 through 7	8) _____	_____	
9)	Multiply line 8, column (b), by line 3		9) _____	
10)	Add line 8, column (a), and line 9		10) _____	
11)	Business expenses not from business use of home (see instructions)		11) _____	
12)	Add lines 10 and 11			12) _____
13)	Deduction limit. Subtract line 12 from line 4			13) _____
14)	Excess mortgage interest	14) _____	_____	
15)	Insurance	15) _____	_____	
16)	Repairs and maintenance	16) _____	_____	
17)	Utilities	17) _____	_____	
18)	Other expenses	18) _____	_____	
19)	Add lines 14 through 18	19) _____	_____	
20)	Multiply line 19, column (b) by line 3		20) _____	
21)	Carryover of operating expenses from prior year (see instructions)		21) _____	
22)	Add line 19, column (a), line 20, and line 21			22) _____
23)	Allowable operating expenses. Enter the **smaller** of line 13 or line 22			23) _____
24)	Limit on excess casualty losses and depreciation. Subtract line 23 from line 13			24) _____
25)	Excess casualty losses (see instructions)		25) _____	
26)	Depreciation of your home from line 38 below		26) _____	
27)	Carryover of excess casualty losses and depreciation from prior year (see instructions)		27) _____	
28)	Add lines 25 through 27			28) _____
29)	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 24 or line 28			29) _____
30)	Add lines 10, 23, and 29			30) _____
31)	Casualty losses included on lines 10 and 29 (see instructions)			31) _____
32)	Allowable expenses for business use of your home. (Subtract line 31 from line 30.) See instructions for where to enter on your return			32) _____

PART 3—Depreciation of Your Home

33)	Smaller of adjusted basis or fair market value of home (see instructions)	33) _____
34)	Basis of land	34) _____
35)	Basis of building (subtract line 34 from line 33)	35) _____
36)	Business basis of building (multiply line 35 by line 3)	36) _____
37)	Depreciation percentage (from applicable table or method)	37) _____
38)	Depreciation allowable (multiply line 36 by line 37)	38) _____

PART 4—Carryover of Unallowed Expenses to Next Year

39)	Operating expenses. Subtract line 23 from line 22. If less than zero, enter -0-	39) _____
40)	Excess casualty losses and depreciation. Subtract line 29 from line 28. If less than zero, enter -0-	40) _____

Instructions for the Worksheet

If you are an employee, a partner, or you file Schedule F (Form 1040), use the preceding worksheet to figure your deduction for the business use of your home. The following instructions explain how to complete each part.



If you file Schedule C (Form 1040), use Form 8829 to figure the deductions and attach the form to your return.

Part 1—Part of Your Home Used for Business

Lines 1–3.

If you figure the percentage based on area, use lines 1 through 3 to figure the business-use percentage. Enter the percentage on line 3.

You can use any other reasonable method that accurately reflects your business-use percentage. If you operate a day-care facility and you meet the exception to the exclusive use test for part or all of the area you use for business, you must figure the business-use percentage for that area as explained under *Day-Care Facility,* earlier. If you use another method to figure your business percentage, skip lines 1 and 2 and enter the percentage on line 3.

Part 2—Figure Your Allowable Deduction

Line 4.

If you file Schedule F, enter your total gross income from the business use of your home. This would generally be the amount on line 11 of Schedule F.

If you are an employee, enter your total wages from the business use of the home.

Lines 5–7.

Enter only amounts that would be deductible whether or not you used your home for business. In other words, these amounts would normally be allowable as itemized deductions on Schedule A (Form 1040). Enter your expenses paid for deductible mortgage interest, real estate taxes, and casualty losses. Include only the part of a casualty loss that exceeds $100 plus 10% of adjusted gross income.

Under column (a), *Direct Expenses,* enter expenses that benefit only the business part of your home. Under column (b), *Indirect Expenses,* enter expenses that benefit the entire home. You generally enter 100% of the expense. However, if the business percentage of an indirect expense is different from the percentage on line 3, enter only the business part of the expense on the appropriate line in column (a), and leave that line in column (b) blank.

Lines 9–10.

Multiply your total indirect expenses by the business percentage from line 3. Enter the result on line 9. Add this amount to the total direct expenses and enter the total on line 10.

Lines 11–13.

Enter any other business expenses that are not attributable to business use of the home on line 11. For employees, examples include travel, supplies, and business telephone expenses. Farmers should generally enter their total farm expenses before deducting office in the home expenses. Do not enter the deduction for one-half of your self-employment tax. Add the expenses on line 11 to the line 10 amount, and enter the total on line 12. Subtract line 12 from line 4, and enter the result on line 13. This is your deduction limit. You use it to determine whether you can deduct any of your other expenses for business use of the home this year. If you cannot, you will carry them over to next year.

If line 13 is zero or less, enter zero. Deduct your expenses for deductible home mortgage interest, real estate taxes, casualty losses, and any business expenses not attributable to use of your home on the appropriate lines of the schedule(s) for Form 1040 as explained earlier under *Where To Deduct.*

Lines 14–21.

On lines 14 through 18, enter your otherwise nondeductible expenses for the business use of your home. These include utilities, insurance, repairs, and maintenance. If you rent, include the amount paid on line 18. If you file Schedule F, include any part of your home mortgage interest that is more than the limits given in Publication 936. (If you are an employee, do not enter any excess home mortgage interest.) In column (a), enter the expenses that benefit only the business part of your home (direct expenses). In column (b), enter the expenses that benefit the entire home (indirect expenses). Multiply line 19, column (b) by the business-use percentage and enter this amount on line 20.

If you claimed a deduction for business use of your home on your 2000 tax return, enter the amount from line 39 of your 2000 worksheet on line 21.

Lines 24–29.

On lines 24 through 29, figure your limit on deductions for excess casualty losses and depreciation.

On line 25, figure the excess casualty loss by multiplying the business use percentage from line 3 by the part of casualty losses that would not be allowable if you did not use your home for business ($100 plus 10% of your adjusted gross income).

On line 26, enter the depreciation deduction from Part 3.

If you claimed a deduction for business use of your home on your 2000 tax return, enter on line 27 the amount from line 40 of your 2000 worksheet.

On lines 28 and 29, figure your allowable excess casualty losses and depreciation.

Lines 30–32.

On line 30, total all allowable business use of the home deductions.

On line 31, enter the total of the casualty losses shown on lines 10 and 29. Enter the amount from line 31 on line 27

of Form 4684, Section B. See the instructions for Form 4684 for more information on completing that form.

Line 32 is the total (other than casualty losses) allowable as a deduction for business use of your home. If you file Schedule F (Form 1040), enter this amount on line 34 of Schedule F and write "Business Use of Home" on the line beside the entry. Do not add the specific expenses into other line totals of Part II of Schedule F.

If you are an employee, see *Where To Deduct*, earlier, for information on how to claim the deduction.

Part 3—Depreciation of Your Home

Figure your depreciation deduction on lines 33 through 38. On line 33, enter the smaller of the adjusted basis or the fair market value of the property at the time you first used it for business. Do not adjust this amount for changes in basis or value after that date. Allocate the basis between the land and the building on lines 34 and 35. You cannot depreciate any part of the land. On line 37, enter the correct percentage for the current year from the tables in Publication 946. Multiply this percentage by the business basis to get the depreciation deduction. Enter this figure on lines 38 and 26. Complete and attach ***Form 4562*** to your return if this is the first year you used your home, or an improvement or addition to your home, in business.

Part 4—Carryover of Unallowed Expenses to Next Year

Complete these lines to figure the expenses that must be carried forward to next year.

How To Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at **1-877-777-4778.**
- Call the IRS at **1-800-829-1040.**
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call **1-800-829-4059** if you are a TTY/TDD user.

For more information, see Publication 1546, *The Taxpayer Advocate Service of the IRS.*

Free tax services. To find out what services are available, get Publication 910, *Guide to Free Tax Services.* It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

Personal computer. With your personal computer and modem, you can access the IRS on the Internet at **www.irs.gov**. While visiting our web site, you can:

- Find answers to questions you may have.
- Download forms and publications or search for forms and publications by topic or keyword.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at **ftp.irs.gov.**

TaxFax Service. Using the phone attached to your fax machine, you can receive forms and instructions by calling **703-368-9694.** Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.

For help with transmission problems, call the FedWorld Help Desk at **703-487-4608.**

Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call **1-800-829-3676** to order current and prior year forms, instructions, and publications.
- *Asking tax questions.* Call the IRS with your tax questions at **1-800-829-1040.**
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call **1-800-829-4059** to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call **1-800-829-4477** to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous,

and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.



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- Current tax forms, instructions, and publications.
- Prior-year tax forms and instructions.
- Popular tax forms that may be filled in electronically, printed out for submission, and saved for record-keeping.
- Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling **1–877–233–6767** or on the Internet at **www.irs.gov.** The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, *Small Business Resource Guide,* is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling **1–800–829–3676** or visiting the IRS web site at **www.irs.gov.**

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Tax Publications for Business Taxpayers

See *How To Get Tax Help* for a variety of ways to get publications, including by computer, phone, and mail.

General Guides

- **1** Your Rights as a Taxpayer
- **17** Your Federal Income Tax (For Individuals)
- **334** Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)
- **509** Tax Calendars for 2002
- **553** Highlights of 2001 Tax Changes
- **910** Guide to Free Tax Services

Employer's Guides

- **15** Circular E, Employer's Tax Guide
- **15-A** Employer's Supplemental Tax Guide
- **15-B** Employer's Tax Guide to Fringe Benefits
- **51** Circular A, Agricultural Employer's Tax Guide
- **80** Circular SS, Federal Tax Guide For Employers in the U.S. Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands
- **179** Circular PR Guía Contributiva Federal Para Patronos Puertorriqueños
- **926** Household Employer's Tax Guide

Specialized Publications

- **225** Farmer's Tax Guide
- **378** Fuel Tax Credits and Refunds
- **463** Travel, Entertainment, Gift, and Car Expenses
- **505** Tax Withholding and Estimated Tax
- **510** Excise Taxes for 2002
- **515** Withholding of Tax on Nonresident Aliens and Foreign Entities
- **517** Social Security and Other Information for Members of the Clergy and Religious Workers
- **527** Residential Rental Property
- **533** Self-Employment Tax
- **534** Depreciating Property Placed in Service Before 1987
- **535** Business Expenses
- **536** Net Operating Losses (NOLs) for Individuals, Estates, and Trusts
- **537** Installment Sales
- **538** Accounting Periods and Methods
- **541** Partnerships
- **542** Corporations
- **544** Sales and Other Dispositions of Assets
- **551** Basis of Assets
- **556** Examination of Returns, Appeal Rights, and Claims for Refund
- **560** Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)
- **561** Determining the Value of Donated Property
- **583** Starting a Business and Keeping Records
- **587** Business Use of Your Home (Including Use by Day-Care Providers)
- **594** The IRS Collection Process
- **595** Tax Highlights for Commercial Fishermen
- **597** Information on the United States-Canada Income Tax Treaty
- **598** Tax on Unrelated Business Income of Exempt Organizations
- **686** Certification for Reduced Tax Rates in Tax Treaty Countries
- **901** U.S. Tax Treaties
- **908** Bankruptcy Tax Guide
- **911** Direct Sellers
- **925** Passive Activity and At-Risk Rules
- **946** How To Depreciate Property
- **947** Practice Before the IRS and Power of Attorney
- **954** Tax Incentives for Empowerment Zones and Other Distressed Communities
- **1544** Reporting Cash Payments of Over $10,000
- **1546** The Taxpayer Advocate Service of the IRS

Spanish Language Publications

- **1SP** Derechos del Contribuyente
- **579SP** Cómo Preparar la Declaración de Impuesto Federal
- **594SP** Comprendiendo el Proceso de Cobro
- **850** English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
- **1544SP** Informe de Pagos en Efectivo en Exceso de $10,000 (Recibidos en una Ocupación o Negocio)

Commonly Used Tax Forms

See *How To Get Tax Help* for a variety of ways to get forms, including by computer, fax, phone, and mail. Items with an asterisk are available by fax. For these orders only, use the catalog number when ordering.

Form Number and Title	Catalog Number
W-2 Wage and Tax Statement	10134
W-4 Employee's Withholding Allowance Certificate*	10220
940 Employer's Annual Federal Unemployment (FUTA) Tax Return*	11234
940-EZ Employer's Annual Federal Unemployment (FUTA) Tax Return*	10983
941 Employer's Quarterly Federal Tax Return	17001
1040 U.S. Individual Income Tax Return*	11320
Sch A & B Itemized Deductions & Interest and Ordinary Dividends*	11330
Sch C Profit or Loss From Business*	11334
Sch C-EZ Net Profit From Business*	14374
Sch D Capital Gains and Losses*	11338
Sch D-1 Continuation Sheet for Schedule D	10424
Sch E Supplemental Income and Loss*	11344
Sch F Profit or Loss From Farming*	11346
Sch H Household Employment Taxes*	12187
Sch J Farm Income Averaging*	25513
Sch R Credit for the Elderly or the Disabled*	11359
Sch SE Self-Employment Tax*	11358
1040-ES Estimated Tax for Individuals*	11340
1040X Amended U.S. Individual Income Tax Return*	11360
1065 U.S. Return of Partnership Income	11390
Sch D Capital Gains and Losses	11393
Sch K-1 Partner's Share of Income, Credits, Deductions, etc.	11394
1120 U.S. Corporation Income Tax Return	11450
1120-A U.S. Corporation Short-Form Income Tax Return	11456
1120S U.S. Income Tax Return for an S Corporation	11510
Sch D Capital Gains and Losses and Built-In Gains	11516
Sch K-1 Shareholder's Share of Income, Credits, Deductions, etc.	11520
2106 Employee Business Expenses*	11700
2106-EZ Unreimbursed Employee Business Expenses*	20604
2210 Underpayment of Estimated Tax by Individuals, Estates, and Trusts*	11744
2441 Child and Dependent Care Expenses*	11862
2848 Power of Attorney and Declaration of Representative*	11980
3800 General Business Credit	12392
3903 Moving Expenses*	12490
4562 Depreciation and Amortization*	12906
4797 Sales of Business Property*	13086
4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return*	13141
5329 Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts	13329
6252 Installment Sale Income*	13601
8283 Noncash Charitable Contributions*	62299
8300 Report of Cash Payments Over $10,000 Received in a Trade or Business*	62133
8582 Passive Activity Loss Limitations*	63704
8606 Nondeductible IRAs*	63966
8822 Change of Address*	12081
8829 Expenses for Business Use of Your Home*	13232