

104
**KEEPING UP WITH THE TREND:
ISSUES AFFECTING HOME-BASED BUSINESS OWNERS**

Y 4. SM 1/2: S. HRG. 104-511

Keeping Up With the Trend: Issues A...

HEARING
BEFORE THE
COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE
ONE HUNDRED FOURTH CONGRESS
SECOND SESSION

APRIL 23, 1996



DEPOSITORY

SEP 18 1996

Printed for the Committee on Small Business

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The above referenced hearing held before the Committee on Small Business was inadvertently printed with the designation of S. HRG. 104-511.

The correct designation is S. HRG 104-544.

S. HRG. 104-511 has been assigned to another hearing.

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KEEPING UP WITH THE TREND: ISSUES AFFECTING HOME-BASED BUSINESS OWNERS

TUESDAY, APRIL 23, 1996

UNITED STATES SENATE,
COMMITTEE ON SMALL BUSINESS,
Washington, D.C.

The Committee met, pursuant to notice, at 10:30 a.m., in room SR-428A, Russell Senate Office Building, the Honorable Christopher S. Bond, Chairman of the Committee, presiding.

Present: Senators Bond, Pressler, Burns, Snowe, Bumpers, and Wellstone.

OPENING STATEMENT OF THE HONORABLE CHRISTOPHER S. BOND, CHAIRMAN, COMMITTEE ON SMALL BUSINESS, AND A UNITED STATES SENATOR FROM MISSOURI

Chairman BOND. The United States Senate Committee on Small Business is called to order. Good morning, and welcome to Washington.

I very much appreciate your joining us this morning. We had to delay the opening of this hearing because of other hearings going on. Unfortunately, my colleagues on this Committee are all in other hearings right now. We hope that a number of them will be able to join us today. I assure all of the witnesses that your full written statements, and a transcript of the hearing, will be made available to all members of the Committee.

This is a very important subject. We are here today to recognize and pay tribute to a growing phenomenon in America, that of the home-based entrepreneur. Over 14 million Americans now operate home-based businesses. Women have a significant stake in the market, as more than half of the home-based business owners are women.

While women have worked hard inside the home for centuries, the home has only recently begun to be thought of as an income-generating workplace. This is occurring for a variety of reasons.

First, technology makes it possible for us to communicate with another through modems, faxes, cellular phones, and all those things that drive us nuts as we go everywhere and find that we are in communication. There are advantages, as well as the disadvantages. We can now have all of the comforts of the office at home, even in the car or on an airplane.

Second, many talented mid-level managers and highly skilled engineers, marketers and sales people have been "downsized" out of a job in corporate America. For these folks, starting a home-based

business is a way of using their skills to generate income, to establish some independence and self-reliance.

Finally, and perhaps most important, home-based businesses offer the flexibility many men and women need to combine work and family responsibilities. For many families, it takes two incomes to make ends meet anymore. But the cost of daycare sometimes does not make even a moderately well-paying second job worthwhile. It is possible that daycare for one child can cost more than \$2 an hour. Two children, perhaps \$4 an hour. Add that on to taxes, the cost of dry-cleaning, lunches out, and suddenly that second income is not quite so lucrative or attractive. Many mothers, and even some fathers, are getting around the problem by starting a business at home.

As Priscilla Huff will tell us, their businesses run the gamut from daycare services to desktop publishes to cleaning services to cosmetics to toy and craft sales. The benefits of operating a home-based business are tremendous. You are your own boss. You do not have to spend hours a day in traffic. You can see your children during the daylight and you do not have to wear a necktie or a dress to work.

But the picture for home-based entrepreneurs is not entirely rosy. As is the case for all business owners, the hours are long, there is no guarantee of success and, not surprisingly, Uncle Sam too often complicates matters.

Government is well behind the curve. The IRS, in particular, is a problem for home-based business owners. Changes in tax policy need to be considered to ensure that our laws do not inhibit the growth and development of home-based industries.

Let me mention just a few examples, and I will go into them at greater length. Worker classification, the independent contractor test, the 20-factor formula to determine whether somebody is an independent contractor or an employee. Too often the small business owners cannot make out the details, but the headlines say IRS wins. And that can be a disaster.

I have introduced, with Senator Nickles, S. 1610 that sets out three simple tests and require that the parties report the income paid out or the money paid out. I think this change will ensure tax laws can be enforced, and that small business owners will not be hassled.

Another top concern is health insurance. Right now a self-employed person gets to deduct only 30 percent. On behalf of small business I took on that battle and took on the leadership. We passed overwhelmingly in the Senate a measure to raise that deduction to 55 percent. Right now we are working on a health insurance reform bill that I hope will be passed this afternoon that will get that deduction up to 80 percent, to make it economically feasible for home-based workers to buy health insurance.

The home office deduction is another very important item to self-employed and to parents raising children while working at home. This deduction is extremely important as the number of home-based businesses expands. I see the trend continuing with access to technology, corporate downsizing, and the need for two incomes.

That is why, as Chairman of this Committee, and as a strong supporter of home-based entrepreneurship, I think Congress needs

to do everything we can to help create and maintain an environment where home-based businesses can flourish. That means reasonable taxation, easier access to capital, and fewer regulations.

With your guidance, and with your testimony today, I hope we will have an even better idea of how to make sure those things are accomplished.

I have a much longer statement that will be made part of the record. I am sure that you all will be fascinated to read it, but I will spare you going through it.

[The prepared statement of Chairman Bond follows:]

PREPARED STATEMENT OF SENATOR CHRISTOPHER S. "KIT" BOND, CHAIRMAN
COMMITTEE ON SMALL BUSINESS
APRIL 23, 1996

The U. S. Senate Committee on Small Business is called to order. Good morning, and welcome to Washington. We are here today to recognize and pay tribute to a growing phenomenon in America: that of the home-based entrepreneur. Over 14 million Americans now operate home-based businesses. Women have a significant stake in the market, as more than half of the home-based business owners are women.

While women have worked hard inside the home for centuries, the home has only recently begun to be thought of as an income-generating workplace. This is occurring for a variety of reasons.

First, technology makes it possible for us to communicate with one another through modems, faxes, and cellular phones. We can now have all of the comforts of the office at home, and even in the car or on an airplane. Second, many talented mid-level managers, and highly skilled engineers, marketers and salespeople are being "downsized" out of a job with corporate America. For these folks, starting a home-based business is a way of using their skills to generate income and to establish some independence and self-reliance.

Finally, and perhaps most important, home-based businesses offer the flexibility many men and women need to combine work and family responsibilities. For many families, it takes two incomes to make ends meet anymore. But the cost of day care sometimes doesn't make even a moderately well-paying second job worthwhile. Consider that day care for one child often costs more than \$2 per hour. Two children would be more than \$4 per hour of wages. Add that onto taxes, the cost of dry cleaning and lunches out, and suddenly that second income is not so attractive. Many mothers --and even some fathers --are getting around the problem by starting businesses at home.

As Priscilla Huff will tell us, their business run the gamut, from day care services, to desktop publishing, to cleaning services, to cosmetics, toy and craft sales.

The benefits of operating a home-based business are tremendous. You are your own boss. You don't have to spend hours a day in traffic. You can see your children during the daylight. And often you don't have to wear a necktie or a dress to work.

But the picture for home-based entrepreneurs is not entirely rosy. As is the case for all business owners, the hours are often long, and there is no guarantee of success. And, not surprisingly, Uncle Sam often complicates matters.

Government is well behind the curve. The IRS, in particular, is a problem for home-based business owners. Changes in tax policy need to be considered to ensure that our laws do not inhibit the growth and development of home-based businesses. I will briefly mention a few examples.

Independent Contractors

Determining worker classification is one of the most important tax issues facing small business today. As many of you know, the ambiguity in the current law makes it extremely difficult for business owners to determine whether a worker is an independent contractor or an employee.

For years now, the Internal Revenue Service has been using a 20 factor common law test to determine worker status. The test is a nightmare of subjectivity and unpredictability. Inevitably, what happens is that the IRS agents are capitalizing on the lack of clarity and are resolving far too many cases in favor of an employment relationship at the expense and disruption of bonafide independent contractor arrangements. As a result, some small business owners are reluctant to hire independent contractors.

To help correct this problem last month Senator Nickles and I introduced S. 1610, The Independent Contractor Tax Simplification Act. My bill sets out 3 simple questions to be asked in determining whether a person providing services to another is an employee or an independent contractor.

- First, is there a written agreement between the parties?
- Second, does it appear the worker has made some investment such as incurring substantial unreimbursed expenses or being paid primarily on a commission basis?
- Third, does the worker appear to have some independence such as having his own place of business?

To take advantage of this simple rule, the parties must properly report payments to the IRS, just like under current law. This ensures that all taxes properly due to the Treasury will be collected. This bill provides immediate clarification and relief to taxpayers currently undergoing IRS examinations. This change will save many businesses from long and expensive battles with the IRS. S. 1610 currently has 17 cosponsors and perhaps we will pick up a few more today as a result of this hearing. The bill has been referred to the Finance Committee and I urge those members to act quickly so we can get this bill to the floor.

Health Insurance

Another top concern of home-based business owners is health insurance. Nearly four million of the self-employed are uninsured. Under the current tax code, corporate employers can deduct the full cost of health insurance, while self-employed owners of unincorporated businesses can deduct only 30%.

Last week the Senate voted on an Amendment to the Health Insurance Reform Act that would increase the amount that self-employed individuals can deduct for health insurance costs. The deduction increases to 35% in 1997 and 5% more will be added every year after until 2006. While the legislation, which is likely to pass later today is not perfect, it represents a step in the right direction in terms of leveling the playing field for America's small business entrepreneurs. My effort to achieve tax equity on this issue will continue to be a top priority throughout the year.

Home Office Deduction

Many taxpayers would also like to see Congress expand the availability of the home office deduction. That way self-employed plumbers, home care nurses, contractors and many others who perform their work outside of the home, but whose office is their home, will be allowed to take the deduction.

This deduction is very important to the self-employed and especially to parents raising children while working at home. As the number of home-based businesses increases, the importance of the deduction mounts. I look forward to hearing the witnesses comments on this as well as other issues identified.

The three trends I mentioned earlier that are leading to the growth of home-based businesses: access to technology, corporate downsizing, and the need for two incomes, are likely to accelerate over time. That is why, as Chairman of the Small Business Committee, and as a big advocate for home-based entrepreneurs, I believe we in Congress must do everything we can to help create and maintain an environment where home-based businesses can flourish.

That means less taxation, easier access to capital, and fewer regulations. And we are working on making all of these things happen.

I now turn to the distinguished ranking member, Senator Bumpers, for his opening comments.

Chairman BOND. We are very fortunate to have on our first panel two distinguished authors. First, Ms. Alice Bredin, author of "The Virtual Office Survival Handbook: What Telecommuters and Entrepreneurs Need to Succeed in Today's Nontraditional Workplace." I hope you will not mind my plugging your book. She is also writer of the nationally syndicated column "Working at Home" and the owner of WorkAnywhere, Inc. in New York, New York.

Our second witness is Ms. Priscilla Huff, who is the owner of the Little House Writing Services in Sellersville, Pennsylvania, and is the author of "101 Home-Based Businesses for Women: Everything You Need to Know About Getting Started On the Road to Success."

Before we begin, I see we have been joined by my colleague from Montana. Senator Burns, would you like to make an opening statement?

OPENING STATEMENT OF THE HONORABLE CONRAD R. BURNS, A UNITED STATES SENATOR FROM MONTANA

Senator BURNS. Thank you. And thank you for holding this hearing, Mr. Chairman, and I will tell you why. Workplace 2000 is going to look a lot different than the workplaces we have known in the past. Several things are going to have to be done in order to accommodate home-based businesses. The way we handle telecommunications and that tool, how that affords opportunity to us, and how it opens up the possibility of the entrepreneurialship among everybody, no matter where they are, because I think telecommunications takes away this business called space and distances and the ability to communicate and present our products not only in this country but around the world.

I spoke to a young high school group. And I will tell you, everybody going around says your kids will not have the opportunities that we have. Well, let me tell you, before my opportunities opened up, when I was a young lad and left the farm, it was how far would this thumb take me, because I started out hitchhiking and left his home state, in fact, my home state.

But anyway, today there are more opportunities for more people and they are exciting because we have eliminated this thing called distance and space. So it is pretty exciting out there. Mr. Chairman, you are right on target. You are ahead of the curve, but there is going to have to be some legislation to change the way we do business.

So I congratulate you for that and I would just like to be a part of it. And I thank the witnesses for coming today, because I think you are an important key to this, a very important key.

[The prepared statement of Senator Burns follows:]

STATEMENT OF SENATOR CONRAD BURNS
COMMITTEE ON SMALL BUSINESS
APRIL 23, 1996

Mr. Chairman, I thank you for holding this hearing today. This is a subject that is near and dear to my heart because this is the new workplace. Montana is filled with home-based businesses and with folks just itching to stay home and telecommute. And I know there are numerous issues that remain unaddressed that would help these folks succeed.

With the widespread use of computers, the Internet, the libraries on-line, the video technology that's available, and the prominence of fax machines, the new workplace no longer requires "going to work". More people are setting up home offices and I see that all across Montana. In fact, as telecommunication networks are more and more common, folks aren't even traveling to meetings anymore; they are teleconferencing, saving travel costs and time.

And it's not just a matter of cost, it's a matter of lifestyle. With all the technology available, the new workplace means you can live anywhere you want and still make a living doing what you love.

But there are issues that would make that a whole lot easier. Tax deductibility of health insurance costs would make being self-employed more attractive. And I'm glad to see that in the Health Insurance Reform Act that we'll be voting on this afternoon, we have increased that tax deduction to 80%. It's still not 100%, which is what I believe would be fair, but it's a whole lot better than the 30% it is now.

Tax deduction of home offices would also help. That's an idea I've supported for years, and again, I think it's an issue of fairness. I know many folks think of people who work from home as perhaps, spouses, making a second income. But its realtors, accountants, salesmen and women, and consultants. In fact, just recently, I ran into a constituent who is a telemedicine consultant all around the nation, but he works out of his home in Billings, Montana. This gives him the opportunity to be with his children and be in an environment

that he enjoys. And since travel is a necessary part of his job, the new workplace allows him to spend more time with his family.

There is also a man in Northeastern Montana, a little town called Navajo -- it's not even on the map -- who runs a telemarketing company from his home. He employs women in a number of states who, from their homes, follow up with customers on the satisfaction of recent services they received. The results of their calls are downloaded to the computer in Navajo, compiled and submitted to the company that is paying for the survey . . . all from his home in Navajo. So, here's a home-based business employing people in other home-based businesses. That's exactly what we're talking about here.

Mr. Chairman, the work environment is changing -- it's new and the rules are different. As we discussed at the last hearing on the TEAM Act, in which a Labor law made 60 years ago is no longer relevant in today's market, the home-based business is becoming the trend. Actually, it is already the trend; we just need to do what we can to facilitate this progression and to make sure home-based businesses are treated fairly. This is not a trend that will - or should - go away.

Anytime quality of life is an issue we need to take notice. And as the swing is to return to the family, and the technology is allowing that, more and more folks will opt for the new workplace -- working out of their homes. We can't be behind the ball on this, and I look forward to hearing from our witnesses today to hear their thoughts on how we can move this along. As the soldiers in the trenches, your input is very much needed.

I appreciate the timeliness of this hearing, Mr. Chairman, and I stand ready to work with you to move this forward. Thank you.

Chairman BOND. Thank you very much, Senator Burns. Your full statement will be made a part of the record. As I indicated earlier, all of the statements will be made a part of the record.

Now Ms. Bredin, if you would begin, please.

STATEMENT OF ALICE BREDIN, AUTHOR, "THE VIRTUAL OFFICE SURVIVAL HANDBOOK: WHAT TELECOMMUTERS AND ENTREPRENEURS NEED TO SUCCEED IN TODAY'S NON-TRADITIONAL WORKPLACE;" WRITER OF NATIONALLY SYNDICATED COLUMN, "WORKING AT HOME;" AND OWNER, WORKANYWHERE, INC., NEW YORK, NEW YORK

Ms. BREDIN. Thank you for inviting me down here to speak today. It is nice to be in the company of so many people who share my belief that home-based business owners are an important part of the economy. What I hope to share with you today are some details about who these people are and what I believe the potential to be for this sector of the economy.

You have talked a little bit already about the numbers of people working at home. In 1995 alone two million people started up full or part-time businesses at home. It is important to include part-time home-based business owners as well as the full-time entrepreneurs when you are examining this sector, because the part-time ones often become full-time businesses employing lots of people in this country.

So who are these home-based business owners? Well, they are people running bookkeeping companies, general construction businesses, consulting firms, and video production companies. They are illustrators, architects, chiropractors, and engineers. I even know a woman in New York whose business it is to drive people's pets from their New York City apartments to their country homes for the weekend. So it can be just about anything.

This sector of the economy has developed from one that was comprised primarily of craft home-based businesses to a phenomenon involving one in eight Americans. Today it is management and professional businesses, service businesses, and sales businesses comprising the bulk of the home business market. The crafts businesses I was referring to a minute ago make up only 5 percent of all home-based businesses today.

More than half of all home-based business owners have an annual household income of more than \$60,000, a graduate school education, and their age is likely to be late 40's. All of this information comes from an AT&T survey called the AT&T Home Business Resources Survey conducted in 1995. About an even number of men and women work at home, and a full two-thirds of home-based business owners own computers with modems. That makes them more technologically on the cutting edge than small business owners who have offices outside of the house.

The growth in the home-based business market has its foundation in this country's shift from a manufacturing to a service and information-based economy. People are no longer required to report to a workplace of any kind to do their jobs, so they can work from wherever they choose.

Its growth, as we have already heard this morning, has been fueled by the increased availability and affordability of all kinds of

office technology. The price of desktop computers continues to drop dramatically. Today if you buy a PC it is likely to be about 80 times faster than the original IBM PC. And ongoing technological developments, such as the Internet, video conferencing—which I believe we are going to soon see sold with most PCs—groupware, digital phone technology, will all make home offices even more prevalent.

It is also fueled by baby boomers who, frankly, refuse to work the way they used to work. They do not want the double digit daily hours in the office and the long commutes. They have the pressure of caring for children. Their parents are aging and they need a way to better integrate their home and their work life.

You can see evidence of this in a 1994 Hilton Hotels survey of 1,000 professionals. Seventy seven percent of them ranked spending time with family and friends ahead of money and prestige. Money and prestige came in second. Spending time with family and friends was No. 1 on their list of priorities.

The massive downsizing of corporate America has also contributed to the increase in the number of people working at home. Employees who have left corporate jobs are starting businesses in record numbers. These former corporate employees have the work experience and business skills, and in many cases the severance packages or savings to launch a small business. A home office provides a convenient affordable location. In fact, it is these people who have legitimized the home office and contributed to its growth because they have close contacts in the corporate world and by working with and for them, have demonstrated that the home is an OK place to have a business.

In fact, that AT&T study I referred to earlier found that over 90 percent of people running businesses at home now feel free to be up front about the fact that they work at home. And even 5 years ago, that would not have been the case.

In fact, what I have discovered is that the home is such a desirable place for work that many entrepreneurs choose to stay in their home offices long after they can afford traditional office space. They are buying bigger houses, they are building onto the houses they currently have, rather than investing their money in office space.

Corporate America has recognized the viability of this market. You see financial services companies, furniture companies, insurance companies, all developing products and marketing campaigns to sell to them. Other small businesses are also taking advantage of how many people are working at home. I once wrote a story on a company called California Garden Office. They will build an office in your backyard if you do not want to actually work in your home but you want to work nearby.

There is another company in California that is planning on opening 20 retail stores to sell to the home business market just in California in the next year.

One of the questions I am asked frequently—and I see the yellow light, so I will bring this to a close—but I am often asked about the future potential of this market. In response to that, I usually say a couple of things. I read about a survey, it was a Gallup poll I believe, in which two-thirds of teenagers, when asked what they wanted to do, said that they wanted to be entrepreneurs. And I am

sure a lot of those kids will find that the home is an affordable and convenient place to work.

All of the factors that have contributed to the growth of the the home-business sector promise to continue to do so: the affordability and availability of technology, corporate downsizing, and a reordering of baby boomer priorities. All of these ensure our continued rapid growth. Thank you.

Chairman BOND. Thank you very much, Ms. Bredin.

Ms. Huff.

STATEMENT OF PRISCILLA Y. HUFF, OWNER, LITTLE HOUSE WRITING SERVICES, SELLERSVILLE, PENNSYLVANIA, AND AUTHOR, "101 HOME-BASED BUSINESSES"

Ms. HUFF. Good morning, Mr. Chairman, Senator. Thank you for giving me the opportunity to speak on behalf of home-based business owners. Forgive me if some of the information is repeated but I have talked to home-based business owners in my own community and across the Nation as I have done research for my book.

I am the owner of my own home-based business, about 30 miles north of Philadelphia. I am in a rapidly growing suburban community.

What are some of the reasons women are starting home-based businesses? As you mentioned, family matters. If you are a sandwich generation, where you have younger children and older parents, you have the flexibility to work your hours around their routines and day-to-day small and major crises.

As you stated, most families today need two incomes. A home-based business can provide a full or part-time income opportunity. With corporate downsizing, job security is questionable and I believe home-based businesses will help create jobs that will supply some more income opportunities.

Also, it is the convenience of having a home-based business, less money spent on commuting, clothes, overhead costs. Again, it gives independence. Do you want to change the direction of your business, if you find a new market, you can go there. You do not need to have a corporate meeting, you have it with yourself.

One of the strengths, I think, of home-based business is the stability that a home-based business gives to the community. Your customers are your neighbors, friends, relatives, and others who live in the same township, borough, town, or city.

Also, since you have a vested interest in your community, you have more opportunity to do volunteer work, again to promote your community.

What are some of the problems faced by home-based businesses today? Zoning restrictions. Many home-based businesses are hampered in developing and conducting business because of local zoning laws preventing business from one's home. Solution? We need guidelines for States and local communities to follow in acknowledging and working with this fast growing sector of the economy, instead of penalizing their existence.

Kimberly Stansell, who writes for Home Office Computing and who also has her own home-based business in Los Angeles, says Government should pay attention to the burgeoning home office industry, primarily because America's workplace is redefining how

people will earn their living. Neglecting or ignoring the needs of millions of Americans who work from their homes, and the millions that will in the future, is a big mistake. It encourages home-basers to work underground and not legitimize their enterprises, robbing city and local governments of revenues.

Financing is also a need. The Small Business Administration does do a good job with their workshops, but we need more loans at more affordable rates. Health care costs and deductions, as you mentioned. If we can take more deductions, that is a big benefit.

Also, taxes in general. Sometimes self-employment taxes make it prohibitive to continue running a small business.

What are some examples? As you mentioned, all kinds, business to business services, personal services, health services, entertainment services, green services. Wherever there is a niche in a market in a community a woman, or a man these days too, can start a home-based business.

In conclusion, I believe the growth of home-based businesses will help to stabilize our lives, our families, and our communities in these hectic times in the United States. It will continue to be an option for those who choose to be independent and allow us the pursuit of our ideals while helping to strengthen our society and our economy.

Thank you for giving me the opportunity to express my views and the views of many other owners.

[The prepared statement of Ms. Huff follows:]



Little House

Writing Services Priscilla Y Huff, owner

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RE: HEARING BEFORE THE U S SENATE COMMITTEE ON SMALL BUSINESS

"Keeping Up With the Trend: Issues Affecting Home-Based Business Owners"

WHAT ARE SOME OF THE LATEST STATISTICS ON HOME-BASED BUSINESSES?

- 1 14.0 million home businesses are full-time with the numbers increasing at the rate of 500,000 per year.¹
- 2 13.1 million home businesses are part time with the numbers increasing at a rate of 600,000 per year.²
- 3 66% of home businesses are owned by women.³
- 4 In 1995, over 40% of all U S households in the U S had income-generating home incomes.⁴

WHAT QUALIFIES ME TO ADDRESS CONCERNS ABOUT HOME-BASED BUSINESSES

- 1 I am a writer specializing in small and home-based business articles and books for primarily women (please see the attached sheet). I operate a home-based writing and publishing business as well as being a part-time consultant.
- 2 I am presently writing a second book, 101 Best Small Businesses for Women (Prima Publishing).
- 3 I have published an annual women's small and home-based business directory for two counties.
- 4 I am in the process of establishing a local home-based business association with some twenty other women home-based business owners.

WHAT ARE SOME OF THE REASONS WOMEN ARE STARTING HOME-BASED BUSINESSES?

- 1 *Family Matters*-Many women are caregivers to both children and elder parents. A home-based business allows for the flexibility of scheduling their work hours around their families' routines and day-to-day small and major crises.
- 2 *Two Incomes*-Despite misconceptions, women do not primarily start home-based businesses just "for something to do" or for luxury items. They do it because two incomes are needed just to maintain a basic standard of living. "Good jobs at good wages are becoming harder to find and keep. The United States is the only major industrialized nation where low-wage workers have had large declines in real-earnings."⁵ A home-based business can provide a full or part-time income opportunities with unlimited earning potential.
- 3 *Employment Downsizing* - With layoffs, cutbacks, streamlining, new technology happening in all sectors of business, increasing numbers of workers are presently unemployed or forced to take one contingent job after another. "In a *Washington Post*

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story on the 'growing minimum wage culture,' Sheldon Danzinger, professor of public policy at the University of Michigan, observes, 'Where you used to have six people in the [secretarial] pool earning \$14,000 a piece, today you have one desktop publishing expert making \$24,000 and five former secretaries earning \$9,000 at Kmart.' If they're not unemployed''''

- 4 *Convenience* - Having a home-based businesses means less money spent on commuting, clothes, overhead, etc
- 5 *Independence* - In a home-based business the owner makes the major decisions concerning the direction and philosophy in running the business, answering only to oneself. It gives the owner a sense of empowerment—that he or she is in control of their business careers and their lives as well
- 6 *Stability* - A home-based business helps to establish that owner in his or her community. Customers are neighbors, friends, relatives, and others who live in the same township, borough, town, or city. The home-based business owner will not have to fear of a job transfer (or will her family) to another job in another part of the country from year-to-year because of a company's demands.

''Manpower CEO Mitchell Fromstein predicts that the average worker will hold up to 15 different positions by retirement time. Career adviser Carol Kleiman asserts, 'The Bureau of Labor's statistics project that we will change careers three times over our lifetimes and that we will change jobs six times, but I think it will be much more than that. [Much] of this will be because we're fired and replaced with somebody cheaper, fired and replace by nobody or because a computer can do our work.'''''
- 7 *Altruism* - Having one's home-based business gives the owner the opportunity to help others start their own businesses (networking information) and most importantly have the time to help others in his or her community and pursue causes and ideals about which one feels strongly.

WHAT ARE SOME OF THE PROBLEMS FACED BY HOME-BASED BUSINESSES TODAY; AND WHAT ARE SOME SUGGESTED SOLUTIONS BY HOME-BASED BUSINESS OWNERS?

- 1 *Zoning Restrictions* - Many home-based businesses are hampered in developing and conducting business because of local zoning laws preventing business from one's home. Because of the lack of information and confusion as to what home-based businesses are and are not, restrictions vary widely from community-to community.

Solutions - Offer guidelines to states and local communities to follow in acknowledging and working with this fast-growing sector of the economy instead of penalizing their existence. The American Planning Association offers information on zoning for home-based businesses (312) 431-9100.

Kimberly Stansell of Research Done Write¹ in Los Angeles says, "Government should pay attention to the burgeoning home office industry primarily because America's workplace is redefining how people will earn their living. Neglecting or ignoring the needs of millions of

Americans who work from their homes and the millions that will in the future is a big mistake. It encourages homebasers to work underground and not legitimize their enterprises, robbing city and local governments of revenues.”

Model cities, who are leading the way in incorporating homebasers into their economic development plans, have been identified in an annual ‘Best Cities for Running a Home-Based Business,’ (spearheaded by Ms Stansell) for the past three years. The results are published in Home Office Computing magazine (December, 1995) ¹⁰⁰

- 2 *Financing* - Betsy Myers, White House director for women’s initiatives and outreach says, “More than 50% of women use personal resources, including credit cards to start their businesses” ¹⁰¹. Women applying for bank loans are routinely asked to have men to co-sign their applications, or are flat-out denied loans because they are considered poor credit risks. A new Working Woman magazine/Dun & Bradstreet study, though, “has found that women’s businesses are not only solid credit risks—they are *as good as or better* risks than men’s firms *across a broad array of industries*” ¹⁰².

Others have told me that SBA interest rates on loans are so high they might as well use their credit cards for financing. Many use what is called, “Creative Financing,” such as having part-time jobs, selling personal assets, borrowing from family or friends, or getting funds from nonprofit groups, foundations, or small business investment companies.

Solutions encourage financial institutions to change their conceptions about women as credit risks. Continue SBA loans, possibly with better interest rates and continue workshops at Small Business Development Centers to offer business plan instructions at their business start-up seminars.

- 3 *Health Care Costs and Deductions*-Many home-based business owners pay for their own and their families health care. Big businesses who offer healthcare for their workers can deduct 100% of these benefits. Self-employed persons who purchase their own health coverage can only deduct 30%. Often this coverage is only for basic costs with many self-employed being only able to afford health care with high deductibles and few of other coverages such as dental and eye care because of the added costs. Solutions - Allow home-based and small businesses to deduct as much as large companies, and help get affordable health care for everyone.
- 4 *Child Care Costs* -Many women home-based business owners who have preschool children, pay for some hours of child care—often in their own homes—so they can work uninterrupted for a block of time. Child care expenses can be so much that it does not pay for the primary caregiver to start a business or even get a job outside the home. Solutions - Give more deductions for child care.

- 5 *Taxes* - Self-employed persons pay about double of Social Security taxes as do those who work for someone else. If any employees are hired, worker's compensation insurance premiums and payroll taxes are often too costly to make it worthwhile.
Solution - lower these rates for the self-employed

WHAT ARE EXAMPLES OF HOME-BASED BUSINESSES?

Home-based businesses exist wherever there is a need or niche to be filled. They range from

- * business-to-business services such as medical transcription, billing, bookkeeping, consultants, etc .
- * personal services such as professional organizers, credit consulting, tutoring,
- * health services such as medical claims, home care, medical claims process,
- * others such as entertainment services, "green businesses," art and/or handcraft businesses,
- * Many others!!

CONCLUSION

In conclusion, I believe the growth of home-based businesses will help to stabilize our lives, our families, and our communities in these hectic times in the U.S. It will continue to be an option for those who choose to be independent, and allow us the pursuit of our ideals while helping to strengthen our society and economy.

Thank you for giving me the opportunity to express my views and the views of many other home-based business owners. Listening is the first step in understanding.

Respectfully submitted,



Priscilla Y Huff

* * *

^v Entrepreneur Magazine September 1993-1995 issues

^{vi} Ibid

^{vii} Ibid

^{viii} Terry Cullen "The Best & Worst of Working at Home Over The Past 40 Years," Income Opportunities, (May, 1996), p 18

^{ix} Holly Sklar, Chaos or Community (Boston, MA, South End Press, 1995) p 23

^x Holly Sklar, p 14

^{xi} Ibid

^{xii} Kimberly Stansell "Home-Based Havens," Home Office Computing (December, 1995), p 73

^{xiii} Janean Chun, Cynthia E. Griffin & Debra Phillips "Women and Minorities-Entrepreneur's Special Report," Entrepreneur magazine, (January, 1996), p 42

^{xiv} Clint Willis "Smart Women, Foolish Bankers," Working Woman magazine (March, 1996) p 27/

SOME HELPFUL RESOURCES FOR HOME-BASED BUSINESSES

Associations

- The American Association of Home-Based Businesses (202) 310-3130
- The National Association of Home-Based Businesses (410) 363-3698
- Mother's Home Business Network, P O Box 423, East Meadow, NY 11554

Online

- American Online
 - The Entrepreneur Zone (keyword ezone)
 - HOC Online (keyword hoc)
- CompuServe
 - Working from Home Forum (go work)
- Microsoft Network
 - HOC Online (go hoc)

(SEE ALSO "The Small-Business Yellow Pages," by Leigh Ann Shevchik (Home Office Computing, March '95) p 67, for a listing of 149 associations and organization)

Books

- 101 Best Home-Based Businesses for Women by Priscilla Y' Huff, 1995 Prima Publishing
- Homemade Money by Barbara Brabaec, 5th ed., 1994 Betterway Books
- Working Solo Sourcebook by Terri Lonier, 1995 Portico Press

SOME IMPORTANT RESOURCES FOR WOMEN'S HOME-BASED BUSINESSES -4/96ASSOCIATIONS - NATIONAL FRANCHISES

- * WOMEN'S FRANCHISE NETWORK
International Franchise Association
1350 New York Ave., NW Ste. 900
Washington, D.C. 20005. Regulations and information on franchises for women (202) 628-8000

OTHERS

- * NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED (NASE)
Member Services 2121 Precinct Lane Rd
Hurst, Texas 76054. 1-800-232-NASE. local rep -215-638-7497. benefits for the self-employed
- * NATIONAL ASSOCIATION OF WOMEN BUSINESS OWNERS (NAWBO)
1100 Wayne Ave. Ste. 830
Silver Spring, MD 20910-5603, (301) 608-2590. support of women business owners. its research branch is National Foundation for Women Business Owners

LOCAL ASSOCIATIONS

- * WOMEN OF THE WORKPLACE (W O W) women's group of the Upper Bucks Chamber of Commerce—meets monthly for lunch and is an excellent networking source. You do not have to be a member of the Chamber to belong to W O W. Call (215) 536-3211 to be placed on mailing list 320 W. Broad St., Quakertown, PA 18951
- * WOMEN'S BUSINESS DEVELOPMENT CENTER -
1315 Walnut St., Suite 1116 Philadelphia, PA 19107-4711 (215) 790-WBDC(9232)
associated with SBA, and is located in Philadelphia, but is providing entrepreneurial services for the "economic empowerment of women," in the Greater Philadelphia area, including workshops and seminars in Doylestown, Bucks County

GOVERNMENT SOURCESFEDERAL

- * OFFICE OF WOMEN'S BUSINESS OWNERSHIP
U.S. SBA
409 Third St. S.W. 6th Floor
Washington, D.C. 20416. Send for FREE packet of business information of interest to women (202) 205-6673
- * SMALL BUSINESS ADMINISTRATION ANSWER DESK 1-800-827-5722 (1-800-8-ASK-SBA)
Recorded business topics, ask for a free copy of *The Small Business Directory*, a listing of SBA publications and products including the video *The Home-Based Business - A Winning Blueprint*
- * SMALL BUSINESS DEVELOPMENT CENTERS (SBDC'S)—SEE LOCAL SBDC'S
SBA Centers are affiliated with state's universities across the county that offer business counseling. Ask them for a small business start-up kit

STATE

- * BUREAU OF WOMEN'S BUSINESS DEVELOPMENT-LENORE CAMERON, DIRECTOR
Pennsylvania Dept. of Commerce
Room 462
Forum Bldg
Harrisburg, PA 17120, (717) 787-3339. information on starting a business in Pennsylvania, classes, women's business conferences
- * BOOK *Starting and Operating a Business in Pennsylvania* by Michael D. Jenkins The Ours Press 1994, \$24.95

RESOURCES (continued)

LOCAL

- *LOCAL SBDCs - CALL FOR THE OFFICE NEAREST YOU-
LaSalle College-(215) 951-1416
Lehigh University- Bethlehem Office (610) 758-3980, Quakertown (215) 536-3404
Women's Business Development Center (SEE LOCAL ASSOCIATIONS)
- *BUCKS COUNTY EXTENSION OFFICE - (215) 345-3283
Offers courses on small business, crafts marketing for BOTH Bucks & Montgomery Counties
- *COMMUNITY COLLEGES-
Check their Continuing Education Catalogs for entrepreneurial courses
Bucks County Community College (BCCC) - (215) 968-8409 (Continuing Ed)
Montgomery County Community College (MCCC) - (215) 641-6489 (Lifelong LearningCon Ed)
- **ENTREPRENEURIAL EDGE*-publication for women entrepreneurs, covers Philadelphia Area
Jill Bond, editor, 527 Colony Dr., Ste. A, Collegeville, PA 19426, (610) 287-4492, \$14.95/yr 4 issues
E-Mail address: Edgeonline @WEB.COM
- *MONTGOMERY CO. DEPT OF COMMERCE & ECONOMIC DEVELOPMENT
151 W. Marshall St
Suite 320, #3
Stony Creek Office Center
Norristown, PA 19401-4739, (610) 278-5950, EXCELLENT source of free information on
business start-ups, resources, etc for MontgomeryCo residents and small business owners
- *US SBA PHILADELPHIA DISTRICT OFFICE - REGION III
475 Allendale Rd., Ste 201
King of Prussia, PA 19406-1415, (610) 962-3800, seminars, SCORE assistance
- *SCORE (SERVICE CORPS OF RETIRED EXECUTIVES)
Chester County Chapter, CHESCO Government Services Center
601 Westtown Rd., Suite 281
West Chester, PA 19382-4538, workshops, business counseling, (610) 344-6910
- *VO-TECHNICAL SCHOOLS -Check their fall and spring course listings for small business courses

BOOKS (check the business section of your local library book store)

- **101 Best Home-Based Businesses for Women* (1995), *101 Best Small Businesses for Women* (1996, both published by Prima Publishing) by Priscilla Y. Huff
- **Homemade Money* by Barbara Brabec, 5th ed., 1994 Betterway Books-Excellent start-up info
- **Working Solo Sourcebook* by Terri Lonier 1995 Portico Press-Excellent resource book

SMALL BUSINESS MAGAZINES (National-check your library, book store)

**BUSINESS START-UPS, HOME OFFICE COMPUTING, INCOME OPPORTUNITIES, SMALL BUSINESS OPPORTUNITIES, WORKING WOMEN, NATIONAL HOME BUSINESS MAGAZINE*

LIBRARY REFERENCE SECTION-*ENCYCLOPEDIA OF ASSOCIATIONS* (lists trade associations)

**GALF SOURCEBOOK SMALL BUSINESS SOURCEBOOK*

- **If you have any questions, please call me at (215) 453-9212, or write P.O. Box 286, Sellersville, PA 18960

Chairman BOND. Thank you very much, Ms. Huff. We appreciate your time and your thought and attention to this.

Both of you and all of us have noted some of the factors that lead people to want to start a home-based business. In your research, and I would ask this of both of you, are there different reasons for men and women to start a home-based business? And are there specific characteristics or reasons beyond those broader reasons we have discussed that people start those home-based businesses? Let me start with Ms. Bredin.

Ms. BREDIN. I found it to be the desire for flexibility and freedom predominantly, whether you are talking about men or women. The difference I would cite is that because women are still the primary caretakers when it comes to family, they are sometimes still—and you can probably address this maybe better, Priscilla—but often they find themselves in the circumstance and then decide to start a home-based business.

With men, my experience has been that they are either laid off or they make the decision based on their own desire to have flexibility or even on a business decision that they see an opportunity and decide they want to develop a business.

Ms. HUFF. I would concur with Ms. Bredin. Women have—sometimes they face feeling low, a depression after having children and this gives them an alternative—an option. They can start a home-based business part-time with just their own money that they are able to earn or save. It is easier and then still work their hours around their children, or as I said their elder parents or somebody else in their family.

Men, as you said, sometimes they are forced into it because they are laid off or they want to go a different direction, that they cannot in the corporate world.

Chairman BOND. Ms. Bredin, one of the interesting things you pointed out in your book is that home-based businesses fail less frequently than other startup businesses. Any thoughts on why that is the case?

Ms. BREDIN. The primary reason that is the case is that if you work at home you do not have the overhead that you have if you have a regular office place. What happens with any small business, home-based or otherwise, a lot of times is that you start out with an idea of what direction you are going to go in and then the market modifies that idea for you, or you modify it based on what you learn along the way. To change directions when you have a lot of overhead can be very difficult and very damaging to the potential for a business to survive. If you work at home, it is sometimes a matter of just reprinting your business cards.

Chairman BOND. Ms. Huff, you say in your book, that women, with service-based home businesses usually have an income potential of \$20,000 to \$40,000. Is this enough to provide supplement to the family income? Is there a practical limit on the ability of a home-based business to earn more than that, for example?

Ms. HUFF. Naturally, there is unlimited potential. I have known women who have started for \$10,000 and they are making close to \$100,000, depending upon the market for their services. I do find the women again, as Ms. Bredin said, have the opportunity to diversify. I know one woman who has three businesses going on at

the same time. She developed first antiques from her home, and now she is into mail order, and she is also going into consignment. So as I said, unlimited potential.

Chairman BOND. I would ask both of you a question about daycare. Ms. Bredin's book describes some various daycare options women with home businesses are utilizing. Any thoughts you can share with the Committee on how the women you have talked to are able to balance the family needs and run a business at the same time? Are there problems with that, Ms. Bredin?

Ms. BREDIN. It depends a great deal on whether the person is the primary caregiver or is in a position to have someone help them out with child care. My opinion on one of the best ways that I have seen people do it is to have some help at home and be able to spend time with the children because they are near the home, but not be in a position that they are both caring for the children and trying to run a business.

Many parents, men and women, who talk to me about the benefits of working at home say that it is sometimes something as simple as being able to spend an extra hour with the kids over lunch or not have to run to the office after trying to rush the kids into daycare. So in many cases, it is not so much that these parents are juggling work and family by spending the entire day juggling the two responsibilities. It is more just having a little bit of extra time or being available if there is an emergency, or maybe there is a Little League game. I know a father who can now coach Little League because he can take the time and then he can go back to the office later.

So really you are seeing just that, even a small amount of increased flexibility, really means a lot to people. But they are still putting in very long hours on their business. It is not as though now that they can juggle the two responsibilities that they are working less hard in any respect than any other small business owner.

Chairman BOND. Ms. Huff.

Ms. HUFF. Again, I concur. Most women sometimes do work double the hours. But when you talk to them, you hear the enthusiasm. It is their business. They can do it in small blocks of time. Most women or men who have small children at home do usually have some child care, maybe a person to come in again for that block of time. I know women who share babysitters different days of the week, one on Monday, Wednesday, and Friday or Tuesday and Thursday, and then switch the next week. That way they are able to work.

So yes, they still use it, but again the children are in their home or close by, that they can reach in an emergency.

Ms. BREDIN. A co-op child care situation can work well, in which a group of parents get together and share and take turns when they are not working, and they can help each other out.

Chairman BOND. The lights inexplicably did not go on when I started asking my questions, but I think I want to ask one final question before I turn it over to my tender mercies of my colleagues.

You have mentioned zoning restrictions, the need for more capital, some zoning restrictions. Are there other things at the Federal

level that we should be looking at? Are there other Federal impediments or Federal problems that we could deal with in this Committee?

Ms. Huff.

Ms. HUFF. I would say with the deductions for, as I said, for health care because my husband and I are both self-employed so we can only take 30 percent. So that is a big thing. Then if you do hire an employee, then you have sometimes prohibitive costs with Workman's Compensation and all those deductions, all of those things that you have to pay for.

Chairman BOND. Ms. Bredin.

Ms. BREDIN. The home office deduction needs to be something that home business owners are not afraid to take. The bulk of home-based business owners I speak to do not take it because they fear being audited and that is money that they should legitimately be able to keep for themselves.

The tax, the double tax that brings our tax rate up to 15 percent before we pay our other taxes, is also very onerous.

Chairman BOND. Thank you very much, Ms. Bredin. We have been joined by two more of our colleagues. I will turn first to Senator Burns for his questions, and then ask Senator Snowe and Senator Wellstone to give us their comments and questions, if they wish to.

Senator Burns.

Senator BURNS. Thank you very much, Mr. Chairman, and mine will be very brief. I want to tell both of you that you are just a breath of fresh air around here, because I think we are starting to put together a package now and have been working on it.

In 1989, when I joined the U.S. Senate, I started working on telecommunications issues because I knew that we cannot out-build all of the cars in the world for roads. We cannot out-build those kinds of things. We have to figure out some way to put this family back together. This was probably one of the building blocks of starting home business. So you are just a breath of fresh air.

He got my question, but I think we can go on a little different way. What changes do we have to make, and it may take working with your attorney or your accountant or whichever. How are we going to approach things—now, I realize zoning, that is a local thing. You are going to have to take that up with your local government and your local entities, to work that out. But I think it is not insurmountable. I think that can be done.

But on the Federal level, how do we approach not only the IRS and, of course, with the Supreme Court saying that if the business does not walk across the transom you cannot deduct that one room in your house as an office expense. We know we have to deal with that.

But how do we deal with work comp, liability, unemployment insurance? Then we are going to vote on, which is a very positive thing I think for you, in the National Health Care Act of the Kassebaum-Kennedy is the allowability of the deduction of your premiums as far as your health care insurance. Also health care deductions for taking care of your parents. Years ago, we all took care of our parents. We did not track them off into some nursing home.

But how do we approach those things, especially in the areas of work comp and injuries associated with work? Because if those injuries are on the job at a site, then they are not covered. So what do we have to do to rewrite those laws?

Because I am going to write a bill called Workplace 2000. I think it is going to be different and I think you are a vital part of that. Would you want to respond to that?

Ms. BREDIN. What would help a great deal would be if it was easier to classify your workers as contract workers rather than full-time employees. That is one of the biggest complaints I hear from business owners. In fact, a lot of them are considering whether it is worth being in business, because the cost of having employees almost runs them right out of business.

So it is a constant struggle, if you run your own business, how can I possibly classify these people as contract workers? There is, I believe, a 20 point checklist that you have to go through to be able to classify someone and it is almost impossible unless you were just to hire someone and say I want to do something for me. But if you tell them much beyond that, sometimes beyond what it is that you want them to do, suddenly they are classified as an employee whether they work in your office—as I am sure you know—or according to your own hours.

So some kind of a change in that which is a little more sensible and we are able to say, this person is not a full-time employee, therefore I should not have to pay for all those things for them.

Senator BURNS. Do you want to respond to that, Ms. Huff?

Ms. HUFF. I definitely agree with her.

Senator BURNS. We will be working very hard now. Just real quickly and then I will not bother you any more. What is the most obvious and the biggest barrier that you have faced in order to really get your business off the ground? What has been the biggest barrier?

Ms. HUFF. I would say financing for women. Now I just went to another topic but I am just saying, financing. Women, we do not seem to be considered worthy credit risks, and the March 1996 issue of Working Women addresses—there is an excellent article entitled “Smart Women, Foolish Bankers,” and tells how their statistics show how we (women) are just as good if not better than men as credit risks.

Senator BURNS. I can tell you from my family, my wife is a hell of a lot smarter than I am, I will tell you that.

Chairman BOND. She made one bad choice.

Senator BURNS. Yes, she made one bad choice but—

[Laughter.]

Senator BURNS. Ms. Bredin, what about—

Ms. BREDIN. I would say it is money and cost of worker's compensation insurance. Those are the two biggest barriers.

Senator BURNS. I have got another hearing to go to, but I want to thank you for coming in because you are just a breath of fresh air. We just like to hear these kind of things because we are going to have to change some things on how we approach things to allow you to do business. So thanks very much, and nice books. Thanks for your contribution. It is really important.

Chairman BOND. Thank you very much, Senator Burns. I might say that this independent contractor bill that we have introduced requires three things. No. 1, a written agreement. No. 2, the worker has to have some investment, either incurring substantial unreimbursed expenses, or have some training or specific educational background, or being paid primarily on a commission basis or a contract basis with their responsibility to complete a contract. Third, the worker has to have some independence, own place of business or something like that.

If we get that passed they might not—somebody who comes in and works in your home, just works directly for you is not going to be an independent contractor. But a person who really does have those features of independence and risk in it would be an independent contractor.

With that, we are very pleased to welcome Senator Snowe. Would you care to give us a statement?

Senator SNOWE. Thank you, Mr. Chairman. I do not have an opening statement. However, I do want to welcome our witnesses here today and ask them a few questions. I certainly think you bring considerable expertise and experience on the issue of home-based offices. Certainly the State that I represent, the State of Maine is very conducive for home-based businesses so I am very interested in this issue. I think that clearly it is a trend for today as well as to the future given all the changes in our society, both at home and in the workplace.

So it makes a great deal of sense and we should do everything that we can here at the Federal level to encourage the development of home-based businesses to allow people to raise their families and also at the same time make an income. Especially in this era of downsizing it just makes a great deal of sense. So I want to commend you for the expert testimony that you have presented both in your writings and here today.

Ms. Huff, you mentioned in your response to Senator Burns with respect to financing for women—and that is true—that women are discriminated against when it comes to commercial credit. I gather that continues to be a problem. That is an issue—frankly, we have introduced legislation and I was thinking about it again—reminds me when I was in the House that we certainly should follow up on that issue. But that is a major problem when it comes for women seeking commercial credit today and it continues to be a problem.

Ms. HUFF. Right, half of all women use credit cards, or creative financing as they call it, to start a business.

Senator SNOWE. You just reminded me on that issue and I will follow up on that because I do think that that is very important and a great inhibitor for women getting into business today. Interestingly enough, the majority of small business owners today, the persons that are coming into the arena are women. We ought to be promoting that and expanding that as well. I am going to make sure that I address that particular issue.

[In further response, Ms. Huff submitted the following:]

WOMEN'S COLLATERAL FUNDING, INC., PHILADELPHIA, PENNSYLVANIA**FACTS ON WOMEN-OWNED BUSINESSES**

Source: National Foundation of Women Business Owners and The U.S. Small Business Administration

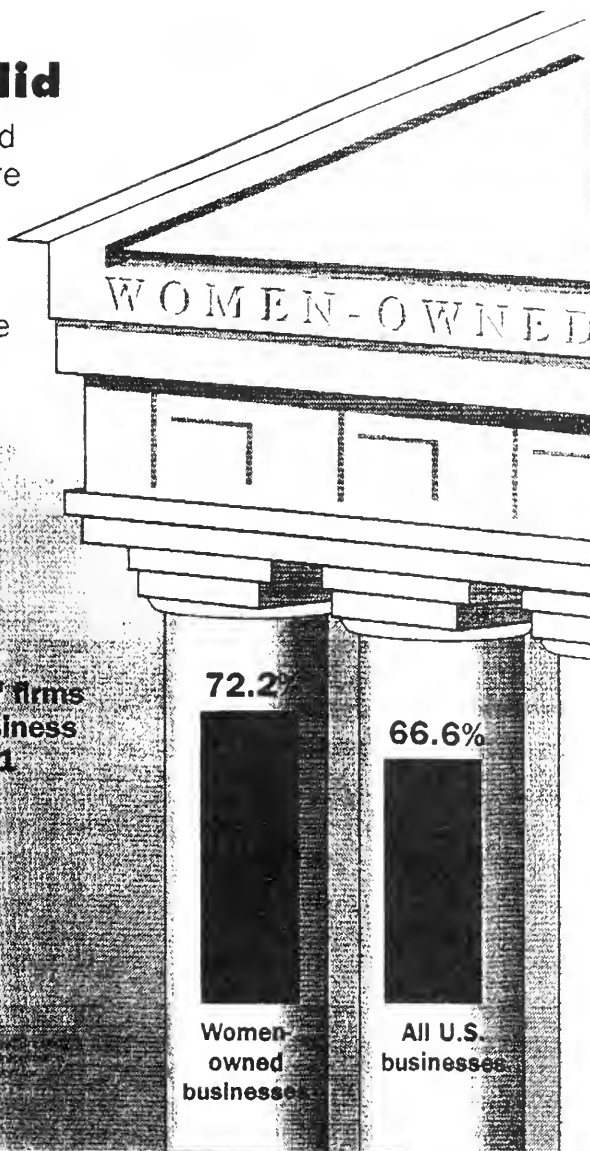
- Women are starting businesses at twice the rate of men. (U.S. SBA)
- Between 1982 and 1987, the number of women-owned businesses increased by 58%, more than 4 times the rate of all businesses. (U.S. SBA)
- As of 1987, women-owned businesses employed more than 3 million American workers, more than twice the 1.3 million workers employed by women-owned businesses in 1982. (U.S. SBA)
- 11 million were employed by women-owned businesses in 1990 - 90% of the people employed by the Fortune 500. Predictions are employment by women-owned businesses will surpass the Fortune 500 in 1992. (NFWBO)
- The total receipts of women-owned businesses tripled from \$98.3 billion in 1982 to \$287.1 billion in 1987. (U.S. Census Bureau statistics)
- During the period between 1982 and 1987, the receipts of women-owned businesses in construction industry quadrupled, rising from \$4.6 billion in 1982 to \$20.3 billion in 1987. (U.S. SBA)
- Women are moving into many "non-traditional" industrial sectors. The largest growth areas for women-owned firms during the 1980s were in wholesale trade, agriculture and manufacturing. (Bureau of the Census)
- The manufacturing industry experienced similar growth, with women-owned businesses posting receipts of \$5.3 billion in 1982 and \$30.9 billion in 1987, nearly a six-fold increase. (U.S. SBA)
- 75% of women-owned businesses succeed. (NFAWBO)
- Women are relying to a much greater extent on credit cards to fulfill their short-term capital needs: 52% vs. Only 18% among all small firms. (NAWBO)
- In fiscal year 1992, SBA approved 24,060 loans, of these 3,273 went to women. (U.S. SBA)
- Women-owned businesses show a greater tendency than all businesses to be stable (NFWBO) -- and thus are an excellent investment.

Rock Solid

Women-owned firms are more likely to have remained in business in the past three years than the average U.S. firm.

Percent of firms still in business since 1991

Source: Women's Business and Enterprise Center, the Small Business Administration, and the Service and Business Administration, U.S. Department of Commerce.



Top Ratings

Women-owned firms are as financially sound and creditworthy as the typical U.S. firm



Credit Comparison	Women-owned firms	All U.S. firms
Pay bills within 30 days of due date	92.0%	93.6%
Low credit risk (as measured by D&B Credit Score)	59.5%	56.0%
Low risk of failure (as measured by D&B Financial Stress Score)	85.3%	86.3%

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Senator SNOWE. Child care. Do most home-based owners keep their children at home, or do they send them to a child care facility, or to a babysitter outside the home?

Ms. HUFF. I have found that they keep them at home. As I said, they bring in babysitters or they will tradeoff, or have the husband assist, as my husband did. When he came home, I went to work. Again, I would work till midnight or whatever. It works well that way.

Senator SNOWE. Ms. Bredin.

Ms. BREDIN. There is a mix of solutions to it, but people would prefer to keep their kids, if not at home, nearby.

Senator SNOWE. The child care deduction obviously continues to be an issue and the financing of child care because, no matter what, it is very expensive. If you have an infant, even much more expensive. So clearly that continues to be a problem for those who work in the home or in the workplace and it is something we need to address.

Ms. BREDIN. May I add something on the financing topic?

Senator SNOWE. Yes.

Ms. BREDIN. I was just addressing a group of bankers who go after the small business market last week and they are very much interested in reaching this market. So it also seems to be an issue of education. The funds seem to, in many cases, be available but the business owners do not know about them.

So I think it is more than a matter of just having the money be available. There has got to be an education campaign to let the business owners know that they should even bother going after loans. Because I have met many business owners who would not have thought to even try their bank for a loan. In fact, as part of my research for my presentation last week I attempted to get a loan and was—I am being pursued now vigorously by my bank. So I feel it is really as much an issue of making the money available, as it is also education.

Senator SNOWE. What advice would you give somebody who wanted to start a home-based business? What is the first thing you would recommend that they do?

Ms. BREDIN. The very first thing is to write a business plan. It is an unattractive, unappealing prospect because it is lengthy but it helps you to weed out and anticipate a lot of the problems that you will encounter later on. I would also say to procure some financing, although a lot of small business owners do not. They try and bootstrap it. If you really want to develop a strong, viable business in which you will be able to hire people and grow, I think it is good to have some money behind you.

Senator SNOWE. I know there are a number of tax issues, obviously, affecting home-based offices and small businesses and several were mentioned here this morning: the independent contractor issue, the health deduction, as well as the home office deductions. Which of the three is the most important?

Ms. BREDIN. I would say independent contractor.

Senator SNOWE. That is the one that we really should focus on?

Ms. BREDIN. And the taxes. The 15 percent tax that we have to pay should be addressed, too. That is very, very expensive. The business owner in New York who is making a decent living is at

the 60 percent tax rate. And a decent living only in their financial statement because there is not a lot left for them at that tax rate.

Senator SNOWE. Finally, where do you see the trend of home-based businesses for the future, let us say in 5 years?

Ms. HUFF. I see it not stopping. I see it just growing—this is not my idea. Kimberly Stansell said she saw an article in Esquire magazine saying it pictures us working from our home, educating from our home, shopping from our home, etc., via the technology.

Senator SNOWE. Thank you both very much.

Chairman BOND. Thank you very much, Senator Snowe. There is nothing like being able successfully to repay a loan to get a bank interested in making you more loans. If they think you do not need one, they are really ready and willing to lend you the money.

We have been joined by our distinguished ranking member. But if you do not mind, Senator Wellstone has been here, I thought I might—

Senator BUMPERS. By all means. I will just offer my opening statement for the record.

Chairman BOND. That will be made a part of the record.

[The prepared statement of Senator Bumpers follows:]

STATEMENT OF SENATOR DALE BUMPERS
COMMITTEE ON SMALL BUSINESS
APRIL 23, 1996

Mr. Chairman, thank you for holding this hearing on home-based businesses. Americans who work at home are increasing in number for several reasons, including improved telecommunications, corporate downsizing, and the desire to spend more time with family, and I believe we should do everything possible to support this important entrepreneurial segment of our workforce.

In particular, I want to comment on three tax issues affecting home-based businesses -- the independent contractor rules, the self-employed health care deduction, and the home office deduction. These three issues are important to millions of businesses around the country, and it is appropriate that we hear from the small business community regarding their impact.

The independent contractor issue has been a perennial problem. For years, independent contractors and those who hire them have complained that the IRS rules do not provide enough certainty. The 20-factor common law test is very subjective, and some IRS auditors have abused their discretion by making unreasonable and contradictory determinations. I fully support clarifying these guidelines so small businesses can have a clear idea of whether the federal government considers them independent contractors or employees.

We must be careful, however, with any statutory change. Specifically, we must not to create a new law which encourages the coercive reclassification of workers. If we define "independent contractor" so broadly that a written contract is the determining factor, we will undoubtedly see employees given the ultimatum of becoming independent contractors or losing their jobs. Clearly, people who do not really want to be independent contractors will have little motivation to stay abreast of the legal obligations incumbent upon them, resulting in very detrimental circumstances later on. For example, if workers do not understand their estimated tax requirements, they may face back taxes, interest and penalties later on. And if they fail to pay FICA taxes or file appropriate earnings reports, they will lose Social Security and unemployment benefits down the road.

For this reason, I would like to see the definition of independent contractor in the Bond-Nickles bill tightened up, and I hope we can come to agreement soon. While we need to clarify the independent contractor rules, we do not need to exchange one problem for another by putting traditional employees at risk.

In the meantime, I am pleased that the IRS has proceeded with its own administrative changes in an attempt to solve the problem. The Service has recently issued a very detailed manual for its auditors making worker classification determinations, and the public has even been invited to comment. This is a rare, if not unprecedented, request for outside input into an internal IRS guideline, and many small business persons have noted their appreciation for this cooperative spirit. In addition to the worker classification manual, the Service will soon initiate an expedited settlement process designed to minimize both the length and potential downside risk of worker classification audits.

I think these changes show that the IRS is working in good faith to overcome the long-standing independent contractor problem. Certainly, Commissioner Richardson has done more in this regard than any previous IRS Commissioner, and I commend her and her staff for their conscientious efforts. I urge them to continue their work in this regard, and we as a committee should help by providing feedback on how the changes are working.

On the issue of the self-employed health insurance deduction, the Senate approved a substantial increase -- from 30% to 80% -- in the Kennedy-Kassebaum health care bill. Hopefully, the House will agree to this increase as well so that we can send the bill to the President right away. The disparate treatment for self-employed persons is one of the greatest inequities in the tax code, and we must find ways to continue increasing the deduction until it is 100%.

Finally, I look forward to hearing testimony regarding the home office deduction issue. During the reconciliation process last October, the Democrats on this committee supported an amendment offered by Senator Lautenberg to restore the home office deduction to its treatment prior to the Supreme Court's decision in the Soliman case. As everyone here knows, the Soliman decision severely limited the availability of the deduction, and in my opinion the logic was somewhat flawed, ignoring the realities of today's business environment. While it is true that the home office deduction has been abused by some, that is no reason to deny it to those who are legitimately entitled to it. We should do whatever we can to allow the deduction when a home office is a real cost of doing business, while at the same time taking care not to open a new loophole for those who are simply seeking a tax write-off. I hope our witnesses can offer some suggestions in this regard, and also suggestions on paying for the deduction's \$1.4 billion revenue loss.

Mr. Chairman, again, thank you for holding this hearing. Our witnesses have my full attention.

Chairman BOND. I will now turn to Senator Wellstone who has been one of our most reliable members of the Committee, and has held hearings in his home State of Minnesota.

Senator Wellstone.

Senator WELLSTONE. Thank you, Mr. Chairman. I will submit an opening statement for the record as well.

Chairman BOND. That will be accepted and included in the record.

[The prepared statement of Senator Wellstone follows:]

PREPARED STATEMENT OF SENATOR PAUL D. WELLSTONE
COMMITTEE ON SMALL BUSINESS
APRIL 23, 1996

Mr. Chairman, thank you for holding this hearing on issues that are of great importance to small business people in my state.

Last month I was able to meet with a number of Minnesota small business people about some of these issues in my St. Paul office. Jere Glover, SBA's Chief Counsel for Advocacy, joined me there to meet with Minnesota delegates to last year's White House Conference on Small Business, and with representatives of the Minnesota Chamber of Commerce small business policy committee.

We spent a good deal of time on the independent-contractor tax classification and home-office deduction issues. These issues are of major concern to Minnesota small business people. I hope to work with you, Mr. Chairman, and with this Committee, to find common-sense solutions on both that can pass this Congress and be signed into law by the President.

I have been very pleased by the bipartisan efforts in recent weeks on matters affecting small businesses, such as regulatory flexibility and the deductibility of health insurance for the self-employed. I would be thrilled if we can reach the same kind of agreement on these issues affecting home-based businesses, as well.

I look forward to hearing our witnesses today. Certainly, the classification of independent contractors is a crucial issue. The current, 20-point test used by the IRS to decide who is an employee is complex and often unclear. The consequences even of unintended misclassification can be damaging and expensive.

We need to simplify and clarify the classification, and I believe that enforcement should focus more on achieving compliance than on punishing unintended misclassification.

I support the intent of S. 1610, the bill introduced by the Chairman and Senator Nickles. I recall questioning Senator Nickles in this Committee on that bill.

I am unable to support the bill as it is currently drafted, however, although, as I said earlier, I would like very much to work with the authors to make it acceptable if that is possible.

The bill as introduced would simplify independent contractor classification. By going too far in that direction, however, in my opinion, the bill does not clarify. It oversimplifies, and thus would make it too easy to classify workers in enterprises of all sizes as independent contractors. The definition would in fact be less clear, and a large new class of workers could find themselves classified as independent contractors -- workers who really are employees according to any common-sense understanding of the term.

Because income-tax compliance generally is lower for independent contractors than for employees, there could be significant revenue losses associated with such a change. Social-security tax collection and unemployment insurance could also be severely compromised.

It is my strong hope that a bill can be made acceptable to a majority in the Senate and to the President, so that real reform can be enacted this year. I am eager to work with Senator Bond and Senator Bumpers to do just that.

I am also eager to work with them and with Senator Hatch to pass a responsible Home Office Deduction bill that will help people with legitimate home office expenses get the same tax treatment as people who work from rented office space. Many people choose to work at home for many reasons, and they should not be discouraged. Many home-based businesses are owned and operated by women. More and more of them are located in rural areas. I hope that our witnesses today will speak to some of the concerns regarding the cost of the home deduction and the issue of whether to include commuting costs in any deduction.

Thank you.

Senator WELLSTONE. I appreciate the focus. I have been working closely with the delegation from Minnesota that was at the White House Conference. We continue to do follow-up meetings and both these issues that we are focused on today are a big concern to the small business community in Minnesota.

Before I go to questions, I was just listening to the responses—and I apologize, you guys—in the Midwest you guys is men and women—I apologize to both of you for being here late. I had a conflict.

When Senator Snowe was asking about access to loans, capital, and also women not getting a fair shake there were a couple things that occurred to me. One is that I think one of the really startling successes in Minnesota—I just love to go to their annual gatherings—is the Microloan program. You know, where you have micro-lenders it is \$10,000 to \$15,000 loans that the banks will not give. We have some incredible success stories that I love to focus on and emphasize.

It occurred to me also that the SBDCs could do a better job on technical assistance and outreach, especially with women-owned businesses because there is a gap—no one thing does the job, but I think we could do better. I know in Minnesota—if I could just brag for a second—the SBA office has just been great.

The Chairman here has done a really good job of making this a bipartisan Committee. We did that on Reg Flexibility and I think now we have done it—Senator Burns mentioned a much higher deduction on health care expenses in the insurance reform bill. And last year on the guaranteed loan programs I think we came up with a really good compromise rescue plan.

I know in my State, between 504 and 7(a), we leveraged about \$225 million last year, about half of it in greater Minnesota outside the urban areas. So all of this I think is critical.

I have two questions. One question, is it or is it not true—I keep hearing at the different hearings we have back home and at meetings—that women-owned businesses employ more people than the Fortune 500 companies? What is wrong about that, or is that exactly right? I see some people nodding their heads. Can somebody tell me for sure because that is a dramatic figure? Is that true?

Ms. HUFF. It goes along with small businesses in general because they are the backbone of the economy.

Senator WELLSTONE. I know on the small business part, but I have heard over and over again the figure—Olympia, have you heard this—that women-owned businesses employ more men and women than the Fortune 500 companies?

Chairman BOND. The figure we have is that 54 percent of all employees in the country are employees of small business. Now that does not break it down on the figures that you—

Senator WELLSTONE. Anyway, I am going to have to corroborate it, but it is a dramatic figure.

Chairman BOND. Why don't you report back on that? Senator Wellstone, we will charge you with that.

Senator WELLSTONE. OK.

Senator SNOWE. I think they are the fastest growing.

Senator BUMPERS. You testified that 64 percent of these home-based businesses were women, were they not?

Senator WELLSTONE. Right.

Ms. HUFF. Yes, 66 percent. I know that I have heard—I can get that statistic for you, who quoted that. I will get that to you because—

Senator WELLSTONE. I will bring it back to the Committee.

Ms. HUFF. I think it might be the Women's Business Association here in Washington. I am not sure, but I can get that to you.

[In further response, Ms. Huff submitted the following:]

Women Business Owners Quick Fact Sheet

Women-owned businesses employ 35% more people in the United States than the 1994 statistic. 50% of women do world-wide. *The National Foundation for Women Business Owners*

Women Owned Businesses in the National Economy Women business owners.

- Lead 7.7 million businesses
- Provide jobs for over 15.5 million people
- Are a powerful economic force, generating nearly \$1.4 trillion in sales per year
- Operate in every industrial sector, including manufacturing, agribusiness, and retail, as well as high growth industries such as health, business and professional services.
- In agriculture, mining and manufacturing grew between 1991 and 1994, in direct contrast to an overall contraction in these industries
- Are well established - over 28% have been in business 12 years or more
- Own 37% of all businesses

Contributing to the Gross National Product

Women owned businesses continue to expand, contributing an estimated \$1.4 trillion in revenues to the economy and creating jobs. Nearly one third of NAWBO member owned businesses have ten or more employees, averaging

- 9.8 full time employees
- 3.6 part time employees
- 1.3 contract or temporary employees

Employee Benefits

Women owned businesses offer benefits which reflect a holistic and innovative management style. They

- Are as likely as all businesses to offer basic benefits, such as health insurance and holidays
- Are more likely than all businesses to offer flex time, job sharing or tuition reimbursement
- Offer profit sharing at a much smaller size than all businesses

Financial Savvy

Over half of NAWBO members currently have some form of credit with a financial institution, and 66% report having a regular working relationship with a particular bank official. Nearly six in ten NAWBO members were in the market for financing during 1994, and 44% report that capital availability is a current issue for their businesses. In 1994

- 60% used business earnings to meet their capital needs
- 51% used credit cards
- 38% used private sources (i.e., savings, family, friends)
- 32% obtained a commercial bank loan
- 18% leased equipment
- 12% obtained a personal bank loan
- 12% used vendor credit

Looking Forward

Women owned businesses are growth oriented. Seven in ten NAWBO members are optimistic about the U.S. economic outlook for 1995/96, which is a 10% increase from their view two years ago. During 1995

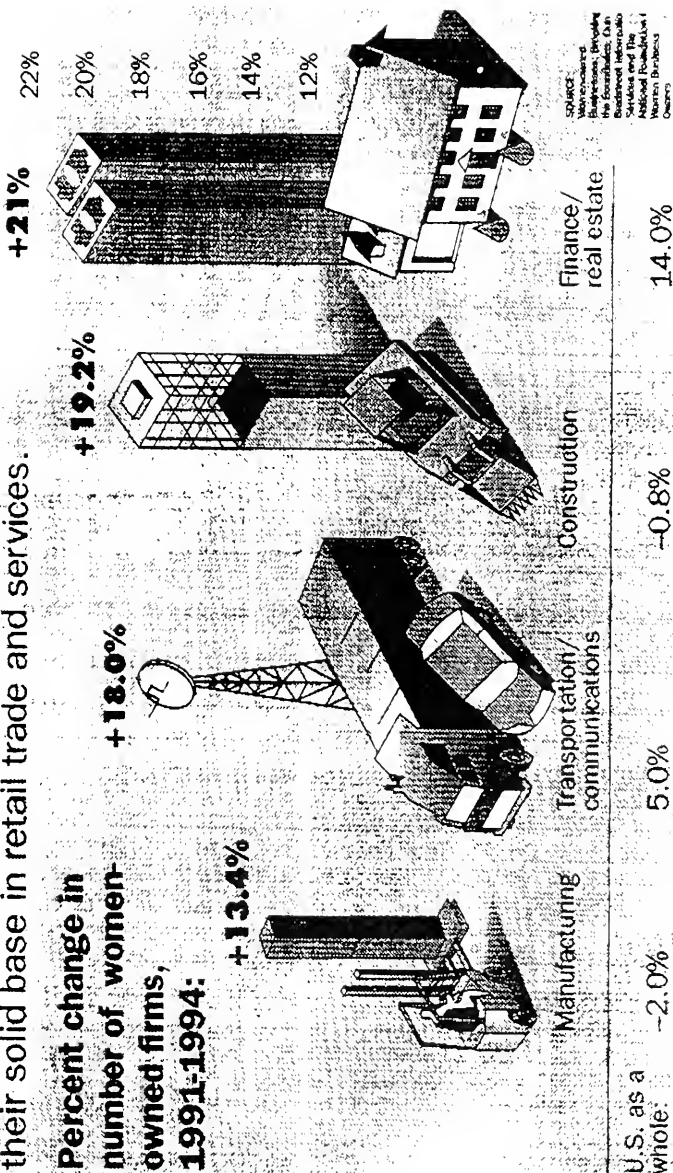
- 88% expect their sales to increase
- 46% expect to increase their employment
- 71% will improve the quality of the products and services they offer
- 55% will add new products and services
- 45% will expand into new markets in the U.S.
- 38% will increase capital investment in their business
- 33% will increase capital spending specifically for technology

Sources: 1994 NAWBO Membership Survey; NAWBO 1995 "Women Owned Businesses - Breaking the Boundaries"; NAWBO and Dun & Bradstreet Information Services 1995 "Employee Benefits Offered by Women Owned Businesses: A Framework for Comparison"; NAWBO 1994

Industry Diversity

Women-owned businesses continue to expand into "non-traditional" industries, while still maintaining their solid base in retail trade and services.

Percent change in number of women-owned firms, 1991-1994:



Top Employers

Women-owned firms employ 35% more workers in the U.S. than the Fortune 500 does worldwide.

Number of employees

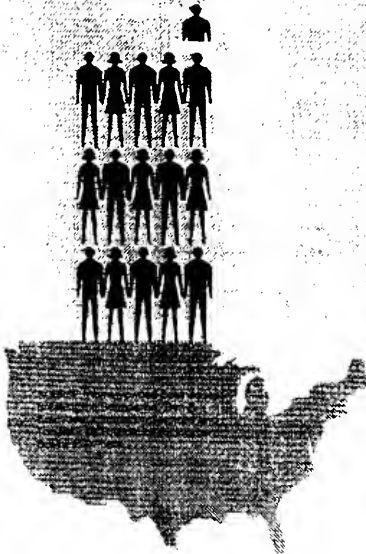


Women-owned
firms in the U.S.

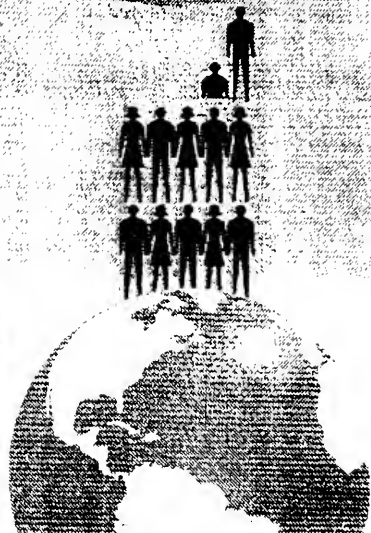


Fortune 500
firms worldwide

15.5 mil.



11.5 mil.



Senator WELLSTONE. Just two quick questions. Do you have any figures on the number of home-based businesses—not that are owned and operated by women. You have presented that, 60-some percent—but that are located in rural areas? I come from a State with a real strong rural component, greater Minnesota.

Ms. BREDIN. I have looked for that information myself. As far as I know, I am not aware of a breakdown of where these businesses are located except from what I gathered anecdotally, and knowing what I do about the reasons that people work at home, there are a lot of businesses. A lot may not help you, but a lot of businesses in rural areas because one of the great things about working at home is that you can be located wherever you like to be.

Senator WELLSTONE. Right. It would be interesting to try and get that, because that is my sense of it as well. Are there any, and you gave an answer in part to Senator Snowe to this question, but are there any policies or programs that we ought to be considering that might affect women-owned or rural-owned home-based businesses differently than other home-based businesses? Now one of those was the access to loans. But are there other policies that we ought to be thinking about, whether things that we ought to be doing to nurture and encourage women-owned or rural-owned home-based businesses as opposed to other home-based businesses?

Ms. HUFF. I think getting the word out. I think it is intimidating for a woman to go up to even a Small Business Development office and say, I want to start a business. I think making it more welcoming, having smaller SBA groups, field groups. Women have said to me they feel more comfortable talking to a woman who has been in business before. That is why I have a networking association where we help one another.

Again women network; it is traditional. But women often need confidence. It is a psychological factor. They do not feel confident. And yet many women have many skills like other people, they just do not have the confidence to do it. So they need to be walked through.

But I do commend the Small Business Development Centers. They do help with writing a business plan, et cetera. And by the way, St. Paul has been designated as one of the best home-based havens in the Nation by Home Office Computing.

Senator WELLSTONE. They are doing a great job.

Ms. Bredin.

Ms. BREDIN. In the study I referred to in my presentation, the AT&T home business resources survey, the results indicated that women go out to lunch less frequently than men, women home business owners. I translate that into, women are networking less. I think that you can probably say the same about people in rural areas, just for obvious reasons.

What home-based business owners need, particularly these two groups, is some kind of opportunity to meet decisionmakers in large businesses that in many cases they are trying to sell to. It is relatively easy for someone like me in New York City to network. But if you are more isolated, then to have an opportunity to meet those people, it would be helpful. And if that could be facilitated, even by Government—I do not know exactly how you would do

that. I could help you with ideas if you need them, but that would be very helpful.

Senator WELLSTONE. Last quick question. This is a tougher one. This is one that I am grappling with. People, for a variety of different reasons, find it attractive to work at home, set up their own businesses at home. Are there cases where it would make sense for a person to be working at home yet be considered an employee? What I am really getting at is, I know what we are trying to look at with independent contractors and I have said in Committee, Mr. Chairman, that I am very sympathetic and really would like to see us be able to do something.

One of the obvious questions is, when it comes to the issue of who is responsible for paperwork, or taxes, or Social Security, or unemployment benefits, what is the best way to ensure that people who really are employees by any common sense perception do not get classified as independent contractors because it is simply a better deal for a larger company to do that? How do we make sure that that does not happen? That to me is sort of the kind of fine line that we are walking here.

Ms. BREDIN. How do you make sure that corporate telecommuters do not become classified as independent contractors; is that your question?

Senator WELLSTONE. It would be a good example, yes.

Ms. BREDIN. I think that would be difficult because businesses want to save money. I am usually coming at it from the other perspective. You have to provide some incentive for them or incentive somewhere maybe to give them the opportunity to take some kind of deduction if their employees are working at home. Somehow give them the opportunity to save on their employees working at home, because otherwise you are talking about something that is going to cost them money. So you have to compensate the businesses somehow, the businesses employing the people working at home.

Ms. HUFF. I just read—I cannot quote the statistics right now, but telecommuting has gone down a million from last year because workers are afraid that if they are out of the office, they are out of the sight of the boss and they might lose—someone else might jump into their positions. So now it is going back; it is reversing slightly.

Senator WELLSTONE. But you understand what my concern is. I know we really need to have—I understand the 20-step process. I understand the need to improve this. But I also am concerned that if we are not careful, at least by way of language, you are going to have a bunch of people who really are employees all of the sudden classified as independent contractors for the convenience of the company vis-a-vis all of the things that we have been talking about with those employees worse off. That is the question I think that we are struggling with.

Chairman BOND. Thank you very much, Senator Wellstone.

I might just add by way of comment on the independent contractor measure we have introduced, you have to sign a written agreement to say that you are an independent contractor. Absent that, you are not an independent contractor. I visited a very high tech company in Blue Springs, Missouri where a significant number of women take their circuit board assembly—work at home as em-

ployees. They are clearly employees and they are doing very high tech stuff, but they can do that at home.

Senator WELLSTONE. I just want to make sure that—you still get into a power arrangement and some people may have no other choice but to sign that. That is what I am worried about.

Chairman BOND. Senator Bumpers.

Senator BUMPERS. Thank you, Mr. Chairman. I will be very brief.

Let me ask each of you this question. Let us say a person worked at a company and did a specific job with a computer, and then when 4:30 in the afternoon comes, they go home and they do that same job. They continue the same job because their computer is hooked up to the one at the plant, and they spend 4 hours each evening under a consulting contract with the employer. Should they be classified as an independent contractor?

Ms. BREDIN. They are both actually. They are an after-hours workers and an employee.

Senator BUMPERS. They are doing the very same work, they are just doing it at home on their own computer. Let us, just for fairness to make the question more realistic, let us assume that they are doing some kind of work where they are paid on the productivity of the job. Just like a woman sitting at a sewing machine who is paid on piece-work. Let us assume they are paid in the workplace on a sort of a piece-work basis, whatever it may be, and then they just continue that at home. But the employer gives them a contract, an independent contract to do this work at home, and the price would be the same. Should they be classified as an independent contractor?

Ms. BREDIN. I would not consider them an independent contractor, although it would depend on whether or not—what benefits they are getting.

Senator BUMPERS. I guess I am just raising that question, Mr. Chairman, more than anything else to point out that this thing can get rather complex. There are situations where it is very difficult to put everybody in the same hole. I am very sympathetic with what we are trying to bring to the process.

Chairman BOND. Senator Bumpers, I might just say that anticipating your interest in this, we do have a specialist on the second panel who can get into that.

Senator BUMPERS. Fine.

Chairman BOND. Because these two witnesses have a broad perspective, and we have asked somebody who is an accountant to go into those issues for us.

Senator BUMPERS. OK. I just wanted to make this observation. I think somebody did mention Social Security, and to say that—when I practiced law I paid Social Security on my employee, but I paid, as I recall I paid—just as a self-employed person I paid a considerably smaller rate than—I take that back. I had a business and I paid my employee and myself both, we paid Social Security out of the business. The extra income I had as an attorney I paid Social Security on at a rate approximately two-thirds.

Today, for example, it is 15 percent, 7.5 percent for the employee, 7.5 percent for the employer. Back in those days—and I used to do some tax returns for farmers—and a self-employed person then paid considerably less than the amount that both the employer and

the employee paid. And I guess over the years we have gotten to the point now where they pay the same amount, do they not? Doesn't a self-employed person pay 15 percent?

Ms. BREDIN. Yes.

Senator BUMPERS. There is a suggestion here this morning by somebody that that ought to be lowered. I do not know whether that is one of the Chairman's intentions or not, but I am rather sympathetic to lowering that rate.

Well, we will pursue that further, Mr. Chairman. Thank you.

Chairman BOND. Thank you very much, Senator Bumpers. Thank you, Ms. Bredin, and Ms. Huff. We very much appreciate it. As soon as Senator Burns finishes reading these books we will pass them around to the rest of the Committee and allow them to read them as well.

Our next panel is Ms. Debbi-Jo Horton, an accountant from East Providence, Rhode Island; Mr. James M. Johnson, owner and photographer. He owns Jim Johnson Photography of Washington, D.C., and also testifying on behalf of the National Federation of Independent Business. We have Ms. Dianne Floyd Sutton, president of Sutton Enterprises, human resource development specialist, Washington, D.C., testifying on behalf of the National Association of the Self-Employed. Thank you all very much for joining us today. As I indicated, your full statements will be made part of the record and we now invite Ms. Horton to begin the discussion.

Ms. Horton.

STATEMENT OF DEBBI-JO HORTON, ACCOUNTANT, DEBBI-JO HORTON ACCOUNTANT, EAST PROVIDENCE, RHODE ISLAND

Ms. HORTON. Thank you, Chairman Bond, and members of the Committee. I was chomping at the bit when all those questions were being asked earlier.

My name is Debbi-Jo Horton. I am the New England Regional Taxation Implementation Chair to the 1995 White House Conference on Small Business, a CPA, and an owner of a small business in East Providence, Rhode Island. I have been in business for 7 years during which time I have worked closely with clients on the independent contractor versus employee issue, and the frustration of facing tax inequity at nearly every turn.

Many of the White House Conference delegates participated in long, hard debate on the final 60 recommendations that were presented in the report to the President and Congress. Three of these recommendations are included in my written testimony.

Senators Bond's and Nickles' bill, S. 1610, adds to the current Internal Revenue Code of 1986. It sets standards for the determination of an independent contractor versus an employee. It establishes a series of tests that identify the qualifications which must be met in order to be classified as an independent contractor.

The first test requires that the independent contractor meet one of five criteria in order to be classified as an independent contractor. These criteria follow the IRS' for-profit standards for establishing oneself as a viable business rather than a hobby.

The second test requires that the independent contractor meet one of two criteria dealing specifically with the location of the business activity and revenue source. This section reflects many of the

concerns of the White House Conference. For instance, it does not exclude a service provider from being an independent contractor simply because the service provider uses the equipment of the service user.

The final test requires that services be performed pursuant to a written document between the service user, or the payor, and the independent contractor. If such a document exists, the independent contractor will not to be treated as an employee with respect to such services.

The elimination of back taxes due for misclassification when Form 1099s are filed and there is no evidence of fraud is the only major piece of the White House Conference's recommendation that is not present in this bill. There are times when parties operate under the belief that they are in accordance with the law, and later find that they were not. It is not intentional, but it happens nevertheless. Delegates ask that when this is the case and the service user has filed the appropriate documents under the assumption that their position was correct that they not be punished for being in error. The delegates do want to see full penalties enforced when the misclassification is intentional and fraudulent.

This bill represents the spirit of the White House Conference on Small Business recommendation No. 224. It addresses a majority of the concerns raised by the delegates as their top vote-getter. I commend Senators Bond and Nickles for their diligence and consideration. It is one of the most important issues plaguing small businesses today.

Another issue that plagues small business is the tax inequities they suffer. The fact that self-employed persons can only deduct a small portion of their health insurance premiums from their income is unacceptable. A deduction of 100 percent of these medical premiums must be allowed in order to determine the net profit of the company. This would allow the benefit of the deduction for purposes of income, FICA, and Medicare taxes. This allowance should be available to self-employed, partners, and shareholders of S corporations.

If a self-employed person hires employees, they are allowed to deduct 100 percent of their employees' health insurance premiums and the employer's portion of FICA and Medicare payments from his/her self-employment income, but yet not their own. If you operate as anything other than a C corporation, you are not allowed these deductions. Why?

C corporations are allowed to deduct this expense in its entirety, and Congress has not asked them to give up 70 percent of their deduction, nor is it anticipated. Small business ask that they be treated in an equitable fashion. The 100 percent deduction for health care premiums for all business entities ranked 15th in the final recommendations of the White House Conference.

I am very appreciative of Senator Bond and this Committee for making it a priority to streamline regulations. It is my belief and that of the 1995 White House Conference on Small Business delegates that independent contractor rules merit immediate attention. Additionally, tax equity and equal tax treatment should apply to all entities regardless of the legal form they chose to do business

in. This also received overwhelming support on the part of the delegates.

I thank Chairman Bond and the Committee for giving me the opportunity to testify and I will answer any questions that you have.
[The prepared statement of Ms. Horton follows:]

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1995 White House
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Congress of the United States
 Committee on Small Business
 Senator Christopher Bond, Chairman
 Subcommittee on Taxation and Finance
 428A Russell Senate Office Building
 Washington, DC 20510

Chairman Bond and Members of the Committee,

My name is Debbi-Jo Horton. I am the New England Regional Taxation Implementation Chair to the 1995 White House Conference on Small Business, a CPA, and an owner of a small business in East Providence, RI. I hold a Bachelor of Science Degree with a major in Accounting from Bryant College. I have been in business for seven years during which time I have worked closely with clients on the independent contractor vs. employee issue and the frustration of facing tax inequity at nearly every turn.

Many of the White House Conference on Small Business Delegates participated in long, hard debate on the final 60 recommendations that were presented in the Report to the President and Congress. Through the generosity of America Online, delegates from across the Country communicated their views, debated and refined the wording of these final 60 recommendations which represent the viewpoints of a majority of small business owners. The final version of three of these recommendations are as follows:

NCRA 34 Congress should further legitimize home-based businesses and restore the home-office tax deduction by reversing the effect of the 1993 Solman decision which requires that:

- a) Clients physically visit a home office, and,
- b) Business income be generated within the home office.

This would again allow essential administrative, operational and/or management tasks to qualify a home office as the "principal place of business" (votes received - 1239)

NCRA 78 Congress shall enact a 100 percent deduction for health care premiums for all business entities so that there is equity in taxation for the self-employed, partnerships, S Corporations, limited liability corporation, and C Corporations. This benefit shall continue to be excluded for tax purposes from the income of employees of all small businesses regardless of form, including from the income of the self-employed. (votes received - 1283)

NCRA 224 The definition of an independent contractor must be clarified Congress should recognize the legitimacy of an independent contractor

a) The 20 factor test is too subjective. The number of relevant factors should be narrowed with more definition guidelines for implementation. Realistic and consistent guidelines which require one of four criteria plus a written agreement. The criteria are (1) realization of profit or loss, (2) separate principle place of business, (3) making services available to the general public, or (4) paid on a commission basis

b) Safe harbor provisions should be established which would protect the hiring business from the burdensome penalties currently being assessed by the IRS. De Minimis rules based on dollars paid, hours worked, years in business, and/or specified closed end projects should be established

c) The IRS should eliminate back taxes for misclassification when Form 1099's are filed and there is no evidence of fraud

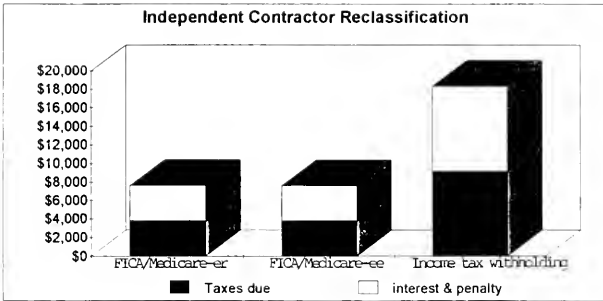
d) Congress should specifically allow employers and independent contractors to provide joint technical training and to jointly utilize major specialized tools without jeopardy of reclassification of the independent contractor to employee status

e) Changes and implementation processes should be formulated by a joint committee of legislators and small business people (votes received 1471)

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Many small businesses are either independent contractors or the users of the services of independent contractors. Frequently they are both. For instance, I am an independent contractor to the clients I service and I use independent contractors for such things as brokering assets, marketing advice and computer work. I engage the services of independent contractors because I do not possess the knowledge to service my clients properly in these specific areas.

Many problems arise when the IRS reclassifies independent contractors as employees. The subjectivity of the IRS's 20 factor test and resulting determination of the IRS can bankrupt a small business. The ramifications of reclassification is costly and often the reclassification is unfair and unreasonable. Some worst case scenarios regarding taxes, penalty, and interest are illustrated in the following graph.



This graph illustrates an independent contractor with a \$50,000 contract, who has been reclassified as an employee by the IRS. Additionally, the IRS has determined intentional misclassification. The ultimate result of the intentional misclassification has the following implications: 100% of the employer's FICA & Medicare and 100% of the employee's FICA & Medicare; 100% of the income taxes that would have been withheld assuming the contractor was single with one exemption.

Because the determination that the misclassification was intentional, (IRS Regulations do not require the IRS to prove it) the resulting penalty would be 100% of the tax. In addition the IRS could assess penalties for failure to file employment forms, failure to make timely deposits, accuracy-related penalty for negligence or substantial understatement of taxes, penalty for civil fraud, and even aiding and abetting the understatement of tax liability.

Interest charges could also be assessed. This would apply to all open years. Personal liability exists for "trust fund" portions of these taxes and 100% penalty for failure to file cannot be discharged in bankruptcy.

This is only the beginning.. reclassification can affect qualified pension plans and other benefit plans because all of the nondiscrimination tests must be recalculated.

One example, is what happened to a Smithfield, RI company. They were contacted by an IRS Agent. He asked if he could stop by to discuss the independent contractor vs. employee issue. They were assured that this was not an audit. It was an informative interview only.

They cooperated and were very forthcoming in their interview with the agent. Shortly after completion of the interview, they were again contacted and informed that a payroll and subcontractor audit would be conducted.

The IRS reclassified ALL of their subcontractors as employees for the years 1986-1988 and assessed penalty, interest and all portions of payroll taxes for both employer and employee. They were assessed a total of \$72,000 and were told that a certified check must be delivered within 24 hours or a one and one half times penalty would be assessed bringing the total to \$108,000.

This company hired legal counsel and spent the next two years fighting this assessment, incurring \$10,000 in attorney fees. The IRS settled for \$38,000, and required that affidavits signed by each independent contractor certifying that they had paid their self-employment taxes. The IRS refused to access their own databases to determine if the independent contractor had filed a Schedule C. They required that this company contact each individual independent contractor on their own to ascertain if the proper taxes had been paid. If it hadn't been for the financial support of family and friends this company would have been ill-prepared to deal with this assessment and litigation and would have been forced to close their doors. The settlement amount was paid.

But it didn't end there. The IRS still kept placing liens on their property, even though the settlement had been paid. It took an additional 6 months to straighten it out, at which time they received a hand-written note of apology from the IRS for this "inconvenience".

The independent contractor issue is a major concern for small business. While it may appear that individuals are serving as employees of a small business they are conducting themselves as an independent contractor. The duration of employment under contract may very well be an issue for the Internal Revenue Service, however, there is a severe misunderstanding of the overall status of this individual.

Another example would be a repertory theater. Many of the actors classify themselves as independent contractors and operate their activities as an independent contractor. While they may be contracted by a particular theater for a duration of time, the fact is that they are also marketing their skills and abilities to many other theaters.

An actor is responsible for auditioning for roles in a play. Inasmuch they may be successful in obtaining roles in a series of plays over an extended period of time with the same theater. However, the individual still serves as an independent contractor and not as an employee. The guaranteed employment is not present at anytime, and their ability to provide services to others at the same time is still present.

Similar arguments could be made for nurses that serve as independent contractors. Self employment and the ability to market their services to others provides them with the flexibility to serve numerous clients. This is very important to them as a small business. The fact that they may serve the same company for multiple patients does not constitute the presence of permanent employment status.

A large number of independent contractors have no financial means to educate themselves or their employee(s) with technical training. They can often obtain this training through a client with joint training sessions. To the client, this would make sense. If you change part of your system or procedure, it makes sense to train ALL the people who use it, including the independent contractors you use.

Senators Bond's and Nickles's bill S 1610 adds to the current Internal Revenue Code of 1986. It sets standards for the determination of an independent contractor vs an employee. It establishes a series of tests which identifies the qualifications which must be met in order to be classified as an independent contractor.

The first test requires that the independent contractor meet one of five criteria in order to be classified as an independent contractor. These criteria follow the IRS's "for profit" standards for establishing oneself as a viable business rather than a hobby.

The second test requires that the independent contractor meet one of two criteria dealing specifically with location of business activity and revenue source. This section reflects many of the concerns of the White House Conference on Small Business. (For instance, it does not exclude a service provider from being an independent contractor simply because the service provider uses the equipment of the service recipient.)

The final test requires that services are performed pursuant to a written document between the service user (or the payor) and the independent contractor. If such a document exists, the independent contractor will not be treated as an employee with respect to such services. A written agreement is also a requirement in the recommendation put forward by the WHCSB recommendation #224.

The elimination of back taxes due for misclassification when Form 1099's are filed and there is no evidence of fraud is the only major piece of the White House Conference's recommendation that is not present in this bill. There are times when parties operate under the belief that they are in accordance with the law, and later find that they were not. It is not intentional, but it happens nevertheless. Delegates to the White House Conference ask that when this is the case and the service user has filed the appropriate documents under the assumption that their position was correct, they should not be punished for being in error. The delegates do want to see full penalties enforced when the misclassification is intentional and fraudulent.

This bill represents the spirit of the White House Conference on Small Business recommendation #224. It addresses a majority of the concerns raised by the delegates as their top vote-getter. I commend Senators Bond & Nickles for their diligence and consideration. It is one of the most important issues plaguing small businesses today.

Another issue that plagues small businesses is the tax inequities they suffer. The fact that self-employed persons are allowed to deduct only a small portion of their health insurance premiums from their income is unacceptable. A deduction of 100% of these medical premiums must be allowed to determine the net profit of the company. This would allow the benefit of the deduction for purposes of income, FICA, and Medicare taxes. This allowance should be available to the self-employed, partners, and shareholders of an S Corporation.

The effect of this is complicated for self-employed persons doing business in states that piggyback US gross income for the state tax calculation. There is then no benefit to a 100% deduction unless it is part of computing the Schedule C net income or the pro-rata share of partnership, S Corporation, or LLC income.

If a self-employed person hires employees, they are allowed to deduct 100% of their employee's health insurance payments and the employer's portion of FICA and Medicare payments from his/her self-employment income and not their own. If you operate as anything other than a C Corporation, you are not allowed these deductions. Why?

The 100% deduction of health care premiums ranked #15 in the final 60 recommendations of the White House Conference on Small Business. C Corporations are allowed to deduct this expense in its entirety. Congress has not asked them to give up 70% of their deduction, nor is it anticipated. Small business ask that they be treated in an equitable fashion. This sort of inequity places a severe financial burden on the small business owner.

Another inequity which exists is the manner in which home office business expenses are classified as non-deductible expenses. The Soliman decision only accentuates the tax ramifications of this inequity. The fact that the business might have another outside location should not be a disqualifying factor. A barber might cut hair in his

salon, but perform essential administrative duties from an office located within his home not in his hair salon. Currently, all of the work which the barber may perform in his home office is classified as **nondeductible**.

Clients do not always visit a home office. Clients can be serviced at their place of business and often prefer to have services performed in this manner. Consultants and accountants often provide services in the client's office rather than their own. According to the Soliman decision, if the majority of the work is performed outside the home office the expense is classified as **nondeductible**.

A reversal of the 1993 Soliman decision would allow essential administrative, operational and/or management tasks to be performed from a home office allowing them to be classified as **deductible** business expenses and to qualify as the "principal place of business".

The reversal of the 1993 Soliman decision ranked this issue as #20 out of the 60 final recommendations.

I am very appreciative of Senator Bond and this Committee for making it a priority to streamline regulations. It is my belief and that of the 1995 White House Conference on Small Business delegates that the independent contractor rules merit immediate action. Additionally, tax equity and equal tax treatment should apply to all entities regardless of the legal form they chose to do business in. This also received overwhelming support on the part of the delegates.

I thank Chairman Bond and the Committee for giving me the opportunity to testify on Tuesday, April 23, 1996.

Chairman BOND. Ms. Horton, I believe there may be a few questions.

We are now ready to turn to Mr. Johnson. Mr. Johnson, would you give us your testimony, please?

STATEMENT OF JAMES M. JOHNSON, OWNER/PHOTOGRAPHER, JIM JOHNSON PHOTOGRAPHY, WASHINGTON, D.C., ON BEHALF OF NATIONAL FEDERATION OF INDEPENDENT BUSINESS, WASHINGTON, D.C.

Mr. JOHNSON. Yes, thank you, Mr. Chairman. I also was excited when I heard the questions of the first panel and wanted to jump up to the table.

I thank you for the opportunity to be here representing the NFIB. I am a photographer. I have been in business, self-employed for 18 years. I have been a member of NFIB since 1987. NFIB represents 600,000 small businesses, average gross income \$250,000 with an average of five employees. They get their positions that they bring to congressional attention by polling their members each month. I get tons of mail every month. So I think they are very accurate in what they have to say about representing us. I am a very enthusiastic proponent of that organization. I was on TV this morning and a woman who teaches music asked how she could join. So they are going to get the small people also.

I also commend you on taking the opportunity to bring to the attention of the public the urgency of the health care issue, deductibility of premiums. In this country, small businesses like myself can pay up to 30 percent more premium than a corporation, and some States where other mandates are in effect they pay even another 30 percent premium for having to get comprehensive programs that they do not necessarily need.

Also, they are subject to discrepancies in coverage. I myself had this experience where I had a claim after one time and they kept increasing the premiums, 20 percent; sometimes they go as much as 300 percent. I think there needs to be some control there. I take it upon myself to go out and find premiums. It is difficult to find certain coverages. I thought I had one thing, did not have another. Partly, that is my fault for not reading the fine print, but there needs to be some leveling of the playing field and monitoring of what these insurance companies are doing.

In 1986, the NFIB began some health studies or questioning of their members and they found that small businesses said their No. 1 concern was health insurance premiums. I strongly urge Congress to look further into the tax deductibility of the premiums. I understand that there has been recent legislation introduced where we are going to have a graduated program up to possibly 80 percent. I am a proponent of 100 percent.

Small business no longer is competing with corporate America. Small business and self-employed are picking up the ball that corporate America can no longer carry. I think the playing field needs to be leveled. There need to be more incentives, more encouragement and more national recognition of legitimizing the home-based business as well as more help for small business.

In bringing about status quo in the tax deductibility of premiums, you bring about parity. Why should a large corporation pro-

vide a gold-plated health plan whereas myself struggling along can barely get nuts and bolts? The incentives also would be for myself, if I cannot deduct my health insurance premium what incentive is there for me to go the extra mile for my employees?

In closing I would like to say, you quoted earlier a figure of 54 percent of the work force in America now currently being employed by small businesses. I think as we approach the year 2000 we are going to see that number of 54 percent grow dramatically. Again, it is about making America grow. It is about reviving the American dream. And anything that is good for small business—I hate to be cliché—is going to be good for America.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Johnson follows:]

Testimony of
Jim Johnson
Jim Johnson Photography
National Federation of Independent Business (NFIB)

Thank you, Mr. Chairman. My name is Jim Johnson, and I am a photographer and owner of a home-based business. I have been a member of the National Federation of Independent Business (NFIB) since 1987. NFIB is the nation's largest small business advocacy organization, representing more than 600,000 small business owners from all fifty states. The typical NFIB member has five employees and has \$250,000 a year in gross annual sales. NFIB sets its public positions through regular polling of the membership.

I want to take this opportunity to thank you for inviting NFIB to participate in this hearing today, and also to commend you for bringing attention and urgency to the issue of health insurance deductibility for self-employed Americans -- sole proprietorships, partnerships, and subchapter S corporations.

The High Cost of Health Insurance

Self-employed business owners often pay approximately 30 percent more than larger companies for similar benefits because of higher administrative costs. In addition, they often pay another 30 percent in premiums because of costly state mandates for specific types of insurance coverage, which prevent self-employed business owners from shopping for only the basic care that they and their employees might need. Larger firms that self insure, by contrast, are not subject to these costly mandates. The self-employed usually lack access to cost-saving managed care arrangements because of a reluctance by insurers to create and market them in small towns and rural areas. Additionally, a small, unincorporated firm is far more likely than others to feel the painful brunt - both economic and emotional - of the pre-existing condition exclusion or, when an employee get sick, the 20 percent to 300 percent premium hike or sudden cancellation of insurance. Insurance companies are much more likely to require exclusions, raise premiums or cancel policies to shield themselves from risk when insuring a small firm or a one person firm rather than a large business.

All of this accounts for a trend found in NFIB Education Foundation studies that began in 1986. In that year, small business owners -- both self-employed and incorporated -- for the first time identified the cost of health insurance as their number one problem in a study entitled *Small Business Problems and Priorities*. That trend has continued ever since, with the cost of health insurance proving to be twice as critical a problem as the number two problem (federal taxes on business income) in a follow up study published in 1992. With health insurance premiums still growing faster than the rate of inflation today, this problem has not abated.

Recommendation

NFIB strongly urges Congress to end the health insurance tax deductibility status quo and address the tax fairness issue head on. Specifically, NFIB supports action taken by the House early this month and the Senate last week, during consideration of health insurance reform bills, H.R. 3102 and S. 1028, to increase the deduction for health insurance for the self-employed to 80 percent.

NFIB supports quick passage of a reconciled health care reform bill which includes health deductibility.

Ending the status quo -- setting a course toward 100 percent deductibility -- accomplishes the following:

(1) **Parity.** Full deductibility for the self-employed would end the idea that an executive for a Fortune 500 company can get a full deduction for a gold plated health insurance policy but a self-employed business owner receives no deduction at all -- solely because of the way the business is legally organized.

Some may argue that limited deductibility for self-employed should be preserved at some level in an effort to make Americans more sensitive to the actual cost of their health care, thereby making the market place more competitive. NFIB believes that concerns about the impact of the tax code on health care cost sensitivity are legitimate. However, any approach to this issue which says that limited deductibility is good policy for the self-employed but not simultaneously for C corporations is unfair and unacceptable.

(2) **Incentives for the self-employed to purchase health insurance for their employees.** NFIB strongly believes that full deductibility for the self-employed would also reduce the number of uninsured among the employees of the self-employed. According to the Health Insurance Association of America, only 26 percent of small business employers with less than 5 employees provide health insurance for their employees. The main reason they do not provide health insurance is cost. Under current law, self-employed business owners find themselves in the peculiar position of being permitted to deduct the health insurance costs of their employees, but not their own premiums. If they have no incentive to purchase health insurance for themselves, they are far less likely to consider buying it for their employees. Full deductibility would change that.

Self-Employed Health Insurance Deduction: A History

1986-1989:	The self-employed were first given 25 percent deductibility as part of the Tax Reform Act of 1986.
1989:	The Omnibus Budget Reconciliation Act of 1989 extended the deduction for nine months (for taxable years beginning before October 1, 1990.)
1990:	25 percent deductibility was extended through 1991.
1991:	25 percent deductibility was extended through June 30, 1992.
1992:	On June 30, 1992, 25 percent deductibility expired.
1993:	25 percent deductibility was included in Omnibus Budget Reconciliation Act of 1993 and applied retroactively from July 1, 1992, to December 31, 1993. (The deduction was limited if the individual or his or her spouse was eligible to participate in an employer-paid health plan.)
1994:	Self-employed deductibility no longer exists.
1995:	25 percent deductibility increased to 30 percent and made permanent.

Summary

NFIB members have long favored several principles of health care reform -- small employer pooling, deductibility for health insurance for self-employed, guaranteed availability and renewability in the small group market, medical savings accounts and medical malpractice reforms. Small business owners support this Committee and the Congress in your effort to move forward on a health care bill that would help America's job creators.

Chairman BOND. Thank you, Mr. Johnson. I will buy into that cliché myself.

Ms. Sutton.

STATEMENT OF DIANNE FLOYD SUTTON, PRESIDENT, SUTTON ENTERPRISES, HUMAN RESOURCE DEVELOPMENT SPECIALIST, WASHINGTON, D.C., ON BEHALF OF NATIONAL ASSOCIATION OF THE SELF-EMPLOYED, WASHINGTON, D.C.

Ms. SUTTON. Good morning, Senator Bond. I am Diane Floyd Sutton. I am president of Sutton Enterprises. This is a nationwide network of professional human resource consultants based here in Washington, D.C. Today I am also representing the National Association of the Self-Employed, the Nation's largest organization of micro-businesses and the self-employed with more than 320,000 members.

I personally formed Sutton Enterprises 9 years ago because I saw an opportunity. It was a chance to use my expertise in human resource development and diversity training. A chance to improve the daily practices and the team spirit in a wide variety of organizations and companies. I also saw that I could link up with other professionals who shared my interest and my vision.

I have been able to carry out my dream. Today my office is a gathering place for this network of consultants. Together we develop proposals, we create workshops and seminars. I have interns from the American University School of Communications, where I serve as an Adjunct Professor, who join with us.

Since the workshops and seminars themselves occur in my clients' places of business, there is no reason whatsoever for me to rent expensive office space. And since I confer with my professional colleagues by telephone, fax, and network, I can just as easily operate out of my own home. So like millions of other Americans, I operate a home-based business—in an area of my home specifically set aside for these activities.

Because I deal professionally with changes in the American work force as the focus of my business, I perhaps know more about this subject than the average small businessperson. I have also talked to a variety of groups and organizations nationwide and what I know is this, sir. We are seeing more home-based businesses because our society is changing.

No. 1, the economy is shifting from manufacturing-based to service-based, and within that, to knowledge-based. More business work is being done by focused team using technology and expert knowledge systems. The increasing globalization of industry standards means that buyers can more confidently purchase goods and services from around the world, rather than relying on established suppliers. To aid just-in-time manufacturing and purchasing, suppliers are giving more customers computerized access to their ordering and inventory systems.

The technology is changing, No. 2. The explosion of computer networking is undermining the rationale for having large numbers of people working in close physical proximity. Distance learning technology is allowing individuals to learn more on their own, so places of learning are becoming more disperse. Wireless technology like laptop computers is increasingly permitting information termi-

nals to travel with the user rather than forcing the user to stay put at the information terminal.

And the work force is changing. By far the greatest growing segment of the work force is the self-employed, followed by businesses with four or fewer employees. More mid-career professionals are becoming entrepreneurs as they are squeezed out of the narrowing managerial pyramid in large companies. In spite of persistent recruitment problems in the United States, many companies continue to promote early retirements. As life expectancy lengthens and more workers take early retirement, there will be more older workers in the workplace, particularly more older, self-employed workers. Already the United States has more people over 65 years of age than the entire population of Canada.

Two-wage earner families are becoming the rule rather than the exception. Over 75 percent of women between 25 and 34 are now in the work force. Telecommunications is enabling more families to have two wage earners while attending to child care.

Now I have identified some of the changes. No longer will our society have a big employer, many employees, and just one job site. Nearly all of these changes are shifting the economy toward more autonomous workplaces like home offices. What has been the response of the Federal Government? Consider the tax code. It stands like a King Canute commanding the waves of modernization to recede.

First, we have a totally confusing morass of distinctions between independent contractors and employees. The IRS has a 20-factor test to make these determinations. Elements of the test are over 600 years old. They were used to distinguish between masters and servants in medieval England. So we have 14th century feudal social distinctions applied to the emerging 21st century capitalist.

I will close with a couple more points that you had asked to be addressed. We do not know if this 20-factor test means anything. Apparently, identical cases are decided on opposite sides of the IRS. The IRS' proposed new manual on independent contracting is over 200 pages long. The real purpose of this fog seems to be to classify as many people as employees, and note that the examples in the new manual are cases of people who the IRS say should be classified as employees not independent contractors. That is why your independent contractor bill is so important, Senator Bond. We urgently need simplification and modification of the whole area.

I have got to conclude with the home office deduction. An enlightened approach to home-based business would be to facilitate home office deductions with appropriate safeguards against abuse. Instead, the IRS sued a doctor who took a perfectly justifiable deduction for his home office. When the IRS lost the case in the U.S. Tax Court they took it to the Court of Appeals. When they lost against the Court of Appeals they took it to the Supreme Court. Only then did they finally win. So we got the infamous Soliman decision making it far more difficult to claim the home office deduction. Surely, Congress did not intend this to be harmful.

Again, I would like to commend you for your leadership in this issue, Mr. Chairman. The child care deduction is essential and our organization, the National Association of the Self-Employed, in

1993 created a coalition to revitalize the home office deduction. This coalition now includes more than 30 organizations.

Again, it is commendable but I must say this. Home-based offices are not—I repeat, are not the flavor of the decade. They are not going to go away. They are a trend in our employment system that will impact the 21st century, because basically we need a new paradigm. We need to be thinking about how to encourage business to take advantage of change, how to use the tax code to foster home-based businesses, how to facilitate changes in business styles that strengthen our families, and how to expand access to the American dream.

Again, thank you for permitting me to testify and I will be happy to accept any questions.

[The prepared statement of Ms. Sutton follows:]

Testimony of

Dianne Floyd Sutton
President, Sutton Enterprises
Washington, DC

on behalf of

THE NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED

Senator Bond, Senator Bumpers, members of the Committee, good morning. I am Dianne Floyd Sutton, President of Sutton Enterprises, a nationwide network of professional human resource consultants based here in Washington. Today I am also representing the National Association for the Self Employed, the nation's largest organization of microbusinesses and the self-employed, with more than 320,000 members.

I formed Sutton Enterprises nine years ago because I saw an opportunity. It was a chance to use my expertise in human resource development and diversity training. A chance to improve the daily practices and the team spirit in a wide variety of companies and organizations. I also saw that I could link up with other professionals who shared my interests and my vision.

I have been able to carry out my dream. Today, my office is a gathering place for this network of consultants. Together we develop proposals. We create workshops and seminars. Interns from The American University School of Communications, where I serve as an Adjunct Professor, join with us.

Since the workshops and seminars themselves occur at my clients' places of business, there is no reason for me to rent expensive office space. And since I confer with my professional colleagues by phone, fax and computer network, I can just as easily operate out of my own home. So, like millions of other Americans, I operate a home-based business -- in an area of my home specifically set aside for these activities.

Because I deal with changes in the American work force as the focus of my business, I perhaps know more about this subject than the average small business person. I have also talked to a variety of groups and organizations nationwide.

And what I know is this. We are seeing more home-based businesses because our society is changing.

- the economy is shifting from manufacturing-based to service-based, and within that, to knowledge-based;
- more business work is being done by focused teams using technology and expert-knowledge systems;

- the increasing globalization of industry standards means that buyers can more confidently purchase goods and services from around the world, rather than relying on established suppliers;
- to aid just-in-time manufacturing and purchasing, suppliers are giving more customers computerized access to their ordering and inventory systems;
- the technology is changing. The explosion of computer networking is undermining the rationale for having large numbers of people work in close physical proximity;
- distance learning technology is allowing individuals to learn more on their own, so places of learning are becoming more dispersed;
- wireless technology like laptop computers is increasingly permitting information terminals to travel with the user rather than forcing the user to “stay put” at the information terminal;
- and the work force is changing. By far the fastest growing segment of the work force is the self-employed, followed by businesses with four or fewer employees;
- more mid-career professionals are becoming entrepreneurs as they are squeezed out of the narrowing managerial pyramid in large companies;
- in spite of persistent recruitment problems, many companies continue to promote early retirements;
- as more workers take early retirement and life expectancy lengthens, there will be more older workers in the marketplace, particularly more older self-employed workers;
- already, the United States has more people over 65 than the entire population of Canada;
- two wage-earner families are becoming the rule rather than the exception;
- over 75% of the women between 25 and 34 are now in the work force;
- telecommuting is enabling more families to have two wage earners while still attending to child and elder care responsibilities;

- many women and minorities in the professional ranks are hitting the “glass ceiling” -- and are becoming self-employed rather than unemployed;
- overall, far greater numbers of women, minorities and immigrants are coming into the workplace. In fact, by the turn of the century 5/6ths of all new entrants into the labor force will be women, minorities, and immigrants. Unfortunately, because of discrimination, many have very little capital they can access for business start-ups. So they’ll be searching for business opportunities with low start-up costs.
- and finally, efforts to reduce pollution and energy consumption are also spurring business decentralization. Just as more employers are promoting carpools, so also are they promoting telecommuting and subcontracting from independent contractors to meet pollution and energy reduction goals.

The changes I’ve just identified are pushing our society away from the “big employer / many employees / one job site” model that prevailed through the 1950’s and 1960’s. Pushing us toward a lean, “just-in-time” work force heavily dependent on independent contractors.

And nearly all of these changes are shifting the economy toward more autonomous work places, like home offices.

But what’s been the response of the federal government?

Consider the tax code. It stands like King Canute, commanding the waves of modernization to recede.

First, we have a totally confusing morass of distinctions between independent contractors and employees. The IRS uses a 20-factor test to make these determinations. Elements of the test are over six hundred years old -- they were used to distinguish between masters and servants in medieval England. So we have 14th century feudal social distinctions applied to an emerging 21st century capitalist, technological economy.

Of course, no one knows what this 20-factor test means anyway. Apparently identical cases are decided in opposite ways by the IRS. The IRS’ proposed new manual on independent contracting is over 100 pages long.

The real purpose of all this fog and obfuscation seems to be to classify as many people as possible as employees. Note that the vast majority of

examples in the new manual are cases of people who the IRS says should be classified as employees, not independent contractors.

That's why your independent contractor bill is so important, Senator Bond. We urgently need simplification and modernization of this whole area.

Then there's the home office deduction.

An enlightened approach to home-based businesses would be to facilitate home office deductions, with appropriate safeguards against abuse. Instead, the IRS sued a doctor who took a perfectly justifiable deduction for his home office. When the IRS lost the case in US Tax Court, they took it to the Court of Appeals. When they lost again in the Court of Appeals, they took it to the Supreme Court. There they finally won. And so we got the infamous *Soliman* decision, making it far more difficult to claim the home office deduction -- surely much harder than Congress ever intended it to be!

There's also a general kind of "chipping away" at Schedule "C" by the IRS. Schedule "C" lists the expenses sole proprietors use to run their business. Accountants and other tax preparers report that IRS has become increasingly aggressive in its efforts to "knock out" Schedule "C" deductions.

IRS is a problem, but sometimes Congress itself seems to stand in the way of these changes, too.

Anyone who thinks about being self-employed has to be disheartened by the discriminatory tax laws. Only the self-employed are DOUBLE-TAXED on Social Security -- paying both the employer's and the employee's share. 15.3%. And that comes right off gross revenue, too, before even a nickel of deductions for expenses or for income taxes.

Then there's health insurance. For years, the self-employed got only a 25% deduction for health insurance -- in contrast to larger companies, which got a full 100%. In 1995, our health insurance deduction was raised to 30%. The health care bill being voted on today may well raise the deduction to 80%, in stages. That's an improvement, and we appreciate it. But in fairness the deduction should be a full 100% now, just like other businesses receive.

And here again, I want to commend you for your leadership on this issue, Mr. Chairman.

The child care deduction is essential for parents who must have someone watch their children in order to work. And that includes even many parents

who work at home. But the deduction is so small that it is rapidly exhausted in areas where child care is expensive, like most cities.

For a small home-based business, generating new clients or customers often comes down to taking people to lunch. This serves exactly the same function as advertising -- which most home-based businesses can't afford or don't need to reach their specialized audiences. Yet advertising is a 100% deductible expense. Meals and entertainment, even when fully documented as a business development expense, are still only 50% deductible.

Forcing husbands and wives to pool their income for tax purposes also deters home-based businesses. If one spouse is near the top of a tax bracket, like the 15% bracket, a small income from the other spouse can push them both into a higher, say 28%, bracket -- wiping out any gains.

These policies are counter-productive. Our country is just not maximizing the economic flexibility and productivity we could have if we made it easier for more people to work at home. We're keeping individuals, and to some extent the whole country, from having a higher standard of living.

So it's good that the Senate Small Business Committee is looking into home-based businesses, and the related tax issues. Home-based businesses are not just the "flavor of the decade"; they're a trend in the employment system that will impact the 21st Century.

Basically, we need a new paradigm to deal with this. We need to be thinking about how to encourage business to take advantage of change.

How to use the tax code to foster home-based businesses.

How to facilitate changes in business styles that strengthen families.

And how to expand access to the American dream.

Thank you for permitting me to testify. I would be happy to accept any questions at this time.

Chairman BOND. Thank you very much, Ms. Sutton, for your spirited testimony. I wish we could have had the entire Finance Committee here listening to this panel and the previous panel.

Let me start off with a couple of questions going back to the independent contractor. Ms. Horton, do you find yourself in a position where under the current law you have to tell a client, better not use an independent contractor because of the dangers of being reclassified by the IRS as an employee?

Ms. HORTON. Yes, because if they do want to take the chance and they are reclassified, it goes much beyond having to pay back taxes. It could include 100 percent penalties and interest. You see, you have to go back and reclassify all of your benefit packages as well and you could suddenly find that your pension plan is no longer a qualified plan because you did not incorporate one of your employees who you had originally classified as an independent contractor. So it can be devastating to a small company or even a mid-sized company to suddenly realize that their tax bill to the IRS, because of misclassification, is well over \$250,000.

Chairman BOND. You were kind enough to say nice things about S. 1610, the bill we introduced. Let us be honest, what changes would you like to see in it? Where did we go wrong, what can we improve?

Ms. HORTON. What I had indicated, where a company moves forward under the belief that they are in accordance with the law, later find that they are not because one of those 20-factor tests does not quite fit right and they find themselves being misclassified. They still are subject to the penalty and interest based on that misclassification. What delegates to the White House Conference felt very strongly about was that if there was no intention to misclassify and it was not fraudulent, that those penalties and interest be waived.

Chairman BOND. Are you saying under the three-factor test, if taxpayers think they have got it and they miss it, then you would urge that the penalties be waived?

Ms. HORTON. I am talking more about what has happened in the past, because they can still go in and if they deem it to be intentional—and they do not need to prove that it is intentional—they can go back as far as they like.

Chairman BOND. What we have tried to put in our bill—I do not know whether it will survive—is that test applies as of now for anything still in the pipeline. So we have tried to deal with that.

Let me turn to Mr. Johnson and Ms. Sutton. Tell me what you really think is probably the single greatest hurdle to a successful home-based business today. Mr. Johnson.

Mr. JOHNSON. I would think the home-based businessperson's mindset as far as operating as a business, developing a business plan, putting certain financial monitoring aspects into place and things like that. Historically, my father was a photographer. He operated part-time. I know a lot of other people that operate part-time businesses but never really consider them a business. They just do not. They think it is a hobby, and that generally gets them in trouble.

When you think like a corporation and operate—I know my accountant hammered on me when I first started out, you have got

to do this, you have got to do that. I did not see all the aspects of it, but down the road you do. So the mindset of that person is the No. 1 thing.

Then looking at IRS legislation, certain taxes. I have a problem with the Social Security tax and certain levels of taxes. But if you plan appropriately, you can handle those kind of things.

Chairman BOND. Ms. Sutton, what would be the most significant barrier?

Ms. SUTTON. He has hit on one. But for me I find finances and taxes are the biggest one; being able to get my business financed and having to pay the taxes. Those are the two biggest concerns I have.

Chairman BOND. To all of you, if your businesses grew significantly would you choose to remain a home-based business? Do you see any chance that you would have to set up an office somewhere?

Ms. SUTTON. No, because the nature of my business says that I can do my design and development, and that all my delivery is going to be at my client's facility. So there would never really be a need for me to take my business outside of my home.

Chairman BOND. Mr. Johnson.

Mr. JOHNSON. I do. In fact, this year it is beginning to push me out. So I am going to have to find a new place even if I keep that structure totally for business.

Chairman BOND. Ms. Horton.

Ms. HORTON. I started out as a home-based business and I now rent over 1,100 square feet of office space because my staff has grown to five full-time employees.

Chairman BOND. Would you prefer to maintain a home office?

Ms. HORTON. No, sir, I would not.

Chairman BOND. Thank you very much.

Now it is my pleasure to turn to Senator Bumpers.

Senator BUMPERS. Mr. Chairman, having once been a small town lawyer with the personnel problems of one secretary, and I think about what it was like to be self-employed, I have become more acutely aware of this problem. On the other hand, Congress, as always, is also charged with the responsibility of being fair and making sure that whatever we do here with the Bond-Nickles bill or whatever, that it is fair both to the Government and to the self-employed. Now I generally come down very strongly on behalf of self-employed persons as independent contractors.

Ms. Sutton, you alluded to the Soliman decision which I guess, if you were going to summarize, the Supreme Court said, your home activities have to be essential to your business. I am not quite as offended by that as you are. I know that the IRS says—and I did enough tax work as a country lawyer. I was about the only person in town that did tax work, and I had three hungry kids so I did it. But I can tell you that oftentimes my clients wanted me to fudge and fudge greatly on that issue.

I used to allow them a certain latitude, but I did not allow them total latitude on how much of their home, for example, they could deduct for their self-employment activities at home. If you were a salesman—I had a very close friend at one time who was a salesman. He stayed 5 days on the road and on weekends I suppose he did a certain amount of work at home just tallying up his expenses,

which he was allowed to deduct, his hotel and motel and food expenses and so on.

But I am not sure that that—if we allowed everybody to deduct a portion, depreciate a portion of their home for their self-employment, I am not sure that would make a lot of sense.

Now my point I guess—I am sort of rambling here, but my point is this. The IRS says that this very activity is the biggest abuse that they have to enforce. So what Senator Bond and the rest of us want to do—and we are not on the Finance Committee so we are limited on what we can do in that regard—we want the IRS to be more realistic than their 20-factor test.

And because of a bill chiefly crafted by Senator Bond and introduced as the Bond-Bumpers bill and sailed through the Senate 100 to zip, we are requiring the IRS in the future, when they issue regulations, to also issue an explanation in the mother tongue, which is English, telling us what it means. And I think that is a real blow for liberty, and I think we have gotten more favorable comment out of that bill by not just the IRS, but all Federal agencies who do regulations, to also explain—for the non-Philadelphia lawyers—what they are trying to say.

Now having said all that, I want to do everything I can to encourage the Finance Committee to increase the deductibility of health insurance. I think that is a very legitimate concern. And I also think—I just asked the staff to call the Social Security Administration today and find out what the rate was for self-employed persons 20 years ago. I do not think it was a full 100 percent, 15.3 percent. It was something less than that. And slowly but surely, I guess because the Social Security Trust Fund needed to be refurbished, we just kept raising the rate.

But in any event, let me ask you a specific question about child care. Let us assume that you do your work out of your office at home and you have two children, and you hire somebody to take care of the children while you do your work. What is the maximum deduction you can take for child care?

Ms. SUTTON. Six hundred dollars. We think it is \$600 at this time.

Senator BUMPERS. A year?

Ms. SUTTON. Yes, that is it.

Senator BUMPERS. What would it be if you were dropping your child off at a child care center on the way to work? What is the allowable deduction?

Chairman BOND. We have an expert here.

Senator BUMPERS. Ms. Horton.

Ms. HORTON. It is exactly the same regardless of whether you do your child care in-home or out of home. Currently, the \$600 is a tax credit, so it is worth more to the taxpayer than if it is a deduction on your Schedule A.

Senator BUMPERS. Say that again. I did not understand that, Ms. Horton?

Ms. HORTON. I am sorry. The \$600 is a direct reduction of your taxes, it is a tax credit rather than a tax deduction, which would get diluted on your Schedule A under 2 percent of miscellaneous, that is after your 2 percent adjusted gross income figure is deducted. So a tax credit would actually translate into a higher

amount if it was transferred into a deduction. But it is still not a lot of money.

Senator BUMPERS. That sounds outrageous to me. A \$600 tax credit for a woman who is dropping her child off at a child care center so she can work 8 hours a day, and she gets a \$600 tax credit? And I do not know what child care cost is today, but I would assume if she has her child in just an ordinary daycare center, she is probably spending somewhere around that much every month for child care.

Did you know that, Mr. Chairman?

Chairman BOND. I have been in that childcare business not too many years ago and there are limitations, I believe, on where it phases out.

Ms. HORTON. Right.

Chairman BOND. It phases out at what?

Ms. HORTON. I believe \$25,000.

Chairman BOND. On the credit.

Ms. HORTON. You are limited to 20 percent of what you paid up to the credit.

Senator BUMPERS. Twenty percent up to \$600, is that it? Is that what you are saying?

Ms. HORTON. Twenty percent of what you actually paid for your child care up to \$600.

Senator BUMPERS. If I pay say \$5,000 a year, I would be limited to \$1,000?

Ms. HORTON. No, \$600.

Senator BUMPERS. I know that, but I do not understand. What is this percentage of what you pay? What did you say the percentage is?

Ms. HORTON. The lowest percentage, I believe, is 20 percent. There are several different levels, depending on what your wages are or your self-employment income.

Chairman BOND. In other words, they make it so complicated that you have to hire an accountant or a small town lawyer.

Senator BUMPERS. Six hundred dollars is the cap, is it not? That is the maximum you can get, a \$600 tax credit?

Ms. HORTON. Yes.

[In further response, Ms. Horton submitted the following:]

Senator Bumpers had asked me about the Child Care Credit limitations. I indicated that I recalled the maximum amount of the credit allowed was \$600 per child. I have had the time to clarify that information and would like to forward it to you.

The amount of credit is figured as such:

The amount of qualified expenses you incurred and *paid* in 1995, up to \$2,400 for one qualifying person or \$2,800 for two or more persons *but not more than you or your spouse's earned income*. The amount of credit is then the \$2,400 (or \$4,800) times the percentage applicable from the chart below:

If Your Adjusted Gross Income Is:	Applicable Percentage Is:
\$0-10,000	30
\$10,000-12,000	29
\$12,000-14,000	28
\$14,000-16,000	27
\$16,000-18,000	26
\$18,000-20,000	25
\$20,000-22,000	24
\$22,000-24,000	23
\$24,000-26,000	22

If Your Adjusted Gross Income Is:	Applicable Percentage Is:
\$26,000-28,00021
\$28,000-no limit20

This limits the credit between \$480-\$720 for one dependent and \$960-\$1,440 for two or more.

Senator BUMPERS. Ms. Sutton, let me ask you a personal question. Do you deduct a portion of your home on your tax return?

Ms. SUTTON. I do.

Senator BUMPERS. How do you base that? On the fair market value of your home?

Ms. SUTTON. The fair market value of my home and also the number of cubic feet of the house that I am using.

Senator BUMPERS. And you just take a percentage?

Ms. SUTTON. I just take a percentage.

Senator BUMPERS. In other words, if you have a 2,000 or a 3,000 square foot home and you are using 500 square feet for your office, you do it on that basis?

Ms. SUTTON. Yes, sir, up to a maximum of about a third.

Senator BUMPERS. If the IRS questions you about that, would you be required to come up with some appraisal of what the value of your house was?

Ms. SUTTON. I probably would have to, but that would not be a problem because if you are taking that deduction you anticipate an audit, so you are always prepared. OK? And you make sure that you pay a lot of money for very good accountants.

Senator BUMPERS. You know, on that connection, Mr. Chairman, I know I am not going to live long enough to see the kind of civilized country that I would like to see. And I was just thinking yesterday, and I probably should not even tell this story. But I went out to Great Falls to be with the President. He is a very good friend.

I want him protected. I want the Secret Service to do everything in their power to make sure that he is protected fully. And yet, I have gotten to where I do not even want to go to those functions because of the lack of judgment of people who are charged with his security.

It was very hot yesterday out in the open, 87 degrees at the time. And the President left and everybody was required to stand behind and he had to get completely out of sight, walking. And of course if you know Bill Clinton, he wants to shake hands with every person there, and that is very admirable. But you know, being a Senator gave me no status. They finally recognized me and offered to let me out, and I said no, I will just stay here with everybody else.

But it looked to me like a ludicrous thing and I was terribly agitated when I left there. So I had to balance my agitation about the way the Secret Service operates when the President is around with my really total commitment to his safety.

And I thought, at first, I am going to go back and see if I cannot cut the Secret Service budget.

Then I cooled off on the way home, recognizing that the people who were there in charge were only following orders, were only doing what they had been told to do.

Now this brings me down to the point of the IRS—

Chairman BOND. That is a relief.

Senator BUMPERS. You were beginning to wonder where this was headed, were you not?

Chairman BOND. Well, Senator Pressler and I were discussing that and we were taking bets on whether it was going to get back or not.

Senator BUMPERS. Nobody likes to see the IRS walk into their office, and that is very understandable because you feel like the minute they walk in, you are going to be poorer when they leave than you were when they came in.

But I want to say that the present commissioner, Peggy Richardson, is trying to change that.

I am something of a fan of hers because I think she is really trying to address the problems we are talking about. And it has nothing to do with collection of taxes. It has to do with the civility of her agents who walk into your office and, as I say, they have a tendency to be graduates of the Lyle Alzado charm school. And that is not necessary. All of those things are unnecessary.

That is one of the reasons, particularly small businesspeople, who have to spend 54 percent more to comply with Government regulations than big business does, that is the reason they are so terribly agitated all the time with the IRS, including me.

So this is a two-pronged thing, as far as I am concerned. No. 1, Senator Bond and I are charged with the responsibility of making sure that what we try to do here and get the Finance Committee to do, is fair. Fair to the taxpayer and fair to the Government. And that you, as a taxpayer, understand what the rule is so you do not have so much trouble complying with it or knowing what the rule is.

So as I say, we have a double-whammy of trying to be an arbiter and to make sure that these things—yes.

Ms. SUTTON. Senator Bumpers, Secret Service is one of my clients, so do not do anything to their budget. I need their work. But let me say this to you, sir. If I had an outside facility and never showed up at it at all, I could write it off. But because I want my facility inside of my home, I am more closely scrutinized. I have got to make sure that I can document that I am definitely doing business there, which is opposite if I had a facility. No one would even question it. They would say yes, this is your business address, this is where you conduct business. They would never check. And I think that is very unfair.

All we are asking for is to give us some very practical concrete guidelines as to how we can operate and how we can keep some of our profit. That is all we are asking. We are not asking that you give us anymore than anyone else has in the United States, but that we be fairly represented.

I just wanted to make that point, but please do not do anything to the Secret Service budget.

Senator BUMPERS. Ms. Sutton, that is a very compelling point, extremely well made. I had an uncle many years ago with the IRS, and he has told me he said we take doctors in alphabetical order, and I think they do the same with self-employed persons. Thank you, Mr. Chairman.

Chairman BOND. Thank you, Senator Bumpers. Senator Pressler has joined us and we are very pleased to have him here.

Senator PRESSLER. Thank you. I would like to submit my opening statement and a question or two for the record.

[The prepared statement of Senator Pressler follows:]

PREPARED STATEMENT OF SENATOR LARRY PRESSLER
COMMITTEE ON SMALL BUSINESS
APRIL 23, 1996

Good morning. I would like to thank my friend, the Chairman, for continuing this series of hearings on the special problems faced by certain small businesses.

As our witnesses will tell the committee, technology developments have increased the capacity for home based businesses. Telecommunications and other new technologies are revolutionizing the way we study, play, and work. As our society moves to an information and service based society, telecommuting will become more prevalent. Telecommunications reform legislation recently passed by Congress will accelerate this trend, making it easier for people to operate businesses from their homes.

This revolution can level the playing field in several ways. Now, with just a home computer, modem and fax, entrepreneurs can have access to the same information and have the same capacity for technology as their large competitors. An entrepreneur in Humboldt, South Dakota can serve customers in Hong Kong. Technology also can level the playing field among geographic areas. Development can bring new economic growth to small cities and towns in rural areas across the country. A customer service center for credit cards or a can be located in Huron, South Dakota just as easily as in Los Angeles.

Congress must now examine other federal law and regulations which may block this progress. I look forward to hearing from today's witnesses on some of these issues including independent contractors and the deductibility of health insurance for the self-employed.

Senator PRESSLER. Mr. Chairman, I want to commend you on holding this hearing.

Chairman BOND. Thank you, Senator. Are you sure that you do not want to ask anything? No Lyle Alzado charm school or anything like that?

Senator PRESSLER. Let me ask my colleague, what is the Lyle Alzado charm school?

Senator BUMPERS. Do you know who Lyle Alzado was?

Senator PRESSLER. No.

Senator BUMPERS. And you never heard of the Lyle Alzado charm school?

Senator PRESSLER. No.

Senator BUMPERS. That is an expression that used to be very common when he was playing football, because he was considered something less than the civilized nice guy on the football team. I should not use that term anymore, because he has been long since gone. I will think up somebody else, Larry.

Chairman BOND. This has been a very informative session. We will keep the record open for additional questions and I think some of us who have been here may have additional questions that we would like your advice on. You have given us some very, very strong arguments, some good facts to back up a number of the changes that we are pursuing in the Small Business Committee.

Senator Bumpers was correct that the Small Business Regulatory Relief bill that we put forward from this Committee had passed 100 to nothing. As soon as that happened, I looked around and said we probably left something on the table because if it passed that strongly, we probably did not ask for enough.

But we will, I assure you, continue to pursue the challenges in the specific areas that you have set forth. It is very, very helpful to us to hear from you in your personal capacities and also for the many people who are involved in home-based businesses for whom you speak, that we do need to change these laws. We do need to make a level playing field because this is a wave of the future. We are going to see more employment in home-based businesses, and we ought not to be discouraging them.

Senator PRESSLER. Mr. Chairman, I might just say that I want to commend these witnesses. My wife happens to be a self-employed individual so I have become aware of these issues. She is in the real estate business. She does not have a home-based office because of the rules, but she pays all the D.C. taxes and the Federal taxes. I am just amazed at the struggle that independently employed business people have. Our taxes are amazing again this year.

Watching her has been quite an education and I want to commend these people who are able to carry on.

Chairman BOND. Thank you very much, Senator Pressler, and with that the hearing is adjourned.

[Whereupon, at 12:08 p.m., the Committee was adjourned.]

APPENDIX MATERIAL SUBMITTED

May 10, 1996

Senator Christopher Bond
 US Senate
 Committee on Small Business
 Washington, DC 20510-6350

Re: "Issues Affecting Home-Based Business Owners" testimony

Dear Senator Bond and Member of the Committee

I would like to clarify some of my testimony, if I might. Senator Bumpers had asked me about the Child Care Credit limitations. I indicated that I recalled the maximum amount of the credit allowed was \$600 per child. I have had the time to clarify that information and would like to forward it to you.

The amount of credit is figured as such:

The amount of qualified expenses you incurred and **paid** in 1995, up to \$2,400 for one qualifying person or \$2,800 for two or more persons **but not more than you or your spouse's earned income**. The amount of credit is then the \$2,400 (or \$4,800) times the percentage applicable from the chart below:

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\$20,000 - 22,000	24
\$22,000 - 24,000	23
\$24,000 - 26,000	22
\$26,000 - 28,000	21
\$28,000 - no limit	20

This limits the credit between \$480 - \$720 for one dependent and \$960 - \$1,440 for two or more.

There had also been questions raised during the first panel discussion from Senator Bumpers and Senator Snow about the concern of companies forcing their employees to sign contracts that would make them independent contractors. I would like to offer the following:

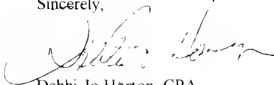
Having a signed contract is only one requirement of S 1610. These people would also have to meet two other criteria. There is also a question of whether companies would want to jeopardize the loyalty they have built in their employees. They would also have to allow these people to work for others in the same industry and chance them sharing information about them with their competition.

The concern that the Senators have is, unfortunately, a legitimate concern, to a point. There are employers who are unethical enough to force their employees to work as independent contractors and not as the employees they are. However, they are doing so now, without the legislation being changed. The need for clarification is so that legitimate users of independent contractors and the legitimate independent contractors are protected from reclassification.

Clarification of the definition of independent contractor is needed. I urge that a bill be passed that does just this and doesn't get bogged down with special interests getting a piece of it.

If there is any additional information I can provide, contact me.

Sincerely,



Debbi-Jo Horton, CPA

cc Senator Bumpers
Senator Snow
Taxation Implementation Chairs - 1995 WHCSB

Priscilla Y. Huff

111 Almont Road
Sellersville, PA 18960

(215) 453-9212 (Business)
(215) 257-5989 (Home)

May 22, 1996

Karen Ponzurick
Legislative Clerk
Senate Committee on Small Business
428A Senate Russell Office Building
Washington, D.C. 20510

RE: Response to post-hearing questions submitted by Senator Larry Pressler

Dear Karen Ponzurick

Here are my answers to Senator Pressler's two post-hearing questions

QUESTION

1. What further developments need to be made in telecommunications and information technology for home-based businesses to succeed

Answer

There should be an access to a central center where home-based business owners can call or go online to find out where loans, grants, government contracts, etc., are currently available and then be able to find out if they qualify for them. Home-based business owners are often isolated and have difficulties finding the resources that are available to them.

2. How does the increasing use of wireless technology, like laptop computers, change the ability of businesses to qualify for a home office deduction? That is, if an entrepreneur conducts business with a laptop computer at a customer's location, would that change their ability to qualify for a deduction? How should reforms to the law incorporate new wireless technology?

Answer

Wireless technology, like laptop computers, should not really change the ability of a business to qualify for a home office deduction, if the home-based office is still the core from where that business operates. The IRS says a home office deduction can be taken only if the majority of the business is conducted from that home office (not the exact wording). In my opinion, wireless technology should be considered as an extension of that home-based business' office which therefore would not affect the status of the home office deduction.

Please do not hesitate to contact me if there are any additional questions

Sincerely,



Priscilla Y. Huff
LITTLE HOUSE Writing & Publishing Services

COMMENTS FOR THE RECORD

**WRITTEN STATEMENT OF THE
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

The American Institute of Certified Public Accountants (AICPA) is submitting comments for the written record on two issues affecting home based business owners relating to 1) the home office deduction, and 2) the self-employed deduction for health insurance costs. The AICPA is the national, professional organization of CPAs comprised of more than 328,000 members who advise clients on federal, state and international tax matters as well as prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-size businesses, as well as America's major businesses, including multi-national corporations. Many serve businesses as employees. It is from this base of experience that we offer our comments.

The AICPA has previously supported S. 327, the *Home Office Deduction Act of 1995*, and continues its strong support. This home office deduction bill would modify the U.S. Supreme Court decision in Commissioner v. Soliman (113 S.Ct. 701 (1993)) in deference to today's working environment and lifestyles.

The Soliman decision curtails deductions for legitimate business expenses relating to the home office for many taxpayers -- particularly those who have no other office provided or available to them -- as it precludes these offices from falling within the definition of a principal place of business. It penalizes home-based businesses solely because they operate from their homes rather than from store fronts, industrial parks, or office buildings, even though these businesses may be practically identical. Subsequent IRS rulings (Rev. Rul. 94-24 and Rev. Rul. 94-47) have further restricted the deductibility of home office expenses, as well as related travel expenses.

The technological advances of the past twenty years have alleviated the need for hiring many support personnel and for coming in personal contact with colleagues on a day-to-day basis. As a result, many taxpayers have found it advantageous to work from their homes. Home offices are utilized by sole proprietors, and owners of small businesses operating in partnership and corporate form. In addition, many businesses have found it necessary to promote flexible and alternative work schedules for their employees, balancing work and family issues. As a result, many of these employees have set aside a separate area of their homes to accommodate their business needs.

Without passage of legislation to liberalize the rules for the eligibility of the home office deduction, many home-based business owners and employees are denied this deduction. The bill clarifies the definition of the principal place of business. It allows for the home office to be used for essential administrative or management activities conducted on a regular and systematic basis, where no other office space is provided for such activities.

We support this bill because it upholds the original intent of the home office deduction and provides standards that reflect the realities of the business world today. It would make clear that essential administrative and management activities, such as bookkeeping and billing, are legitimate uses of business time and office space for the purpose of deducting the expenses of a home office.

Since the IRS has announced in Notice 93-12 (1993-8 I.R.B. 46) that Soliman would be effective for 1992 and later years, we also support the effective date of this bill which would apply to taxable years beginning after December 31, 1991.

We also urge Congress to increase the deduction for health insurance costs of the self-employed. Unfortunately, the present rules place a significant penalty on the health costs of those who operate as proprietors, partners, or S corporation shareholders/employees, vis-a-vis those who are employees of C corporations and enjoy a full deduction. We have previously stated our position that equity would dictate an increase of this deduction to 100%. While we would prefer an immediate increase of the deduction to that amount, we are pleased that both the House and Senate have approved, as part of health insurance reform legislation (H.R. 3101), proposals to increase this deduction to 50% and 80% respectively. Given the options before the conference committee that will have to consider this issue, we strongly support the increase to 80%.

Statement of
Robert A. Georgine
President
Building and Construction Trades Department, AFL-CIO

Before the Committee on
Small Business
The Honorable Christopher S. Bond, Chair
United States Senate

April 23, 1996

Mr. Chairman and Members of the Committee:

I appreciate the opportunity to submit this statement on behalf of the Building and Construction Trades Department, AFL-CIO, which is a federation of 15 national and international building trades unions representing more than four million construction workers across the country.

The Department has grave concerns about S. 1610, the Independent Contractor Tax Simplification Act (the "Bill"), introduced by Senator Don Nickles (R-OK) and Senator Christopher Bond (R-MO) on March 13, 1996. After careful analysis, the Department has concluded that S. 1610, if enacted in its present form, would have serious adverse consequences for the construction industry and for the millions of working men and women, and their families, who depend upon that industry for their livelihoods.

For the reasons discussed in detail below, the Department urges a fundamental reconsideration of the approach now embodied in S. 1610 to ensure that the Bill would not be used to treat workers who are clearly employees as independent contractors. The need for this reconsideration is most obvious with respect to the potential application of the Bill to the circumstances of the construction industry, where rampant and

deliberate misclassification of workers is inflicting enormous harm on legitimate contractors, construction workers and their families, and federal and state revenue sources.

I.

The Department's Concern with the Bill
Relates to the Rampant and Deliberate
Misclassification of Construction Workers and
is not Directed at Efforts to Encourage
Legitimate Independent Contractors

I would like to make it very clear at the outset that the Department supports efforts to encourage legitimate independent contractors and their business ventures. We all want to promote entrepreneurial initiative. The Department recognizes that the ability of enterprising men and women to establish their own businesses is of fundamental importance to the health of our economy.

What the Department is concerned with are not the legitimate independent contractors. Rather, our concerns focus on the widespread practices in the construction industry whereby employers deliberately misclassify workers as independent contractors when those workers are employees under any reasonable interpretation of the laws. Thus, we frequently find construction sites with scores of workers operating under the direction and control of one or more supervisors, where none of the workers is being treated as an employee. They are all treated as independent contractors -- even though most, if not all, of them obviously are employees.

The problem is that the economic incentives to misclassify construction workers are overwhelming. A contractor that misclassifies its workers thereby greatly reduces its labor costs by not paying employment taxes, workers compensation premiums, or pension and welfare benefits. These ill-gotten savings mean that a contractor who is prepared to misclassify has an almost insurmountable bidding advantage over legitimate contractors.

The victims of worker misclassification are the federal and state governments which lose enormous amounts of tax revenues; construction workers and their families who lose basic pension and other benefits and

protections; and legitimate construction contractors who are forced out of business by unfair competition.

It is beyond question that worker misclassification abuses are rampant in the construction industry, as the U.S. House of Representatives, Committee on Government Operations, has documented based on extensive testimony.¹ In April of 1991, the Subcommittee on Employment and Housing of the U.S. House of Representatives, Committee on Government Operations, held a hearing on the problem of worker misclassification, focusing in particular on the construction industry. Witnesses at the hearing, including representatives of labor and industry, testified that many construction contractors deliberately misclassify workers. On June 8, 1993, the Commerce, Consumer and Monetary Affairs Subcommittee of the U.S. House Committee on Government Operations held a further hearing on worker misclassification. An IRS official testified that, in one district, the IRS learned that employers in the residential construction industry were misclassifying some 64 percent of their workers as independent contractors and that in 20 percent of the cases, the employers had failed to file Forms 1099 for their workers. In another district, the IRS found that general contractors had one of the highest classification error rates. In November 1990, the U.S. House of Representatives, Government Operations Committee, issued a report estimating that the misclassification of workers under the federal tax laws results in annual revenue losses in the billions of dollars.²

¹ House Comm. on Gov't. Operations, Contractor Games: Misclassifying Employees and Independent Contractors, H.R. Rep. No. 1053, 102d Cong., 2d Sess. at 7 (Oct. 16, 1992) (the construction industry "appears to be the industry most widely affected" by misclassification.); Exploiting Workers by Misclassifying Them as Independent Contractors: Hearing Before the Comm. on Gov't Operations, 102d Cong., 1st Sess. 76 (April 23, 1991).

² House Comm. on Gov't Operations, Tax Administration Problems Involving Independent Contractors, H.R. Rep. 101-979, 101st Cong., 2d Sess. (1990). The findings incorporated in this Report were based in part on three Government Accounting Office ("GAO") studies that had been commissioned by the Commerce, Consumer, and
 [Footnote continued on next page]

II.

S. 1610, in its Current Form, Will Make it
Substantially Easier for Construction Contractors to
Misclassify Employees as Independent Contractors

The Bill would supplant the Internal Revenue Service's 20 factor common law test for distinguishing employees from independent contractors. Under S. 1610's approach, the determination of independent contractor status would be made by answering the following three general questions: (i) Has the worker made a significant investment?; (ii) Does the worker have some independence?; and (iii) Is there a written agreement between the parties stating that the worker will not be treated as an employee? An employer (referred to as the "service recipient" in the Bill) may treat a worker (the "service provider") as an independent contractor if these three questions are answered in the affirmative.

Under the first requirement, which relates to the worker's performance of services for the employer, the worker must:

- (1) have a significant investment in assets and/or training;
- (2) incur significant unreimbursed expenses;
- (3) agree to perform the service for a particular amount of time or to complete a specific result and be liable for damages for early termination without cause;

[Footnote continued from previous page]
Monetary Affairs Subcommittee of the House Government Operations Committee, following that Subcommittee's hearings on the issue on May 16, 1989. See GAO Report, GAO/GGD 89-110, Tax Administration: Missing Independent Contractors' Information Returns Not Always Detected; GAO Report, GAO/GGD 89-63, Tax Administration: State and Local Compliance with IRS Information Reporting Requirements; GAO Report, GAO/GGD 89-107, Tax Administration: Information Returns Can Be Used to Identify Employers Who Misclassify Workers.

- (4) be paid primarily on a commissioned basis; OR
- (5) purchase products for resale.

Under the second requirement, which relates to the worker's performance of services for others:

- (1) the worker must--
 - (a) have a principal place of business,
 - (b) not primarily provide the services at the employer's place of business,
 - (c) pay a fair market rent for use of the worker's place of business; OR
 - (d) operate primarily with equipment not supplied by the service recipient; OR
- (2) the worker must--
 - (a) not be required to perform services exclusively for the service recipient, and
 - (b) in the year of the services, or in the immediately preceding or subsequent year, the worker must either (i) have performed a significant amount of services for other persons, (ii) have offered to perform services for other persons through advertising, individual written or oral solicitations, listing with registries or others in the business of providing referrals to other service recipients, or "other similar activities," OR (iii) provide services under a business name which is registered with (or licensed

by) a State or any political subdivision thereof.

The third requirement is satisfied if the services are performed by the worker pursuant to a written contract which provides that the worker will not be treated as an employee with respect to such services. An employer that fails to file Forms 1099 and W-2 as required will be permitted to rely on these provisions to treat workers as independent contractors only if such failure is due to reasonable cause and not willful neglect.

Many of the criteria set forth in S. 1610 could be appropriate factors to take into account in the determination of whether a worker is an employee or independent contractor. As is the case with H.R. 1972, the Christensen Bill, the flaw with S. 1610 is that these factors are listed as a series of alternative criteria, so that a worker could be classified as an independent contractor by satisfying only a minimum number of the factors.

To take just one example, under the language of S. 1610, a construction worker who owns some tools, has a pickup truck that he uses to haul equipment without being reimbursed for such use, and has worked for several contractors during the 3-year period surrounding the time of the particular services, would be treated as an independent contractor if his employer has him sign an agreement stating that he will not be treated as an employee. The Bill would treat this worker as an independent contractor even though he is required to report to work at a set time, works for a specified number of hours each day, has no risk of loss or prospect of profit (other than the receipt of wages), and is subject to the direction and control of the employer as to performance of the job.

The worker just described is not in any sense an independent contractor, and allowing the employer to treat him as such would permit the employer to evade lawful tax obligations and could cause the worker and his family to lose needed protections under the labor laws and the employer's benefit plans.

A critical problem with S. 1610 is that many of the factors listed are susceptible to being manipulated within the construction industry. For instance, contractors could require their workers to purchase some

tools over and above normal hand tools in order to satisfy the "significant investment in assets" factor.

A further problem is that the second general requirement, regarding work for others, typically will be met in the case of construction workers, who often work for a number of contractors over a three-year period. Thus, this requirement will not provide a meaningful way to distinguish employees from true independent contractors in the construction industry. A construction contractor could also satisfy the second requirement by agreeing that a worker is under no obligation to work exclusively for the contractor, yet require such a substantial time commitment from the worker that additional work with other contractors is unfeasible for the worker.

The written contract requirement easily could be satisfied by a contractor that wants to treat its workers as independent contractors, even though those workers are in every real sense employees.

Thus, S. 1610, if enacted in its present form, would give certain construction contractors an unjustified degree of discretion to treat their employees as independent contractors, thus obtaining unfair bidding advantages over other contractors who are in essentially the same circumstances but are unwilling or unable to treat their workers as anything other than employees. As a result, S. 1610 would have a devastating impact on the construction industry, and on the millions of men and women, and their families, who depend on that industry for their livelihoods.

III.

The Department Urges a Fundamental Reconsideration of S. 1610 or, at a Minimum, the Exclusion of Construction Workers from Coverage under the Bill

The Department urges a fundamental reconsideration of the approach now embodied in S. 1610, to ensure that whatever standards are provided in the Bill cannot be used to treat workers who are clearly under the direction and control of their employers as independent contractors. Even if it is determined that the approach in S. 1610 meets the needs of other industries, where the incentives for misclassification are less dramatic, something still must be done to prevent abuses in the construction industry.

At the absolute minimum, the Department urges that S. 1610 be amended to recognize the special circumstances of the construction industry by either (a) specifically excluding construction workers from the coverage of the Bill, or (b) including special rules to govern the classification of workers in the construction industry which would be tailored to prevent abuses.

The following legislative language could be used to exclude construction workers from S. 1610's coverage.

Amend Section 3511 as follows:

- (f) CONSTRUCTION WORKER EXCEPTION.-- None of the provisions of this Section shall apply for purposes of determining the status of construction workers.

Amend Subsection (f) as follows:

- (g) DEFINITIONS.-- For the purposes of this section--

* * *

- (6) CONSTRUCTION WORKER.--The term "construction worker" means any individual employed, whether as a skilled, semiskilled, or unskilled laborer, in the building or construction industry, but does not include clerical or management workers.

Alternatively, criteria applicable to the construction industry could be drafted and included to limit the Bill's application to those construction contractors who are, in fact, legitimate independent contractors. For example, the criteria might provide that a purported contractor will be treated as an independent contractor only if he or she obtained the work by submitting a bid that includes substantial labor and materials costs and obligates the contractor to complete the job in accordance with a set price and enumerated specifications, even if doing so produces a loss for the contractor. The precise criteria, however, would need to be drafted carefully to prevent manipulation by employers that might seek to use sham transactions or other means to disguise the true substance of their arrangements so as to misclassify their employees as independent contractors. The

Department would be pleased to assist in the effort to develop appropriate criteria for the construction industry, in lieu of the easily manipulated factors now contained in S. 1610.

* * *

We appreciate your consideration of the concerns expressed in this statement on behalf of the millions of working men and women in the construction industry. The Department will provide further information or meet with Committee staff if that would be helpful.

Thank you, Mr. Chairman



ICAA

The Independent Contractor Association of America, Inc.

The Independent Contractor Association of America, Inc. (the "ICAA") is a national association dedicated to the preservation of independent contractor status. ICAA members consist of individuals working as independent contractors and businesses that purchase services from independent contractors. ICAA currently represents over 3,000 independent contractors and businesses that engage independent contractors.

The ICAA is supportive of the *objectives* of the independent contractor reform legislation introduced by Senators Nickles (R-Okla) and Bond (R-Mo) and the similar bill introduced in the House of Representatives by Representative Christenson (R-Neb). ICAA, nonetheless, urges the Congress to proceed with caution and careful deliberation in enacting any legislation that would affect the definition of independent contractor status.

ICAA agrees with the proponents of the pending independent contractor reform legislation that the Internal Revenue Service ("IRS") construes the tax laws that distinguish between employees and independent contractors unfairly, with an overemphasis on converting independent contractors -- whether or not bona fide -- to employee status. The fact that the IRS would include as part of its Employment Tax Examination Program ("ETEP") a component that targets for worker classification challenges businesses with assets of less than \$3 million (who are least financially able to defend against IRS challenges), exacerbates taxpayers' outrage at the IRS's enforcement efforts in this area.

The basic problem, however, is one of enforcement, not the law. The law works perfectly well for thousands of taxpayers who work as, or who engage, independent contractors. A good law can be made to look bad, however, if the law is subject to perverse enforcement. *The law for distinguishing employees from independent contractors has been subjected to an enforcement philosophy that is hostile to independent contractor status.*

ICAA submits that the legislation that has been introduced appears to have been helpful in sensitizing the IRS national office to the harsh treatment that taxpayers who engage independent contractors are receiving at the hands of overzealous IRS agents. Recent developments at the IRS -- that arguably resulted from the pending legislation -- include (1) a set of draft Training Guidelines for IRS agents concerning the independent contractor issue, (2) Announcement 96-13, which allows certain employment tax issues, including worker classification disputes, to be eligible for an early referral during audit for IRS Appeals consideration, and (3) an IRS Fact sheet that announced a new worker classification settlement program ("CSP") that might be advantageous to some businesses.

While at this juncture ICAA believes it is too soon to tell whether IRS's new initiatives will provide meaningful change, ICAA does believe that it would be prudent to allow the IRS some time to demonstrate whether its enforcement philosophy has, or can be, modified before changing the law. In addition, ICAA submits that the Congress should maintain vigilant oversight of the IRS to encourage an even-handed administration of the laws relating to worker classification.

ICAA also submits that one of the reasons for going slow with major legislation, such as has been proposed, is that certain aspects of current law are for many taxpayers sacrosanct. ICAA's concern with *any* law that would affect the determination of a worker's status for federal tax purposes is attributable in part to the fact that the legislative process can be unpredictable. Consequently, ICAA respectfully urges that the Congress, in its consideration of legislation affecting independent contractor status, ensure that:

- The protection currently provided under Section 530 not be displaced.
- The other statutory independent contractor provisions be preserved.
- The 20-factor common law test for determining independent contractor status remain as the "fall-back" test for workers who do not satisfy a safe harbor test, and
- If the proposal results in a revenue loss to the government, the proposal not be "paid for" by imposing withholding -- mandatory or optional -- on payments made to independent contractors.

According to the Small Business Administration, there are five million independent contractors in America. Almost one-third of all companies use independent contractors to some degree. Independent contractor status gives both service providers and service recipients the flexibility needed to be competitive in today's economic environment. It is submitted that the fact that so many independent contractors currently exist demonstrates that the existing laws, while perhaps not perfect, are *not* altogether flawed.

Preserve Section 530

Section 530 of the Revenue Act of 1978 was enacted in reaction to overzealous efforts by the IRS in seeking reclassifications of workers to employee status. During the past several years, the IRS has been pursuing a worker reclassification program with similar aggression. Many businesses that engage independent contractors currently do so with great fear of having to possibly defend against an IRS worker reclassification challenge in a lengthy — and expensive — court battle. Section 530 provides a valuable refuge for such businesses. Section 530 provides businesses with a means of engaging independent contractors with some degree of security that the IRS will leave them alone. Each of the safe harbors of Section 530 are important for a specific reason.

Reasonable reliance on administrative or judicial precedent is important, because it protects businesses that have sought to properly classify workers based on a good-faith interpretation of applicable precedent. The subjective nature of the common law test in many cases defies a precise conclusion as to a worker's status. This safe harbor is needed, therefore, to enable businesses to enter into business relationships with contractors, based on a reasonable interpretation of case law and certain IRS administrative guidance, without fear that the IRS will later interpret that precedent differently and force the business to litigate the matter in court.

The prior IRS audit safe harbor is also important because it protects businesses from repeated IRS audits, year after year, concerning the same workers. The safe harbor was enacted precisely because the IRS was harassing businesses with recurrent audits concerning the very same workers. The criticism sometimes made about this safe harbor — that it would apply to a business that had been audited by the IRS on an unrelated issue — is simply unfounded. The requirement that reliance on the safe harbor be "reasonable" would prohibit that possibility. To eliminate this valuable safe harbor would subject businesses, once again, to repeated harassment by the IRS concerning workers who the IRS has previously determined to be properly classified.

The industry practice safe harbor is a critical safe harbor for those industries where a type of worker had always been classified as an independent contractor, but no administrative or judicial precedent has been established to confirm the appropriateness of that classification. It is submitted that where an industry practice has been followed year after year with respect to the classification of a type of worker, there is no plausible rationale for disrupting that practice — especially when the compensation paid such workers is reported on Forms 1099, as Section 530 requires.

The "other reasonable basis" safe harbor is valuable to those businesses that have a reasonable basis for classifying workers as independent contractors but do not qualify for one of the statutorily-prescribed safe harbors. Courts have provided a constrained interpretation of this safe harbor, and current law in this area should not be disturbed.

Overall, Section 530 provides a safe haven protection to businesses that, since the law's enactment, have assiduously complied with its requirements. Tens of thousands of business arrangements have been structured in reliance on Section 530. To abandon any of the safe havens offered under Section 530 would significantly disrupt the market for freelance talent, and produce no offsetting benefit. The Form 1099 requirement contained in Section 530 already requires that the compensation paid an independent contractor that is covered by Section 530 be reported to both the worker and the government. Thus, there would be no revenue gain to be derived from such a disruptive action (actually there would likely be a revenue loss as a consequence of existing business relationships that produce taxable income being severed).

Section 530 was enacted to stop repeated audits and ensure fairness. The fairness established by Section 530 should not be eliminated.

For the foregoing reasons, ICAA strongly urges that the Congress, in its consideration of alternative proposals to reform the independent contractor laws, not disturb the protection currently provided under Section 530.

Retain the Common Law Test

No matter what the Congress decides with respect to the establishment of additional safe harbor protection for independent contractor status, ICAA submits that it is imperative that the common law test be preserved for those workers who might not qualify for a safe harbor.

The nation's economy is dynamic and unpredictable. Individuals are currently providing services that merely a decade ago could not have been fathomed. Thus, while a safe harbor could be devised that covers all types of services that are provided in today's economy, there is simply no way to ascertain whether the safe harbor would also cover new types of services that might be performed five years from now, or even two or three years hence. For this reason, ICAA submits that it is imperative that the common law test — as a test of last resort — remain sacrosanct.

No Withholding

Proposals have been offered to impose withholding on payments made to independent contractors. The proposals have been offered either as a "trade-off" for certainty in a worker's independent contractor status, or as a means to "pay for" the revenue loss that would be attributable to a proposal that modifies the worker classification rules in a way favorable to independent contractors.

ICAA submits that any withholding proposal — mandatory or optional — would be devastating to the viability of independent contractor status.

To single out the independent contractor sole proprietorship for withholding — while exempting other forms of business — would place independent contractors at an unfair disadvantage relative to their competition. Current law recognizes several forms of business, e.g., corporation, partnership, proprietorship, LLC and LLP. A company that contracts with a firm to provide services currently has no duty to withhold on the fees paid the firm, irrespective of the form of entity through which the firm operates. To single out proprietorships for imposing withholding would impede their ability to attract and retain clients, inasmuch as the clients and potential clients of a proprietorship subject to withholding would be burdened with administrative withholding duties that they would avoid by contracting instead with the proprietorship's competitors that operate through a different form of business.

Furthermore, to impose withholding on payments made to independent contractors would create competitive imbalances within and among industries. The actual financial impact on a business of, for example, a 5-percent withholding rate would depend on the business's net profit as a percentage of gross revenues. A business with a net profit margin of 10 percent of gross revenues would be much more affected by 5 percent being withheld from their fees than a business with a net profit margin of 50 percent of gross revenues. In the former case, the government would be withholding 50 percent of net income for the year (5% / 10%), whereas in the second case the government would be withholding 10 percent (5% / 50%). Such variances of net income as a percentage of gross revenues exist both within and among industries.

The reason that withholding is not problematic as applied to employees is that an employee's net income from a job is generally equal to or very near 100 percent of wages paid. Employees are not required, for example, to advertise their services, to purchase the equipment and supplies needed to perform their services or to pay the expenses otherwise incurred in running a business. Their employer assumes those burdens. And, their employer is *not* subject to withholding with respect to its revenues.

Conclusion

For the foregoing reasons, the ICAA respectfully urges that the Congress approach new legislative proposals for addressing the perennial issue of worker classification cautiously, and that protections that are contained under current law not be sacrificed as a price to be paid for a new approach for resolving worker classification disputes.

ICAA appreciates the opportunity to present this statement. If you have any questions or would like additional information concerning the foregoing comments or the ICAA, please let us know.

Respectfully submitted,

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