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FEDERAL ESTATE TAX: UNCERTAINTY IN PLANNING UNDER THE CURRENT LAW

HEARING

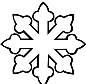
BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

NOVEMBER 14, 2007



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FEDERAL ESTATE TAX: UNCERTAINTY IN PLANNING UNDER THE CURRENT LAW

WEDNESDAY, NOVEMBER 14, 2007

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Max Baucus (chairman of the committee) presiding.

Present: Senators Rockefeller, Lincoln, Wyden, Cantwell, Salazar, Grassley, Lott, Snowe, Kyl, Smith, Bunning, Crapo, and Roberts.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. The hearing will come to order.

The English philosopher, Francis Bacon, said, "Men fear death as children fear the dark, and, as that natural fear in children is increased with tales, so is the other." Many Americans feel that on the day that they die, the tax man will coming knocking at their family's door. And, as with children's natural fear of the dark, the fear of the death tax has been increased with tales.

The estate tax is complicated and it is intimidating. It needs serious reform. I support repeal, but we need certainty in this area, so we need a deal that can garner 60 votes. We need to provide predictability and relief for taxpayers like ranchers and farmers in Montana.

But the fact of the matter is, 99 times out of 100, the tale is worse than the tax. Less than 1 percent of all estates are currently subject to estate tax. According to IRS data, out of nearly 2.5 million deaths in 2004, about 19,300 estates paid the estate tax. These numbers have decreased as the exemption level has increased. The tax will completely disappear in 2010, but then, as in the children's campfire tale, it returns, in the end, in 2011.

Many small business owners fear that their kids will have to liquidate the business to pay the estate tax. Once again, the tale there is worse than the tax. The National Research Service reports that very few family businesses are subject to the estate tax; in addition, very little of the tax is collected from family businesses.

In 2003, only a little more than three out of 100 businesses where the owner died had an estate tax liability. The reason is planning. Estates can eliminate the tax burden with a myriad of tax provisions. One way to decrease the amount of the gross estate is by electing a special use valuation. When certain conditions are

met, an estate can revalue certain farm and closely-held business real property at its special use value rather than a fair market value.

The estate can further decrease its taxable state through deductions—the marriage deduction and the deduction for charitable giving, just to name a few. Families can also form family partnerships and use different trust instruments in estate planning. Through such planning, many taxpayers lower their estate tax, and some even eliminate it.

But does estate tax planning need to be so complex? For many smaller estates, the problem with the current estate tax is that the law keeps changing every year. Estate tax law will change every year from 2008 through 2011. It is easy to just say "plan," but with the state of the current estate tax laws, a family cannot have just one plan; families must have multiple estate plans, and that is expensive.

Today we will hear about the complexity in estate tax planning as a result of the changing law. It will appear that some estate tax fears are like a child-like fear of the dark. We will see whether this committee, at least, can resist the temptation to increase those fears with campfire tales of our own, but rather try to find a solution, a durable solution, to this very vexing problem that is affecting so many people.*

I would like to now turn to Senator Grassley, ranking member of the committee.

OPENING STATEMENT OF HON. CHUCK GRASSLEY, A U.S. SENATOR FROM IOWA

Senator GRASSLEY. Thank you, Mr. Chairman, particularly for holding this hearing and for always being available to discuss and work for reform of the estate tax—modernizing it—and voting with us on several occasions. We have made significant progress throughout the years, but all of our hard work will be undone in 2011 if Congress does not act before then.

Under current law, in that year, 2011, the estate tax will return to a rate of 55 percent, and sometimes up to 60 percent of assets above $1 million. The tax must be paid within 9 months of the death of an individual. I believe that the estate tax is unjust from a philosophical, and even technical, viewpoint.

From a philosophical perspective, I have always said that death should not be a taxable event. There is something fundamentally wrong when the government swoops in after a funeral to take a cut of what that person had worked their whole life for and has already paid taxes at least once on. Any monetary benefit obtained by any individual is either taxed or not taxed for a very specific reason. As long as a person has accumulated an estate in accordance with the law, the government should not be able to profit just because of the incident of death.

From a technical standpoint, and maybe more importantly than the philosophical one, the death tax is fatally flawed in that, owing to the due date 9 months after death, the estate tax forces sur-

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*For additional information on this subject, *see also,* "History, Present Law, and Analysis of the Federal Wealth Transfer Tax System," Joint Committee on Taxation staff report, November 13, 2007 (JCX–108–07).

vivors to liquidate assets in economically poor circumstances. Instead of the free market determining when assets are bought or sold, the death tax makes that determination. As most people are not privy to the exact date that they will hand over half of everything they own to the government, the death tax then is fundamentally not fair.

Whenever a discussion of the death tax comes up, especially on the Senate floor, it is fashionable for some of my colleagues to talk about the very wealthy, as if we should base our actions solely on how they impact billionaires. According to *Forbes,* as of March of this year, there were approximately 946 billionaires throughout the world, and of course, many of them are not Americans. Even if all of them were Americans, I believe that a few of the other 300 million people we collectively represent would like us to keep them in mind as well as we consider this issue.

I want to mention some real people who live in Iowa, and who have graciously agreed to be with us to share their stories. Not only do they live in Iowa, they have devoted their entire lives, for multiple generations, to build businesses and create good jobs for the people of Iowa.

As I see at the table, Eugene and Mary Sukup started a grain-handling, storage, and manufacturing company in Sheffield, IA, a very small town. Today, the Sukups and their two sons and their families still headquarter there among a population of 938. They employ 350 people in good-paying jobs, with good retirement plans. Mr. Sukup will tell his own story, but we should all keep in mind what he says as we contemplate what to do with the death tax.

Forty percent of a billion dollars is still a great deal of money, but how we deal with the estate tax will determine whether Sukup Manufacturing Company is able to survive and continue serving their community.

I want to highlight a few numbers that the Joint Committee on Taxation has made available for this hearing. The Joint Committee estimates that in 2009, there will be 9,600 estates subject to the estate tax. Of course, that number falls to zero in 2010, but jumps up to almost 62,000, compared to the 9,600 in 2009, by 2011, and will continue to increase very dramatically through the years.

I know for a fact that most of these 62,000 estates will not be billionaires. I have consistently maintained that the death tax should be completely repealed, but have also let it be known that I am willing to compromise. What I am not willing to compromise on is that we need to make sure that we are looking out for small business owners and family farmers in order to ensure that what amounts to a personal tragedy does not also amount to a government-driven fiscal tragedy as well.

I am sure that somebody is going to denigrate these efforts by saying that not very many family farmers are caught up in this, but that statement was made before the price of farmland almost doubled in the last 4 or 5 years, mostly because of ethanol, I guess. [Laughter.]

Thank you, Mr. Chairman.

The CHAIRMAN. Viva ethanol.

Now I would like to introduce the panel. The first witness is Mr. Warren Buffett, chairman and chief executive officer of Berkshire

Hathaway; second, Conrad Teitell, who is the principal who specializes in estate planning at Cummings and Lockwood. We also have Dean Rhoads, a State Senator from Nevada who is here today, although he will be testifying as a rancher, giving his experience with estate tax. The last witness, as mentioned by Senator Grassley, is Mr. Eugene Sukup, who is chairman of the board for Sukup Manufacturing.

Thank you all for coming. The general rule here is, your written testimony will be included in the record. I would encourage you each to speak for about 5 minutes, then we will open it up for questions. Thank you all for taking the time and effort to come here. I deeply appreciate it.

Mr. Buffett?

STATEMENT OF WARREN BUFFETT, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, BERKSHIRE HATHAWAY, OMAHA, NE

Mr. BUFFETT. Thank you, Mr. Chairman.

Mr. Chairman, Senators, I appreciate the opportunity to express a few views on the estate tax. I will limit my remarks to three points. The first relates to the intellectual dishonesty employed by those who use the phrase "death tax." This term is clever, it is Orwellian, and it is—if you will pardon the expression—dead wrong. More than 2.4 million Americans will die this year. About 12,000 of them will leave an estate that will be taxed when the exemption goes to $3 million, as Senator Grassley mentioned; it will be 9,600 estimated, and it was 19,000 when the exemption was higher.

That means that 99.5 percent of estates will be tax-free. You would have to attend 200 funerals to be at one at which the decedent's estate owed a tax. Indeed, far more people who die receive a large tax benefit—I do not think that is generally understood—namely, a stepped up basis on appreciated assets. If people insist on renaming the estate tax, it would be more appropriately labeled "the death present."

The second point I would like to make is, in a country that prides itself on equality of opportunity, it is becoming anything but that as the gap between the super rich and the middle class widens in dramatic fashion.

Here are a few figures on the *Forbes* 400. Other people save their *Playboy* magazines, I save the *Forbes* 400 magazine. Twenty years ago, 1987, it took $220 million to make the list. Now it takes $1.3 billion, about a 6-for-1 increase. The total wealth of the list in 1987 was then $220 billion; now it is $1.54 trillion, exactly a 7-for-1 increase. Tax law changes have benefitted this group, including me, in a huge way.

During that same period, the average American went exactly nowhere on the economic front. His income went from a median $26,061 to $48,201, almost exactly the increase of the CPI during the 20 years. He has been on a treadmill while the super rich have been on a space ship. Dynastic wealth, the enemy of a meritocracy, is on the rise. Equality of opportunity has been on the decline. A progressive and meaningful estate tax is needed to curb the movement of a democracy toward a plutocracy.

Finally, I have a suggestion. Estate taxes now raise about $24 billion. It is one of the lowest percentages, incidentally, of total

taxes in the history of the tax system. As mentioned, about $24 billion will come from about 12,000 estates. Indeed, half of that sum will come from only about 1,500 estates. The beneficiaries of each of those estates will receive millions, in many cases tens of millions or more. One point you never hear from proponents of estate tax elimination is whom they would get the $24 billion from if they did not get it from the 12,000 large estates. They just say "free us." They do not say whom to further shackle.

Here is the suggestion: keep the estate tax and its $24 billion. Reshape it if you will, but keep the estate tax and its $24 billion. Then take a look at the bottom fifth of America. There are 23 million households in the United States with $20,000 or less of income. Many are paying payroll taxes that now total 15.3 percent. That 15.3 percent alone is more than the rate on dividends for capital gains and more than the rate on carried interest.

Let us give those 23 million households a $1,000 annual credit. Every dollar of such a credit would effect real change in the lives of the 50 million-plus people residing in the 23 million households. Yet, the cost of this would be less than getting rid of the tax on the 12,000 estates. Fifty million people would be helped in a material way. The beneficiaries of the 12,000 estates would still receive what looks like a fortune to almost all Americans.

Leona Helmsley's dog, Trouble, reportedly is inheriting $12 million. If Mrs. Helmsley's estate is in the 45 percent bracket, Trouble could, instead, receive $22 million if the estate tax was removed. Alternatively, just from Trouble's share of the Helmsley estate tax, 10,000 families making less than $20,000 annually could receive $1,000 each to make their lives a bit better.

Even though Trouble probably heard Leona say, "Only the little people pay taxes," I do not think he would mind the estate paying $10 million in order for him to get his 12 million. We need to raise about 20 percent of GDP to fund the programs the American people want from the national government. Further shifting of this requirement away from the super rich is not the way to go.

The CHAIRMAN. Thank you, Mr. Buffett.

Mr. Teitell?

STATEMENT OF CONRAD TEITELL, PRINCIPAL, CUMMINGS AND LOCKWOOD, LLC, STAMFORD, CT

Mr. TEITELL. Mr. Chairman, Mr. Ranking Member, members of the committee, I am Conrad Teitell. I am an estate planning lawyer with Cummings and Lockwood, based in our Stamford, CT office. We have over 50 lawyers who are involved in estate planning day in and day out.

I also teach this stuff at a law school, and I write books and articles on this. Thanks to you, the IRS and the Treasury, I am continually and constantly updating and revising my books.

In "Gone With the Wind," Margaret Mitchell said, "Death, childbirth, and taxes never come at a convenient time." She might have also added that those events never come at a known time. When this Congress gave birth, in 2001, to the estate tax law, it enacted a roller coaster exemption. All the troglodytes are aware that we have a $2 million exemption this year, next year, 2009, it goes up to $3.5 million, then in 2010 the estate tax is gone with the wind,

although, Mr. Buffett, at that time there is a carry-over basis for that 1 year.

It is said that "the meek shall inherit the earth," and they shall do so with a stepped up basis, but not for the year 2010. Then in 2011 and later years, the estate tax blows back in with a $1 million exemption and a 55-percent rate, and, as Senator Grassley mentioned, in some cases as high as a 60-percent rate.

My charge today was not to talk about whether there should be a tax or whether there should not be a tax, but to talk about the complexities in planning. My written statement goes into great detail. What I would like to do is just highlight a few of the points. Some of the people that you have been talking about, perhaps the millionaire next door, for married couples and families with an estate just between $1 and $2 million, we find it very difficult to plan for them.

As Senator Baucus pointed out, we have to make three or four plans. Then when we get some minor millionaires, people who have a taxable estate of $5 million, let us just take a look at the arithmetic and see what happens over the next few years. Death in 2008 by the estate tax turns out to be $1.35 million. In 2009, it is $675,000; 2010, it is zip, zero, but with carry over rather than a stepped up basis.

Then in 2011, that $5 million taxable estate, in that year, the tax would be $2 million. We live in a very complex society, and our tax laws reflect the complexity of our society. But the tax law that the Congress gave birth to in 2001 makes complicated plans even more complicated.

Just to tick off a few of the areas that we have to deal with: life insurance planning. Life insurance is part of an estate plan to provide liquidity and also to pay taxes. That has become very difficult. Rodney Dangerfield once said that he gets no, what?

The CHAIRMAN. Respect.

Mr. TEITELL. Respect. Thank you very much. Well, the estate tax law, when clients come into our office, and in my lectures throughout the country, the comment I hear is, how could the Congress do that? There is no respect for the estate tax law. A disrespect for one law, I believe, breeds disrespect for other laws, such as the gift and the estate tax.

One of the problems we have is, some people say, let's wait and see what happens. Well, that may work out all right in some cases, but in other cases delay can be hazardous to your wealth.

Now for a ray of sunshine, a bright note: charitable contributions are not complicated at all. There is an unlimited estate tax charitable deduction, and that has been in the law for almost 100 years. So whatever the Congress does, there is a great precedent for continuing that estate tax unlimited charitable deduction.

Thanksgiving is almost upon us. In our family, we, at Thanksgiving every year, have a tradition. We have a marathon Monopoly game. It goes on all weekend. But this year, to make the game more realistic for my grandchildren, I have indexed the game for inflation. So, for example, if you were to land on Park Place and you wanted to buy it, it now costs $5 million.

You know that card, "Chance—Pay Tax Collector $200"? Well now, if you get that card at 7 o'clock or 8 o'clock, pay $20,000. If

you get it at 9 o'clock, pay $10,000. If you get it at 10 o'clock, you do not have to pay anything at all. But if you get it at 11 o'clock or thereafter, why, then you have to pay $40,000. Now, this surely will make our Monopoly game much more interesting, but our Nation's tax laws should not be a roll of the dice.

The CHAIRMAN. Do you issue more money to your players? [Laughter.]

Mr. TEITELL. Pardon me?

The CHAIRMAN. Do you issue more money to your players, too?

Mr. TEITELL. Like the government, we print it. [Laughter.]

The CHAIRMAN. Well said.

[The prepared statement of Mr. Teitell appears in the appendix.]

The CHAIRMAN. Mr. Rhoads?

STATEMENT OF DEAN RHOADS, RANCHER, DEAN RHOADS RANCH, TUSCARORA, NV

Mr. RHOADS. Good morning, Mr. Chairman and members of the committee. I am a rancher from Tuscarora, NV, which is 60 miles northwest of Elkwood, NV. I have been involved in livestock industry activities my whole career as a rancher. I have also been a State Senator since 1984. My State Senate district is the largest in the United States, outside of Alaska, and stretches over 73,000 square miles.

My district is larger than 34 States and accounts for over two-thirds of the land area of Nevada. Prior to serving as a State Senator, I served three terms in the Nevada State Assembly. I am the past chairman of the Public Lands Council, an affiliate of the National Cattlemen's Beef Association, and also the past chairman of their Public Lands Committee.

Today I am here on behalf of all the ranches, farms, and small businesses in my district, as well as those throughout the State of Nevada. Although I am going to tell you the story of my family, there are many others like me who have been generally impacted by the estate tax.

Since shortly after my wife Sharon and I graduated from college, we have lived on the ranch that was established by her parents in 1943. We now own the ranch. Our daughter, her husband, and our two teenaged grandsons all work on the ranch. We also have a nine-month-old grandson. Our other daughter, her husband, and our granddaughter live on a ranch in southern Oregon.

My father-in-law came to Elkwood County in the 1930s when he was 15 years old. He worked as a cowboy and a ranch hand, saved his money, and eventually bought his first property over 60 years ago. My father-in-law became a good friend of Bing Crosby when he owned ranches in Elkwood County, including one adjacent to my father-in-law's ranch that we purchased in 1966. My wife and family lived there for 18 years.

I believe if we had a willing buyer, our ranch would be valued at about $2.5 million in today's market, assuming it was not broken up or sold for water. My mother-in-law died in 1976. My father-in-law paid a total estate tax then of over $300,000. To do this, he could not afford to keep the ranch where my wife and I and our two daughters lived, the old Bing Crosby ranch. Losing this ranch and our home was not only a personal blow, but it was

crippling to our operations. This was our primary hay ranch, and at 6,000 feet in elevation, we need every bale of hay we can produce. Losing this ranch meant we were forced to buy hay almost every year since 1985.

When my father-in-law died in 1995, there was no more land left to sell if we wanted to survive in the ranching business. Based on the ranch's value, the tax we now owed, with interest added, was over $340,000. Therefore, we have been paying $18,000 in estate taxes, plus interest, every year, which we are continuing to pay. We have had to borrow money to make these payments. We pay this money back through the revenues produced by our ranching business.

Because of this, I can say without a doubt that we have not made very many capital improvements to our ranch, nor have we been able to take advantage of some expansion opportunities to plan for the future when our grandchildren might want to continue the tradition started by my wife's parents 66 years ago.

I appreciate the Senate Finance Committee holding this hearing to investigate problems caused by the uncertainty of current law. My family is a good example of what happens when the law does not offer solutions. Hopefully, any future solutions will provide my family, and other families like us, some relief down the road.

A current estimate of the value of our cattle would be about $1,100 to $1,300 for a mature, pregnant cow with a calf at her side. Understanding that the cattle market is not constant, we own about $2 million worth of production units in our ranching business, in addition to our horse herd and the land value.

Let me illustrate the uncertainties of planning. Under current law, if my wife and I were killed in a common accident in December of 2009, our family ranch would be valued at about $7 million, counting all the land and all the animals. Because my wife and I have tried to do some estate planning to divide our ranch assets between us, my daughters should have a $3.5-million exemption on my estate and a $3.5-million exemption on their mother's estate. They would not have to sell any land or cattle to pay the Federal Government, assuming the ranch does not continue to increase in value, and also assuming that the ranch was not broken up for the water.

But if they were faced with dealing with our estates in January of 2011, they would owe nearly $2.5 million within 9 months of our death. That would be in addition to the over $640,000 we have paid in estate taxes to the Federal Government. So how do we plan without some certainty? Everyone in my family wants to continue our ranching business.

Ranching is a tough way to make a living, but we can do it and make a profit over time. It is difficult, but we can deal with the variables of weather, drought, labor shortages, market conditions, and day-to-day business expenses, such as the increase in the price of fuel. But if you continue to add the specter of the burden of this unfair tax, if we have to pay this much a third time as a family for one ranch, I do not have much optimism for our future.

Thank you.

The CHAIRMAN. Thank you, Mr. Rhoads.

[The prepared statement of Mr. Rhoads appears in the appendix.]
The CHAIRMAN. Mr. Sukup?

STATEMENT OF EUGENE G. SUKUP, CHAIRMAN OF THE BOARD, SUKUP MANUFACTURING COMPANY, SHEFFIELD, IA

Mr. SUKUP. I would like to thank the Chairman and members of the committee for offering me the chance to testify. My name is Eugene Sukup, and I am founder and chairman of the board of Sukup Manufacturing Company. We are a small manufacturing company located in Sheffield, IA.

I started Sukup Manufacturing Company 44 years ago while still working on the farm. I bought my first grain bin to dry and store shelled corn, but the process did not work quite right, so I came up with a new design that worked better. Today, I am proud to say that, 40 years after our first item was patented in manufacturing, my sons, Charles and Steve, and I have expanded a single idea into a worldwide company, employing over 350 workers in 7 States.

We now hold over 70 U.S. patents and produce a broad line of grain handling and storage equipment. In addition to our plant in Sheffield, IA, we operate six distribution centers in Arcola, IL, Aurora, NE, Defiance, OH, Jonesboro, AR, Cameron, MO, and Watertown, SD. We sell products all over the United States and into 50 foreign countries.

I firmly believe that one of the reasons and the key to our company's success is our ability to hire and retain top-notch employees. Over 30 percent of our workers have been with us for more than 10 years. We provide exceptional benefits, including health insurance coverage at no cost for our workers, and only $60 per month for their family. In addition, we offer a 401(k) program, dental health plan, and a profit-sharing program that was started back in 1973.

As the largest employer in Franklin County, IA, we have watched the community grow around us. Today, we have a health clinic, a dentist's office, a chiropractor, a drug store, a bank, a grocery store, a restaurant, and a golf course. The growth of the town can be seen by the new homes that are being built, and a church that has overgrown its capacity and is making plans for a new one.

We believe in giving back to the community, which is why my company is a major donor of the Sheffield Care Center for Senior Citizens. We helped build a local swimming pool and a playground. We also gave $1 million to help fund a child day care center that cares for over 100 children in Hampton, IA.

Sukup Manufacturing Company contributes 10 percent of its taxable income for charitable contributions for local charities and contributions to the Sukup Family Foundation, which also contributes to area charities. The Family Foundation does not build up a large balance, but uses the money for charitable gifts. The Foundation balances over $1 million with the over $500,000 that has been contributed from the Foundation in 2006. I am not bragging when I tell you that businesses like Sukup Manufacturing are the backbone of our economy.

By the same token, when a business like ours is sold off, the loss to the economy is great. If Sukup closed today, 350 people would lose their jobs. But that is just the beginning. Without jobs, there

is no reason for a child care center. As people move on to other places, the restaurants and stores close down, the dentist's office moves to a bigger city with more customers. The loss would be felt in Arkansas and South Dakota.

Now, to be clear, we are a growing company, so why would we close down or sell off? I am here to tell you today that one of the greatest threats to our family-owned business is the estate tax. If my wife Mary and I died today, we estimate that our estate tax liability would be somewhere between $15 and $20 million. The only way for my sons to pay that tax would be to sell off the business. Folks will tell you that you can avoid the tax.

Well, maybe that is true in some cases, but it also involves extremely high financial planning costs, including expensive life insurance policies that businesses pay year in and year out. Money that we put into life insurance policies and other financial planning tools to avoid the tax is money that we could have put into the business, hiring more employees and expanding to other States.

Furthermore, it is nearly impossible to plan for a tax that changes every year. Under current law, the exemption for the tax is $2 million, with a top rate of 45 percent. In 2010, the tax is repealed, but in 2011 the top tax rate goes back up to 55 percent and the exemption drops back down to $1 million.

The uncertainty of the tax means that we have to plan for the worst case, costing us even more money. Even if my sons are able to somehow keep the business after we pass on, my grandchildren will have to pay the same tax again when they take over the company. There is no limit to how many times our company will be taxed. We are truly a family-owned business. I am fortunate to have two sons working with me who are graduate engineers, two grandchildren who have returned to the company full-time, and two grandchildren who are still attending Iowa State University.

One of my grandsons is disabled and has been working at the company running the robot welder. I cannot tell you how much it means to me to be able to provide him a job that allows him to make a real contribution to the company and to society. I built this company. My sons helped me build it, and my grandchildren want to carry it on. Is that not the kind of business that our government should encourage? This tax discourages, it destroys family businesses, and it is unfair. I hope that you will all work to permanently end this unfair burden on family-owned businesses like mine.

Thank you very much for hearing me today.

The CHAIRMAN. Thank you, Mr. Sukup, very much.

[The prepared statement of Mr. Sukup appears in the appendix.]

The CHAIRMAN. I am going to begin with Mr. Buffett and ask a broader question. That is, as you look at our country and our tax system, and at other countries, how do we compare with other countries? The goal is clearly to enhance American competitiveness to help raise American living standards—at least not lower them; our tax structure is only a small part of all that.

But how would you suggest to this committee that we go about looking at restructuring the tax code? I say that because I suspect that next year, the next couple of years, this country will seriously restructure our tax code. This committee is going to have very ag-

gressive hearings next year on this subject. Whoever is elected President clearly is going to have some significant suggestions in 2009 and 2010. But let us give that next President the benefit of your views, and let us give this committee the benefit of your views. What do you think? What should we do?

Mr. BUFFETT. Well, the Federal tax system has raised close to 20 percent of our GDP fairly consistently. I mean, it has varied a point or two, but since World War II, I am counting all taxes, payroll taxes and so on. In the 20th century, the United States had the greatest economic period that any country has ever seen. The real standard of living improved 7 for 1. So we do not have a broken system in the United States. I am a bull on America over time. We will have recessions from time to time and all of that. Many industrial countries, as you know, have had higher tax rates than the U.S., but we have had, more or less, 20 percent.

Everybody who is taxed is unhappy about it, and they would rather have somebody else taxed. As Russell Long said, "Don't tax you, don't tax me, tax the fellow behind the tree." We all feel that way. But the country has worked pretty well with the 20-percent allocation to the Federal Government.

If you asked me what my druthers would be, if I thought I was designing a perfect system, I would have a very progressive consumption tax. I really think that would tax the people who use the resources, who are making withdrawals from society's resources, and really not tax the people who are contributing, making deposits, to society's resources. So I think that, in theory, a progressive consumption tax makes the most sense, but I do not see how you get there from here.

So, absent that, I would say that the level of revenues, which I think should come close to approximating the level of expenditures—I mean, when you have decided on your expenditures, then part of your job is to go out and get the money. I think 20 percent is not a crippling level to assess the American people for all the things that the American people demand of their national government. I would make it somewhat more progressive.

I would take that bottom fifth of the people. If you have 23 million households at $20,000 or less, I do not know how I would—I mean, there are some tough problems around here, maybe, in terms of family businesses and that sort of thing, but I cannot imagine a tougher problem than living in the United States and having a $20,000 income and having payroll taxes of $3,000 taken out of that income. So, I would make it more progressive than it is now.

The CHAIRMAN. How would you do estate tax reform? You do not want to repeal it, so what would you do with the Federal estate tax?

Mr. BUFFETT. I would not do anything that raised less than the $24 billion. Like I say, that is a historic low, almost as a percentage of the revenues. I certainly would not have the capriciousness of 1 year this, 1 year that. I think that is terrible, and I do not know how anybody does plan for something like that. It just does not make any sense to me. It may have helped on some scoring system a long time ago, but that is about it.

No. I would have a significant deduction, probably along the lines of what happens in 2009, and I would have much more of a sloped set of rates. I would not have it kick in at maximum rates at a low level. I would say that is not in the tradition of America. Part of what has made America what it is, is we have had more equality of opportunity in this country.

I mean, you do not get to be quarterback of the Nebraska football team this year because your father was quarterback 25 years ago. You do not get to be on the Olympic team because your mother or father was on it 25 years ago. The resources of society, I think, should not pass along in terms of an aristocratic dynasty of wealth. I think that has been part of the reason for the success of our economy—the people like Jack Welch, or something, where his father was a train conductor, who can rise to command the resources.

So I believe in keeping equality of opportunity as much as you can in the country. My kids are going to have it better than the kids of a poor person no matter what the tax laws are. I mean, they are around a different environment, they get to go to college, all kinds of things.

But when you have $45,000 of GDP per capita in the United States, and that bottom fifth, 23 million households, 50 million-plus people, have $20,000 or less income, I think we ought to do more for them, and I think we ought to take a little more out of the hides of fellows like me. The *Forbes* 400, they have their $1.54 trillion, 7 for 1, and on average I think are paying a lower tax rate, counting payroll taxes, to the Federal Government than their receptionists are—I think you ought to do something about that.

The CHAIRMAN. Thank you, Mr. Buffett. I have many more questions, but my time has expired.

Senator Grassley?

Senator GRASSLEY. Yes. As a matter of transparency, I want to say that my farm has all Sukup grain handling equipment on it. [Laughter.] So he is not only a good business person and I trust him, he has also been a good friend and political supporter as well.

So, Mr. Sukup, your testimony reflects that you, your family, and your employees have already used many of the estate planning tools that Mr. Teitell talked about, but I understand you still may have to consider selling the company because of the estate tax. I know that you have discussed who could purchase a grain bin manufacturing company. Could you talk about the impact of that potential sale and who, or more importantly where, would the grain bin manufacturing go if it perhaps would leave Sheffield, IA?

Mr. SUKUP. Senator, I think that this is a real problem, that we could have to sell the business. Our sons might have to sell the business. It will probably go to a competitor or somewhere overseas; you never know exactly where it will go. But for them to come up with $15 to $20 million to continue is a real burden. It is something that they are not used to, borrowing money like that. It is probably a competitor.

Mr. Buffett is one of our competitors. He owns Brock Manufacturing. So, consequently, if we had to sell in 9 months, as it goes, I mean, that is a fire sale. That is what other people have made their money on, buying small business companies when they are in a fire sale like that.

Mr. Buffett, if you did buy it, would you leave it in Sheffield, IA or would you move—[Laughter.]

Mr. BUFFETT. I would now, Senator. [Laughter.] Yes. As Mr. Sukup mentioned, he is a terrific competitor. We own a company called CTB, which is based in Indiana. We bought that about 5 years ago. They make hog and poultry feeding equipment, as well as grain. They make a lot of grain bins. My son actually worked with a grain bin company in Illinois, GSI.

We not only did not touch any plants—I mean, we expanded a little—but every plant that was operating then, there are more people employed than before. The plants are all in the same place. And you might find this interesting. We probably bought it 5 years ago. I have never been there. Nobody from our office has been there, except probably auditors go occasionally.

The people run that business exactly as they ran that business before, except they have even added resources behind them. We have bought some other companies. They have generally been abroad. So we actually are a domestic company that buys foreign companies in that business.

Senator GRASSLEY. All right. Mr. Buffett, I want to take advantage of your being here to get your view on another issue that sometimes comes before this committee. I am sure you are familiar with the current debate surrounding carried interest. I am a strong supporter of lower rates on capital gains. I am still studying the carried interest issue; I have not made up my mind.

What are your views on whether carried interest received by alternative asset managers represents compensation for services or capital gains? Second, are your views on carried interest influenced in any way by your general views on the lower capital gains rate?

Mr. BUFFETT. Senator, from 1956 to 1969, for 14 years, I ran an investment partnership. I had a carried interest in that. The rates were higher then, but I had a carried interest. I was managing money for other people. I could have managed it in a trust department and we would have charged them a fee. I could have managed it as an investment counselor and we would have charged them a fee. I elected to go with a partnership form and, in effect, I received a large percentage of my income from capital gains. The rate was higher then, but there was a wide differential. So, I have had a little experience with it.

I can tell you, whether I was managing money in a trust department or whether I was managing money as an investment counselor, or whether I was managing money as the general partner of an investment partnership—sometimes called hedge funds—I was doing the same activity, I was working the same hours, I was working for the same people. Believe me, it is an occupation. If you believe in taxing people as earned income on their occupation, I think you should tax people on carried interest.

Senator GRASSLEY. All right.

Mr. Buffett, on another point of interest to me and this committee, there is a part of your charitable donations that does not get much notice, but has caught my attention. You have been very direct that the money that you give to foundations should be spent within a set period of time and actually go to help those in need and improve the community. You are basically requiring spending

of your gifts at far above the 5 percent minimum set by law. I commend you for your actions in this regard.

As I think you are aware, private foundations are required to only pay out 5 percent and university endowments have no requirement to pay out anything. We are seeing a growing phenomena that, in both cases, we are seeing billions and billions of dollars stockpiled by foundations and university endowments all getting very significant tax breaks, but only pennies actually going to charities or helping those in need.

What are your thoughts on this general subject, and what suggestions do you have for Congress in this area, both for foundations and university endowments? Should we do more to encourage increased spending for charity?

Mr. BUFFETT. Senator, I will tell you what I believe on it. I looked at the spending of the 30 largest foundations in the United States. I have looked at it for several years. If you take the 30 largest, at least 27 every year—28 some years—spend right at the 5 percent or a little less. Now, it is astounding to me, frankly, that the Congress should have been so wise as to pick exactly the right amount for foundations to spend.

I mean, the idea that 5 percent should be the end result of a foundation looking at its objectives, the reasons it was set up and all that sort of thing, the time horizon of the problems that they are working on, whatever, and that they would all come up with the idea that exactly 5 percent of their principal is the right amount to spend, strikes me as absurd. I mean, it is driven by the tax law. It is not driven by the logic of philanthropic distribution. I think if you set it at 3 percent, I think most of them would spend 3 percent.

I do not blame the people. It is what I call institutional dynamics. I mean, once any large organization gets set up and it gets funding, it starts subconsciously probably thinking about just perpetuating itself forever. I see it in business, I see it every place. I mean, it is not limited to philanthropy at all.

The CHAIRMAN. Thank you very much. Thank you, Senator.

Senator Wyden?

Senator WYDEN. Thank you, Mr. Chairman.

Gentlemen, I think it is pretty clear there is a tax code meltdown coming very shortly. We are looking today at just the question of estate taxes, but I think this has to come up in the context also of income tax rates, capital gains, and dividends. Suffice it to say, if this committee does not come up with a thoughtful response here, there is just going to be chaos in the world of taxes. So, I think it is obvious we want to promote growth, we want predictability, and we want certainty in terms of the next steps in taxes.

My question really revolves around the fact that in 1986, we had a pretty good model of how to proceed. Ronald Reagan and Bill Bradley came together and they said, here is something that gives everybody the chance to get ahead, everybody. It is not class warfare. It is giving everybody a chance to get ahead.

So I have introduced the Fair Flat Tax Act. Essentially, the same principles: get rid of the tax breaks, keep progressivity, clean out the clutter.

My question for each of you—I will start with you, Mr. Buffett—is would it not make sense to look at something like that, because that also moves in the direction of what the small farmers and the small businesses have been talking about? If you go to a fair, flat tax, clean out all these special interest breaks, maybe make it harder to add them back in, and then you have some certainty and predictability which farmers and small business people want, and the chance for everybody to get ahead.

Mr. Teitell, you will not be revising your planning books every year if the Fair Flat Tax, or something like it, goes through. Would that not be a pretty good model—we will start with you, Mr. Buffett, and go down the line—to at least attack part of the problem that the farmers and small business people, I think, are very legitimately talking about? Mr. Buffett?

Mr. BUFFETT. I chaired with Bill Bradley and it did not last long, as you know. I do not believe in being flat all the way.

Senator WYDEN. Fair Flat Tax.

Mr. BUFFETT. Yes. It should be progressive. I liked the Bradley plan. Like I said, it did not last long. I would say this. There is one flat tax that quits. I mean, the payroll tax, which is a third of our total budget, is flat, up to $97,500, and then it quits for me. So at 15.3 percent right from the word "go," and then that tax at $97,500, 99 percent of my income does not get taxed at that. So, I think anything you do should also consider the impact of the Social Security and the payroll tax, because that is a huge element of what most people are paying in this country. But I am with you in principle.

Senator WYDEN. Mr. Teitell?

Mr. TEITELL. Senator, may I answer your question by just quoting a legendary politician to begin with, then I hope you will see how this fits into my answer. He was asked his position on whiskey and he responded, "If by whiskey you mean the devil's brew that has wrecked millions of marriages, taken the bread from the mouths of hungry children, and has toppled countless men and women from the pinnacle of righteousness, then I'm against it. But if by whiskey you mean the oil of convivial conversation, the traditional expression of Christmas cheer, the source of millions of tax dollars for orphans, disabled children, and the blind, then I am for it. This is my position and I will not compromise."

Senator LOTT. Do you know who the author of that quote was, sir?

Mr. TEITELL. If you go to the Congressional Research Service, they have a wonderful book called "Respectfully Quoted."

Senator LOTT. Well, it actually came from a fellow named Soggy Sweat, who was a lawyer and a judge in Mississippi. [Laughter.] I just thought I would tell you where it came from.

Senator WYDEN. I was pretty sure, Mr. Teitell, it did not come from Ronald Reagan and Bill Bradley. [Laughter.]

Mr. TEITELL. Thanks for the citation. To answer your question, Senator, I am really of two minds. If, by the flat tax, you mean a flat rate with no deductions——

Senator WYDEN. No. Something along the lines of what Ronald Reagan and Bill Bradley put together, that went from 14 to 28 per-

cent, essentially was fair to the person who worked for a wage and the investor, and was paid for by cleaning out the clutter.

Mr. TEITELL. Well, what do you mean by "the clutter"?

Senator WYDEN. The 16,000 tax breaks that have been added, 3 for every working day since Ronald Reagan and Bill Bradley did that.

Mr. TEITELL. Do you mean the mortgage interest deduction, Senator?

Senator WYDEN. No. I protected that, health, and charities. But there have been 16,000 tax breaks. Can we not clean some of those out to hold down the rates and keep progressivity and give everybody a chance to get ahead?

Mr. TEITELL. Senator, I quite agree with you. I just remembered one hearing when they were talking about reducing or disallowing the deduction for the so-called three-martini lunch. Do you know who came and testified to keep that deduction at 100 percent for the business lunch? The waiters' union. So, sometimes there are side effects. I quite agree with you, we should clear out the clutter.

The CHAIRMAN. Senator Kyl?

Senator KYL. Thank you, Mr. Chairman. I think we could all benefit by having these witnesses talk to us all day long. This is most elucidating. I thank you for holding the hearing, incidentally.

Just let me note a couple of things I thought were especially interesting from testimony. Mr. Sukup, you said a couple of things I thought were really important to just reiterate. The first is that you could have, instead of putting a lot of money into estate planning and to purchasing of life insurance and the like, put that back into your business and built it even bigger and have even more employees, and so on. Correct?

Mr. SUKUP. Senator, that is right.

Senator KYL. I will not ask you how much money you spend on life insurance, but would you characterize it, at least in general terms?

Mr. SUKUP. We did not spend a lot of money in life insurance. We plowed our money back into the company. That is why we were able to grow like we have been. It really concerns me that we would have 350 people—we are in a local, small town—that may have to move out to a different area in case our company would have to be sold and was sent to a competitor or to someplace else in the world.

Senator KYL. Right.

Now, you also said that you have kids and grandkids, and sound very proud of them. You made the point that there is no limit on how many times your business will be taxed.

Mr. SUKUP. That is right.

Senator KYL. I mean, each generation.

Mr. SUKUP. You can go to 45 percent or 50 percent, and when Mary and I pass away, Charles and Steve will have to dig up $15 to $20 million. And the same thing is going to happen when it goes to our grandchildren. We are so fortunate that we have grandchildren who want to come back to the company to run it. They are there now and they are enthused about it, which may be unusual. But we are very fortunate.

Senator KYL. Now, I think you all know the answer to this question, but Mr. Teitell, you are probably the most authoritative to provide the answer. Do corporations pay taxes in a similar way at the death of a CEO or some event like that?

Mr. TEITELL. Well, the corporation does not pay a tax. Of course not.

Senator KYL. Right. But a family-owned business is generational. In other words, the tax does apply each generation. Is that correct?

Mr. TEITELL. It applies to the owner of the business.

Senator KYL. At the time that the previous generational owner dies—parent, grandparent, whoever it is—then it applies to those who are left?

Mr. TEITELL. Senator Kyl, may I frame the issue that we are all——

Senator KYL. Please describe it in more specific and humorous terms than I did.

Mr. TEITELL. I would like to note, you have described it admirably all along. But I would like to frame the issue by going back to that whiskey politician and just update it to what we are talking about here today. So, if he were asked about his position on the estate tax, he no doubt would respond: "If by the estate tax you mean a tax that punishes hard work, prevents people from passing the fruits of their labor on to their heirs, and forces the sale of farms and small businesses, then I am against it."

Senator KYL. Well, you can stop right there. [Laughter.]

Mr. TEITELL. If the Senator would yield, may I just finish?

Senator KYL. Sure. [Laughter.]

Mr. TEITELL. "But if by the estate tax you mean the source of essential revenues for the Federal Government to serve our citizens, a crucial supplement to the funds needed by the States for the general good, and the way to prevent," as you said, Mr. Buffett, "an aristocracy of inheritance, than I am for it." Basically, those are the two sides of the argument. This committee, in its wisdom, has to find whether you go one way or the other to make sure you do not end up somewhere in between.

Senator KYL. Sure.

Just for the record, Mr. Buffett, you are talking about roughly 20 percent in taxation, 20 percent of our economy being revenue to the Federal Government. Actually—and I just checked—the 40-year average is 18.2 percent, and we are currently collecting 18.8 percent. On a $13.9 trillion economy, even 1 percent is a heck of a lot of money.

Mr. BUFFETT. Yes.

Senator KYL. So part of it, too, I suspect, is a debate between those who would have the government taking even more income from our families and workers than it is today versus those—and I count myself in the group—who would say the government does not lack for money and that we should not be collecting an even higher percentage.

Mr. BUFFETT. I do not disagree with you on that.

Senator KYL. All right.

And there is something else I know you do not disagree on, because you said it. I will quote from your most recent Berkshire

Hathaway letter to shareholders talking about a business that you purchased, an electronics distributor from Ft. Worth.

You talked about how Paul loves running his business. He is a remarkable entrepreneur. But not long ago, he happened to witness how disruptive the death of a founder can be, both to a private company's employees and to the owner's family. What starts out as disruptive, furthermore, often evolves into destructive. You wrote that to note how you had purchased his business and you purchased many other family businesses.

I appreciate the fact that you have kept those family businesses going so the employees do not get laid off, but I also think you would agree that in most of those cases the families would prefer to run their own business than to have it purchased by somebody else.

Mr. BUFFETT. Actually, that case I referred to, though, that was squabbling among the family. That was not all by taxes.

Senator KYL. All right.

Mr. BUFFETT. Oftentimes they do not agree on which ones should run the business subsequently. We bought one business in Seattle, WA that has bridged the fourth generation. People have managed their businesses, true. What I do find kind of interesting sometimes is, if they do decide to sell their businesses to us, we look at the figure they put on their estate tax return for the business, and that is not the figure they think the business is worth the day after the return is filed.

Senator KYL. It is the American way.

Thank you.

The CHAIRMAN. Senator Bunning?

Senator BUNNING. Thank you very much.

Mr. Sukup, I was inspired by your story about your invention that led to the start of your business over 44 years ago. Some economists have said that business owners do not care that much about leaving a legacy or passing on a business to their heirs. They say that business owners build wealth primarily for themselves. But you testified today about your grandchildren and those in your family whom you think would like to stay in the business and inherit the business from you, and your grandchildren are working in the business also.

My question is, how many times do you have to pay the same estate tax to retain the business in your family?

Mr. SUKUP. Senator, you would have to continue. It goes from as soon as our sons pay the tax, the grandchildren will have to pay the tax.

Senator BUNNING. Are they also in the business like you are?

Mr. SUKUP. Yes, they are. We are very fortunate. They are. We have three of them working in the business now, two are in college, and they are hoping to come back to the business.

Senator BUNNING. Well, I can give you chapter and verse on a small horse farm in Scott County, KY that had a $12 million tag on it. Four million dollars in estate tax. They tried to make it go. Hawked the farm to a bank, 37 mares and a couple of brood mares. And guess what? It did not produce enough income and/or interest to pay the debt. The bank took over, and the $12 million estate was

completely lost because of the estate tax. Now, this was the original estate tax, not the improved estate tax that we now have.

But I do not believe the estate tax was ever designed to confiscate wealth like you have created and your community has prospered by.

Mr. SUKUP. Thank you.

Senator BUNNING. And I do not think anybody on this panel believes that that is the case either. We think you should be able to survive as a small business person, but we need some direction, because, come 2011, if we do not have that direction, we are going to go right back to where we were in 2000. So can you give us some direction?

Mr. SUKUP. Just repeal the death tax.

Senator BUNNING. Repeal it.

Mr. SUKUP. That is it.

Senator BUNNING. Yes. Well, we cannot get that done. We have been trying to make a compromise where we can get a certain amount on the spouse and the owner at a certain level, and tax the rest of the estate at a certain level also. We cannot come to a compromise. We ought to be able to come to a compromise, because I do not think we were ever intended to confiscate the wealth that has been created.

Now, certain members of our society are able to escape estate tax because they have enough dollars and planning expertise to escape all estate taxes. God bless them. I give them credit for that ability. But the average American cannot. If only 12 percent is covered by estate tax, then those 12 percent ought to be able to do something in regards to their own estate.

You are absolutely right, Mr. Buffett. Very few people are affected. But when we go back in 2011, a lot more are going to fall under those auspices of a million dollars and less.

Mr. BUFFET. I do not recommend going back, in 2011, to what is scheduled. I think that was an abomination, actually.

Senator BUNNING. Well, I can remember when income tax rates were at 70 percent. Can you all remember that?

Mr. BUFFET. I can remember when they were at 91 percent.

Senator BUNNING. Well, I only remember 70. I got stuck at 70 percent when I started in baseball. I can tell you this, $5,000 a year—that was the minimum salary at the time—I got a big raise to $14,000 a year because I won 20 games. That did not get me into the 70 percent bracket right away. But if you got up to $40,000, you were in the 70 percent bracket. That is unusual. We ought not go back there because we do not think we should go past what Senator Kyl said, 18.2, 18.3 of the GDP coming in. I think that is a fair amount to spend on our Federal Government expenditures.

Thank you. Thank you for your input.

The CHAIRMAN. Thank you.

Senator Smith?

Mr. BUFFETT. If I can just mention one figure on that. The 18 and a fraction is what comes in, but closer to 20 goes out. That is the real amount the government raises, borrowing, plus taxes.

The CHAIRMAN. Thank you.

Senator Smith?

Senator SMITH. Thank you, Mr. Chairman.

Gentlemen, thank you all for being here. I must tell you, there are probably few issues I have encountered in Congress that divide the parties more than just the view about government's role in redistribution. I will acknowledge my own bias. I think freedom redistributes better than government central planning, and usually when money gets to the third generation it is redistributed through profligate living. Whether that is better done by bringing it into government, I guess we each have to make a value judgment.

My own experience as a small businessman, not unlike Mr. Sukup, in a small, rural community in Oregon, has taught me that, in order to pass on to my heirs what my wife and I have built, we spend extraordinary amounts on lawyers, accountants, and insurance policies in the hope that there is something that, when we die, will not be carved up by a big firm on Wall Street and leave a community very, very desperate.

I think, Mr. Buffett, I must say, I am a huge fan of yours and I mean no disrespect in my views towards you. My concern, though, is exactly the point between these two ends of the table, that big Wall Street firms can go after companies like that and carve them up and leave rural communities in very desperate shape. I have seen it, and it is driven by the estate tax. I do not want to see it any more in America.

I think that the money that I have spent in my life, if I could spend it on some cows or doing something to keep investing in my community, in my business, in the enterprise that employs 1,000 people, that that is money better spent than bringing it here, because it is going to go one of two places: it is going to stay home or it is coming here. If you like how we spend it, bring it here. My own experience is, it is better spent when it is left at home.

But that really brings me to you, Mr. Teitell. You are the expert. We are trying to craft a compromise. I do not think Mr. Buffett wants to take his company. I do not think that at all. But how do I make sure somebody else does not take his company? What is the compromise we ought to, as Americans—not as Republicans or as Democrats—strike so that people in that situation, small businesses, are not forced because of debt to sell to big businesses?

Mr. TEITELL. Realistic exemptions, realistic rates. Under current law, there is special use value for a farm or a ranch, and there is also the ability to pay taxes if you meet certain tests on a small business, or even a larger business, over 15 years, perhaps at a lower interest rate in many cases, so perhaps that could be revisited. I was taken by the importance of passing down the business.

I know there is not a Senate committee that deals with this, but what Mr. Buffett has done, and what the two of you have done with your philanthropy, in addition to passing down the business—I know in our law office we talk about all of the generation-skipping trusts, the grantor-retained annuity trusts, irrevocable life insurance trusts, and the like. But then we also talk about passing down values, the value of philanthropy. There are family meetings to talk about that. So I think, although that is not the charge of this committee, I just wanted to say that. That is equally important.

Senator SMITH. Well, I hope you will help us write a bill. Mr. Chairman, I really do think that, for the sake of small business,

if America is about small business, we ought to be about coming up with a deal on estate taxes, because I cannot think of many things more disruptive to the growing of small businesses so that they can become big businesses than the forced sale of small businesses to big businesses. I just think it is bad public policy. I really think it is incumbent upon us to come up with a compromise.

I know Senator Kyl and you have worked on it. We ought to do it, for our country's sake. Thank you.

The CHAIRMAN. Thank you, Senator. You are right. This is an abomination, the current situation. The sooner we correct it, in some reasonable way, the better. Nobody is going to agree—not with every "i" dotted and "t" crossed—but, in some reasonable way, we need to get this thing handled.

Senator Rockefeller?

Senator ROCKEFELLER. Thank you, Mr. Chairman.

I want to associate myself completely with what Mr. Buffett said, associate myself with some confusion with what the rest of you said, and make a couple of points.

First, is a philosophical one as far as I am concerned, which I think you made. A couple of months ago, somebody asked me to go to the 86th floor of some building in New York City. I walked in to the room and he glared at me. Now, this was his invitation. I sat down and he continued just to glare at me.

Somehow, we had to start a conversation, so I decided to start it in the following manner. I said, "How much money are you going to make this year?" And he said, "One hundred and eighty-three million dollars." And then he came back and said something very interesting. He said, "But I could be making more if you people in the Finance Committee would do something about deferred compensation."

I then said to him, in what was a total of about a 4-minute meeting, "How do I hold something called America in my hand, and you are making $183 million, and I am sure you work hard for it, and the average income of a family in West Virginia of four which pays taxes, works extraordinarily hard, is always scared financially, is around $26,500?"

How do I do that? Do I call it income disparity? Do I say that merit will always rise, and that, if you are born in West Virginia, somehow you cannot? It is not true. We have Ray Lanes and people all over the place who come from West Virginia and have done very well. But to me it was a very interesting conversation about the mood of America in these last 10 years.

The second thing I want to say is, I very much agree with what Ron Wyden said when he was here, that there is going to have to be some major tax readjustment. These last 7 years have done as much damage to America as any that I can think of in my numbers of years of life, in terms of infrastructure, research, medical discoveries, and all the rest of it.

To me, that has sucked the strength out of America psychologically, and out of entrepreneurship, out of investigation at the NIH, the National Science Foundation, all the rest of it in gargantuan ways because we cut taxes because the war was going on and that was taking a lot of attention.

So in the meantime, all these tax cuts were being passed which benefitted, fundamentally, the people whom you have been talking about, along with my Uncle David. Everybody forgot that there was a whole other section of people out there who do not buy Bing Crosby's ranch. My heart did not bleed a lot when you said that. They are just struggling to make it.

I have a friend in West Virginia who, every year, comes up. He is a farmer. He complains to me about the estate tax. Now, he does not say "the estate tax," he always says "the death tax." I think you have mentioned that, but I missed that part because I walked in late. Well, that is a brilliant maneuver which is used by some on this committee, because if you say "a death tax," that means that when you die you pay a tax. Of course, nothing could be necessarily further from the truth.

So after about 5 years of these visits, which never changed in content, I said, all right, I am going to go to the IRS, the actual IRS, and I am going to get out their books and I am going to turn to the year 2005, because this happened in 2006. When he came that year, in 2005, I said that I have not made up figures, I have simply gone to the IRS.

In terms of their predictions—I guess it was 2006, looking back at 2005. There were 100 West Virginians who would pay less if the estate tax was repealed, that would benefit. Across the country of 300 million people, there were 9,000. I put this in letter form, asked him to respond, to give his side of the argument. I never heard from him.

The final thing I want to say is that, what nobody ever talks about is, if we did this, it would cost $1 trillion. Now, $1 trillion is not much these days on tax cuts. We do it so regularly and the lust for more tax cuts is always there. Unfortunately, it usually goes to the people whom you and I are talking about and it does not go to the people who, in my judgment, need it.

I come from West Virginia. I get very angry about that. I am not talking from a broad, societal point of view; I am talking about the people I represent. I get very, very angry when they get the short end of the stick, when my friend—former friend—up on the 86th floor is complaining about deferred compensation. And, yes, I am almost finished.

So while we were doing all this, we got all these skipped years; it fades in this year, comes back that year. Nobody paid any attention. We did it all just so that it could be sort of disguised in the budget and not look too dangerous. I think this country is in real trouble. I think we just happened to have reached that particular point in our country where we have to remake pretty much the general nature of our country, in education, in science, the values.

Thank you.

The CHAIRMAN. We will solve that in the future.

Senator Salazar?

Senator SALAZAR. Thank you very much, Chairman Baucus. Thank you for keeping your promise to hold a hearing on estate tax reform.

I want to ask a couple of questions, first to Mr. Buffett. As background, let me just say that my own involvement in this, as a farmer, rancher, with a family who has been on the same farm now

for 150 years, I am not sure that the estate tax, frankly, coined as the "death tax" adroitly by some people who are opposed to the tax, would ever hit 99.99 percent of our farms and ranches in Colorado, including ours, because it just does not have that kind of value where it is going to be that kind of a rate.

So, I agree with Senator Rockefeller that those who are opponents of this have been very successful in terms of putting a label on it that essentially uses a lot of people in a political debate on what really ought to be a good debate on the principles that we are debating here, which include the issue of fiscal responsibility.

Also, Mr. Buffett, as you and I have talked about, my wife was the owner/operator for a long time of a Dairy Queen franchise, and still has the best ice cream in the country.

But let me ask you this, Mr. Buffett. The reality of it is, I do not think there is going to be a repeal of the estate tax here, but there is going to be a reform. I think that is what you have been an advocate of.

So, tell us what you would specifically recommend to this Finance Committee in terms of the components of that reform, which, from my point of view, include: (1) the amount of the exemption for an estate so small estates come out; (2) what the rate of the tax should be in terms of whatever you think we ought to go for; and then (3) any other issues, including the issue of indexing. How would you advise us as a committee, and as the U.S. Senate, to move forward on the issue?

Mr. BUFFETT. I would probably have, today, an exemption of about $4 million. I would certainly have it indexed. I would have the slope be more gradual above that $4 million, but I would have it end up at higher than 45 percent. I would certainly not have it raise less than the $24 billion that it is raising now. In 1987, again, there was one individual on the *Forbes* list that had more than $5 billion. There are now 63 that have more than $5 billion. If you invest $5 billion at 7 and a fraction percent a year—and these people know how to do that—that is $1 million a day.

In terms of passing on dynasties of wealth, I really think the rate ought to be a lot higher than 45 percent. But I would go much easier than the early stages above the $4 million exemption, and like I say, I would have that indexed. I think you could do something like that.

Well, 1,500 of the estates paid half the estate tax. So it is 1,500 people. These are people who are inheriting tens of millions of dollars, in those particular cases, so you would hit very, very, very few people.

Senator SALAZAR. Let me ask you this question.

Mr. BUFFETT. Sure.

Senator SALAZAR. So we may end up moving forward in that kind of a direction. I am sure we will see how this all turns out. But in terms of people in the range of wealth who actually have to deal with these issues of estate tax, do you think that we could get a number of those people to support that kind of reform? Let me ask you this question. Really, this is my question, the issue of certainty and uncertainty. How big is that an issue for people who have to deal with the estate tax issue?

Mr. BUFFETT. The issue of certainty?

Senator SALAZAR. Yes.

Mr. BUFFETT. I think it is enormously important. I do not think people should have to guess at what year they are going to die.

Senator SALAZAR. And right now we are guessing. So it would be much more important for us, whether it is reform, repeal, whatever it is that we do, but we essentially have the long-term road map for anybody to be able to plan.

Mr. BUFFETT. Yes. I would put it to bed for a while. I think there has been enough uncertainty and confusion created, so whatever I did, I would put it to bed for a while.

Senator SALAZAR. All right.

I do not want to run over my time too much here, but Mr. Rhoads, as a rancher, one of the concerns I very much have is what happens to family farms and family ranches and the situation that I know a few examples of in Colorado, family farms and ranches that had to be sold in order to pay the estate tax.

We had some kind of a reform along the way that Mr. Buffett has testified to, along with an exemption that is specific to family farms and ranches, so that, if they continue on as operational farms and ranches by the heirs and we exempt those estates from taxation, it seems to me that would be a useful move in the right direction. And Senator Crapo, Senator Roberts, and Senator Feinstein and I have introduced legislation that would be specific as to these farms and ranches.

What is your view on our move in that direction?

Mr. RHOADS. Yes. I would certainly support that effort, and I have in the past. It is something that we fully need, because we went through two generations now and have ended up paying $640,000. When I die and my wife dies, we are going to go through one more. So, I would certainly support something like that. I believe the National Cattlemen's Association does also.

Mr. BUFFETT. Senator, can I make one suggestion on that?

Senator SALAZAR. Certainly.

Mr. BUFFETT. Just throwing out an idea. I am just coming up with it now. But you could have the government assess at whatever the normal rates would be at the time of death where it is being left to a family. You could have interest on that accrue, but never have it be collectible until the farm left the family. Now, at that point, all this appreciation that takes place, and land and everything—the government would get its money, with interest, but get it when it left the family.

Mr. RHOADS. I see. I could live with that.

Senator SALAZAR. Well, thank you very much. You have been a stellar panel.

Thank you again, Chairman Baucus, for this very interesting hearing.

The CHAIRMAN. You bet. Thank you very much.

Next on the list is Senator Lincoln.

Senator LINCOLN. Thank you, Mr. Chairman. I certainly appreciate you and our ranking member, Senator Grassley, for holding this hearing. I have been passionate about this issue for years. I think we in Washington have left far too many of our family businesses in a quagmire as a result of the erratic estate tax policy that we set in 2001.

I think that much—certainty—is in agreement on this panel, as certainty is an incredibly important part to any business, whether it is a family-owned business or a large, huge business. But it is critically important to our family-owned businesses and farms. They have spent tens of thousands of dollars each year in planning for the tax, and the status quo is unacceptable.

I hope that through what we are doing here in the committee, both today and continuing onward, that we can come up with something that is going to lead ultimately to a committee product that modernizes our estate tax portion of the code and really clears up the current uncertainty in those rates and exemption structures that are so important to have certainty to them.

My questions. I have several. Mr. Teitell, thank you for your testimony, in that you have kind of provided an overview of the numerous estate planning considerations that families currently face when they go through this erratic estate tax policy. We recognize that the largest number of estates that are filing estate tax returns are in the $1- to $2.5-million range. I believe that around 70 percent of the returns that are filed are in that range.

Is it not true that, when you look at the vast majority of those filers right now, they would not have to plan if we had a reasonable rate? I know Mr. Buffett has mentioned $4 million. But anyway, if we had a reasonable rate there, the key here would be that we would take out the bulk of the individuals, particularly family-owned businesses, and what have you, that are really being strapped by that.

The follow-up question to that would be, although the majority of the filers are in the smaller estates, in terms of the actual estate tax revenue, which I think Mr. Buffett seems to focus on as well, that is coming into the coffers, more than 40 percent of it comes from large estates, estates over the $10-million value. So, for those estates which are not going to be protected by the exemption, it is important that we set a fair rate. Mr. Buffett, I noticed you mentioned that you would not be supportive of going back to pre-2001 rates.

So to both of you gentlemen, if we come up with something reasonable, we knock out the majority of the 70 percent that are filing now that really do not need to be and are spending a lot of resources that they could be investing in their businesses, as Mr. Sukup mentioned, and then putting in a reasonable rate, is that—I mean, I am hoping that is the direction you are going to tell us to go in.

Mr. TEITELL. Senator, you have answered your own question.

Senator LINCOLN. I want you to answer it, though. I know where I am. I have been fighting for it.

Mr. TEITELL. Well, for the estate of $1, $2, or $3 million, certainly a more realistic exemption would cover that and indexed, as Mr. Buffett says, for inflation, because otherwise what is good today might not be good 8 or 9, or 5 years from now.

As far as the so-called "larger estates," let us say $10 million and way, way, way above that, in my travels around the country and in our law practice, our wealthier clients, of course when they come to our office they want to make sure they get their parking tickets validated. So, they care about everything. But they like the exemp-

tion. That is nice, but that is really not important. There could be a minus exemption as far as somebody who has $50 million or $100 million. It is really the rate. To paraphrase Shakespeare, the rate is the thing. That is where you have your work cut out for you.

Senator LINCOLN. Oh, yes. Thank you.

Mr. Buffett, did I hear you correctly that you did not think we should go back to pre-2001. Is that correct?

Mr. BUFFETT. Yes.

Senator LINCOLN. Mr. Rhoads, as the daughter of a 7th-generation farm family in our State of Arkansas, I am certainly appreciative of your testimony and understand the tremendous feeling of pride that you must feel, not just for maintaining, but for building upon the work of those who came before you. I watched my father as a rice farmer in the Mississippi delta of Arkansas take tremendous pride in caring for his land and what he produced, and more importantly, making sure it would be there for future generations. I think that is really important. It is an important part of who we are as Americans.

Mr. Sukup, the fact that you have two children and two grandchildren working in your business and who want to be there, I think that that is tremendous. There is one thing my mother said to me when I ran for Congress. She said, please do something up there that will make our children want to stay at home in these small, rural communities. Provide them the business and the wherewithal to be able to stay here and not have to leave and go to the big cities, and what have you.

So I was hoping that either one of you gentlemen might elaborate a little bit on how often you have to reassess your wealth.

The CHAIRMAN. Very briefly, please. Your time has expired, Senator. Very briefly.

Mr. SUKUP. We look at it every year or two to see what we can do, the changes in the laws, things like that so we can update it.

Mr. RHOADS. We do it the same way. Every 2 or 3 years we have another grandchild or something like that, and we try to include them in. So that is about it.

Senator LINCOLN. Thank you, Mr. Chairman. I do not know if we are going to have a second round.

The CHAIRMAN. Thank you, Senator. We will have some time.

Senator Cantwell?

Senator CANTWELL. Thank you, Mr. Chairman. Thank you, gentlemen, for participating in today's panel. Mr. Buffett, thank you for that investment in Washington State businesses, and thank you for the pledge to a great use of your funds to the Gates Foundation in the future. I think that is what it is, a pledge.

I am specifically interested in the impact of the estate tax on family-owned enterprises. Recently, Copley Press in San Diego was forced to sell off nine of its small newspapers in order to pay estate tax liability. That is when their principal died.

What do you think we should do in reform as it relates to those family-owned enterprises, specifically?

Mr. BUFFETT. They probably made a decision on selling that, for example, rather than borrowing. If you have a business, take a business worth $100 million. Like I said, the estate tax valuations are not usually the asking prices for the businesses later on, but

take a business that is worth $100 million. It probably is earning $8 million or something like that, at a minimum. If $45 million is due on the estate tax, there are special provisions, as you know, for the family-owned businesses. They can spread it out over 15 years.

The interest costs on that, tops, would be $3 million a year, so there is still $5 million a year left over for the business. It is inconvenient, but when somebody wins a $100 million lottery and they run the story in the paper, they also mention the fact that they will probably have to pay $40 million in taxes.

Now, I send that person a congratulatory card, not a sympathy card. If somebody wins the ovarian lottery and inherits a business worth $100 million and has $40 million that they owe in tax, they have a $100-million asset to work with. They may elect to sell off part of it, like somebody may sell off some of the newspaper. They may elect to borrow $40 million.

But in any event, they have the carrying capacity to do that. It is true, when you get into farms and ranches—I have a son who farms 800 acres in Illinois and it is worth $6,000 an acre now, but it does not earn based on $6,000 an acre. So if you get an asset, a piece of art that is worth a lot of money but does not produce much income, that is one thing.

But with businesses, I look at businesses all the time. You are not going to get a business valued at $100 million by the court with an estate tax challenge that is earning less than $8 million. Like I say, that will leave $5 million over after you set up the payments to pay interest of $3 million a year, or actually less than $3 million in the early years.

Senator CANTWELL. So you would make no reform as it specifically relates to family-owned businesses, from their structure? That is a structure you think is manageable when you are dealing—I mean, I am a great deal concerned about media concentration. We have an FCC that is moving forward on that. It is becoming increasingly hard for family-owned businesses, particularly in the newspaper industry.

It is a very complex structure to try to run an operation that way, divvying up various assets and resources among family members and still running a business. I do not know. To me, that is a very complex operation and a very big challenge, all because of the estate tax.

Mr. BUFFETT. Well, they would like you to believe that. But if you have a newspaper that is worth $500 million, it is probably throwing off $50 million a year. That is why it is worth $500 million. If you borrowed $200 million, or $225 million to pay the estate tax on that and your interest rate is 7 percent, that is $15 million a year. You have $35 million a year left over. I mean, they would rather not pay the tax, but I know of no newspaper owner that owned a monopoly newspaper who, after the estate tax, ever ended up leaving anything but a lot of money.

Senator CANTWELL. And let me ask you specifically, when you make your donation at whatever point in time to the Gates Foundation——

Mr. BUFFETT. I do it every July. They receive two installments, each worth a little less than $2 billion.

Senator CANTWELL. But when you think about this investment, the charitable contribution, you are making a decision about what you think is the best use of your funds.

Mr. BUFFETT. Absolutely.

Senator CANTWELL. But here we are, basically incentivizing or saying, from a tax structure perspective, you can make those charitable contributions. But if somebody wants to invest in their business, they have a——

Mr. BUFFETT. They have a lot of money to invest in their business. But we invested Berkshire Hathaway. We will pay $5 billion of Federal income tax in 2007. We still have money to invest. We have our after-tax money to invest in the business. We would have $5 billion more if we did not have to pay any Federal income tax, but we pay tax. We make a lot of money, we pay a lot of tax, we reinvest the balance.

People with their newspapers can do the same thing. They might prefer if they did not pay any tax, but they have the resources—they have ample resources—to pay the tax. They have the earning power to do it, and they will have plenty of money left over, money the average American would only dream of.

Senator CANTWELL. And you do not think that there is anything structurally about some of those smaller businesses as opposed to Berkshire Hathaway that complicates that structure for them?

Mr. BUFFETT. Well, I think when you get down to the very small ones, sure. I would have an exemption for those. But a business that makes $8 million a year, is worth $100 million, that is a high-class problem. There are 23 million families in this country who are making $20,000 a year or less that would just love to have that problem.

Senator CANTWELL. Thank you, Mr. Chairman. My time is up.

The CHAIRMAN. Thank you, Senator.

I would like to ask Mr. Sukup and Mr. Rhoads the degree to which you can live with the amounts suggested by Mr. Buffett. I think everyone in this room knows we are not going to repeal the estate tax. It is not going to happen in the foreseeable future. So the next question is, what should the law be? What is reasonable? What makes sense? We want certainty, we want predictability. But what should the exemption levels and what should the rates be, et cetera? I mean, this is not rocket science. It is pretty basic.

So the question is the degree to which you, Mr. Rhoads and Mr. Sukup, can live with the broad parameters that were somewhat outlined by Mr. Buffett. I do not want to put words in his mouth, but he talked about a $4-million exemption. I assume that is an individual, with husband and wife, it is $8 million. I assume—I do not know—that we are going to have a family-owned business exception here. If not, there would be some limits there.

But what can you live with, something along the lines of what Mr. Buffett suggested? Indexed. Remember, indexed.

Mr. RHOADS. Yes. The ranches in Nevada are larger than anyplace in the United States, so I think a $4- to $6-million exemption would cover most family ranchers and farmers in my State.

The CHAIRMAN. Mr. Sukup?

Mr. SUKUP. It is hard for me to say. With our company, we would like to have repeal of the death tax, but I cannot really say what

would help us out. I mean, anything is going to help, there is no question about it.

The CHAIRMAN. It is not going to be repealed. I think that is a given. So the question is, if it is not repealed, what is reasonable? What makes sense here? Mr. Buffett gave a starting point. He threw some numbers out for discussion.

Mr. SUKUP. I would like to see at $10 or $15 million, and a benefit in there for family-owned businesses that continue on throughout the years. I liked someone's suggestion here when they mentioned, as long as it stayed in the company and was not sold.

The CHAIRMAN. Yes.

Mr. SUKUP. When it was sold, then you could levy the tax.

The CHAIRMAN. But what would happen to your business if, say, it were $4 million for individual, a husband and wife, $8 million, indexed, and you had the benefit of all the different kinds of estate planning that Mr. Teitell and his folks have, would you have to sell your business when you, unfortunately, pass away?

Mr. SUKUP. Would we have to sell it now?

The CHAIRMAN. Yes. Would you have to sell it at those levels, at $4 million indexed, with all the planning devices that are available today?

Mr. SUKUP. We probably would.

The CHAIRMAN. You would have to sell it?

Mr. SUKUP. Have to sell it.

The CHAIRMAN. And why is that?

Mr. SUKUP. Well, when you start to get the tax up that you have to borrow $15 to $20 million, and it depends on when we pass away——

The CHAIRMAN. I do not mean to get personal, but what is the value that you think the estate might be? How much?

Mr. SUKUP. The value of our estate?

The CHAIRMAN. Yes.

Mr. SUKUP. Probably $70 million.

The CHAIRMAN. Seventy. Yes. And you think you would have to sell?

Mr. SUKUP. This would be up to our sons whether they wanted to accept the debt or not.

The CHAIRMAN. Yes. It is a tough situation. I am sympathetic. This happened in our family. It is a question of my other brother and sister taking over the family ranch. We had the same issues. As you all know, these questions are very complex. There is a lot to do with who really wants to stay in the business. Some children want to do something else. Who wants to take on the debt, how much debt to take on, can they handle the debt? You know, there are lots of different options here. We worked it out. The ranch was not sold off. But it was very, very difficult.

Mr. SUKUP. I am so fortunate, Senator, to have both sons—there are only two sons in the family, and they are both in the business. They go their ways in the business to run each division of it.

The CHAIRMAN. Right. All right. We have to find a solution here, though, that is fair and can get 60 votes so we can get some predictability and some certainty here. That is the goal. Thank you very much.

I have to leave here, but, Senator Kyl, you are next. Senator Lincoln, if you want to chair the rest of this hearing.

Senator LINCOLN. You bet.

The CHAIRMAN. Thanks.

Senator KYL. Thanks again, Mr. Chairman.

Just a couple of points and questions here. I think the estate tax amounts to about 1 percent of our Federal revenues each year. It is loathed by anywhere between 60 and 80 percent of the people who are surveyed, depending upon the survey, including those people who know they will never have to either pay it or plan against it. The majority in Congress actually favor repeal. Last year, I believe there were two different votes where 57 members of this body favored repeal or significant reform.

So one of the questions is, with that support for repealing it or substantially reforming it, why can it not be done? One of the answers is, of course, that the insurance industry, which makes a lot of money on it, lobbies very strenuously to retain the estate tax, because they can sell people insurance, which is one way to shelter some of the income. They have been lobbying very, very strongly to maintain a 45-percent rate.

I know that, Mr. Buffett, you have spoken with passion about what you consider to be a tax that can help end dynasties, so I know this is a personal view of yours. But it is also true that your company benefits greatly. In fact, you own several insurance companies.

Mr. BUFFETT. We own property/casualty insurance companies.

Senator KYL. And life insurance?

Mr. BUFFETT. We own a company that reinsures life. We do not sell life insurance directly to the public.

Senator KYL. What percentage of your profits do you think are made either on the insurance or the float from the insurance on an annual basis? Just nominally, roughly speaking?

Mr. BUFFETT. Well, the life insurance company—the property/casualty insurance company insures autos, insures homeowners. It has nothing to do with life.

Senator KYL. No. I am just talking life and the float on the life.

Mr. BUFFETT. The life company is a reinsurance company. It writes health insurance. I would say that it would be well under half of 1 percent. That is all kinds of life insurance. People buy life insurance for a lot of other things than——

Senator KYL. Sure. Sure.

By the way, one of the more famous companies I think you own is GEICO. Is that correct?

Mr. BUFFETT. That is one.

Senator KYL. Great advertising on that, by the way.

Mr. BUFFETT. Well, that is where we make some money, yes.

Senator KYL. Do they sell any life insurance?

Mr. BUFFETT. No.

Senator KYL. All right.

But this industry, this life insurance industry, can make a lot of money when one of the methods of sheltering income is the purchasing of life insurance. I kidded one of my friends who lobbies for them that, if Congress magically came up with a way to end

death, he would be in there, representing the undertakers, opposing it somehow or another.

I mean, it is just not fair, it seems to me, to take advantage of people, or rather to urge Congress to keep a law in place so that you can sell them something that they would not have to buy otherwise, and the only reason they buy it is to shelter income, because they clearly would prefer that it go to a charitable cause rather than to the U.S. Government.

I just want to note—because there seems to be a big disconnect. I appreciated Senator Cantwell's comments. It is one thing for a company that pays billions in taxes and another for a company that may be worth maybe $5 or $10 million to consider their options. A real case in my home town of Phoenix involved a printing company, and virtually all of the assets, the earnings, went back into the company every year because in that business you either bought the latest printer or you did not do well.

The person who started it came out from New York as an individual. He ended up with over 200 employees. When the estate tax came due, they could not borrow enough because everything was back in the business itself. The end result was, they had to sell this business to pay the taxes.

The family wanted to stay in the business. The son-in-law continued to advise the purchasers for a couple of years. Eventually, however, they were bought by a bigger company, and then that company was bought by a bigger company, which then consolidated operations, sold off all of the equipment for whatever it was worth, closed the business, and 200-plus employees were out of work.

The other point is, this family was one of the most charitable, giving families in Phoenix. They had a great reputation for giving to all sorts of causes. Of course, once the company was bought, not another dime in contributions came from that company. So much like in your community, Mr. Sukup, where you do contribute 10 percent and it is a big part of the community, that was the case here. So it was kind of a heart and soul. The community lost out. The employees all lost out.

The family that had great capability to run this business is not running it anymore. In fact, the business got shut down. Those are the kind of stories that we would like to end with reform of the estate tax. I agree with others who have spoken here, the votes are not there to repeal it, notwithstanding its unfairness.

But I think we can make it much more fair and provide that, at least for those estates that are in the lower range, maybe $5 to $10 million, something in that neighborhood, we should have to create a situation where they do not have to worry about spending as much on the estate preparation as they might actually have to pay in the taxes.

By the way, a question for any of you. The estimate has been that there is as much spent each year on estate planning, folks like Mr. Teitell, on insurance and lawyers and so on, as the estate tax actually collects, roughly $20 billion a year. Any contradiction of that, to your knowledge?

Mr. TEITELL. Well, I can just tell you how some clients feel. One client said, "Estate planning under the current law is the orderly

and systematic transfer of a client's wealth and assets into fees and commissions."

Senator KYL. Beats paying it into taxes, I guess. Thank you all.

Mr. BUFFETT. I have lived with it for 50 some years, having an estate that would be taxable. I would say the applicable portion of the total attorneys' fees I have had has not been more than $25,000, and I have never bought any life insurance to take care of it.

Senator KYL. You are getting a heck of a deal if you only paid $25,000, because I think some of these folks with a lot smaller estates pay a lot more than that.

Senator WYDEN. I thank our friend from Arizona. I think I want to pick up with you, Mr. Rhoads and Mr. Sukup, on this question of the calamity that this committee is going to be facing here fairly shortly. I mean, there is really going to be chaos in the tax world on a whole host of matters: income tax rates, capital gains, estate taxes. I think you all have a very compelling case, and I am certainly trying to fit this in to my thinking on how to respond here for 2010. The point Senator Kyl has made, I think, is very valid.

What I see at home in Oregon is a lot of our farmers, ranchers, and small business people pour enormous sums into all of these exercises to try to figure out how to keep the axe from falling. They are not plutocrats. They are not well-to-do people. They are just people trying to run family businesses.

So for you two who are running businesses and ranches, if you were on the Senate Finance Committee and you were facing this tax melt-down and you had to figure out how to get people some relief on the estate tax issue and deal with the capital gains question so as to promote growth and fairness, and the income tax issue, how would you all, just from the seat of your pants, if the roles were reversed and you were on this side of the dais, how would you all approach it? Mr. Sukup?

Mr. SUKUP. This is a very difficult situation for you, Senator. I appreciate all the work you are doing to try to solve this problem. To satisfy everybody is going to be impossible. There is no question about it. Some of us are going to be unhappy about it, I am sure. But we do need the rate much higher than it is for our particular company.

Senator WYDEN. On the estate tax?

Mr. SUKUP. On the estate tax.

Senator WYDEN. The exemption amount.

Mr. SUKUP. The exemption. And the 45-percent rate, we would like to see that go down. If that could go down to 14 or 20 percent, it would make it much more palatable.

Senator WYDEN. And from the standpoint of your business, that is more important to you than potential changes on the income tax side, capital gains, and the like, because that is what it is really going to come down to. Frankly, that is why I am so interested in going back to the philosophy of Ronald Reagan and Bill Bradley, because I think they looked at the whole picture, figured out how to give everybody a chance to get ahead—farmers, ranchers, and people who work for a living—and that is why I am trying to bring that philosophy back in the context of what the Congress is going to be looking at.

But I gather that of the big three, in terms of estate taxes, capital gains, and income taxes, estate taxes is the one that you would put as the big one?

Mr. SUKUP. That is the one we are facing and would be the greatest. I think the committee is going to have to look at how much the increase is in the farmland, in farmers, and that. Like Mr. Buffett said, their land in Illinois, which used to sell for $3,000, is up to $6,000 an acre now. This is going to rise tremendously. If we want to stay at the same amount of your $24 billion, it is going to change your levels that you look at in there because the whole economy out there is rising and going up 30, 40, 50 percent out there.

Senator WYDEN. We have small business people all over Oregon who are in much the same situation you all are in Sheffield, and we are going to try to figure out how to be responsive.

Mr. Rhoads, the same question. You have all these tax changes coming, income taxes, capital gains, estate taxes. It all comes up in the context of decisions that have to be made in this room, decisions that you have to deal with in a thoughtful way or there is going to be a lot of hurt in our country.

How would you approach it?

Mr. RHOADS. I am on the Senate Finance Committee in the State of Nevada, and I know the problems about taxes and all that.

Senator WYDEN. There you are.

Mr. RHOADS. I think I would agree with the gentleman who spoke before me. I think the estate tax is the number-one tax that is hurting us in the livestock industry, in farms, and small businesses in the State of Nevada. As you know, we have no inheritance tax, no Nevada State inheritance tax. I think most of us could live with a $4- to $6-million exemption.

Senator WYDEN. What is your sense—I think Mr. Sukup got pounded on this one earlier. What is your sense on what a typical small business will have to spend on insurance and all of the efforts to try to keep from getting clobbered by estate taxes?

Mr. RHOADS. Yes. I am afraid I cannot answer that. Perhaps you could. Off the top of my head, I——

Senator WYDEN. We will leave the record open so that if there is any information you can give us—because I think, frankly, in our efforts to reform the estate tax, I have been like a lot of Senators here. I voted for repeal in the past. I voted for changes. I have now come to the conclusion that I think that this has to come in the broader context of tax reform.

It is why I think that the model of keeping some progressivity, cleaning out the clutter, holding down rates for everybody, at least gives some certainty and predictability, which I have heard farmers and business people talking about. But if we are going to do this right, and Senator Lincoln has put a lot of time into this as well, we have to get a sense of how much small business people are paying today for these insurance and planning kinds of tools.

Do you want to add anything, Mr. Sukup?

Mr. SUKUP. Yes. I would just like to say that it is the individual that is in the company, and probably our company did not spend enough on life insurance and other things to avoid the estate tax, which I wanted to apply back to the company. I had wonderful em-

ployees and they were doing a great job, so we bought the very latest equipment for them instead of putting it in life insurance. Now we are going to pay the price.

Senator WYDEN. Mr. Buffett, only one comment. I have enjoyed talking with you about tax reform over the years. The tall Democrat, 20 years ago on the Finance Committee, wanted to be part of a bipartisan effort to fix the tax code. I went to school on a basketball scholarship. My jump shot was certainly not as good as Bill Bradley's. But I hope that you and other business people will keep saying, that is the model that we ought to pick up on.

We can have debates about the specifics about how to do it, but we have had 20 witnesses before the Finance Committee and Budget Committee, and I have asked each of them, with all different philosophies, whether they think the basic structure that Ronald Reagan and Bill Bradley talked about 20 years ago was right, and 19 out of those 20 witnesses said that they did.

I appreciated your supportive comments this morning. If you can be part of an effort with business people around the country to keep drilling that message home, I hope we can have another bipartisan tax reform effort, much like Ronald Reagan and Bill Bradley did in this room, coming up.

Thank you, Madam Chair.

Senator LINCOLN. Thank you.

I think I am bringing up the rear here. I have just a few more questions, if I may. I would like to follow up a little bit from Senator Cantwell in her discussion about the family-owned newspaper businesses, Mr. Buffett. I know on your company's website you have a link to an owner's manual for your investors. On that page, I think there is a document where you make a statement. You say, "On my death, Berkshire's ownership picture will change, but not in a disruptive way. None of my stock will have to be sold to take care of the cash bequeaths that I have made, or for taxes."

I think looking at the other end of the table, Mr. Sukup would love to be able to say that in his business. Whereas your businesses are really parts of your business, for other small business owners, particularly Mr. Rhoads, and I would think Mr. Sukup, too, it is their heritage.

So it is a little bit of apples and oranges in terms of how those things are dealt with and in terms of the generations that would depend on them in that perspective of being able to take that family heritage and continue to provide for the next generation and the generation after that.

So I think that is an important thing that we have to understand as well if we want to maintain the entrepreneurial engine of the small businesses and the family-owned businesses in this country, and I think that we do.

It is also an issue we have to deal with in terms of particularly family-owned farms and ranches. We are debating the farm bill right now. The fact is, whether it is land prices, whether it is trade issues, whether it is tariffs, we are denied access to markets in other countries, and a whole host of things, we are seeing a decline. Probably in the next couple of years, for the first time in the history of our country, we will see a trade deficit in agriculture.

That is going to make it more and more difficult to keep those family farms. But then on the other side, we have all these huge arguments about corporate farms, and nobody really can define those. Most of them are family farms that are incorporated between fathers and sons, daughters, and what have you. So I do think that that is an issue that we kind of have to take a little time and really think through.

There are two questions that I have left on my mind. One is, I think we had hoped that we would have a representative from the insurance industry here today. They have been vocal in their opposition or concern about what it does to their industry. From your website, again, I noticed that there is a tremendous amount, or at least 49 percent of your businesses there, that are in insurance, Mr. Buffett.

Mr. BUFFETT. Practically none from life insurance though, Madam Chair.

Senator LINCOLN. Is that right?

Mr. BUFFETT. No. Practically none.

Senator LINCOLN. No life insurance there?

Mr. BUFFETT. There is some life reinsurance, but it is practically none. It is not as good a business as property/casualty is.

Senator LINCOLN. Oh. All right. Well, you are a good businessman though, we know that.

But following up on Mr. Sukup, because I know that in our own family business and farm my dad was very cautious and wanted to make sure that there was life insurance, but he also wanted to reinvest in the farm and he wanted to buy more property and to have the ability for my mother to have that as a retirement to fall back on.

But I guess, to all of you all, we hear a lot about, when we talk about family farms and other things, the farms not necessarily being sold in order to pay estate tax. Well, a lot of those family farms and businesses are paying insurance and they are paying into those insurances and it is taking away their ability to reinvest.

Mr. Sukup has made a different decision. In his sense, he has tried to split the difference there. I do not blame him, because he wanted to build that business and be an active part of what he was able to give to his children. But it does strike me as a little bit unfair and costly to the cash flow and their competitiveness in terms of the marketplace for family-owned businesses. They have to pay an insurance company for years, kind of, in those premiums to protect the integrity of their farms or their businesses.

My question to you would be, if the value of that money that is paid into that insurance company—and it may not be life insurance, but you have a lot of annuities, do you not?

Mr. BUFFETT. No. We are not big in the annuity business at all.

Senator LINCOLN. No?

Mr. BUFFETT. No.

Senator LINCOLN. All right.

Anyway, what if we were able to give to the small business or the family-owned business or farm the ability to pre-pay that estate tax in a way that you were actually kind of self-insuring, and then you still had those resources as an annuity or as a capital investment or as a resource that you could use as your backing in

terms of reinvesting in yourself, as opposed to giving those dollars to the insurance industry where they are going to take it, invest it, and make the money off of it, to give small businesses and others the ability to pre-pay some of their estate tax and then use that as a collateral in the needs that they have to grow.

Mr. BUFFETT. Madam Chair, I have no objection to any—I think you would not get too many takers on a pre-paid fund, but I would have no objection to that. I should mention, incidentally, that Ted Turner is the largest land owner in Nebraska by some margin. My guess is, he will be able to pay his estate taxes in fine shape. But I empathize. Like I said, my son would never give up farming. He loves it. They will never sell an acre, unless he has to.

Senator LINCOLN. But that is the point. He does not have to. Mine did.

Mr. BUFFETT. Well, he does not have a lot of money. He ran for office one time. I told him he should put his name in small letters on the ballot because he is Buffett with no capital. [Laughter.] But I do think what I just pulled out of the air a little while ago actually addresses this problem. I would have no problem with somebody with a family-owned business or a farm, which is a family-owned business of a specialized sort——

Senator LINCOLN. Sure.

Mr. BUFFETT [continuing]. If, on their death, the tax is computed, interested is accumulated on it but it is not paid, but it does not become due until the farm or the business leaves the family. In effect, the government would collect its money, plus interest. Nobody would have to sell a thing. Nobody would have to give up any dollars of working at improvement.

Nobody would have to move their plants. They could do it for generation after generation. In the end, the government would have gotten original, plus interest, on it, and nobody has suffered in between as long as it is in the family.

If that farm is worth $200 million some day and they sell it and the accumulated obligation now is $60 million, then the heirs get $140 million when they decided to sell the family farm.

Senator LINCOLN. But I think the biggest problem—and you all correct me if I am wrong—that we have run into in that is in terms of the cost, because when we go to do something like that, to make a carve-out like that, it gets scored at an enormous cost.

Mr. BUFFETT. Yes. In 2006, taxable estates were $116 billion. In that $116 billion, there was $770 million of farm assets, six-tenths of 1 percent of all the assets. If I die tonight, I have a farm. I am not a farmer, so even some of the six-tenths of 1 percent would not be a huge item. The government would have an asset. It would have this claim which it was eventually going to collect, with interest.

Senator LINCOLN. I have certainly been supportive of the carve-outs for family farms and some of what we have talked about. The concern we always get presented when we start talking about that, from the estimates that we get, is the enormous cost that we see and what it does to the cost of what we are trying to do, because we are trying to be fiscally responsible in how we move forward in estate tax reform and what it costs us.

I do not have any further questions. I appreciate so much all of you all bringing to the table your particular expertise. I hope that you will not go far, because I think you have found that there are many of us here on the committee who feel a tremendous passion about doing something and moving forward and making things right, and we are certainly going to need your continued interest and continued input into this issue.

Thank you so much. The committee stands adjourned.

[Whereupon, at 12:03 p.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Statement for Senator Bunning
Senate Committee on Finance
"Federal Estate Tax:
Uncertainty in Planning Under the Current Law"
November 14, 2007

Thank you, Mr. Chairman.

One of the witnesses today describes the pattern of death tax exemptions over the next few years as a "roller coaster." This year and next, it is $2 million. The following year it goes to $3.5 million. After that, the death tax is put to death for one year, only to be revived the following year with a $1 million exemption.

For the many small business owners attempting to plan a transition from one generation to the next while riding the Congressional death tax roller coaster, this is no amusement park ride. The large swings in liability from one year to the next have life or death consequences for small businesses that employ thousands of my constituents.

Family business owners are making irreversible decisions today that will have unintended consequences and lead to substantially higher taxes, if the planners don't guess right. Tragically, others will defer planning, due to the uncertainty, and they will miss the opportunity to plan. This is an intolerable situation.

Small business owners should not have to read the minds of Members of Congress or predict the future in order to plan their estates. I thank the Chairman for recognizing the problem Congress has created and for holding today's hearing. I look forward to the testimony and discussion today.

Thank you.

Senator Maria Cantwell
Statement for the Record

Senate Finance Committee Hearing
Federal Estate Tax: Uncertainty in Planning Under Current Law

November 14, 2007

Mr. Chairman, thank you for holding this hearing today. It has been a while since this committee took a comprehensive look at the estate tax and I hope that the hearings you have planned will help us move forward with permanent, meaningful reform.

I know I share the commitment to finding a permanent solution with many of my colleagues on both sides of the aisle. The prospect of returning to a tax rate of 55 percent on estates over $1 million in 2011 is unacceptable.

Our small businesses and family farms should not be left with the uncertainty that the federal government could lay claim to more than half of the family businesses they built simply because of the death of the founder or owner.

Likewise, we should not force them to spend their resources on expensive estate planning just so they can avoid a tax we have imposed simply to raise revenue. If we decide to keep an inheritance tax, we ought to have a tax in place that does not soak up funds that could be better invested back in the businesses themselves.

We tried hard last year to reach a sensible conclusion, but it was not meant to be. Time is running out on us and on the businesses that are wondering when, or if, Congress will act before the clock in 2011 turns back to 2001.

I look forward to working with my colleagues on this committee to give our family businesses and farms some certainty so they can go back to investing in their businesses and not in creative estate planning.

Thank you.

TESTIMONY OF NEVADA STATE SENATOR DEAN RHOADS
BEFORE THE UNITED STATES SENATE
COMMITTEE ON FINANCE

NOVEMBER 14, 2007

Good morning, my name is Dean Rhoads. I am a rancher from Tuscarora, Nevada, which is 60 miles northeast of Elko, Nevada. I have been involved in livestock industry activities my whole career as a rancher.

I have also been a state senator since 1984. My state senate district is the largest in the United States outside of Alaska and stretches over 73,000 square miles. My district is larger than 34 states and accounts for over two-thirds of the land area of Nevada. Prior to serving as a state senator, I served three terms in the Nevada State Assembly.

I am the past Chairman of the Public Lands Council, an affiliate of the National Cattlemen's Beef Association, and also the past Chairman of their Public Lands Committee.

Today I am here on behalf of all the ranches, farms and small businesses in my district, as well as those throughout the State of Nevada. Although I am going to tell you the story of my family, there are many others like me who have been greatly impacted by the estate tax.

Since shortly after my wife, Sharon, and I graduated from college, we have lived on the ranch that was established by her parents in 1943. We now own the ranch.

Our daughter, her husband, and our two teenage grandsons all work on the ranch. We also have a 9-month old grandson who lives on the ranch. Our other daughter, her husband, and our granddaughter live on a ranch in southern Oregon.

My father-in-law came to Elko County in the 1930s when he was 15 years old. He worked as a cowboy and a ranch hand, saved his money, and eventually bought his first property over 60 years ago.

My father-in-law became a good friend of Bing Crosby when he owned ranches in Elko County, including one adjacent to my father-in-law's ranch that we purchased in 1966. My wife and family lived there for 18 years.

We operate on a combination of private and public land, which is common for Western ranches of our type and size. The capacity of our ranch is approximately 10,000 Animal Unit Months or AUMs, which is how ranches in our part of the West are measured and valued.

I believe, if we had a willing buyer, our ranch would be valued at about $2.5 million in today's market, assuming it was not broken up or sold for water.

My mother-in-law died in 1976. My father-in-law paid a total estate tax of over $300,000. To do this he could not afford to keep the ranch where my wife and I and our two daughters lived—the old Bing Crosby ranch.

Losing this ranch and our home was not only a personal blow, but it was devastating to our operation. This was our primary hay ranch, and at 6,000 feet in elevation we need every bale of hay we can produce. Losing this ranch meant we were forced to buy hay almost every year since 1985.

When my father-in-law died in 1995, there was no more land left to sell if we wanted to survive in the ranching business. Based on the ranch's value, the tax we now owed, with interest added, was over $340,000.

Therefore we have been paying $18,000 in estate taxes, plus interest, every year; which we are continuing to pay. We have had to borrow money to make these payments. We pay this money back through the revenues produced by our ranching business.

Because of this, I can say without a doubt that we have not made very many capital improvements to our ranch nor have we been able to take advantage of some expansion opportunities to plan for the future when our grandchildren might want to continue the tradition started by my wife's parents 66 years ago.

The other thing we have not been able to do is put aside any extra money to build up a fund to help our daughters with their own estate tax burden when my wife and I pass on.

I appreciate the Senate Finance Committee holding this hearing to investigate problems caused by the uncertainty of current law. But my family is a good example of what happens when the law does not offer solutions. Hopefully any future solutions will provide my family and other families like us, some relief down the road.

A current estimate of the value of our cattle would be about $1,100 to $1,300 per mature pregnant cow with a calf at her side. Understanding that the cattle market is not constant, we own about $2 million worth of production units in our ranching business, in addition to our yearlings, a horse herd and the land value.

Let me illustrate the uncertainties of planning. Under current law, if my wife and I were killed in a common accident in December of 2009, our family ranch would be valued at around $7 million, counting all the land and all the animals. Because my wife and I have tried to do some estate planning to divide our ranch assets between us, my daughters should have a $3.5 million exemption on my estate and a $3.5 million exemption on their mother's estate. They would not have to sell any land or cattle to pay the federal government, assuming the ranch does not continue to increase in value and also assuming that the ranch was not broken up for its water rights.

But, if they were faced with dealing with our estates in January of 2011, they would owe nearly $2.5 million within 9 months of our death. That would be

in addition to the over $640,000 we have already paid in estate taxes to the federal government.

So, how do we plan without some certainty? Let me tell you, that potential tax bill represents a whole lot of pregnant cows at $1300 a pair.

Everyone in my family wants to continue our ranching business. Ranching is a tough way to make a living, but we can do it and make a profit over time.

It is difficult, but we can deal with the variables of weather, drought, labor shortage, market conditions, and day-by-day business expenses such as the increasing price of fuel. But, if you continue to add the specter of the burden of this unfair tax -- if we have to pay this much a third time as a family for one ranch -- I do not have much optimism for our future.

In closing, I urge the Committee to pass legislation reforming the estate tax by either eliminating or reducing the burden this tax places on families, ranches, farms, and small businesses in Nevada and throughout the United States.

Whether the solution is to eliminate the estate tax altogether or to increase the marital exclusion and lower the tax rate I leave up to the wisdom of Congress. But whatever you decide, I hope you will take action to help my family and others like us.

Thank you for the opportunity to testify before you today.

Responses to Questions for the Record From Senator Dean Rhoads
"Federal Estate Tax: Uncertainty in Planning Under the Current Law"
November 14, 2007

From Senator Baucus

Senator Rhoads, at the hearing there was discussion about, when a family business owner dies, the estate tax and interest due could be computed but not collected until the business was sold outside of the family. What is your opinion of this proposal?

Answer: This would be something new and is worth looking into; however, it looks like this would put a lien on your property and might make it more difficult to obtain a loan for operating purposes. It might also complicate the sale of the ranch or business.

From Senator Salazar

Senator Rhoads, while we have heard a lot of talk over the past few years about the threat the estate tax poses to small business owners and family farmers and ranchers, specific examples of small business owners and farmers having to sell their businesses to pay the tax often prove to be elusive. With that in mind, I'd like to ask a few questions about your own first-hand experiences with the estate tax.

(1) How much estate tax liability would you have today? What about in 2009, when the exemption level is $7 million for a couple and the rate is 45%?

Answer to #1: Our estimated tax liability in 2007 and 2008 would be $1.3 million in estate tax; however, if we are eligible to establish the values using Section 2032A of the tax code, there would not be any estate tax in 2007 or 2008. In 2009 the exemption increases, so we would be exempt.

(2) How much of your operation would you have to sell in order to pay the tax?

Answer to #2: If we were forced to pay $1.3 million, the entire ranch would have to be sold as soon as possible. If we qualify for Section 2032A, the ranch would not have to be sold.

(3) Do you know others in your situation who are legitimate family farmers or small business owners who would be significantly hit by the tax? Can you give specific examples?

Answer to #3: I do know of some ranches who have had estate problems, but I do not know their specific details.

(4) Does the estate tax encourage you to plan in ways that are otherwise beneficial?

Answer to #4: Yes. We have created a Living Trust, updated our will and have discussed Estate Planning with our tax advisors. They have advised us not to set up a corporation in our situation.

(5) In your testimony, you state that you would have no estate tax liability under the 2009 exemption levels and tax rates. Do you believe the majority of family farmers and ranchers you are aware of are in a similar situation?

Answer to #5: Yes.

(6) Can you take advantage of the special-use valuation (Section 2032A of the Tax Code) for farmers and ranchers? How easy are the criteria in that section to understand and navigate?

Answer to #6: Yes, we believe we can take advantage of it. However, it is difficult to understand, as well as costly, with lots of complexities, but well worth the effort.

From Senator Roberts

Senator Rhoads, in your testimony you mentioned the high cost of estate planning. How does the current complexity of the estate tax affect the cost of your estate tax planning?

Answer: It definitely affects the cost of estate planning because attorneys and accountants are involved; property has to be transferred into and out of ownership. It becomes very expensive. I could not give you an accurate dollar amount.

Opening Statement
Senator Ken Salazar
Finance Committee Hearing
"Federal Estate Tax: Uncertainty in Planning Under the Current Law"
November 14, 2007

Thank you, Chairman Baucus and Ranking Member Grassley, for holding this morning's hearing on the present state of estate tax law. I appreciate the opportunity to examine some of the challenges that small business owners, farmers, and ranchers are dealing with as they attempt to plan in the current estate tax environment.

I am also glad that the Finance Committee has begun formal consideration of ways to address this critical issue. The need to enact permanent, comprehensive estate tax reform becomes more urgent with each day as we get closer to the expiration of the President's tax cuts, and we need to start getting serious about how to craft a solution.

I was not in the Senate when Congress enacted the changes to estate tax law in 2001 that have led us to our current predicament. As a result of those changes, the estate tax exemption levels have gradually increased, while rates have gradually declined, setting us on a path to total repeal in 2010. However, the following year, the tax will come back in full force at its pre-2001 levels – a double whammy for Americans subject to the tax.

Let me be clear: I support responsible reform of the estate tax. I fully understand that the tax applies to a very small number of Americans, most of whom are extraordinarily wealthy. But I also understand that circumstances can arise in which individuals who own successful small businesses or vast swaths of farm and ranchland can be hit by the tax and face the prospect of having to sell part of their operations to foot the bill.

I grew up in rural Southern Colorado in a ranching family. Our ranch has been in the family for nearly 150 years, and for five generations. Ranching has become part of our family identity, and I hope to keep it that way for many more generations. I believe that my family and other farming and ranching families in Colorado and across rural America should have that right.

With that in mind, I believe we can and should find a middle-ground solution that ensures that wealthy Americans pay their fair share in taxes, while providing small business owners and family farmers and ranchers with the peace of mind that goes along with knowing they can keep their business in the family.

Earlier this year, I introduced legislation – along with my Finance Committee colleagues Senators Roberts and Crapo – that would exempt family farmers and ranchers from having to pay the estate tax as long as their farm or ranch continues to be owned and operated by the family, and as long as farming or ranching constitutes a majority of their income or their total estate. I am hopeful that my legislation will help begin a serious discussion of how to protect family farmers and ranchers as we work toward a solution on the estate tax that is comprehensive, permanent, and fiscally responsible.

In my view, that discussion starts today. During my first three years in the Senate, much of what has passed for debate on the estate tax has consisted of little more than rhetorical posturing by people trying to use the issue as a political wedge. I am eager to put those political games behind us and to get some real answers about who is actually affected by the estate tax, how it affects them, and what Congress can do about it.

Toward that end, I am glad that we have a balanced and experienced panel of witnesses to help give us the answers that we need, and that the American people deserve.

Thank you.

Committee on Finance
Federal Estate Tax — Uncertainty in Planning Under the Current law

November 14, 2007

Testimony
of
Eugene Sukup
Chairman of the Board
SUKUP MANUFACTURING COMPANY

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I'd like to thank the Chairman and Members of the Committee for offering me the chance to speak here today. My name is Eugene Sukup, and I'm the founder and Chairman of the Board of Sukup Manufacturing Company. We're a small manufacturer located in Sheffield, Iowa. My company also is a member of the National Association of Manufacturers, the nation's largest industrial trade association representing small and large manufacturers nationwide.

I started Sukup Manufacturing Company 44 years ago, while still working on the farm. I had bought my first grain bin to dry and store shelled corn. But, the process didn't work quite right. So, I came up with a new design that worked better. Today, I'm proud to say that forty years after our first item was patented and manufactured, my sons, Charles and Steve and I have expanded a single idea into a worldwide company, employing over 350 workers in seven states. We now hold over 70 U.S. patents and produce a broad line of grain handling and storage systems.

In addition to our plant in Sheffield, Iowa, we operate six distribution centers in Arcola, Illinois; Aurora, Nebraska; Defiance, Ohio; Jonesboro, Arkansas; Cameron, Missouri; and Watertown, South Dakota. We sell products all over the United States and to 50 foreign countries.

I firmly believe that one of the keys to our company's success is our ability to hire and retain top notch employees. Over 30 percent of our workers have been with us for more than 10 years. We provide exceptional benefits, including health insurance coverage at no cost for our workers, and only $60.00 per month for their families. In addition, we offer a 401K Program, Dental Health Plan, and a Profit Sharing Program that was started in 1973.

As the largest employer in Franklin County, Iowa, we've watched the community grow around us. Today, we have a health clinic, a dentist office, a chiropractor, a drug store, a bank, a grocery store, a restaurant, and a golf course. The growth of the town can be

seen by new homes that are being built and a church that has overgrown its capacity and is making plans for a new one.

We believe in giving back to the community, which is why my company is a major donor to the Sheffield Care Center for Senior Citizens. We helped build a local swimming pool and a playground. We also gave a million dollars to help fund a child day care center that cares for over 100 children in Hampton, Iowa. Sukup Manufacturing Company contributes 10 percent of its taxable income to local charities and the Sukup Family Foundation, which also contributes to area charities. The family foundation does not build up a large balance but uses the money for charitable gifts. The foundation balance is over $1 million dollars with over $500,000 contributed from the foundation in 2006.

I'm not bragging when I tell you that businesses like Sukup Manufacturing are the backbone of our economy. By the same token, when a business like ours is sold off or shuttered, the loss to the economy is great. If Sukup closed today, 350 people would lose their jobs. But, that's just the beginning. Without jobs, there's no reason for a child care center. As people move on to other places, the restaurants and stores close down, the dentist moves to a bigger city with more customers. The loss would be felt in Iowa, in Arkansas, in South Dakota.

Now, to be clear, we're a growing company. So, why would we close down or sell off? I'm here today to tell you that one of the greatest threats to our family-owned business is the estate tax. If my wife Mary and I died today, we estimate that our estate tax liability would be somewhere between $15 and $20 million dollars. The only way for my sons to pay that tax would be to sell off the business.

Folks will tell you that you can "avoid" the tax. Well, maybe that's true in some cases, but it also involves extremely high financial planning costs including expensive life insurance policies that businesses pay year in and year out. Money that we put into life insurance policies and other financial planning tools to avoid the tax is money that we

could have been putting into the business – hiring more employees and expanding into other states.

Furthermore, it's nearly impossible to plan for a tax that changes every year. Under current law, the exemption for the tax is $2 million with a top rate of 45 percent. In 2010, the tax is repealed. But, in 2011 the top tax rate goes back up to 55 percent and the exemption drops back down to $1 million. The uncertainty of the tax means that we have to plan for the worst case scenario, costing us even more money.

Even if my sons are able to somehow keep the business after we pass on – my grandchildren will have to pay the same tax again when they take over the company. There's no limit to how many times our company will be taxed.

We are truly a family owned business. I'm fortunate to have two sons working with me who are graduate engineers, two grandchildren that have returned to the company fulltime, and two grandchildren who are still attending Iowa State University. One of my grandsons is disabled and has been working at the company running the robot welder. I can't tell you how much it means to me to be able to provide him a job that allows him to make a real contribution to the company and to society.

I built this company, my sons helped me build it and my grandchildren want to carry it on. Isn't that the kind of entrepreneurship that our government should encourage? This tax discourages entrepreneurs, it destroys family businesses and it's unfair. I hope that you will all work together to permanently end this unfair burden on family-owned businesses like mine.

SUKUP MANUFACTURING COMPANY
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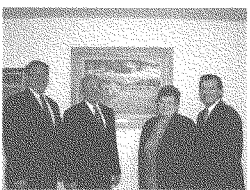

Sukup Manufacturing Co. is located in Sheffield, Iowa, a town of 1,100 people. Sukup Manufacturing Co. is the largest employer in Franklin County, a rural county 90 miles North of Des Moines; 50 miles South of the Minnesota border. We employ 350 people who drive up to 30 miles to work. Eugene has always invested the profits back into the latest machines and technology so that he could compete with other much larger manufacturers owned by Warren Buffet and Investors from the East Coast. Sukup Manufacturing Co. is among the top 3 companies building grain bins. We have been in business 44 years, starting with our first patent on an auger while still farming. Of the first 3 employees we hired, 2 are still working with us 44 years later; the third passed away 10 years ago while still in our employ.

We provide exceptional benefits to our employees. The health insurance is at no cost for the worker, and at a cost of $60.00 per month for their family. In addition, we offer a 401K Program, a Dental Health Plan, and a Profit Sharing Program that was started in 1973. The profit sharing is not given on commission or bonuses. The profit sharing contribution made by the company has been 15% of the employees' wages for each of the last three years with the average contribution of 9.2% over the last 10 years.

Despite the exodus of the farmers the town has maintained its main street. The continued growth of Sukup Manufacturing Co. helps contribute to the community by supplying jobs and attract new businesses to the area. A health clinic, a dentist office, a chiropractor, a drug store, a bank, a grocery store, a restaurant, and a golf course are among the many businesses. The growth of the town can be seen by new homes that are being built and a church that has over grown its capacity is making plans for a new one. We continue to support our local community organizations as a major donor for the Sheffield Care Center for Senior Citizens, and also for the town swimming pool, playground equipment, and a million dollars was given for a child day care center that cares for over 100 children in Hampton, Iowa. If Sukup Manufacturing Co. were sold and moved out of town you can see how it could devastate the town & county.

The key to Sukup Manufacturing Company's success has been its innovative ideas that have resulted in over 70 U.S. patents. Sukup Manufacturing Co. currently produces a broad line of grain handling and storage systems as well as innovative tillage equipment. Sukup is a market leader with many of their products holding the number one or number two spot in terms of market share for their respective product categories. In addition, Sukup products are sold not only throughout the U.S., but also in over 50 foreign countries.

Throughout the years, Sukup Manufacturing Company has continually grown and expanded its product offerings. First, adding products to go in and on grain bins to make in-bin drying more efficient. Then in 1998, venturing into portable, continuous flow dryers that offer higher capacities and more flexibility than in-bin drying. In 2001, Sukup Manufacturing Company took a large fiscal risk and purchased capital-intensive production presses and roll formers to begin manufacturing the grain bins themselves.

Forty years after the first item was patented and manufactured, Eugene and his sons, Charles and Steve, have expanded a single idea into a worldwide leadership role in drying, handling and storage equipment. Sukup Manufacturing Co. remains the largest family-owned full-line grain system manufacturer and employs 350 people in 7 states. Family owned businesses generate about 60% of our gross national product and, in the last decade, accounted for an increase of more than 20 million private sector jobs. With sales over $80 million, Sukup Manufacturing facilities are still located in Sheffield, Iowa and includes over 400,000 square feet of manufacturing space. The company also operates six distribution centers in Arcola, Illinois; Aurora, Nebraska; Defiance, Ohio; Jonesboro, Arkansas; Cameron, Missouri; and Watertown, South Dakota.

When the Founders of Sukup Manufacturing Company, Eugene & Mary are deceased, the tax will be so severe- $15-20 million dollars - that it will have to be sold.

Estate taxes do not just take 55% from the first generation; the money that is left will have another 55% taken out at the next generation of estate taxes until it is all given back in taxes. When Eugene & Mary pass away, the estate will have only 9 months to come up with the 15 to 20 million dollars to pay this tax.

Tax in 2007	45%	with $2 million dollar exemption
2008	45%	with $2 million dollar exemption
2009	45%	with $3.5 million dollar exemption
2010	no tax	
2011	55%	with $1 million dollar exemption

How can you avoid estate taxes? Only by Life Insurance, but you pay out the same amount that you save in estate taxes, only it is paid over 20 years.

Our company is just one example of a small, capital-intensive business, which believes that this estate tax is unfair and should be eliminated.

1.) It is a tax on assets that have already been taxed – at least twice.
2.) The estate tax robs a business of working capital that could be used to expand and provide jobs.
3.) It is taxed on families at the worst time, at the time of a death in the family.
4.) It is the highest rate of tax in our tax code.
5.) It is a tax on savings instead of spending.
6.) Estate taxes often force the sale of companies to firms that take the jobs out of state and outside the U.S.A.

We know that there is a shortage of people to work these days, but we have a wonderful group of people who put out a product that we can sell. We are fortunate to have 2 sons in business who are graduate engineers, 2 grandchildren that have returned to the company fulltime, 2 grandchildren who are still attending Iowa State University and an Autistic grandson who has run the robot welder. Our grandchildren are interested in keeping the company in the third generation if it is not taken away by estate taxes.

At a time when we as a country should be trying to keep manufacturing jobs here in the U.S., the estate tax hits the succession plan of a manufacturing business with a hammer and many times force a sale of the company, including many foreign interests. When the companies are sold the communities lose big when someone locally doesn't make the decisions anymore.

Attorney's and financial planners have a hay day in developing tax schemes to lessen or avoid this double tax on assets at the time of death. We don't need more trust babies, but we need to allow dollars to be reinvested in businesses families have grown and worked in.

Eugene G. Sukup, Chairman of the Board

Charles E. Sukup, President

Steve E. Sukup, Vice President/CFO

Mary E. Sukup, Secretary

Crystal Sukup-Koch, Office Manager

Matt Koch, Electrical Engineer

Nick Sukup, Production Equipment Manager

Andrew Sukup, Production

Emily Sukup, ISU Senior –Business Law

Elizabeth Sukup, ISU Senior – Public Service & Administration of Agriculture

Jon Sukup, High School Jr.

Pictured: Crystal, Steve, Emily, Nick, Andrew, Mary, Eugene, and Charles

United States Senate Committee on Finance Hearing
Federal Estate Tax – Uncertainty in Planning Under the Current Law
November 14, 2007

Questions Submitted for the Record

Questions for Mr. Sukup:

Senator Baucus

Mr. Sukup, at the hearing there was discussion about when a family business owner dies, the estate tax and interest due could be computed, but not collected until the business was sold outside of the family. What is your opinion of this proposal?

I think the devil is in the details; it would certainly help in most cases to have an incentive to keep a company thriving in a community.

Senator Salazar

Mr. Sukup, while we have heard a lot of talk over the past few years about the threat the estate tax poses to small business owners and family farmers and ranchers, specific examples of small business owners and farmers having to sell their businesses to pay the tax often prove to be elusive. With that in mind, I'd like to ask a few questions about your own first-hand experiences with the estate tax.

1) How much estate tax liability would you have today? What about in 2009, when the exemption level is $7 million for a couple and the rate is 45%?

2007	2009	2011
$16.2 M	*$40,000,000.00*	*$20.9 M*
	$33,000,000.00	
	<u>$18,150,000.00</u>	
	$14,850,000.00	

2) How much of your operation would you have to sell in order to pay the tax?

   The whole company, as you cannot part out a company piece meal as you can sell acres on a farm.

3) Do you know others in your situation who are legitimate family farmers or small business owners who would be significantly hit by the tax? Can you give specific examples?

   Yes, other Iowa companies such as - AGRI-Industrial Plastics, Al-Jon, Atlantic Bottling Company, A.Y. McDonald Manufacturing Company, Barker Company, Barr-Nunn, Bro Business Centers, Central Surveys, Citation Homes, Citizen Bank, Determann Industries, Diamond Vogel, Economy Advertising, EFCO Corporation, Erickson Dairy, Essman/Companies, Guarantee Roofing and Siding Company, Harlan Newspapers, Henningsen Construction, Keystone Electrical Manufacturing Company, Krause Gentle Corporation, Lisle Corporation, Marshalltown Company, Nelson Company, Onthank Company, Ritchie Industries, Seneca Foundry, Shine Brothers Corporation, State Steel Company, Strategic America, United Equipment Accessories, and Vermeer Manufacturing Company.

4) Does the estate tax encourage you to plan in ways that are otherwise beneficial?

   Not that I can see.

5) Mr. Sukup, in your testimony, you state that your estate tax liability could be as high as $20 million. Does that mean your small business is worth almost $50 million?

   Our business is worth from $80 to $100 million.

6) What percentage of your business do you currently own? What percentage is owned by your two sons, who you testified have significant roles in the day-today operations of the business?

   Our business is worth from $80 to $100 million as I stated earlier and my wife and I own approximately ½, which is $40 to $50 million. On question number 1 – I used $40 million. My son, Charles, is president and works with sales. Steve is Vice President and does the day-to-day manufacturing operations.

7) Do you believe there should be any limit on the amount of money that an individual can pass onto his or hr heirs tax-free?

   No not in a genuine farming operations or a private owned manufacturing plant.

Senator Roberts

1) Mr. Sukup, in your testimony you shed light on the positive impact family-run businesses have on smaller communities. A company like yours that employs hundreds of people in towns throughout America – sometimes as the largest employer in the county – has a large footprint on the economic well being of these communities.

   a) Can you further explain to me and the committee what would happen to the residents of these communities if businesses like yours were forced to sell simply to pay the death tax?

      The people in our plant have worked up to 40 years with us; to go and uproot a family like this and to find a new job in a larger city would create a problem to learn a new skill and would have to move leaving an empty house.

   b) Specifically, how would such an immediate action affect other businesses in the community that have grown and developed in response to your business' success, such as the drug stores, groceries, medical services, and restaurants?

      The grocery store, the restaurant, the drug store, and school would all have immediate problems.

   c) Are there other related employers and industries in the communities where your business is located to offer comparable jobs with such health benefits to the hundreds of displaced workers from your company?

      There are other small businesses that employ from 12 to 15 people.

2) Mr. Sukup, in your testimony you have mentioned the high cost of estate planning. How does the current complexity of the estate tax affect the cost of your estate tax planning?

You do not know how much tax to prepare for. I hope to live beyond 2010 –what will the law be then? I have been amazed since I testified how many people from all over the Midwest have contacted me about this very problem.

United States Senate

Committee on Finance

Federal Estate Tax — Uncertainty in Planning Under the Current law

November 14, 2007

Testimony
of
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OPENING REMARKS

Mr. Chairman, Mr. Ranking Member, Members of the Committee:

I am Conrad Teitell, an estate planning lawyer with Cummings & Lockwood in our firm's Stamford, Connecticut office. Over 50 of our firm's lawyers are involved in estate planning. And I teach this stuff at a law school.

In *Gone with the Wind,* Margaret Mitchell observed that death, taxes and childbirth never come at a convenient time. Nor, she might have added, at a time certain.

This Committee has asked me to talk about the uncertainty in estate planning under current law — the one that Congress gave birth to in 2001. As all but troglodytes know, that law has a roller coaster estate tax exemption: $2 million this year and next; increased to $3.5 million in 2009. Then there is no estate tax whatsoever in 2010.

But the estate tax is scheduled to reappear in 2011 and thereafter in all its glory. And the exemption will be limited to $1 million.

So, the only convenient time for death and taxes is 2010 — at least for the heirs.

We have complex tax laws because those laws reflect our complex society. However, it's not the complexity that presents the problem with the current estate tax rules, but rather the uncertainty. And to cope with that uncertainty, we lawyers must often make complex plans even more so.

As I said a moment ago, I've been asked to talk about the complexities in planning under the current law — not whether estates should be taxed and if so with what exemption and at what rates.

My written statement for the record details the many problems under the current law that individuals face when trying to plan their estates. To name just a few:

- Complicated trusts often have to be created to deal with the moving-target-estate tax exemption. And we have to draft for the contingency that there won't be an estate tax in 2010;

- Life insurance planning to pay for estate taxes and provide liquidity is difficult; and

- Putting off decisions until Congress acts can be hazardous to your wealth.

Before I get back to the negatives, let me accentuate the positive — charitable bequests. This is the one area where it is easy to plan and draft under current law. The estate tax charitable deduction is unlimited, as it has been under our estate tax laws for almost 100 years.

Thanksgiving is just around the corner. Every year my family has a marathon Monopoly game — over the entire holiday weekend.

This year, to make the game more realistic for my grandchildren, I've indexed the game for inflation.

If you buy Park Place, it will cost you $5 million.

The card that formerly said "Pay Tax Collector $200" will now say: "Pay $20,000 if you land at 7:00 or 8:00 o'clock; pay $15,000 if you land at 9:00 o'clock; and pay nothing at all if you land at 10:00 o'clock. But if you land at 11:00 o'clock or later, pay $40,000."

That's analogous to the changing estate tax exemption over the next couple of years, complete repeal of the tax in 2010, but a return of a $1 million exemption in 2011 and beyond.

My version of the rules will surely make our Monopoly game more interesting.

But our nation's estate tax rules shouldn't be a roll of the dice!

DEATH AND TAXES ARE CERTAIN — THE ESTATE TAX SHOULDN'T BE ARBITRARY

The arithmetic. An individual who dies on December 31, 2008 leaving a $5 million taxable estate to his or her children will pay an estate tax of $1.35 million. If the same individual survived one more day — until January 1, 2009, when the exemption from the estate tax is scheduled to increase from $2 million to $3.5 million — the tax on the same estate will be $675,000. But if the individual had survived for another year — until January 1, 2010, when the estate tax is scheduled to be eliminated — the estate would not pay any tax. Finally, if the estate tax exemption returns to $1 million in 2011 and beyond the estate would pay a tax of approximately $2 million.

To paraphrase Rodney Dangerfield. The fact that the same size estate can have four different tax liabilities — depending solely on dates of death that could potentially be separated by only a few minutes — is not lost on taxpayers. This creates a lack of respect for a tax system and strikes taxpayers as arbitrary. And a lack of respect for the estate tax system can also breed disrespect for the gift and income tax laws.

BASIC ESTATE PLANNING IS MIND-BOGGLING FOR MARRIED COUPLES AND FAMILIES

The estate planning process. In helping clients plan their estates, we first discuss their wishes and their needs, capabilities and other information about the desired beneficiaries; and, of course, the client's assets. That's the easy part.

Then the talk turns to the federal estate tax exemption. The amount that a client can leave to his or her beneficiaries without incurring estate tax is a cornerstone of many estate plans. We explain that the amount has increased over the years, that it was only $600,000 ten years ago, but has gradually increased to its current level of $2 million. We also describe the future scheduled changes in the estate tax: an increase in the exemption to $3.5 million in 2009; repeal of the estate tax in 2010, and then the estate tax's rebirth in 2011 and thereafter with an exemption of $1 million.

We explain the conventional wisdom among estate planning lawyers is that the changes to the estate tax scheduled to occur in 2010 and 2011 are unlikely to occur, but that we must assume that they will in our planning.

Uncertainty about the amount of the estate tax exemption can have unfortunate consequences:

- Estate plans for married individuals with combined estates between $1 million and $2 million currently are far more complicated than may be necessary. Take the case of a married couple with combined assets of $1.2 million. Given the current value of the couple's assets and the current estate tax exemption of $2 million, those clients should

have the flexibility to leave their estates to whomever they choose in whatever manner they wish without paying any federal estate tax. However, the possibility that the exemption from the estate tax might be as low as $1 million in 2011 and thereafter means that the Wills for this married couple must be designed to preserve the estate tax exemption of the first spouse to die by segregating the exemption in a trust for the benefit of the surviving spouse which will be exempt from the estate tax on the death of the survivor. Otherwise, if the property were simply left outright to the surviving spouse, an estate tax of 45% will be incurred on the survivor's death on the portion of the estate that exceeds $1 million, resulting in a federal estate tax bill of $90,000. Yet if we could inform the same couple with certainty that the exemption from federal estate tax is unlikely to return to an amount lower than its current $2 million level, we could advise them that a trust for the benefit of the survivor is unnecessary. In short, many couples are receiving more complicated — and costly — estate plans than they are likely to require.

- Because of the uncertainty in the exemption amount, couples must constantly update their estate plans, and incur additional legal fees, to respond to the scheduled changes.

- The expectation of the average estate planning client is that he or she can sign a Will and related estate planning documents, title assets in accordance with the plan, and return to their estate planning lawyer in five to ten years to assure that the plan remains appropriate in light of then-owned assets and any changes in family circumstances. However, the changes scheduled to occur over the next few years require many individuals to review their estate plans yearly. For example, a married couple with $2 million of assets in the husband's name and only modest assets in the wife's name would need very simple Wills to assure that they pass their entire inheritance tax-free to their children in 2007. However, if that same couple does not revisit the manner in which they hold title to their property in 2011 when the exemption from the estate tax is scheduled to return to $1 million, and the wife predeceases the husband during 2011 without using her $1 million exemption from the estate tax, their Wills drafted in 2007 could result in an estate tax of over $500,000. Sometimes as estate planning lawyers we can, by drafting "disclaimer" provisions in the documents, enable a survivor to take some post-mortem tax-saving actions.

- It is unfair to create this trap for individuals who have conscientiously tried to create tax-efficient estate plans, but haven't kept abreast of the complex changes to the estate tax exemption over time.

CONFUSION REGARDING THE ROLE OF LIFE INSURANCE

Life insurance has traditionally played an important role in estate planning. The uncertainty regarding changes in the estate tax makes it difficult for taxpayers to accurately evaluate the role that life insurance should play in their estate plans.

The proceeds of a life insurance policy are includable in the estate of the policy's

owner. Thus when a client is selecting an asset to give to children during his or her life, life insurance is a desirable asset. It is generally not very valuable during the client's life, but will be highly valued at the client's death. A common estate planning technique involves placing a life insurance policy on the life of a taxpayer into an Irrevocable Life Insurance Trust. That trust enables a taxpayer to take advantage of his or her ability to make annual tax-free gifts of up to $12,000 to each member of his or her family each year by making gifts to the trust for their benefit, and thereby provide funds to pay the premiums on the policy owned by the Insurance Trust. That trust's insurance proceeds will pass to the family members at the taxpayer's death without being exposed to the estate tax in the taxpayer's estate.

Life Insurance Trusts have been an important tool in estate planning not only because they can be coordinated with the gift tax rules, but also a life insurance policy that is payable to a Life Insurance Trust for a taxpayer's family provides an excellent source of liquidity at the taxpayer's death. This source of liquidity can prove helpful to a family needing funds that can be used to replace lost income, pay estate taxes or give the family a source of funds that can be used while a home or business is being sold.

Under the current $2 million estate tax exemption, a married couple with $5 million of assets can assure that the first $4 million of their assets pass to their children without exposure to the estate tax by having properly drafted Wills that take advantage of both of their $2 million exemptions from the federal estate tax. The remaining $1 million will be subject to the federal estate tax, resulting in a tax of $450,000, and a total inheritance of $4.55 million for the children. This couple might decide to purchase a $450,000 life insurance policy that will be payable upon the death of the survivor of them and place that life insurance in a Life Insurance Trust for their family. This way, if both spouses die at a time when the estate tax exemption is still $2 million for each individual, the $450,000 of life insurance proceeds would replace the $450,000 of estate tax due, resulting in the children receiving $5 million.

This planning, which has been very common, is often a victim of uncertainty. A married couple with $5 million and properly drafted Wills would not need a Life Insurance Trust in order to maximize the inheritance of their children in 2009. The individual exemption of $3.5 million that year will mean that a married couple can protect up to $7 million using simple Wills. A Life Insurance Trust would also prove unnecessary for this couple if they both die in 2010, when the estate tax is scheduled to be repealed. However, in 2011 and thereafter, when the estate tax exemption is scheduled to return to $1 million, a married couple will only be able to protect the first $2 million of their estates using their exemptions. If this comes to pass, a much larger life insurance policy might have been advisable.

Certainty regarding the future of the estate tax would eliminate the confusing variables that currently face a taxpayer who is evaluating the role of life insurance in his or her estate plan.

POTENTIAL INCAPACITY AND DELAY RESULTS IN UNFAIR TAX EXPOSURE FOR TAXPAYERS

"Let's see what happens" — the under-planning trap. While some individuals may end up over-planning their estates due to the uncertainty in the estate tax laws, many others under-plan. They defer important estate planning decisions until there is more certainty about the size of the estate tax exemption and the applicable rates. This failure to plan today may result in a significant and unfair future tax bill.

The current planning environment. Some married couples with less than $2 million in combined assets conclude that the exemption is likely to remain at or above its current $2 million level so that they can leave all their assets to the surviving spouse without estate tax exposure on the death of the survivor. But, as already discussed, any married couple with a combined estate in excess of $1 million is at risk of paying estate tax under the current tax regime when the property passes to their children. Estate planners, even if they have the opportunity to meet with those couples, are caught between Scylla and Charybdis when deciding whether to risk over-planning clients' estates or under-planning the estate and hoping for the best.

Lifetime gifts. A common estate tax reduction strategy is giving property away during the taxpayer's life so that it is not part of his or her estate at death. Giving to reduce estate taxes and to benefit family members and others before the giver's death is recognized and encouraged in the Internal Revenue Code. The law allows individuals to make the following gifts without incurring any gift tax: unlimited gifts to charity; unlimited gifts to U.S. citizen spouses; limited gifts to non-citizen spouses; annual exclusion gifts of $12,000 per year per donee; gifts to pay medical and educational expenses; and gifts of up to $1 million during the lifetime of the taxpayer.

While giving has always been a popular strategy for the wealthy, it can also benefit individuals with more modest estates. However, the current estate tax environment has caused individuals who would otherwise engage in appropriate giving programs to forego or postpone giving, thereby potentially losing the benefit of reducing their taxable estates by both the value of the gifted property and the future appreciation on that property.

Of particular import is the decreased use of the $12,000 annual-per-donee-gift-tax exclusion for taxpayers who are on the border of having taxable estates. Annual exclusion gifts can be made each year to the same individuals, or to certain types of trusts for their benefit.

The failure to make the annual exclusion gift in a particular year has a significant opportunity cost associated with it. For example, a single taxpayer can give $12,000, and a married couple $24,000, to a child each year. If the married couple fails to make this

$24,000 combined annual exclusion gift to just one child in just one year, the opportunity cost of this failure could be as much as $12,000 in federal estate tax, assuming an estate tax rate of 50%.

Gifts beyond the annual exclusion. Wealthier individuals are postponing the decision to make larger gifts which may result in the payment of significant federal gift tax because they have concluded that they do not wish to pay a gift tax now if the property may not be subject to estate tax in the future. In the meantime, family members may be deprived of gifts that could enable them to buy homes or start businesses before the parent's death.

Future planning may be impossible. The understandable decision to defer planning for the estate tax (waiting to see what happens) assumes that the taxpayer will have the capacity to plan in the future. A client who postpones making important changes in his or her will in order to avoid the expense of having to redo it after the estate tax law is revised will not have an opportunity to make those changes if he or she loses mental capacity before Congress finally acts.

Uncertainty regarding future estate tax laws is creating two classes of families who will be punished for their failure to act while waiting for Congress to act. First, the families of taxpayers who became mentally incapacitated and, as a result of their incapacity, are unable to implement estate planning techniques that would minimize the impact of the estate tax on their inheritance. Second, the families of taxpayers who wanted to see the future of the estate tax law before engaging in a gifting program and, as a result, missed opportunities to make gifts that would have minimized the exposure of their assets to the estate tax

CHARITABLE BEQUESTS

Outright charitable bequests. Fortunately, this is one area where it is easy to plan and draft under current law. The estate tax charitable deduction is unlimited. So for outright bequests to qualified charities, no estate tax is payable regardless of the size of the bequest. Thus whether the estate tax exemption is $2 million, $3.5 million or higher is irrelevant. Donative intent, of course, is crucial.

IRAs to charity at death. Many individuals give all or part of their IRAs and other pension plans to charity at death. Those gifts qualify for the unlimited estate tax charitable deduction.

Retirement plans payable to individual beneficiaries (instead of charity) at death. The changing estate tax exemption (and estate tax repeal for 2010) must be taken into account in planning and drafting. There can be a double tax (even triple tax if the generation-skipping tax is involved) if a retirement plan is given to a beneficiary other than a charity. In addition to the estate tax (and the generation-skipping tax in some cases), the beneficiary must pay income tax on so-called income in respect of a decedent. However,

if the IRA or other pension plan is given to charity, the estate tax (and the generation-skipping tax if otherwise applicable) and the income-in-respect-of-a-decedent tax are avoided. This benefits charities and those that they serve.

Before 2006 an individual who used funds from his or her IRA to make lifetime charitable gifts was taxed on the funds payable to charity. For nonitemizers, there was no offsetting charitable deduction. And for generous higher-income donors, the income tax charitable deduction was often limited or unavailable because of the adjusted gross income ceilings on deductibility—even taking the five-year carryover into account.

For 2007 (and last year) an individual age 70½ or older can make direct charitable gifts from an IRA (including required minimum distributions) of up to $100,000 per year to public charities (other than donor advised funds and supporting organizations), operating private foundations and "conduit" foundations and not have to report the IRA distributions on his or her federal income tax return.

The Public Good IRA Rollover Act of 2007 (S. 819) with lead co-sponsors Senator Byron L. Dorgan (D-ND) and Senator Olympia J. Snowe (R-ME) has bipartisan co-sponsorship on the Finance Committee and in the Senate. An identical House bill (H.R. 1419) has bipartisan co-sponsorship in the House and the Ways and Means Committee.

Those bills would expand the current IRA/charitable rollover provisions in a number of ways, the most significant for many charities and their supporters would allow a tax-free rollover for a life-income plan (e.g., gift annuity, charitable remainder unitrust) for individuals age 59½ or over. The tax-free direct charitable rollover (as under current law) would be available for individuals age 70½ or over.

Charities are grateful. I am the pro bono legal counsel for the American Council on Gift Annuities (an organization of 1,200 charities nationwide). Those charities are grateful to the Congress for the existing IRA/charitable rollover law and that Congress is considering extending that law. Adding the ability for an individual to roll over part or all of an IRA to charity and receive life income (fully taxable) from a life-income plan would enable millions of taxpayers of modest and average means to benefit our nation's charities and the people they serve. Instead of getting income from their IRAs, they would get income from a charity's life-income arrangement. Currently, about two-thirds of the taxpayers take the standard deduction. This would give them a tax incentive to benefit charities and still provide them with retirement income.

Testamentary charitable remainder unitrusts and charitable remainder annuity trusts (CRTs). Under current law, where a testamentary CRT provides income payments to a survivor for life with a remainder gift to a charity, the charitable gift element is fully deductible under the unlimited estate tax charitable deduction. The value of the life-income interest for a survivor is potentially subject to estate tax. So it is often a challenge to plan not knowing when death will occur and what the estate tax exemption will be (or whether there will be an estate tax).

Testamentary charitable lead unitrusts and lead annuity trusts that make payments to a charity for a period of time with an eventual gift to family members. The remainder gift of the lead trust to family members is subject to the estate tax. Thus the changing estate tax exemption (and whether there will be an estate tax at the time the lead trust is created by an individual's will) has created planning and drafting challenges.

Putting all this in context. An incredibly large number of generous Americans — of modest, average, and wealthy means—include charities in their estate plans. I know this from my law practice (working with both charitable institutions and individuals in their estate planning) and my work with a number of national umbrella organizations of charities. And, of course, published statistics show the magnitude of charitable giving. From the very beginning of our income, gift and estate tax laws, almost 100 years ago, those laws have encouraged charitable contributions. Any new estate tax law should continue to provide for an unlimited estate tax charitable deduction.

THE IMPACT OF CHANGING A TAXPAYER'S DOMICILE

Our firm advises hundreds of clients who have residences in both Connecticut and Florida. Connecticut has decoupled from the federal estate tax system and created a separate Connecticut estate tax, while Florida has no state estate tax. Our attorneys often meet with clients who have residences in both states and we discuss the estate tax advantages of establishing Florida as their domicile.

Many clients have taken the steps required to transfer their domicile from Connecticut to Florida. Although it is usually clear when a client should consider changing domicile to reduce the estate tax burden on his or her estate, it is a decision that comes with collateral consequences. A taxpayer who decides to move his or her domicile to Florida to avoid the Connecticut estate tax at death is no longer going to pay Connecticut state income taxes or sales taxes.

Because a person's domicile is based on many factors, the domicile claimed by the executor of a decedent's estate may be disputed by one or more states taking a contrary position in order to collect state death taxes. The huge dollar amounts that will be at stake as a result of domicile disputes will undoubtably lead to costly litigation.

COMPLEXITY AS A RESULT OF STATES "DECOUPLING" FROM THE FEDERAL ESTATE TAX SYSTEM

Intertwining of federal and state tax laws — the problem. My office at Cummings & Lockwood is located in Stamford, Connecticut, where the Connecticut estate tax exemption is $2 million — the same as the current federal estate tax exemption. Our firm also has two Florida offices. That state does not have a state estate tax. The states which border Connecticut and in which some clients have vacation homes all have a state estate tax system. The exemptions from the state estate taxes of New York, Rhode Island and Massachusetts are, respectively, $1 million, $675,000 and $1 million.

When Congress revised the estate tax law in 2001, that revision gradually eliminated the "state death tax credit." That credit effectively created estate tax revenue sharing between the federal government and the states. With the repeal of the credit, the states lost that revenue source. The states responded to this lost revenue in a number of ways. Some states, like Florida, have elected against implementing a state estate tax. Other states, like my home state of Connecticut and the other states in the area, have "decoupled" from the federal estate tax system, creating an independent tax system with an exemption amount which may match the federal exemption (as in Connecticut), but frequently does not (as in New York, Massachusetts and Rhode Island).

This "decoupling" from the federal estate tax system has had unexpected and significant tax consequences for our clients whose estate plans were designed to avoid federal estate tax. When the federal and state estate tax systems worked together, a Will designed to avoid federal estate tax would also be effective to avoid state estate tax. Not anymore.

Because of this significant change, our law firm contacted every one of our estate planning clients to bring this change to their attention. Our lawyers spent literally hundreds upon hundreds of hours figuring out how to revise our documents to take into account that the state exemption from the state estate tax might be lower than, higher than or equal to the exemption from the federal estate tax. And we have familiarized ourselves with the estate tax systems of other states, and encourage our clients to retain attorneys in other states to determine whether assets outside of our client's primary state of residence will be exposed to a state estate tax.

This is a challenge for our law firm even though we have more than 50 estate planning lawyers. We have the person power to familiarize ourselves with the estate tax systems of other jurisdictions, coordinate our response to our clients and update our firm's drafting system. It is difficult to imagine how a solo practitioner who does some estate planning could adequately understand all of the planning issues that arise out of a state's decision to decouple from the federal estate tax system, communicate all of those issues to his or her estate planning clients and help a client with a vacation home in another state plan for the estate tax system in that state.

The response of the various states to the 2001 changes to the federal estate tax system has made effective estate planning drastically more complex — and costly.

THE REPEAL OF THE ESTATE TAX FOR 2010 MAY NOT BE ALL GOOD NEWS FOR TAXPAYERS: CARRYOVER BASIS (NOT STEPPED-UP BASIS) AT DEATH

A ticking tax bomb. In 2010, carryover basis applies to assets having over $3 million of appreciation inherited by a decedent's spouse, and assets having appreciation of more than $1.3 million inherited by others. The $1.3 million is the amount for all heirs combined,

not for each heir. Inheritances below those amounts are governed by the current stepped-up basis rules. These carry-over-basis rules apply for 2010 only; in 2011 and beyond the current stepped-up basis rules will apply.

Tax Reform Act of 1976—the ancient history. That law provided for a carryover basis instead of a stepped-up basis at death. Apart from the dissatisfaction with a rule that imposed a new tax (capital gains when an heir sold inherited assets), myriad outcries were heard by Congress that it was impossible to comply with the new rules. Congress retroactively repealed the carryover-basis rules to the date of The Act's enactment.

Back to the present estate tax law — added complexity and costs to client. It is possible to draft estate plans to maximize the limited step up in basis (described earlier) and bequeath — if death occurs in 2010 — the most highly appreciated assets to charities (if one is planning charitable bequests). For charities, basis is generally irrelevant because only in rare cases do they pay capital gains taxes on the sale of appreciated assets. The least appreciated assets are bequeathed to family members. Planning becomes more difficult in determining which heirs will get the lower basis assets and which heirs will get the higher basis assets. The heirs will pay differing capital gains taxes on subsequent sales of their inheritances. Some of them will have bad heir days.

What's happening on the ground? Most planners, I understand, are ignoring the issue. They believe that the carryover basis rules will never come to pass. Thus the general attitude is "wait and see." Of course, if the client is mentally incompetent in 2010, planning opportunities could be lost if carryover basis becomes a reality.

PLANNING FOR INTERESTS IN QUALIFIED RETIREMENT PLANS: IRAs, 401(k)s, 403(b)s AND SEPs

The estates of many individuals are comprised of interests in retirement plans and those plans represent a large percentage of their overall net worth. As a result, estate planners must consider those assets when preparing a tax-efficient estate plan. The use of trusts are often involved to hold an individual's estate tax exemption amount and in planning for minor beneficiaries. As the size and importance of those retirement assets increases, so does the complexity in planning for their disposition under the current IRS regulations and rulings. They impose onerous requirements and seemingly arbitrary restrictions. The rules have become so complicated that trust planning with qualified retirement plans, which is absolutely necessary for spouses and minor children, is so complex that even the most sophisticated estate planning lawyers struggle with them.

HIGH-NET-WORTH INDIVIDUALS: ESTATE TAX CONCERNS AND PLANNING TECHNIQUES

Initial observation. While the amount of the estate tax exemption is of some interest, the overwhelming concern is the tax rates for the estate and generation-skipping taxes.

Testamentary planning techniques. The starting point is a testamentary estate plan that efficiently utilizes the estate and generation-skipping transfer tax exemptions, the marital deduction and the charitable deduction.

Lifetime techniques. Once the testamentary plan is in place, estate planning turns to lifetime giving strategies to remove assets from the estate and reduce the value of assets that will be in the estate.

- The use of lifetime gifts up to the annual exclusion amount is one way to give assets to various family members thereby reducing the assets in the individual's estate. Beyond that, any gifts (other than charitable donations) will either use the individual's $1 million lifetime gift tax exemption or generate a gift tax. Thus the strategy is to focus on ways to make lifetime gifts using as little of the exemption or generating the smallest amount of gift tax possible in each transfer; and also to leverage the gifts to remove as much value as possible from the taxable estate for each dollar of exemption used or tax paid.

- Estate planning for high-net-worth individuals focuses on identifying assets that have a lower value now than the individual expects them to have in the future, then transfer those assets now to the intended beneficiaries before the expected appreciation. Those gifts can be outright or in trust, and can employ strategies to further reduce the gift tax cost, such as making gifts to Grantor Retained Annuity Trusts.

- Gift transactions are structured so that for gift tax purposes the taxable value of the gift is less than the liquidation value of the gifted asset. A common technique is a Qualified Personal Residence Trust.

- Tax-efficient lifetime gifts are made by identifying assets that qualify for a valuation discount because of the nature of the assets' ownership — e.g., establishing a valuation discount based on a fractional interest, minority-interest, or lack of marketability.

When the tax man cometh. Depending on the nature of a high-net-worth individual's assets, estate planning can be as much about how to pay the taxes as how to avoid or minimize them. Because the estate tax is tax inclusive while the gift tax is tax exclusive, the same asset can be given during lifetime or at death with different total tax results. For some individuals, paying a gift tax now may be more tax efficient than having the estate pay an estate tax later. An estate planner's job is to identify the individual's ability to (1) make large taxable gifts, (2) pay taxes on those gifts and (3) structure those gifts in the most efficient way to limit the gift tax exposure.

The fly in the ointment. With the current uncertainty in the estate tax law, many individuals are reluctant to pay a gift tax now in order to avoid a larger estate tax later. They believe that there may be no estate tax when they die or if there is, the rates will be much lower. They fear that paying a gift tax now could be a foolish decision.

How to pay the estate tax. For some families, the issue is not when to pay the tax, but how. An estate that is high in value but lacking in liquidity can cause serious problems for the heirs who will be faced with a large tax due but difficulty paying that bill. This can lead heirs to sell estate assets quickly, with little ability to obtain fair market value for the assets. In those situations, the estate planner must work with the family to both reduce taxes and create strategies for liquidity at death. Those strategies may involve life insurance, buy-sell agreements, and complex structures.

CONCLUSION

A fable by the late Ambrose Bierce, American journalist and satirist, may be instructive.

An Associate Justice of the Supreme Court was beside a river bank when a Traveler approached and said:

> "I wish to cross. Will it be lawful to use this boat?"
>
> "It will," was the reply; "it is my boat."
>
> The Traveler thanked him and, pushing the boat into the water, embarked and rowed away. But the boat sank and he was drowned.
>
> "Heartless man!" said an Indignant Spectator. "Why did you not tell him that your boat had a hole in it?"
>
> "The matter of the boat's condition," said the great jurist, "was not brought before me."

When Congress enacted the current estate tax law in 2001, the matter of the uncertainty in planning that would result was apparently not brought before it.

Now that the matter has been brought to the Congress's attention by myriad taxpayers and their advisers, it is time to enact corrective legislation — and soon.

United States Senate

Committee on Finance Hearing
Federal Estate Tax — Uncertainty in Planning
Under the Current Law
November 14, 2007
Questions Submitted for the Record
to
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January 15, 2008

Introductory statement by Conrad Teitell in answering—for the record—questions from Committee Members

Mr. Chairman, Mr. Ranking Member, Members of the Committee:

My charge at the hearing was not to talk about whether there should or shouldn't be an estate tax (and if so, at what rates), but to discuss the complexities in planning under current law (changing exemptions, estate-tax interruptus and resurrection).

A major topic at the hearing was, of course, the tax-or-no-tax issue. It was well framed by the other three witnesses. Investor Warren Buffett argued for retention of the estate tax with a $4.5 million exemption (indexed for inflation) and gradually sloping rates that would go beyond the current 45% top rate; businessman Eugene Sukup urged absolute repeal; and rancher Dean Rhoads said, in effect, that he could live with (die with?) an exemption of $4 million to $5 million (double that for a married couple).

I left the hearing with the belief that even the Committee's strongest advocates for estate tax repeal acknowledged that repeal isn't in the cards now. Thus the real issues are the size of the exemption and the rates.

Woody Allen once observed: "More than any time in history, mankind faces a crossroads. One path leads to despair and utter hopelessness, the other to extinction. Let us pray that we have the wisdom to choose correctly."

No one asked me, but with important issues such as Iraq, healthcare and home-

mortgage foreclosures, to name but a few, resolving the estate tax issue should be easy. People who need to plan their estates have been caught in the politically-charged crossfire for six years. It is time for a truce and a compromise—now. I respectfully urge that the Senate Finance Committee report out a bill for Senate passage by this spring and that you ask both parties in the House to pass an estate tax bill also by that time. This to be followed by a conference committee and passage of legislation before the summer recess.

Conrad Teitell's Answers
to
Questions Submitted for the Record
by
Committee Members

Senator Baucus
1) Mr. Teitell, at the hearing there was discussion about when a family business owner dies, the estate tax and interest due could be computed, but not collected until the business was sold outside of the family. What is your opinion of this proposal?

Conrad Teitell
Mr. Chairman, this proposal should be considered as part of overall estate tax revision. If the estate tax exemption is increased to $4 million to $5 million (double that amount for couples) and indexed for inflation, as suggested by some Members at the hearing, will the survival of family farms and businesses be in jeopardy? Under the current $2 million exemption (slated to increase to $3.5 million in 2009), with the current special-use value and estate-tax-payment deferral rules, are farms and businesses in fact being sold to pay estate taxes?

Assuming that farms and businesses would have to be sold to pay estate taxes and assuming special treatment should be given to those enterprises, here's how the proposal discussed at the hearing could be structured—followed by some comments by the Devil's Advocate.

The estate tax value of a family business or farm ("qualified business") could be determined on the owner's death, but payment of the estate tax could be postponed until the qualifying business is sold without permitting taxpayers to avoid the estate tax on that business and then convert the qualifying business into liquid wealth.

The executor of the qualifying-business owner's estate at death would file an election on the estate tax return (1) to determine the value of the business as of the decedent's date of death and the amount of the federal estate tax, but (2) postpone the payment of the estate tax until the business is transferred outside the decedent's family (family would, of course, have to be defined). Upon the eventual sale to a non-family member, both the estate tax and the capital gains tax (on post-death

appreciation) would be reported on the seller's income tax return. The tax paid would include (1) estate tax on the value of the business at the owner's date of death, as previously reported on the estate tax return plus (2) the capital gains tax on any increase in value after the decedent's date of death. Paying both taxes on the income tax return that reports the sale would facilitate the collection of the estate tax as part of the income tax enforcement system.

Enter the Devil's Advocate: The proposal discussed at the hearing provided for interest to be computed on the deferred estate tax, but for it not to be payable until the business is sold. Will the deferred tax plus the interest—or the interest alone—wipe out the sale's proceeds? Or might the tax and/or interest be greater than the sale's proceeds. If so, the government and other taxpayers would be the losers.

Mr. Chairman, your question deals solely with the estate tax being deferred until the business is sold outside the family. How much involvement must a family member have with the business before it is sold? Just a few of the many other questions that come to mind: What do you do about the estate tax that would have been payable by generations 2, 3 and 4 if a family member stays involved for 100 years? What scope of activities would you allow in a family business? Would you require the posting of a bond? What about liens? Reports to and monitoring by the IRS?

Personally, I wouldn't bet the farm that this proposal would be fair to the government and other taxpayers.

Senator Baucus
2) In your testimony, you said that some taxpayers, and even estate planners, are practicing a "wait and see" attitude in regard to the estate tax.

a) How widespread is this problem?
b) Do a lot of taxpayers postpone estate tax planning because of the current law?
c) What's the range in cost for taxpayers having to change their estate plans so often?
d) Your testimony states that, as estate planners, you try to enable a survivor to take some post-mortem tax-savings actions. How is this done?

Conrad Teitell
Although our law firm's experience has been that many clients did adopt a wait-and-see attitude regarding their estate planning during the three or four year period following the 2001 Tax Act, the recent flow of our estate planning practice supports the conclusion that most of our clients have lost patience with the Congress and are now attending to their estate planning needs. Conversely, I wouldn't be surprised if attorneys who aren't specialists in estate planning find it exceedingly difficult to assist clients in making decisions in light of a tax law where the result may differ so dramatically depending on the year of death.

The change in the estate tax law that has caused the greatest burden for many of our

clients in terms of the added cost of estate planning has been the elimination of the state death tax credit by the 2001 Tax Act. Under the prior law, although the maximum federal rate was as high as 55%, the federal government shared as much as 16% of the 55% with the state where a decedent was domiciled at the time of death. When the 2001 Tax Act reduced the federal estate rates and increased the estate tax exemption, it also eliminated the state death tax credit thereby causing many of the states to enact their own estate taxes.

The elimination of the state death tax credit has added complexity and confusion to the estate planning process. In today's world, where clients not infrequently move from state to state and where it is not unusual for many of our clients to own homes in several states, we face the increasingly difficult challenge of having to take into account the estate tax laws of multiple states. Even if a client is domiciled in a state that doesn't have an estate tax, the client may have real estate located in a state that does have a state estate tax and that must be considered in the estate plan. Because of the complexity of planning for multiple residences and changes of domicile from state to state, the elimination of the state death tax credit has increased the cost of planning. Also, each state will want to impose its own estate tax and that could result in domicile disputes at death and the substantial expense of litigation.

Here is yet another complexity: When the federal exemption is $2 million (currently), a state's estate tax exemption, for example, is $1 million. The taxpayer cannot take full advantage of the federal exemption at death without paying state estate tax or creating a second trust for the differential between the federal and state exemptions and qualifying the second trust for the state's marital deduction. This is an extra expense in planning the estate of the first spouse to die and administering the estate and continuing trusts.

Population movements in the country shouldn't be caused by death tax differences between states. I'm reminded of a play that I saw many years ago, *The Latent Heterosexual,* written by Paddy Chayefsky and staring Zero Mostel. Zero Mostel turns to the audience and asks: "Did you ever hear about the man who got married in order to file a joint return, got divorced in order to preserve his Liechtenstein tax status, and who finally kills himself on the advice of his accountant?"

Mr. Chairman, you ask, "What's the range in cost for taxpayers having to change their plans so often?"

Your question assumes that taxpayers are changing their plans often. As stated earlier, many individuals have adopted a wait-and-see attitude—although our law firm's recent experience is that many clients can no longer play the government-imposed waiting game and are once again planning the tax aspects of their estate plans.

As lawyers, we deal with the changing exemption, estate-tax interruptus and resurrection of the estate tax by using formula clauses in wills (and living trusts) that

direct the assets be placed in one trust rather than another and direct assets to some beneficiaries rather than others—depending on the law in effect at death.

Of course, we don't let taxes rule. The first consideration has to be the client's wishes (apart from tax savings) and needs of the beneficiaries. But keeping that in mind, our firm's aim is to provide tax-efficient estate-planning documents. Disclaimers also provide a mechanism for shifting assets—taking into account family needs, and the estate tax law in effect at death.

Finally, Mr. Chairman, in response to your question about the range in costs for estate planning: Before becoming a lawyer, when asked a difficult question, I had a three word answer, "I don't know." After practicing law for many years, I still have a three word answer, "Well, it depends." Please, however, see my answers to Senator Salazar's and Senator Kyl's questions (below) for a laundry list of estate-planning fees.

Senator Grassley
Mr. Teitell, as you have seen from the House and Senate debate over the last few years, there is a sharp division on what our long-term estate tax policy ought to be. There is a bipartisan group who would like to, at a minimum, ensure that the estate tax does not rise above the level set in 2009. The resistance to estate tax reform resides in the Leadership of the House and Senate majorities. If the Democratic Leadership agreed that, at a minimum, the estate tax would not rise above 2009 levels, would that provide clarity to estate planners like yourself? That is, clarity for the period between now and the time long-term estate tax relief is enacted?

Conrad Teitell
Mr. Ranking Member: I am sure that taxpayers and their advisers would salute members of Congress who reach a compromise so certainty will reign for the foreseeable future.

With all due respect to members of both parties, the mood of the country on this issue—based on what I hear at my lectures on estate planning to professional advisers and laypeople across the country and my discussions with fellow professionals at estate-planning conferences—is that people are fed up with the Congress's inability to resolve this issue.

The present Congress can't, of course, by public statement or legislation, guarantee what a future Congress will do. But for now, passage before the summer recess of a revised estate-tax law with a $3.5 million exemption (the 2009 exemption and rates alluded to in your question) would cure the current planning paralysis. The planning techniques sanctioned under current law—as well as the unlimited marital and charitable deductions—should be retained.

Senator Salazar
1) Mr. Teitell, after listening to the testimony of Mr. Sukup and Mr. Rhoads, how difficult do you believe it would be for them to use planning to significantly reduce their estate tax liability?

2) How easy is it to use planning to completely eliminate one's estate tax liability? How costly is it?

3) In your view, on average, is the cost of estate tax planning overly burdensome?

Conrad Teitell
Senator Salazar, after listening to the testimony of Messrs. Sukup and Rhoads, I was impressed with the closeness of their families and their involvement with their communities. So they have riches apart from their material wealth. Regarding their riches on which Caesar might have a claim, I can't comment because I don't have information about their wishes, their beneficiaries and their assets. And if I did, I hope that you understand that it would be inappropriate for me to comment in a public record. That being said, individuals in their hard-earned and lucky shoes can significantly reduce their gift and estate taxes using current techniques sanctioned by the Internal Revenue Code.

You ask, Senator Salazar, can planning completely eliminate estate tax liability?

The estate tax payable at death is purely a function of the value of the estate and the extent to which taxpayers take advantage of the available estate tax deductions and exemptions and also avail themselves of lifetime planning that reduces the size of an estate at death. The earlier one starts, the greater can be the estate tax savings.

If a taxpayer at death leaves all his or her assets to charity, there is no estate tax. If the taxpayer leaves his or her assets to a spouse, there is no estate tax until the spouse dies. If a taxpayer's assets are less than the amount shielded from estate tax by the exemption (currently $2 million), there is no estate tax. If each of a husband and wife takes advantage of his or her respective exemptions, together they can shield from estate tax assets valued at double the exemption amount (currently $4 million), by using a "Credit Shelter Trust" for the benefit of the surviving spouse. This can be done without depriving the surviving spouse of the cash flow from the assets passing to the trust. The trust has the added benefit of making certain that the trust assets will pass to the couple's children at the surviving spouse's death. The cost of estate planning to take advantage of these exemptions and deductions is marginally more than the cost of an estate plan that does not include planning for the estate tax, but is limited to other objectives of estate planning—e.g., making certain that property passes to the appropriate beneficiaries and that it does not pass to children until they are mature enough to spend and invest it wisely.

A taxpayer with assets valued at substantially more than the amount exempt from

estate tax may make lifetime gifts to descendants or other beneficiaries in order to reduce the estate tax to some extent. The most common approach is to take advantage of the annual exclusion from gift tax that permits the transfer of a fixed amount (currently $12,000 per year) per beneficiary (double that amount for couples).

Some taxpayers go beyond annual exclusion gifts to make gifts that use up all or part of the current $1 million gift tax exemption, but those gifts are much more unusual than annual exclusion gifts and tend to be made only by clients who would be considered wealthy. Also common are "estate freeze" techniques where a taxpayer retains the current value of property plus a fixed annual return, but effectively transfers any excess appreciation over the fixed return to beneficiaries. For wealthy families, the generation-skipping tax and exemption must be taken into account.

Finally, in your third question, you ask: "In your view, on average is the cost of estate tax planning overly burdensome?"

I'm reminded of this interchange between a client and a lawyer:

Client: How do you charge for your advice?
Lawyer: $10,000 for three questions.
Client: Isn't that awfully expensive?
Lawyer: What's your third question?

That being said, the cost of estate tax planning is not burdensome. In fact, clients with less than $10 million usually do little more than include a Credit Shelter Trust in their Wills (or living trusts) and use the annual exclusion from gift tax to make gifts to their children and perhaps their grandchildren. Including a Credit Shelter Trust in a Will involves minimal, if any, additional expense when compared to the cost of preparing a Will that doesn't include such a trust.

While estate planning fees paid by very wealthy clients may at times be significant, typically the fees are nominal in comparison to their net worth. Over the course of a lifetime, a typical client with $20 million is likely to spend less than $20,000 or one-tenth of 1% of net worth on estate tax planning. My recollection is that Warren Buffett, at the hearing, said that over his life he has spent under $25,000 on estate planning.

Senator Roberts
Mr. Teitell, in your testimony you discussed the costs of estate tax planning. Would you agree that the cost of estate tax compliance diverts assets that could otherwise be used to grow a business or for other economic benefit?

Conrad Teitell
Senator Roberts, not all estate planning is estate tax planning. For all but a small percentage of Americans, estate planning doesn't involve the estate tax at all. It focuses on (1) making sure that assets are given to the desired beneficiaries (rather

than as dictated by the intestacy laws), (2) protecting and managing assets for young beneficiaries or beneficiaries who are not capable of managing their assets, (3) providing for health care decisions, (4) drawing living wills, and (5) providing for money management and protection during incompetency. For those whose estates are large enough to involve tax planning, as shown in my answers to questions asked by Senator Salazar (above) and Senator Kyl (below) the costs are not great.

Senator Kyl
1) Mr. Teitell, regarding estate planning strategies and costs:

a) Would the available estate planning techniques differ depending upon the amount and character of assets and the amount of income available to an individual planning his estate?

b) What are the appropriate techniques and costs of those techniques for a moderately wealthy individual or couple with assets between $2 million and $10 million? What about for larger estates?

c) I understand that it is relatively easy for someone to donate publicly-traded stock to a foundation or charitable organization, but that closely held family businesses may not have those same opportunities. What are the available techniques to maintain family ownership for a closely-held business or farm and how effective and easy are those techniques?

Conrad Teitell
Estate planning tax-saving techniques are available to everyone. Whether the technique makes sense for a particular taxpayer depends on his or her objectives, the character and value of the taxpayer's assets and the taxpayer's willingness to make gifts of property during his or her lifetime.

Planning for the estate and gift tax is only a part of the estate planning process. Estate planning involves many other objectives that may, in fact, be more important to a client, such as: (1) planning for the management of the client's assets after the client is no longer able to manage them; (2) restricting the use of the assets by the beneficiary to avoid unproductive uses and providing incentives to the beneficiary to pursue a worthwhile and fulfilling career; and (3) protecting the assets from creditors of a beneficiary, including a divorcing spouse.

Estate tax planning for a moderately wealthy couple with assets between $2 million and $10 million is usually limited to: (1) planning for the establishment of a Credit Shelter Trust upon the death of the first of them to die; and (2) making annual gifts to take advantage of the annual exclusion from gift tax ($12,000 per donee). The cost of estate planning for those clients will fall within a range of $1,000 to $5,000 and would not be appreciably less even if the federal estate tax were eliminated and none of the states had estate taxes.

Clients with more than $10 million may engage in more complex estate planning because they are willing to give away more than the annual exclusion gifts noted above. Those clients may engage in one or more of the following techniques:

1. Low interest loans to children to assist them in purchasing a home (cost—between $500 and $1,000 for advice and preparing promissory notes).

2. Gifts to Section 529 Plans or Uniform Gifts or Transfers to Minors Accounts for grandchildren (no legal expense).

3. Gifts to trust(s) for grandchildren (cost—$2,500).

4. Qualified Personal Residence Trusts (cost—$5,000).

5. Grantor Retained Annuity Trusts (cost—$5,000).

6. Sales of assets to descendants or trust(s) for descendants (cost—$5,000 to $10,000).

7. Charitable Trusts (cost—$2,500 to $5,000).

The costs outlined above are estimates—but in the ballpark. The cost of a technique will, of course, depend on the expertise of the estate planner, as well as the market place (e.g., more in major cities than in smaller cities and in rural areas). Wealthy clients also may decide to implement a gift program through the use of a family limited partnership, in order to control the investment of gifted funds, expand the menu of potential investments by pooling the gifted funds, protect the transferred assets from creditors of the beneficiaries and reduce the gift tax consequences.

The techniques available to maintain family ownership of a closely-held business or farm are essentially the same as the techniques available for making gifts of other assets. When the transferred asset is an interest in a closely held business or a farm, implementation of the technique may be modestly more expensive and complex because of the need to value the business or farm and/or retain control of the transferred interest.

Senator Kyl
2) Mr. Teitell, regarding special use valuation:

a) How difficult or easy is it for a decedent's estate to qualify for special use valuation? Do estates need to maintain the special use for any particular time? I have heard that the special use valuation is of little benefit to many estates. Is that your experience?

b) What are the additional costs to an individual or his or her estate to make sure that a family farm or business will qualify for special use valuation?

Conrad Teitell
Senator Kyl, with hedges the primary crop in our part of Connecticut, our law firm's clients are rarely involved with special-use valuation.

To answer your question, however, Section 2032A and its regulations detail a number of hoops to jump through to qualify a farm for special-use valuation. It can be a hard row to hoe. If you successfully get through the hoops, the decedent's estate may elect to value the farm or other qualifying real property at its farm or business-use value rather than its fair market value. For example, if a farm is worth $500,000 at its current use of growing crops, but would be worth $900,000 as a site for a housing development, the decedent's estate—if numerous tests are met—can value the property on the estate tax return at $500,000. The total value of the property valued under Section 2032A may not be decreased from fair market value by more than $960,000 for decedents dying in 2008. This amount is indexed annually for inflation.

The preliminary hoop to jump through is spelled out in the instructions to Form 706 (the federal estate tax return):

> "a. At least 50% of the adjusted value of the gross estate must consist of the adjusted value of real or personal property that was being used in a farm or closely held business and that was acquired from, or passed from, the decedent to a qualified heir of the decedent, and
>
> "b. At least 25% of the adjusted value of the gross estate must consist of the adjusted value of qualified farm or closely held business property."
>
> [The Code, the regulations and the instructions to Form 706 define—in great detail—all the above terms.]

Yet another hoop: To elect special-use valuation, either the decedent or a member of his or her family must have materially participated in the operation of the farm or other business for at least five of the eight years ending on the date of the decedent's death.

Senator Kyl, you ask: "Do estates need to maintain the special use for any particular time?" Yes—and my answer tells the consequences of failing to keep them down on the farm.

Any estate taxes saved by special-use valuation are recaptured by the IRS if within 10 years of the decedent's death, the qualified heir disposes of the property or ceases to use the property for a qualified use. The qualified heir, however, can avoid the 10-year-recapture rule if he ceases to use the farm during the period because of his death.

Among the many other requirements to qualify for special-use valuation are that the election must be properly made on the return, and an agreement signed by the qualified

heirs must be annexed to the Estate Tax Return. Qualified heirs are personally liable for any recaptured taxes. Then there is the matter of estate tax liens.

Although the rules are many, it shouldn't be costly to make the determination whether an estate qualifies for special-use valuation, and if it does qualify whether that election should be made. The actual making of the election and the other Form 706 requirements shouldn't be expensive.

See Section E.I.E.I.O. for additional rules for farm property. Just kidding.

Senator Kyl
3) Mr. Teitell, regarding Section 6166 election (installment payments):

a) How easy is it for a family with a closely held business to use the Section 6166 estate tax deferral and installment payments treatment?

b) Can you explain how the bond that an estate must give or the lien that must be placed on the closely held stock under Section 6166 works? Does this deter some estates from making the Section 6166 election?

c) How much does it cost an individual to make and implement this election?

Conrad Teitell
Senator Kyl, first let's do the numbers: To qualify for installment payments under the Section 6166 election, the value of the closely held business that is included in the gross estate must be more than 35% of the adjusted gross estate.

Special rules define a closely held business—and when there is more than one business and when businesses are in individual, partnership or corporate ownership. Other rules deal with holding company stock and the business's ownership of passive assets (that could keep the estate from satisfying the 35% requirement). I have just scratched the surface. Additional rules abound.

Lifetime planning may be required to meet the 35% requirement. Generally, gifts made before death are not included in the gross estate and hence the adjusted gross estate. However, for purposes of meeting the 35%-of–the-adjusted-gross-estate requirement, any gifts made in the three-year period ending on the date of death are includable (but not taxed) in the adjusted gross estate.

Note that the maximum amount that can be paid in installments is that part of the estate tax that bears the same ratio to the total estate tax that the value of the closely held business bears to the adjusted gross estate.

Senator Kyl, you also ask about bonds and liens—and your question is most timely because of some recent developments.

The instructions to Form 706 lay out the rules:

> "The IRS may require that an estate furnish a surety bond when granting the installment method election. In the alternative, the executor may consent to elect the special lien provisions of Section 6324A, in lieu of the bond. The IRS will contact you [the executor] with the specifics of furnishing the bond or electing the special lien. The IRS will make this determination on a case-by-case basis, and you may be asked to furnish additional information.
>
> "If you elect the lien provisions, Section 6324A requires that the lien be placed on property having a value equal to the total deferred tax plus four years of interest. The property must be expected to survive the deferral period."

The Tax Court (*Estate of Roski*,128 T.C. 113, 4/12/07) held that the IRS abused its discretion when it required all estates electing Section 6166 estate-tax-payment deferral to provide a bond or consent to a special lien in lieu of a bond. The court held that it was congressional intent that the IRS determine the risk to the government of non-payment on a case-by-case basis. (The instructions to Form 706, above, reflect the Tax Court's requirement of a case-by-case determination.)

In a recent Internal Revenue Service Legal Memorandum (ILM 200747019, 10/11/07), the Service comments on nine questions on its acceptance of stock in a closely held corporation as collateral in Section 6166 lien situations.

Now for the latest development: The IRS announced on November 13, 2007 (Notice 2007-90, IRB 2007-46), that in light of the Tax Court's *Roski* decision (above), the bond/lien security issue will be determined on a case-by-case basis. Standards for making that determination are now being formulated by the Treasury and the IRS. Thus for more on this continuing tax saga, look down the road for proposed regulations, a hearing and then final regulations.

The lien/bond provisions and monitoring by the IRS can be onerous. Rarely do our clients' estates elect installment payments. If paying the estate tax is expected to be a problem, most clients provide for the payment of those taxes by purchasing life insurance—and often second-to-die life insurance for spouses.

Senator Kyl, to answer your last question, the cost of making the election is minimal—but implementing the election can be burdensome.

Senator Kyl
4) Mr. Teitell, regarding redemptions of closely held stock. How easy is it to plan under the rules in Sections 302 and 303 of the Internal Revenue Code to make sure that a redemption of closely held stock from an estate qualifies for capital gain treatment and not ordinary income treatment?

Conrad Teitell
Senator Kyl, it is difficult for an estate to have the redemption of all its stock in a family-owned corporation qualify for capital gains treatment. To qualify for capital gains treatment, the estate must waive family attribution. The family attribution waiver rules can be applied only to stock that the beneficiary of the estate owns constructively by attribution from a member of the beneficiary's family. The waiver of family attribution doesn't apply to stock that the beneficiary (1) owns directly, (2) is considered as owning by attribution from another entity, or (3) can acquire under an option to purchase.

If the family attribution rules are applicable, then two conditions must be met; namely, (1) both the estate itself and each related person must satisfy the normal requirements for a waiver (no post-redemption interest in the corporation, no acquisition of an interest within 10 years from the date of the redemption, and filing of the notification agreement) and (2) each related person must agree to be liable along with the estate for any deficiency (including interest and additions to tax) resulting from a tainted acquisition of an interest during the ten-year period.

"Related person" is specially defined for these purposes as any person to whom stock is attributable under Section 318(a)(1) at the time of the distribution if the stock would be further attributable to the estate under Section 318(a)(3).

It is difficult for the estate to be able to use Section 303 and, therefore, receive capital gains treatment upon a redemption of all or part of its stock. Section 303 requires that: (1) an actual redemption must occur, (2) the redeemed stock must be included in determining the value of the decedent's gross estate for federal estate tax purposes, or the stock must be subject to the generation-skipping transfer tax at death, (3) the distributing corporation's stock included in the gross estate must exceed 35% of the excess of the gross estate over the amounts allowable as deductions for funeral and administration expenses, claims, taxes, losses and so forth, and (4) the benefits of Section 303 cannot exceed the lesser of the (A) sum of (1) the state and federal (and foreign, if any) death taxes imposed because of a decedent's death, and (2) the funeral and administration expenses allowable as deductions for federal estate tax purposes, or (B) the amount by which the death taxes and expenses actually reduced the interest of the person whose stock is redeemed. For example, if a decedent left the stock to her spouse, the stock will be included in the gross estate and, thus, will be potentially subject to Code Section 303; but, if, as is generally the case, the decedent's will frees the marital share from any responsibility for death taxes and expenses, which normally fall on the residue, that provision has the ancillary effect of preventing application of Code Section 303 to the redemption of the stock.

So you see, Senator Kyl—it's hardly a piece of cake.

Senator Kyl
5) Mr. Teitell, regarding life insurance:

a) How important is the purchase of "Key-man" life insurance and other high-premium insurance products in providing liquidity to an estate?

b) Our family business witnesses are understandably reluctant to reveal how much they pay in life insurance premiums and other estate planning. For a business valued at $5 million, how much would key-man life insurance cost? How about for a business valued at $35 million?

c) It is my understanding, and I believe you touched on this in your written testimony, that families need to use irrevocable life insurance trusts to prevent the inclusion of insurance proceeds in an insured's estate. Can you explain how those trusts are structured? What are the costs to an individual of setting up an irrevocable life insurance trust and administering the trust?

Conrad Teitell
Senator Kyl, your question about insurance comes just when I am reading Walter Isaacson's biography of Albert Einstein. Young Einstein, having great difficulty in landing a job, promised his bride-to-be that he would marry her as soon as he found work—and said that he was going to call the director of the local insurance company. I'm no Einstein, but let me answer your questions.

"Key-man" life insurance is a term typically used to describe life insurance payable to a business to assist it in withstanding the economic impact resulting from the death of a person whose participation in the business is essential—key—to its success. It is more a business preservation technique than an estate tax planning technique.

If a taxpayer's estate consists primarily of illiquid assets such as a privately owned business or farm, a common estate planning technique is the purchase of life insurance to provide liquidity to the estate to pay estate tax and thereby avoid the need to raise the required cash either through extensions of time to pay estate tax, borrowing from a financial institution or selling the business.

The cost of life insurance depends on the type of insurance, the amount of coverage and the age and health of the insured. If you give that information to a CLU, I'm sure that you can get a quote quicker than you can wink an eye.

The most common use of a life insurance trust is to implement an annual exclusion gift program. If an individual with significant wealth wants to take advantage of all or part of his annual giving exclusion by making gifts to children and grandchildren ($12,000 per donee), but the beneficiaries have no current need for additional cash, the donor may want to make the gifts to a trust so that a trustee can invest the gifted funds for growth over time. In those situations, it is not unusual to invest the gifted funds in a life insurance policy as a conservative way to guarantee growth. Owning the gifted funds in an irrevocable trust reduces estate tax since the funds will not be taxable in the estate of the donor because the donor no longer owns them.

The estate tax benefit could also be achieved by having the policy owned directly by the beneficiaries and by giving to the beneficiaries the cash needed each year to pay the premiums. Estate planners discourage clients from that approach, however, for the following reasons: (1) individual ownership of the insurance policy may lead to a problem if the beneficiary's marriage is dissolved or the policy is attached by the beneficiary's creditors; (2) it is administratively more difficult to have each of multiple beneficiaries own a share of a life insurance policy than it is to own that policy in a trust; (3) the insured may prefer that the death benefit be held in trust for the beneficiaries rather than be distributed outright to them, particularly if they are young; and (4) many times the beneficiaries of the trust will be minors.

The typical cost of establishing a life insurance trust would be in the range of $2,000 to $3,000. Those trusts are usually administered by family members, thereby eliminating any administration cost during the insured's lifetime. After the proceeds are collected upon the insured's death, income tax returns will be required if the proceeds remain in a trust.

Senator Snowe
Mr. Teitell, thank you so much for your reference in your written testimony to the Public Good IRA Rollover Act of 2007 (S. 819) that I introduced with Senator Byron Dorgan earlier this year. I agree with you that it is a critical incentive for both donors and charities.

Mr. Teitell, focusing on the planned-giving component of this legislation through which an individual could donate to a charity and receive life income that is taxable, could you please comment on how this provision would promote charitable donations while simultaneously reducing individuals' present-law estate tax liabilities and addressing Congress' concern that individuals do not outlive their retirement savings?

Conrad Teitell
Senator Snowe, many individuals would like to give part or all of their IRAs outright to charity, but they need the retirement income from their IRAs. Allowing them to roll over their IRAs at age 59½ or older to a life-income plan that would pay the individual (and a spouse, if desired) income for life (through a charitable gift annuity, charitable remainder unitrust or annuity trust, pooled income fund gift) would enable them to provide retirement income for life <u>and</u> make a charitable commitment. The charities could plan on receiving the gift after the life interest terminates.

A life-income rollover is truly an All-American IRA/Charitable Rollover. It would encourage philanthropy by <u>all</u> Americans—not just those who can afford to part with their assets now <u>and</u> not just those who itemize their deductions on their tax returns.

The ability to roll over an IRA to charity directly—or for a life-income plan—gives charitable tax incentives to the approximately two-thirds of taxpayers who take the

standard deduction. Not being taxed on income that would otherwise be taxed (withdrawal from an IRA) is the equivalent of a charitable deduction.

The IRA assets rolled over for a life-income plan would not be included in the taxpayer's estate at death. However, the vast majority of the rollover gifts would come from individuals who have no estate tax concerns.

The life-income rollover shouldn't cost the government anything because the payments received from the life-income plans would be fully taxable—just as if the payments were received from the original IRA custodian or administrator. The big difference is that the nation's charities and the people they serve will be greatly benefitted.

Rolling over an IRA for a charity's life-income plan is not giving away the assets in the plan. The individual continues to receive income for life—just as if she or he had kept the IRA assets with the current custodian or administrator.

Senator Snowe, as you know the IRA/charitable rollover law that allowed tax-free rollovers for direct (outright) rollovers to charity for 2006 and 2007 wasn't in an extenders' bill at the end of 2007. When the Senate this year (soon, I hope) considers extending the just-expired IRA/charitable rollover provision, I hope that it will add the life-income component of the Public Good IRA Rollover Act of 2007 (S. 819).

As volunteer legal counsel to the American Council on Gift Annuities (an organization of over 1200 charities receiving support through life-income plans), I convey ACGA's thanks for your being an initial co-sponsor of S. 819 with Senator Byron Dorgan—not only in this Congress, but also several years ago in an earlier Congress.

The bill that you and Senator Dorgan initiated now has wide bipartisan co-sponsorship in both the Senate and the House—including many members of the Finance and Ways and Means Committees.

To sum up: The IRA/charitable life-income rollover is not a revenue drainer and it doesn't decrease retirement savings—just puts an IRA in a different container. I hope that Congress agrees that passage should be a no-brainer.

Conrad Teitell's Conclusion.
A fable by the late Ambrose Bierce, American journalist and satirist, may be instructive:

An Associate Justice of the Supreme Court was beside a river bank when a Traveler approached him and said:

"I wish to cross. Will it be lawful to use this boat?"

"It will," was the reply; "it is my boat."

The Traveler thanked him and, pushing the boat into the water, embarked and rowed away. But the boat sank and he was drowned.

"Heartless man!" said an Indignant Spectator. "Why did you not tell him that your boat had a hole in it?"

"The matter of the boat's condition," said the great jurist, "was not brought before me."

When Congress enacted the current estate tax law in 2001, the matter of the uncertainty in planning that would result was apparently not brought before it.

Now that the matter has been brought to the Congress's attention by myriad taxpayers and their advisers, it is time to enact corrective legislation — and soon.

COMMUNICATIONS

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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

I. The effect of the Death Tax on Family Businesses and Farms

Chairman Baucus, Ranking Member Grassley, and members of the Committee. It is a great honor to present testimony on behalf of my organization, the American Family Business Institute (AFBI), and the hundreds of family-owned businesses and farms which we represent. Our name quite appropriately describes the purpose for which we exist – to protect and preserve family-owned businesses and farms. Most specifically, we exist to advocate for full repeal of the death tax, which as my following testimony will show, is the greatest threat to the survival of family-owned businesses.

American Family Business Institute was founded in 1994. I have been with the organization as member from the early days. As an entrepreneur and owner of several businesses, I am acutely familiar with the death tax issue. In fact, before coming on board with AFBI, I successfully led a campaign to defeat the death tax in my home-state of Washington. My message then was the same as it is today – that the death tax threatens family-owned businesses and farms.

To the American Family Business Institute's many members, the preservation of family-owned businesses is more than just protecting a key source of economic growth and jobs, it is about protecting our legacies and our families. I believe that the family is the bedrock institution of a society, and that our laws should not damage the institutions which hold families together.

How the Death Tax Hurts Family-Owned Businesses and Farms

One of the common characteristics of a family business owner or farmer is that their net worth is tied up in their business and farm, and not in cash assets. This is due to the fact that unlike publicly-traded corporations, which are able to acquire considerable outside investment, family-owned businesses must rely on their own capital. Moreover, most family-owned businesses reinvest almost all of their profits in order to keep the businesses competitive. Profits are used to purchase the best possible machinery, new land, or to hire new employees. None of these assets can be sold, or in the case of employees, fired, without considerable cost to the company.

Family businesses and farms represent the majority of those families' net assets. One study found that the typical small-business owner in particular has 60 percent of the family net worth invested in the business. For the purposes of the estate tax, the business is the estate and any tax will have to be paid out of its assets.

Though there are ways to prepare to pay the death tax, these involve a misallocation of resources away from the business. For instance, if a business owner purchases life-insurance in anticipation of the death tax – as many do – the owner is forced to take money away from expanding or otherwise maintaining current business operations. I have heard from hundreds of business owners and farmers who have told me that they are spending hundreds of thousands of dollars each year on life-insurance, rather than

building the business. Unfortunately, most of them tell me that even this is often not enough to meet the cash demands of paying the death tax.

When cash-strapped business owners and farmers are faced with paying the death tax, they are forced to choose among several destructive options.

One option is to take out a large loan. The difficulty is, most businesses are already using credit to invest in their business. Adding an unproductive debt to their balance sheet is not sustainable business practice. Hence, many businesses which initially survive the death tax end up so strapped with debt that they are forced to sell – often at a loss – within a few years. In some cases, businesses are certainly able to find the cash to repay the loan over the course of an extended period of time. However, most family business owners are relying upon all revenue to meet payroll and handle day-to-day operating expenses. A large new debt forces the owner to reduce future investment. For those many small and medium-sized family-owned businesses who depend on the smallest of margins and are always fighting to be competitive against larger corporations, this simply is the beginning of the end. Hence, many businesses which initially survive the death tax end up so strapped with debt that they are forced to sell – often at a loss – within a few years.

Another option is to "trim fat" by laying off unneeded or low-performing employees, and sell assets. Unfortunately, this is a very difficult decision because, again, most family-owned businesses are already as lean as possible in order to stay competitive. Unlike publicly-traded corporations, which have the advantage of large capital reserves and thereby the ability to temporarily maintain unprofitable ventures, the family-owned business must achieve maximum profitability from every dollar. The same is true for farmers, whose production potential depends upon the amount of land in use. When forced to sell land to pay the death tax, the farmer permanently loses long-term production potential and an investment in the land which can never be recouped. This is why the sale of partial assets almost always ultimately leads to the diminishing of the business or farm.

The final "option," to the extent that it can properly be described as one, is to sell the business. Many families who anticipate the death tax years in advance will sell early, in order to avoid the destructive consequences of selling at death and to get the best possible price. While this is never the preferable option, prudent families who do not want to be strapped with debt or the slow, unprofitable demise of their company, will sell while the business is strong and the owner is still alive. This enables the survivors to pay the death tax and continue their lives. It also means the end of a way of life, the end of a legacy, and always has consequences for the surrounding community.

Preserving Family Businesses and Farms, the Moral Implications

Family-owned businesses cannot be easily labeled according to a certain size or business model. A family-owned business ranges from the 500-acre farm to the 25-employee manufacturer to the 100,000 acre forest and lumber mill. The common strand running

through all of these businesses is that that they belong not to a large group of shareholders, but to an entrepreneur who usually diversifies their private holdings among family members. These businesses were almost always started with very little capital but with heavy sweat equity and a belief in the American dream. The entrepreneurs who built these businesses epitomize the core values of hard-work, delayed gratification, love for family, and care for their community.

To punish these individuals and their families through a confiscatory tax is to tell them that our nation does not value their hard work and achievements. It says that we really are a nation of consumers, who prefer that wealth be spent and consumed rather than diligently reinvested.

Family-owned businesses are the pillars of middle America. The owners of these businesses are the elders of their churches, the supervisors of their local school boards, the chairs of their Kiwanis clubs and coach of the little league softball team. Simply put, the family-owned business is a key bedrock of strong communities in America. Hence, when family-owned businesses disappear, the community is irrevocably changed for the worse.

II. A Response to Mr. Buffett's Testimony: Not your Mom and Pop's "Equality of Opportunity"

Mr. Buffett offered four specific arguments concerning the death tax.

(1) He objected to the use of the term "death tax," arguing that it is not accurate since many people who die do not pay the tax.

(2) He argued that the tax is necessary to preserve equality of opportunity, which he defined to mean equality of income.

(3) He proposed using the tax's revenues to address his concerns about wealth disparity, by instituting a redistributive entitlement program for low-income citizens.

(4) He suggested restructuring the tax to make it "less burdensome" for family-owned businesses and farms, by deferring the liability of the tax until the sale of the family business or farm. In this new model of death tax payment, the family would be forced to annually pay interest on each generation's death preceding sale of the businesses.

(1) "The term death tax." Mr. Buffett opened his remarks by questioning the semantics of the debate. He complained that the term "death tax" is intellectually dishonest and is in fact, "Orwellian." He argued that the death tax cannot be an accurate term due to the fact that many Americans don't pay it. Does this make the death tax somehow inaccurate for those who do pay it, and lose significant portions of their livelihood because of it? I have to ask Mr. Buffett, how is a tax which takes up to 55% of a person's wealth when the heart stops beating, not a death tax? When government charges a tax on the sale of an item, we call it a "sales tax." When government charges a tax on the earnings of an individual, we call it an "income tax." And when the government taxes us because our heart stops beating, we call it a "death tax." Finally, Mr. Buffett should know that the term "death tax" has been used by the legal profession since the 1930's.

(2) "The meaning of equality of opportunity." Mr. Buffett is not simply challenging the use of semantics; he is opposed to the very notions on which the debate is held. He charged that the lack of income equality in America is fundamentally at odds with the American ideal of "equality of opportunity," and that a death tax is necessary to restore a contrived egalitarianism to the American republic. The gross illogic of equating "equality of opportunity" with "equality of outcomes," or income disparity, is troubling enough. To suggest that government should confiscate wealth – a form of property – to rectify this perceived problem, entails a fundamental misunderstanding of basic logic, to say nothing of American political freedom.

Most Americans believe that America is a land of opportunity, in which all citizens have the freedom to work hard, increase their wealth, and pass it on to their family or anyone else. Foundational to this concept is our historical legal and philosophical protections for private property. It is understood that unless Americans are free to purchase, own, trade and bequeath property without fear of confiscation, the notion of "opportunity" is

meaningless. There was no "opportunity" in the Soviet Union, because without property, the lowest of citizens had no way to improve their economic condition.

Mr. Buffett wants to discuss "equality of opportunity" in a vacuum. He states that America must remain a country that prides itself on equality of opportunity, but suggests maintaining, if not increasing, the very tax which most hampers the opportunities of entrepreneurs and family-business owners. He wants to tell these families "you are free to pursue your dreams," while taking over half of their property, the fruit of their labors, right out from under them.

(3) "Income redistribution." Mr. Buffett moves another step away from the American dream, and demands that Big Brother redistribute family wealth in what can only be described as an "Orwellian" nightmare. Mr. Buffett suggests taking the revenue from the estate tax, and using it to give $1,000 to every household with $20,000 or less in annual income. In other words, Buffett wants to continue to plunder the property of family-owned businesses and use it to subsidize the less well-off. This is not the American dream, this is plain old redistribution of wealth.

(4) "The Warren Buffett Indentured Servitude Plan." Finally, in de facto recognition of its negative impact on family-owned businesses, Mr. Buffett suggested a strange "restructuring" of the death tax under the guise of minimizing its impact. In what I call the "Warren Buffett Indentured Servitude Plan," families would defer the death tax until the family chooses to sell the business or farm, instead of paying it at the death of the mom or dad. In the meantime, businesses would be forced to pay *annual interest* on each generation's death, on the full amount of the death tax liability. For the first death, the family would pay interest on 55% of the businesses assets. However, with the second generation's death, the family would additionally pay interest on half of what remains, or 22.5%, for a total of 77.5%. By the third generation's death, the family would pay interest on an additional 6%, for a total of 84%.

Obviously, in the event that the family could not pay the interest on the tax, it would be forced to sell. I have no doubt that one of the nation's most willing buyers of family owned businesses, Mr. Buffett himself, would only be more than willing to purchase these debt-strapped businesses. In reality, Mr. Buffett's proposal would substantially exacerbate the harm of the death tax, and likely destroy family businesses we know it.

What Mr. Buffett has proposed is effectively a means by which the federal government becomes a majority partner in all private businesses in America. Moreover, he has created a mechanism by which many family businesses – those which cannot make the interest payments – will be forced to sell. If there have been two generations of deaths in the family, then the federal government would own more than three quarters of the business or farm. If there have been three generations of deaths, then the government will have ownership over 80 percent.

Far from reducing the impact of the death tax on family-owned businesses, Mr. Buffett's proposal would make the death tax an even more onerous event for family-businesses and

farms. Under his proposal, upon the death of the owner, Big Brother would become a "silent partner" in the business without even having contributed a single dollar of capital. However, this partner would make no contribution to the businesses growth, while confiscating a majority of its wealth upon final sale. Having considerable experience in business, I have to ask the question, why should the moment of a person's final heartbeat make the federal government an instant partner in the family's business?

Mr. Buffett's proposals will not expand equality of opportunity, but will shatter the very foundation of the American dream for thousands of families. The death tax cannot be "restructured" in order to become less onerous for these families, and it should not be maintained in order to satiate Mr. Buffett's redistributionist tinkerings. Mr. Buffett's proposals do not bring a fresh approach to the death tax or to the justifications for which it exists. Rather, his comments show that despite the meaningful good which he can voluntarily do through his own wealth, he is more interested in using other families' wealth to toy with redistributionist schemes.

Members of the Senate Finance Committee, I urge you to reject the proposals of Mr. Buffett, and instead, end the burden of the death tax once and for all. Family business owners and farmers across America are depending on you.

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Before the
Senate Committee on Finance on
Federal Estate Tax: Uncertainty in Planning Under the Current Law
November 14, 2007

Observations on the Economics of the Death Tax

Mr. Chairman, members of the Committee. I formerly served on the staffs of two members of the Senate, and during my tenure, I had responsibilities for advising them on tax legislation. Subsequent to my work for those Senators, I worked as Vice President of the economic consulting firm of A. B. Laffer Associates. Since then, I have continued to work in the areas of public policy and particularly, of tax and economic policy. I am currently with the American Family Business Institute, a trade association of family-owned enterprises.

In my discussion of the need to repeal the death tax, I will touch upon three key factors:

- The real economic impact on small businesses
- The real impact on employment and the economy as a whole and on federal revenues
- Why the debate is skewed against repeal

The real economic impact on small businesses

In study after study, economists show that the death tax – a direct tax on capital – deprives the American economy of massive amounts of capital not simply because it confiscates capital, but because of the incentives the death tax gives to the destruction of capital and the misallocation of capital to less or non-productive areas.

The irony of a billionaire supporting the death tax, is that the super-rich are not affected in the same way or the same magnitude that the death tax affects small and medium-sized businesses. Compare the super-rich with a businessman or farmer who has focused on building an enterprise. The cost of reducing the liability of the death tax is marginally higher and may be prohibitive.

One choice faced by those who may be subject to the death tax is to have a lawyer/estate planner calculate likely liability. Perhaps an option is to spend a lot on life insurance to cover the likely IRS levy. That would, of course, take money out of the

business that would otherwise be used for reinvestment and growth. If the actuarial tables say that the odds of living a long time are not good, the cost of the insurance may be prohibitive and an entrepreneur might have to liquidate some or all of the business in preparation of the inevitable. That means a smaller business, fewer employees.

Or, perhaps the entrepreneur chooses to set up trusts, foundations, and other death tax avoidance programs. The same results: a smaller business, fewer jobs.

It is important to understand that while some American entrepreneurs do not take action to prepare for the death tax, the successful woman or man is not naïve. Just as people make out wills, she or he may have made an estate plan that cost real money but also reduces the size of a successful business in order to reduce death tax liability. In fact, simple logic shows that the vast majority of successful people do plan, which not only reduces their liability, but the absolute numbers of filings. In other words, when death tax advocates point out that few estates are affected by death tax, they ignore the vast resources that were devoted to cutting liability, the jobs destroyed and the dislocations caused. Indeed, one can affect one's liability under the death tax, but with significant, real effects to the economy. As former Chairman of the Council of Economic Advisors Martin Feldstein, has said, the death tax is "the optional tax."

When planning for the death tax, estate planners advise against selling appreciated assets because by passing on those assets, the surviving spouse gets a one-time step-up-in-basis. Another aspect is the fact that money consumed is not taxed away. In other words by lowering the value of an estate by consuming it you're lowering the death tax liability. Faced with either spending on a lavish vacation or seeing half of that money go to the tax collector, what choice will many people will make? What it means is that the death tax is a great incentive for spending now. Numerous other mechanisms are used – not because they make economic sense, but because the incentives posed by the death tax encourage them.

The cost of these avoidance maneuvers: hundreds of thousands of jobs per year. The Heritage Foundation estimates 250,000 new jobs per year are lost because of the death tax, and concomitantly there is the loss of economic growth and the creation of additional capital.

One of the economic distorting effects of the death tax is the fact that restructuring a $20 million fortune doesn't cost twice as much as a $10 million fortune. Thus, the super-rich spend a smaller percentage of their estates on planning. What that means is that the farmer or businessman who has a built a moderately successful enterprise valued over the exemption level is hurt by the death tax more than the very successful. He or she has to pay relatively much more to the lawyers and accountants to preserve the results of their sweat and ingenuity.

In sum, it is disingenuous to say that the death tax affects only a small number of people. It affects not only the hundreds of thousands who prepare for it; it affects the

hundreds of thousands of men and women who don't have jobs that would otherwise have been created. Because America is poorer because of the death tax, it affects us all.

The real impact on employment and the economy as a whole

The Heritage Foundation estimate of annual lost job creation (250,000) is cited above, but what also must be looked at is the overall level of wages in the economy. The American Council on Capital Formation estimates that our economy is roughly $1 trillion short of capital that would be in our economy were it not for the death tax.

That directly translates to lower wage levels. If political proponents of the death tax contend it has no adverse affects, they must address the universal understanding that less capital translates into lower wages. The study of Andrew Atkeson, V. V. Chari, and Patrick J. Kehoe, "Taxing Capitol Income: A Bad Idea" (Federal Reserve Bank of Minneapolis Quarterly Review Vol 23, No. 3) is only one of many examples.

Noted economist Steven Entin, President of the Institute for Research on the Economics of Taxation (IRET) estimates that the death tax reduces overall economic output by 1.1% per year. In our economy, that translates to $120 billion of foregone income. If our economy was richer by that sum, it is a fact that given the federal tax code (not counting the death tax), that federal income tax revenues would increase by approximately $35 billion: a sum far in excess of the revenues of the federal estate and gift taxes.

University of California Berkeley professor Douglas Bernheim, estimates that the death tax provides incentives of those that may be subject to the death tax to make gifts to potential heirs in a lower income tax bracket, thus lowering the tax liability of the income associated with those gifts. His estimate is that this reduces federal revenues by a sum in excess of the revenues from the death tax.

In a similar vein, in a 1999 study, economists Drs. Aldona and Gary Robbins show that the effects of the death tax destroy economic activity to such an extent that were that activity going on, it would generate tax revenues in excess of the revenues of the death tax.

Entin makes the point in his paper, "Kill the Death Tax" [url from the IRET site], that even if the above estimates are only half correct, that repeal would pay for itself overnight. If they are both right, repeal would increase federal revenues by $25 or so billion per year.

An August, 2007 study by the Chicago Federal Reserve Bank authored by Marco Cagetti and Mariacristina De Nardi estimates that the death tax results in a reduction of 1.3 % of GDP per year. In other words, repeal would generate added GDP, resulting in added tax liabilities and thus added federal revenues well in excess of any lost death tax revenues. (It should be noted that the variance between the Entin estimates and Cagetti/De Nardi estimates may be attributable to different definitions of output.)

The logical conclusion is that there is no economic rationale for the death tax. The remaining argument for the death tax is that even if it makes every American poorer, and it makes the federal government less rich, that it would somehow be socially "just" to penalize the successful creators of wealth and jobs even if the burden falls most harmfully on the job-holder.

Why the debate is skewed against repeal

Contemporary academic economic analysis seems to be banned on Capitol Hill – the major bill to repeal the death tax is estimated to result in reduced (not *increased*) revenues of $490 billion over ten years. The reason is that the estimators have a political agenda and choose to ignore the predominant economic literature as well as common sense.

The tragedy is that Congressional leaders agree to abide by this lie.

Thus, proponents of the death tax argue that repeal would "hurt the poor" or deprive any other group favored by federal programs.

And one of the defenders of the status quo is the lobbying group in Washington promoting life insurance companies, many of which sell policies that help pay the death tax for those subject to it. The head of the Life Insurance Council is a former Republican governor who when in office opposed the death tax. He is reportedly paid $1.6 million per year and has hired the wife of a Senator who is an avid supporter of the death tax. Her salary is reported to exceed $600,000.

Regardless of these ethical questions, the simple fact is that the life insurance industry lobbies for the death tax – against the interests of its customers. Why? Because of the premiums they get from those policies. One estimate in the year 2004 was $12 billion. Today, that would be in excess of $15 billion.

In other words, the life-insurance industry spends millions to keep a tax that hurts its customers and the economy.

Other supporters of keeping and/or raising the death tax are the more predictable advocacy groups of the left who are motivated by nineteenth century egalitarian ideologies. Other death tax fans are partisans of the late American philosopher, John Rawls, who posited a "fair" society. His views might charitably be regarded as lacking any relation to reality. (See Richard John Neuhaus' essay, in *First Things* magazine, "John Rawls and the Liberal Faith," for a discussion of Rawls' fallacies.) Like other utopians, his followers seem to ignore the real effects of incentives on the creation of wealth and a prosperous society.

Conclusion

Public Choice Theory tells us that politicians will tend to calculate tax changes in ways that will prejudice the outcome to favor more taxes. This school of looking at government also tells us that elected leaders can't ignore the will of the voters forever – the 67% of whom support full death tax repeal. The electorate and the weight of sound economics will eventually overcome.

There will continue to be "rent-seeking" industries that lobby to keep the death tax as long as they make money off of it. This includes not only the life insurance industry, but the estate planning businesses and "vulture capitalists" that seek to buy companies that must be sold at fire-sale prices to pay the death tax. But fortunately, their self-interest against the interests of the nation is becoming more and more apparent.

What is clear is that Americans at large understand the immorality of the death tax and see the clear logic of its repeal.

I urge the Committee to recognize these truths and adopt legislation which would repeal the federal estate tax – the death tax.

Statement of the American Farm Bureau Federation

Submitted for the Hearing Record

Federal Estate Tax: Uncertainty in Planning Under the Current Law

United States Senate Committee on Finance

November 14, 2007

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The American Farm Bureau Federation is a general farm organization with producer members who grow every commodity commercially marketed in this country. They do this on farm and ranch operations in 2,800 counties in all 50 states and Puerto Rico.

Representatives of state and county Farm Bureaus gather annually to discuss the organization's issue positions and to set priorities. Year after year, support for permanent estate tax repeal is reaffirmed, and year after year, it is the organization's top tax priority.

In recent years, however, realizing that intervening relief may be necessary, Farm Bureau members have decided that until permanent repeal is achieved, the exemption should be increased to $10 million a person and indexed to inflation; full stepped-up basis must be maintained; the gift-tax exemption should be increased to $20,000 and indexed; and there should be no limits on the amount that property values can be adjusted under IRS code section 2032A special use valuation.

Federal estate taxes have long been a concern to American farmers and ranchers because of the potential for the tax to force liquidation and hamper or prevent the intergenerational transfer of farm operations after the death of an owner. While other sectors of the economy have similar concerns, farmers and ranchers are particularly sensitive to the estate tax issue for several reasons. First and foremost, farm operations typically require substantially more in capital assets to generate $1 in income than other sectors of the economy. Hence, a more modest-sized farm operation can pay higher estate tax rates compared to non-farm businesses, even if the non-farm estate generated comparable income while its owners were alive. In addition to carrying a larger capital burden while operating and a high estate tax burden in death, the typical farm estate has more capital tied up in fixed assets that are difficult to liquidate. Hence, farm estates typically face greater difficulty making the death tax payment. As a result, roughly twice the number of farm estates paid federal estate taxes in the late 1990s compared to estates in general. Moreover, the average farm estate tax is also larger than the tax paid by most other estates.

This disparate estate tax burden has broadened over the last five years due to a combination of rising inflation in asset values and increasing scale economies forcing farmers to get bigger or get out of business. Appreciation in land values, increasing farm size and more mechanization have worked to increase the size of the average farm operation over time. Hence, farmers and ranchers typically bequeath larger businesses subject to sharply graduated tax rates that translate into big enough tax bills to disrupt larger-sized operations. In many cases, state estate taxes and the cost of complex estate management add to this federal tax burden.

Over time, Congress has included a number of provisions in the federal tax code to ease the burden of estate taxes. These include provisions applicable to all estates as well as provisions applicable only to farm estates. For example, a general unified credit is built into the law, allowing for a sizeable exemption before any tax is collected. In 2007, the exemption from the tax is set at $2 million. Special provisions applicable only to farms and other small businesses include items such as pricing land at its use value rather than

its generally higher market value and paying estate taxes over 14 years rather than over the nine months applicable to other estates. These special provisions have historically cut the number of farm estates paying taxes and the taxes they paid by roughly half, but often at the cost of investing considerable time and money in farm estate planning and administration.

Congress wisely moved in 1997 and 2001 to further ease and ultimately to eliminate the estate tax. Estate taxes are being phased down through 2009 and eliminated completely in 2010. Given their estate tax exposure, farmers and ranchers are a major beneficiary of the 1997 and 2001 initiatives. However, the 2001 legislation included sunset language that provides for the reinstatement of estate taxes (a reversion to the 2001 tax structure) in 2011. As a result of this lack of certainty in the law, the cost of estate planning has multiplied while the confidence that farmers place in their plans' ability to protect their farm and ranch businesses has diminished.

Reinstating estate taxes in 2011 would, in a single year, reverse a decade of declining farm estate taxes. The contrast between 2010 and 2011 is particularly marked. While the 2010 provisions set all estate taxes at zero, the 2011 provisions levy a 41 percent to 55 percent tax on the value of all farm estates in excess of $1 million. The special provisions in effect for farm estates in 2001 (special land valuation, extended payment, etc.) would also be in effect in 2011 and would help keep farm and ranch estate tax liability from increasing even more sharply.

Projecting USDA's farm financial indicators for the 1990s through 2011 provides insight into the impact of reversion on farms and ranches faced with estate taxes and the magnitude of the taxes owed. Assuming trend growth in farm numbers, assets, debts and equity, 13 percent of farm estates will have equity valued at more than $1 million by 2011. This 13 percent share liable for estate taxes in 2011 is more than triple the 4 percent share liable in the late 1990s when the current round of tax reforms began and the 0 percent liable in 2010.

This increased liability reflects rising farm values due to higher prices for land and machinery and growth in average farm size. The average value of land, one of the largest assets for farmers, appreciated 70 percent from 2003 to 2007. Effective estate planning is a time-intensive process that must begin long before an individual passes away. With that said, it can become difficult to conduct long-term estate planning in the face of the sudden appreciation of assets over a short period of time as has been the case with farm land over the past several years.

Since the sunset language makes no provision for adjusting the 2001 structure for intervening growth in farm values, larger farms and ranches face an even higher marginal tax rate on a larger taxable base. And more moderate-sized farms and ranches that would have fallen below the $1 million threshold in 2001 move above it in 2011. Tax liability in 2011 for the 13 percent of estates in question would be approximately $2.8 billion, compared to $700 million to 800 million in the late 1990s. This translates into an average 2011 tax of $1.2 million on an estate valued at $3.4 million or an effective tax rate of 35

percent. Again, this is higher than the late 1990s average rate of 20 percent to 22 percent because of the impact of rising estate values, the graduation of the tax rate and no offset for inflation.

Tables 1 and 2 provide summary statistics for the United States and selected states. The same pattern referred to above nationally is at work at the state level. Variations from state to state largely reflect differences in the capital intensity of a particular region's agriculture. In all cases, however, a reversion to the 2001 estate tax structure in 2011 would increase the estate tax burden sharply relative to the burden currently and, even more so, relative to the sharply declining burden through 2010.

Looking at the likely impact of the 2011 reinstatement of estate taxes on sample farms provides added insight into the widening tax burden in question. By 2011, a $1 million tax threshold would affect significantly more large- and moderate-sized farm operations than in the late 1990s when the impact was concentrated on the largest commercial farms. In the late 1990s, only 3 percent to 4 percent of small- to medium-sized farm estates owed estate tax compared to 10 percent to 17 percent of the largest estates. This burden expands considerably by 2011.

For example, as Table 2 indicates, the $1 million threshold would make a 420-acre corn/soybean farm and a 180-sow hog operation in Iowa liable to estate taxes in 2011, compared to an estate tax threshold of 650 acres and 270 sows in 2001. A 435-acre Arkansas rice farm, a 440-acre Louisiana cotton farm, a 1,050-acre Colorado wheat farm, a 300-acre Florida citrus farm, a 2,210-acre Montana wheat farm and a 105-acre New Jersey specialty crop farm would be liable for estate taxes in 2011. These 2011 thresholds compare to 680-acre, 685-acre, 1,625-acre, 460-acre, 3,420-acre, and 160-acre thresholds, respectively, in 2001. A 220-head dairy operation and a 285-acre vegetable operation in California would be liable in 2011 compared to 330 head and 440 acres in 2001. While all of these 2011 threshold operations would still be above average in size, they are moderate-sized operations when compared to the operations that produce the majority of food and fiber production in this country.

Looking at the tax due in 2011 relative to a farm's income also indicates how burdensome the tax could be and the potential for partial or full liquidation to disrupt intergenerational transfers. Estate taxes due on a moderately sized $2 million estate could be approximately $300,000. This would be the equivalent of more than 2.5 years of farm returns from both income and asset appreciation. For a larger operation with $4 million in equity, the tax liability could be roughly $1.5 million or the equivalent of six to seven years of income and appreciation.

The reinstatement of estate taxes in 2011 would translate into a wider range of medium and large farm estates owing more taxes in 2011 than in 2001 before the latest round of reforms began. With reversion in 2011, a projected 5,008 estates would owe $2.727 billion in federal estate taxes compared to the 1,219 estates owing $735 million in the late 1990s. While the average estate tax rate in the late 1990s was 20 percent to 22 percent for the operations owing the tax, the rate in 2010 would drop to zero before rising to 35

percent in 2011. A tax burden of this magnitude would be large enough to disrupt operations and exacerbate the problem of intergenerational transfers for an expanding circle of medium- to large-size farms. These are the farms and ranches that produce more than 80 percent of all agricultural production in the United States. When the estate tax disrupts these farms it disrupts a critical part of the U.S. economy and our future ability to maintain production of food and fiber.

For these reasons the American Farm Bureau Federation remains committed to the permanent repeal of estate taxes. Until permanent repeal is achieved Farm Bureau believes that the exemption should be increased to $10 million a person and be indexed to inflation; full stepped-up basis must be maintained; the gift tax exemption should be increased to $20,000 and indexed; and there should be no limits on the amount that property values can be adjusted under IRS code section 2032A special use valuation.

Table 1. U.S. Farm Death Tax Indicators

	Actual 1998	Estimated 2007	Projected 2011
Number Farm Operations	2,192,330	2,089,790	2,062,000
Number Farm Estates	31,161	36,870	39,000
Number Farm Estate Filing Death Taxes	5,394	2,385	16,770
Number Farm Estates Owing Death Taxes	1,219	1,054	5,008
Share of Farm Estates Owing Death Taxes	4 percent	3 percent	13 percent
Death Taxes Owed	$735 mil	$1.108 bil	$2.727 bil
Death Tax Owed as Share of Estate Value	21 percent	20 percent	35 percent

Table 2. Death Tax Thresholds for Sample Farms

Operation Type	2001 Tax	2011 Tax
Arkansas Rice	680 acres	435 acres
California Dairy	330 head	220 head
California Specialty	440 acres	285 acres
Iowa Corn/Soybean	650 acres	420 acres
Iowa Hog	270 sows	180 sows
Louisiana Cotton	685 acres	440 acres
Colorado Wheat	1,625 acres	1,050 acres
Florida Citrus	460 acres	300 acres
Montana Wheat	3,420 acres	2,210 acres
New Jersey Specialty	160 acres	105 acres

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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and Members of the Committee: I am honored to present testimony on why the Federal Estate Tax should be repealed.

The death tax, as the estate tax is more properly known, is the scourge of family-owned businesses in America. I know this all too well, having dealt with my father's death tax liability. Today American Pacific Corporation is thriving. Thirty-five years ago, the company was on the brink of being sold and consolidated into a larger corporation.

My father started Pacific Engineering & Production Co., predecessor to American Pacific Corp., in 1955 to produce material for rockets and missiles for the military. Over the course of the last 50 years, the company has grown and expanded to handling such diverse chemical applications as the commercial aerospace industry, anti-viral pharmaceuticals, and water treatment, just to name a few. Between our various operations, we employ more than 500 people, most of whom take advantage of our generous medical and retirement benefits.

Bringing our company to such a level of success was no easy task. My father was a driven and disciplined man, who understood the need to constantly reinvest in the company and take advantage of all sources of capital, including significant credit. This strategy kept us on the cutting edge, and allowed us to quickly build a reputation for high-quality chemical manufacturing. It also left us with very few options when it came time to pay my father's death tax liability.

The initial IRS assessment of our company would have invariably led to its sale. In response, we were forced to hire an attorney and challenge the assessment. Most business owners are not prepared for this ordeal. After months of negotiations and substantial legal

fees, we were able to reach a settlement which, while still confiscatory, we could likely pay. I know there are many other businesses who did not have the resources to challenge the IRS's assessment of their business, and who were forced to scale back their business or completely sell it in order to pay. My good fortune is the exception that proves the rule - the death tax is a dangerous burden for family-owned businesses.

In the aftermath of my father's death, we made the decision to take the company public. This would prevent the death tax from threatening the business in the future. While my family and I initially retained majority stake, today we own a minority of the total shares. On the one hand, I see this development as simply the lesser of two evils. On the other, it bothers me that my company is forced to sacrifice family ownership simply to preserve its longevity. My children will never have the type of creative ownership that my father and I had with the company.

I believe that the purpose of tax policy is to raise government revenue in the least damaging way possible. Tax policy should most certainly not lead to the erosion of family-owned businesses, discourage the capital accumulation that leads to new jobs and higher levels of prosperity, or cause misallocation of precious business resources. However, this is just what the death tax does to businesses throughout America.

For these reasons, I encourage the Senate Finance Committee to support legislation to permanently repeal the death tax.

Testimony Submitted for the Record

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"Federal Estate Tax: Uncertainty in Planning Under Current Law"
November 14, 2007

Chairman Baucus and Ranking Member Grassley:

Thank you for holding a hearing today on issues surrounding the federal estate tax, or the "death tax." Perhaps no area of federal taxation cries out for greater certainty. Certainly no area of the tax code causes so much economic distortion and raises so little tax revenue.

History of the Issue

The last decade has witnessed continued efforts by Congress to kill the death tax. On August 5, 1997, President Clinton signed H.R. 2014, the "Revenue Reconciliation Act of 1997." This bill raised the death tax exemption from $600,000 to $1,000,000 by 2006 ($1.3 million in the case of certain family-owned businesses).

On August 5, 1999, Congress passed H.R. 2488, the "Taxpayer Refund Act of 1999," which would have fully-repealed the death tax (as well as the gift tax and the generation-skipping transfer tax) by 2008. This bill was vetoed by President Clinton.

On July 14, 2000, Congress passed H.R. 8, the "Death Tax Elimination Act of 2000." This bill would have fully-repealed the death tax (as well as the gift tax and the generation-skipping transfer tax) by 2009. This bill was vetoed by President Clinton.

On June 7, 2001, President Bush signed H.R. 1836, the "Economic Growth and Tax Relief Reconciliation Act of 2001" (EGTRRA). This bill slowly-reduced the top death tax rate and increased the exclusion amount according to the following schedule:

	Top Death Tax Rate	Death Tax Exclusion Amt.
2001	55%	$675,000
2002	50%	$1,000,000
2003	49%	$1,000,000
2004	48%	$1,500,000
2005	47%	$1,500,000
2006	46%	$2,000,000
2007	45%	$2,000,000
2008	45%	$2,000,000
2009	45%	$3,500,000
2010	0%	N/A

Due to the rules of the Congressional Budget Act, the tax relief of EGTRRA expires beginning in 2011. At that time, the death tax rate reverts back to 55%, and the exemption level would revert to $1,000,000 (since the schedule of the Revenue Reconciliation Act would then be the controlling law.

Since the passage of EGTRRA, the United States Senate has attempted several times to make the death tax repeal permanent, a position that death tax proponents have chosen to delay via points of order and filibusters.

In June of 2002, the Senate considered and voted on amendments related to H.R. 8, the "Death Tax Elimination Act." While neither cloture nor final passage was voted upon, the lengthy consideration demonstrated the support present in the Senate for it.

On August 3, 2006, the U.S. Senate failed to invoke cloture on H.R. 5970, the "Estate Tax and Extension of Tax Relief Act of 2006." Nonetheless, 56 Senators expressed support for significant reductions in the death tax.

Revenue Impact

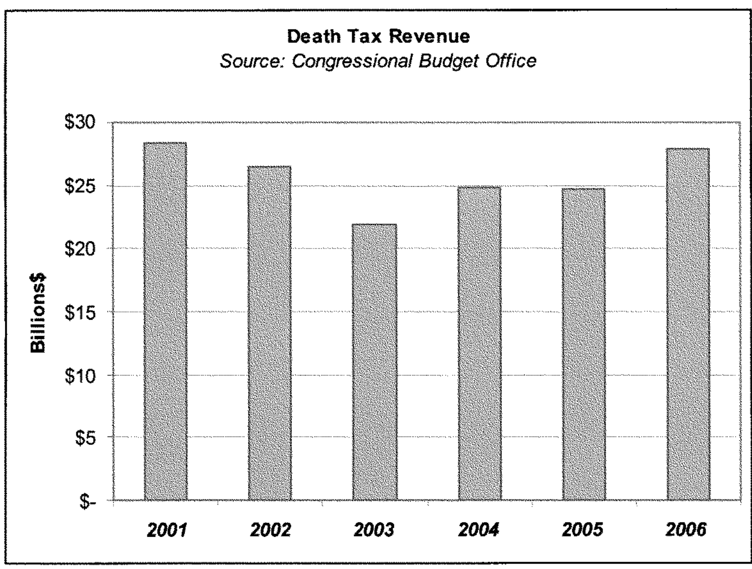
The Joint Committee on Taxation (JCT) has consistently scored death tax repeal as a massive revenue-loser.

On May 26, 2001, the JCT scored the death tax provisions of EGTRRA as costing $138 billion over the 2001-2010 period.

On July 28, 2006, the JCT scored the death tax provisions of H.R. 5970, the "Estate Tax and Extension of Tax Relief Act of 2006" as costing $268 billion over the 2007-2016 period.

However, it seems clear that there is, in fact, a great deal of gamesmanship by wealthy families to avoid paying the death tax. According to the Congressional Budget Office, tax revenue from estate and gift taxes have averaged only 0.3% of GDP from 1962-2006, a period where federal revenues averaged 18.2% of GDP. In other words, tax revenue from the estate and gift tax accounted for less than 2 cents out of every federal tax dollar.

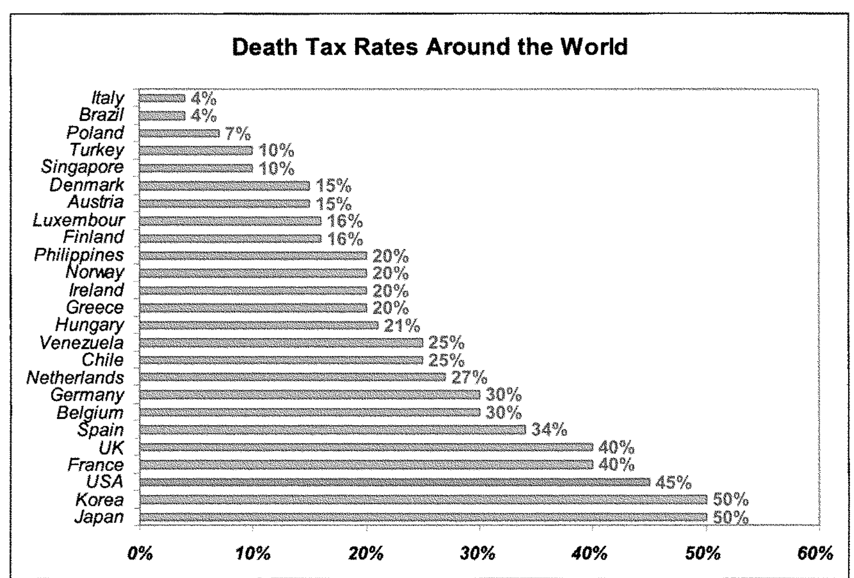
Additionally, revenues from the estate tax have remained relatively stable this decade, despite a ten-point reduction in the rate and a tripling of the exemption amount:



What this should tell policymakers is two things:

1. The ability to project revenues related to the death tax are an inexact science at best, and pure guesswork at worst.
2. Death tax revenues were never particularly-significant to federal revenues, though there are whole industries devoted to helping individuals avoid paying it (thus generating massive compliance costs).

This insignificant amount of revenue is collected using very high death tax rates, relative to an international comparison. The inverse correlation between the high rate and the low revenue is an excellent case study of the principle "tax something more, get less of it; tax something less, get more of it."



Source: American Council for Capital Formation

Solutions

To sum up the prior findings:

1. Congress has had a long history of wanting to cut and even eliminate the death tax.
2. The JCT's revenue scoring on estate tax repeal is unrealistic. In fact, estate tax revenues have been steady this decade, despite a declining rate and an increasing exemption amount.
3. Historically, death tax revenue has been a small and insignificant portion of federal tax revenues.
4. Estate tax lawyers, life insurance arrangements, and charitable schemes introduce tax avoidance costs. These in turn create opportunity costs that distort economic choices. Given the low amount of revenue collected by the death tax, it seems likely the foregone tax revenue from these distorted choices would exceed the actual amount collected by the death tax (see B. Douglas Bernheim, "Does the Estate Tax Raise Revenue?"in *Tax Policy and the Economy*, Vol. I, ed. Lawrence Summers (Cambridge, MA: MIT Press, 1987), pp. 113-138.
5. The U.S. death tax is the third highest in the industrialized world. This provides a strong incentive on the part of taxpayers to use inefficient economic choices simply to avoid the payment of tax.

Congress should, first and foremost, commit to the full and permanent repeal of the death tax. By that, I mean all three elements:

- The estate tax, which has dominated the conversation since EGTRRA
- The generation-skipping transfer tax
- The gift tax

Congress should also consider the simplification benefits of repealing Subtitle B of the Internal Revenue Code. First and foremost, taxpayers would be freed from having to deal with the life insurance industry, the charitable sector, and a host of legal counsels. This money could then be plowed into more economically-efficient endeavors, which would in turn throw off new tax revenue.

Secondly, the tax code would lose a full 96 sections totaling hundreds of pages. That does not include the hundreds of sections of Treasury Regulations totaling thousands of pages of text.

In order to repeal the full death tax, Congress would have to waive its current PAYGO rules. This should not serve as a large impediment to Congress. If historical levels of GDP growth and death tax revenues as a percent of GDP remain constant, the ten-year cost of repeal over the 2008-2017 period would be $568 billion.

While that seems like a significant revenue score, it pales in comparison to the $34.458 trillion in tax revenue that the federal government would collect if the historical average holds up.

Put simply, revenue from the death tax simply does not matter in the long run. Much of the revenue loss on the estate/gift/GST side is made up for on the capital gains side by the repeal of the step-up in basis of inherited assets.

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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee, it is an honor to present written testimony concerning the federal estate, or "death tax." I am a third generation timberland owner and forest products producer. My family's company, Anthony Timberlands, Inc. owns or manages 250,000 acres of timberland in the state of Arkansas, operates three lumber mills, a treating plant, and a laminating facility. We employ 750 full-time employees, plus hundreds of contractors. We are one of only two significant privately-held forest product companies in the state of Arkansas remaining where once there were twenty or more. My story is about how the death tax led to the demise of the other companies, and will lead to the ultimate sale of our company, if the tax is not repealed.

Anthony Timberlands was formed 100 years ago by my grandfather, Garland Anthony. He was a hard-worker and an innovative thinker. He introduced sustainable forestry techniques long before the concept became popular. While most forest operators of his era would clear-cut the land, he introduced the notion of only taking the mature trees so that the saplings and the younger trees could be preserved for later harvest. He initiated the practice of nurturing and protecting the forest, which remains our mantra to this day.

Because of his family's hard work, over time Anthony Timberlands became a successful enterprise and gained respect throughout the nation. Today, we proudly carry on his tradition of hard work, innovation, and sustainable forest practices. It is our hope to pass the company and its 250,000 acres of timberlands and mills down to a fourth generation, now in place as President of our company and then to the fifth generation now in college preparing for a leadership role in our industry. Unfortunately, our company faces the same obstacle to survivability that has led to the sale and consolidation of many other private timber companies – the death tax.

As with most other timber companies, Anthony Timberlands does not have large cash reserves or other liquid assets, we call that being "land poor." Although we have weathered the storm of paying huge death taxes with the passing of my father in 1961 at a young age and my grandfather in 1981 at age 97, when I die, or in anticipation of my death, it will be recognized that it will be impossible to pay the death tax yet again and have the company survive. No entity of consequence can survive when 50% of its assets are confiscated. Like all the other privately owned entities, my family will have no choice other than to seek a corporate buyer who, if the pattern seen so often repeats itself, will liquidate the forest we have grown and ultimately consolidate or close the mills. The employees of the company, the forest, and the local community, will never be the same once local ownership is removed.

Most timber companies are sold to one of the large corporations, such as Weyerhaeuser, Plum Creek or some institutional investor who does not have the long-term focus of a family owner. The wealth of the timberland base and mill, instead of being reinvested in the local region, is sent to the distant central headquarters. Once this happens, the mill communities begin to shrivel up and die. These corporate practices can be distinguished from those of the former local owners. Locally owned business and industry does not give up on its schools, churches, community or employees. Local industry does not outsource its production nor operate out of distant headquarters or bank in foreign cities. Those who own the local industry live and work in the towns where they operate, and support the same institutions as those who work in the plants.

The death tax is the driving force behind a trend we all despise. Rather than diverse and highly individualistic private business and industry, based in thousands of American towns and cities, we are seeing the basic fiber of our culture and society forced into the hands of a few multinational corporations. This is what the death tax does. I have seen local industry disappear time and time again with family-owned timberlands in Arkansas, and I fear that my family's company – and the communities where our families have long lived and worked – will be next.

By this time in my life I have paid a fortune in life-insurance with the hope that it would protect my business from sale in the event that the death tax has not been repealed. However, I recognize that my death tax liability will far exceed my life insurance. For all that Congress likes to pontificate about the importance of protecting small business, repealing the death tax is the best way to do something about it. Congress feels that

exempting $3-4 million in assets will save the family business. This is ludicrous when a substantial lumber mill has a cost of $40-50 million. A timberland base to support a mill might be valued at $100 million. A sudden tax liability of $50-$75 million is a death warrant for any private entity. Without repeal, in the fairly near term, there will be no privately owned industry of consequence left in America. Current tax policy mandates it. That is the simple fact of what the death tax does.

I ask the committee to quickly take up legislation to permanently repeal the death tax.

Statement of Associated Builders and Contractors

Senate Finance Committee

Hearing on Federal Estate Tax: Uncertainty in Planning Under Current Law

November 14, 2007

The Voice of the Merit Shop

4250 North Fairfax Drive
Arlington, Virginia 22203
(703) 812-2000

Dear Chairman Baucus and Ranking Member Grassley:

On behalf of Associated Builders and Contractors (ABC) and its more than 24,000 general contractors, subcontractors, material suppliers and construction related firms nationwide, I would like to thank you for holding this hearing focused on the burdens of the estate tax on America's small and family-owned businesses.

ABC has long supported the full and permanent repeal of the estate tax, and this issue remains a top priority for our members both large and small. Currently, more than 70 percent of all family-owned businesses do not survive through the second generation, and 87 percent do not make it to a third generation. Permanent repeal of the estate tax is also beneficial for employees. Should a business be forced to close its doors simply to pay this tax, valuable long-term employees are given pink-slips-- permanent repeal of the estate tax also means job security for workers.

In addition, repealing the estate tax would bring stability to family-owned construction businesses planning for the future. In 2006 the Small Business Administration estimated that 90 percent of all construction firms employed less than 20 people, representing nearly 10 percent of the entire small business economy. By repealing this tax, these small business owners are able to focus on the daily operations of their company and the creation of jobs, versus spending valuable resources paying this tax, further allowing millions of family-owned businesses the ability to thrive. Given that the construction industry added $648 billion to the U.S. gross domestic product (GDP) in 2006, a contribution that represents 5.6 percent of total GDP, maintaining this engine of prosperity is critical for our nation's economic well-being.

As you know, tax legislation enacted in 2001 gradually phases out the estate tax and ultimately repeals the tax in 2010. However, the tax will revert to even higher levels in 2011, unless additional legislation to make repeal permanent is passed. This uncertainty requires business owners to continue with estate-planning strategies that are costly, cumbersome and time consuming.

The estate tax is unfair, penalizes working families, and is a hindrance to the American dream. We look forward to working with you on this issue of great importance to America's construction industry.

Sincerely,

William B. Spencer

William Spencer
Vice President, Government Affairs

Cc: Senate Finance Committee

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Statement for the Record

John B. Byrd III
President
AMT – The Association For Manufacturing Technology

November 14, 2007

Senate Committee on Finance
Hearing

"Federal Estate Tax: Uncertainty in Planning Under the Current Law"

AMT – The Association For Manufacturing Technology represents more than 400 manufacturing technology companies throughout the United States – including nearly the entire universe of machine tool builders who operate in America. As AMT's president, I appreciate the opportunity to comment for the official hearing record on what the federal estate tax means to these businesses.

In two words, it means potential disaster.

Nearly all of our association members are small to mid-sized companies, and many are closely held and family owned. About three quarters of them, some 78 percent, have less than 50 employees. They are the modern descendants of one of America's earliest and most venerable trades – machine tools – whose predecessors have gone from the founding of our great nation through the Industrial Revolution to the age of modern technology.

But there is a difference between then and now: While America's first machine tool makers overcame English tax tyranny and thrived under the new Republic, our modern counterparts are struggling under complex and punitive American tax law amid an increasingly global marketplace.

And, for our family-owned machine tool companies, no American tax is more punitive in the long run than the federal estate tax.

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There is no need for me to reiterate at length all the arguments that have been made before this committee or others concerning the effects of the federal estate tax on small, family-owned American businesses. Individuals and organizations have pled that case for many years before the Congress.

But I would like to highlight some of my Association members' greatest concerns and thinking.

First and foremost, it is worth pointing out that the original intent of the tax was to prevent financial "dynasties" – the accumulation of wealth among relatively few families in America. And perhaps the tax made sense when it was first conceived. But today's reality is that the U.S. Tax Code has evolved into a complex, special-interest-laden set of laws that has provided the super-rich – at whom the estate tax originally was aimed – with numerous ways to avoid the estate tax altogether. Those "taxpayers" have the advantage of huge resources with which to hire attorneys and accountants to figure out how to structure and restructure their wealth to minimize and, in some cases, avoid taxes. They can reconfigure themselves, they can go offshore, they can purchase substantial life insurance policies to absorb the death tax liability, they can form tax-exempt "foundations" and put their children and families in charge of those "foundations" – thereby ensuring the continuation of their modern-day dynasties without the burden of the estate tax at all.

Most family-owned American companies, however, are not that wealthy – or lucky. They do not have those endless resources to help their heirs avoid a federal tax that can literally wipe out half the assets of their hard-worn labor and investment. And many of them certainly cannot afford significant life insurance premiums if they are trying to invest whatever resources they have into their businesses to build them up, keep them viable and competitive, and provide jobs.

Over the years, the Congress has tweaked the estate tax law to provide some shelter against the effects of this tax on family-owned businesses. But those tweaks, like nearly all other tax laws, are replete with rules and regulations that make them difficult-to-impossible to use. As a result, the federal estate tax represents, for many of these family businesses, a death knell if it is kept on the books and set by the Congress with a high tax rate and a low exemption.

I have no illusion that repealing the federal estate tax is politically possible now. Those who support it – or, at least, support the revenue it produces -- have turned it into a rhetorical war of rich versus poor. But I would make the plea, on behalf of all the small, family businesses that my Association represents, that the Congress at least lock into an

estate tax structure that will not destroy the ability of these American businesses to stay in business.

The 2001 law that reduced the tax rate and increased the exemption has provided some relief to the families of these businesses. Its scheduled repeal in 2010 is an even greater welcome. But as you know, that repeal will die at the end of 2010 and, with the new year, the federal estate tax will spring back to life in 2011 with all its pre-2001 destructive force.

On behalf of all of AMT's family-owned companies that represent the modern version of a very treasured American industry, I ask that you do not allow the federal estate tax to become the instrument that destroys them.

These companies represent an essential industry to America's manufacturing survival – be that manufacturing in automotive, aerospace, defense, public works or virtually any other sector. But theirs is a cyclical industry, in which price pressures are very strong and profitability relatively low – even in good years. Like others in America, these small and mid-sized companies are fighting to survive in a global marketplace against increasing, subsidized foreign competitors.

They can ill-afford a punishing tax levied by their own government – the successor of our Revolutionary forebearers – to be the reason they cannot survive that challenge.

Thank you for the opportunity to represent them here.

###

Donald T. "Boysie" Bollinger
CEO
Bollinger Shipyard
8365 Highway 308 South
Lockport, LA 70374

Statement for the Record to the:

U.S. Senate Finance Committee

November 14, 2007 hearing

Federal Estate Tax: Uncertainty in Planning Under the Current Law

Chairman Baucus, Ranking Member Grassley, and members of the Committee, I am honored to share with you today my outrage with the federal estate tax, or "death tax."

I am the CEO and a major owner of Bollinger Shipyards, a 2nd-generation shipbuilding and repair company which serves both military and commercial marine clients. Bollinger Shipyards was started by my father, Donald G. Bollinger, a man who had no college education and no capital. With the rudimentary knowledge of shipbuilding that he acquired from my grandfather, Donald G. Bollinger built his first shipyard and the beginnings of the company in 1946.

My father was guided by old-fashioned notions of integrity, hard-work and honesty – virtues that continue to guide our company today. He believed that the disciplined life is much more rewarding than profligate consumerism, and this guided his approach to business. Under his leadership, Bollinger Shipyards became an immensely successful enterprise and remains one of the last privately-held large shipyards in America. I have always had great confidence that the business would continue to remain strong and expand under the leadership of a third generation. That is, until I dealt with my father's death tax liability in the wake of his passing.

Because we reinvest our profits back into the business and have very low cash reserves, paying my father's death tax liability was no easy matter. If we had not constantly reinvested our profits and instead given ourselves larger dividends, it is unlikely that this would have ever been a problem. While we have plenty of capital invested in our operations, we cannot simply sell these assets without considerable damage to the business. These assets include our shipyards, the machinery which enables us to perform high-quality

construction and repairs, and of course, the 3,000 employees who make our company a success.

We quickly came to realize that the only way to keep the business and pay the tax was to liquidate my father's shares while he was still alive. We had already redeemed my mother's shares after her death. The effect on the company has been dramatic, as these redemptions were the first time that substantial shares have been liquidated at one time. Capital which has historically been available for reinvestment has been removed, leaving the company substantially weaker and less able to engage in profitable expansion. Additionally, my wife died at an early age and my young children inherited her stock with considerable taxes having to be paid out of insurance funds.

Having learned from my wife's, my mother's, and my father's experience with the death tax, my family and I are making considerable preparations for my estate. I have (placed) willed most of my company stock in a charitable trust, with the hope that it will keep my tax liability lower and reduce the need to sell assets. Of course, nothing is guaranteed, and I am still concerned that my family will not be able to hold the company together after my death. In the meantime, these complicated estate planning techniques have made it difficult to bequeath stock to my children and are tying up needed capital for the business.

Dealing with the death tax is a miserable way to go about business. I should be exploring new markets and expanding my business, not tooling with expensive accounting gimmicks to keep my business from becoming a liability when I die. When my children take over the business, I want them to realize the nobility of building a business the way my father and I did. The last thing I want them to have to deal with is the misery of preparing for and fighting the death tax.

Members of the Senate Finance Committee, please act on principle and support legislation to permanently repeal the death tax.

Statement of the Record with Respect to a Hearing Held on November 14, 2007

In the Senate Committee on Finance Regarding

"Federal Estate Tax: Uncertainty in Planning Under the Current Law"

GIFT TAX EXEMPTION SHOULD EQUAL ESTATE EXEMPTION

Present Law and Background

From 1976 to 2002, the gift and estate tax exemptions were unified through a credit mechanism. Legislative history to the Tax Reform Act of 1976 explains that, "Your committee believes that it would be more equitable if a unified credit ... were available on an equal basis without regard to whether the transfers are made only at death or are made both during lifetime and at death."

The Economic Growth and Tax Relief Reconciliation Act of 2001 provided gradual increases in the estate tax and generation skipping tax (GST) exemptions from 2002 through 2009, and a repeal of the estate tax for decedents dying in 2010. However, the gift tax exemption amount has been frozen at $1,000,000, thus breaking the unified nature of gift and estate tax exemptions.

Reasons for Change

The discontinuity between the exemption amounts applicable to taxable estates and taxable gifts creates a disincentive against lifetime, as opposed to testamentary, transfers. Discouraging lifetime gift giving has the effect of inhibiting succession planning of family-held businesses and concentrating wealth in certain, generally older, family members.

The stated rationale provided for retaining a low gift tax exemption relative to the rising (and, in the case of decedents dying in 2010, unlimited) estate tax exemption is to protect the base of the income tax. That is, without an applicable gift tax, the theory is that donors in a relatively high income tax bracket would have the ability to transfer assets with built-in gain (or income) to donees in a lower income tax bracket, who would realize such gain (or income) and then return the proceeds from the disposition of the property (or the property) to the donor. In addition, a different planning opportunity exists if, as in 2010, there is no applicable estate tax, but the basis of a significant amount of inherited property is determined with respect to the fair market value of the property

CAPITOL TAX PARTNERS, LLP
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(rather than the decedent's basis in the property). Without an applicable gift tax, a donor with an asset with built-in gain would have an incentive to "gift" such property to a donee with a short expected life span with the understanding that the property would be returned to the donor upon the donee's death, thereby avoiding recognition of the built-in gain.[1]

It is not clear that the theoretical concerns that led to the discontinuity between the estate and gift tax exemption amounts would be realized in practice. Although certain income-shifting planning opportunities may exist in some cases, the recognition of a significant amount of income would push the donee toward the higher tax bracket of the donor. With respect to basis step-up opportunities, many "donors" may be unwilling to part with assets based on the "promise" of a "donee" to return the property. However, to the extent these concerns exist despite the applicability of present-law income-shifting or step-transaction doctrines, this proposal addresses these concerns by allowing for lifetime transfers while inhibiting potentially abusive situations.

Description of Proposal

A donor would be allowed to increase his or her gift tax exemption (up to the amount of the applicable estate tax exemption) by an amount equal to the fair market value of property contributed to a "qualified gift trust." A qualified gift trust would be a new or existing trust that is allowed to accept contributions of property for which this additional gift tax exemption is allowed.

A qualified gift trust would resemble an electing small business trust described in sections 1361(e) and 641(c), except that the underlying property need not be S corporation stock and the qualified beneficiaries need not be so limited. Specifically, a qualified gift trust would be a trust (1) for which an election is made to be treated as a qualified gift trust; (2) that does not have as a beneficiary any person other than (a) an individual (other than a nonresident alien), (b) an estate (other than that of a nonresident alien), or (c) an organization described in section 170(c); (3) that no beneficial interest of which was acquired by purchase; and (4) that is not a disqualified trust. A disqualified trust would include any trust exempt from income tax, any foreign trust, any charitable remainder annuity trust, or any charitable remainder unitrust. The election would be made by the trustee and would apply to the taxable year of the trust for which it is made (and all gifts made within such taxable year) and all subsequent years (and gifts) until the election is revokes. Except as provided in regulations, the election may not be revoked until the earlier of December 31 of the calendar year (1) that is ten (10) years after the date of a qualified gift hereunder or (2) that is the year the donor dies.

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[1] This analysis assumes the absence of a rule similar to that of section 1014(e) or some other anti-abuse rule.

A qualified gift trust would be subject to tax on its income at the highest rate of tax applicable to individuals for the same type of income, including the rates provided in section 1(h). Income would not be carried out to beneficiaries and the trust would not be entitled under sections 651 or 661 to deduct any distributions made to non-charitable beneficiaries. Distributions of income or gain subject to tax at the qualifying trust level would not be includible in the income of the beneficiaries. Qualified gift trusts that are electing small business trusts would be subject to income tax rules applicable to such trusts under section 641(c).

Any property distributed to a beneficiary by a qualified gift trust before the election expires in excess of (1) the current and accumulated undistributed income of the trust (2) plus the value of any gifts contributed to the trust to which the increased gift tax exemption does not apply or during a time a valid qualified gift trust election was not in effect and (3) less the sum of prior distributions not taxable as gifts hereunder would be subject to a gift tax liability at the highest gift tax rate. Upon the expiration of the election, a qualified gift trust could elect to convert to a trust otherwise subject to the rules of subchapter J.

Except as otherwise provided by the proposal, the rules generally applicable to trusts under subchapter J would apply to qualified gift trusts. For example, distributions of property from a qualified gift trust would be subject to the gain recognition election of section 643(e) for income tax purposes.

The Secretary of the Treasury would be authorized to promulgate such rules with respect to the proposal, including rules regarding the treatment of trusts that revoke their elections (whether at the death of the donor or otherwise), information reporting for donors and trusts, and the means of collecting gift tax with respect to distributions from a qualified gift trust.

The proposal would be effective for gifts made after the date of enactment to a qualifying trust created before or after the date of enactment.

Analysis

The most direct ways to address concerns about the potential reduction of the income tax base by certain gifting transactions are changes to income tax rules or by general anti-abuse rules. However, to the extent that these rules cannot be sufficiently developed, the proposed qualified gift trust should address the same concerns without creating new opportunities to avoid tax or place administrative burdens on electing taxpayers. Moreover, the qualified gift trust will provide donors with the same treatment for lifetime gifts that they receive for testamentary gifts.

The qualified gift trust is modeled after the electing small business trust of subchapter S. The electing small business trust was developed in order to allow certain types of trusts (known as "sprinkle and spray" trusts) to qualify as subchapter S shareholders. A sprinkle and spray trust is a trust that provides the trustee with discretion to allocate income among a class of beneficiaries. The Federal income tax issues associated with allowing sprinkle and spray trusts are how to count the shareholders for purposes of the S corporation shareholder limit and whether the trust could be used to avoid tax. This latter issue is relevant for purposes of the current discussion. The income tax concern with a sprinkle and spray trust in the S corporation context was that it could be used as a tax shifting device by having the trustee allocate income earned by the S corporation to trust beneficiaries in low tax brackets while making distributions to beneficiaries in higher tax brackets.

The electing small business trust addressed this concern by having all income taxed at the trust level at the highest tax rate. Other income tax shifting or avoidance concerns were addressed by providing other limits regarding trust beneficiaries, how interest in the trust may be acquired, and limiting the types of trusts that can qualify for the election.

The qualified gift trust proposal adopts the electing small business trust regime for the same income shifting concerns. In addition, the qualified gift trust proposal provides that distributions during the donor's lifetime or ten (10) years from the last qualified gift, whichever first occurs, in excess of the current and accumulated undistributed income (plus the sum of gifts not affected by this provision and less distributions not affected by this provision) of the trust would be treated as a gift subject to the highest gift tax rate. This latter feature ensures that the trust cannot be used as a device to circumvent the original concern regarding income shifting.

Thus, the qualified gift trust proposal addresses the income tax concerns that gave rise to the dichotomy of the gift and estate tax exemption amounts in 2001. To address concerns of complexity, the proposal piggybacks a familiar existing structure -- the electing small business trust model, and provides that all other rules applicable to subchapter J trusts shall apply. In addition, the qualified gift trust proposal is elective, meaning that any increased compliance burden is taken on voluntarily.

Thank you for the opportunity to submit these comments. If you have any questions or comments regarding this issue, do not hesitate to contact Joseph M. Mikrut of Capitol Tax Partners at 202-289-8700.

11/14/2007

Richard L. Dees
24 7th Avenue
La Grange Illinois 60525

The Honorable Max S. Baucus
Chairman
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Sirs:

I am sorry to be unable to participate in today's Senate Finance committee hearing on estate tax uncertainty as I believe that a solution is possible, and that the two of you are the key to that solution. You have been stalwart in your efforts to obtain estate tax repeal, and when repeal was not possible, you have sought consensus on reform. Unfortunately your respective parties still consider estate tax reform a political game and business owners, farmers and ranchers their pawns.

I have represented farmers, ranchers and family business owners for my entire 27 years of practice. In the eighties and early nineties I worked with Congress and the administration to improve the estate tax on their behalf. I am stepping forward again in my personal capacity, not as the representative of any client, to offer the alternative estate tax compromise described in the attached white paper. Based on that experience, the compromise I support takes a different approach than previously proposed. An approach without the built in headlines of other compromises, but an approach that over the long-term will provide substantial and certain estate tax relief to business owners, farmers and ranchers with a reasonable estate tax revenue cost and in a responsible manner.

The most important priority for business owners is stability, which means that all estate tax relief and reforms should be immediately effective. On the other hand, both parties have made the highest possible estate tax exemption their first priority. As discussed in the White Paper, this results in an unacceptable revenue loss that leaves no room for making the estate tax fairer to business owners, farmers and ranchers. Rather than give wealthy individuals a free pass, the proposed compromise directs estate tax relief at small business owners, farmers and ranchers by expanding the special use valuation of farms and ranches and by allowing

more estate taxes attributable to business interests to be deferred at the favorable 2% interest rate.

Because the estate tax debate largely has been among politicians rather than tax policy experts, the debate has generally overlooked that the current stated 45% estate tax rate translates into a real 82% rate. The proposed compromise unifies the estate and gift tax and brings the estate tax down to its stated 45%. The compromise focuses on reducing this high estate tax rate, because thus far estate tax relief has produced a 6% higher federal estate tax rate, not a lower rate. Estate tax relief has been almost entirely directed at exempting more wealthy people from the estate tax, without regard to whether they own a business, ranch or farm.

An important part of the proposed compromise is making the estate tax fairer for business owners, farmers and ranchers by reforming Section 2036. That reform is more limited than I recently proposed in my three part article in Tax Notes (copies enclosed), hoping thereby to make the compromise less controversial. Part 1 of the article details how the courts have undermined Congressional intent to make the estate tax fairer to family business owners, while Congress has been distracted by estate tax repeal. If additional revenue is needed to make the proposed compromise immediately effective, Part 2 of the article proposes broader reforms that would make the estate tax fairer while also generating additional gift tax revenue.

No estate tax reform that includes revenue raisers directed only at those decedents who continue owe estate tax will be fair to family business owners, farmers and ranchers. These will increasingly make up a larger portion of those subject to estate tax. We should not be taxing these with the burden of continuing a family business more harshly to pay for lower estate tax rates (or no tax at all) for the wealthy. Rather, revenue raisers should provide for a fairer sharing of the estate tax burden.

Very truly yours

Richard L. Dees

cc. Eric K. Anderson, Esq.

The Transfer Tax Simplification and Family Business Fairness & Relief Act

By Richard L. Dees, La Grange, Illinois

Executive Summary

The debate over an estate tax compromise has devolved into an argument about slogans and numbers. Now that estate tax repeal is no longer an option, the primary focus of estate tax reform should be finding a compromise that will provide the greatest fairness for family business owners, farmers and ranchers at the least revenue cost. This paper proposes the following compromise:

- Make the federal estate tax deductible for federal estate tax purposes, thereby eliminating double death taxation and cutting the current **82%** estate tax to its stated 45% rate
- Maintain the current $2 million estate tax exemption and set the gift tax exemption equal to the estate tax exemption
- Rather than increase the estate tax exemption to $5 million, provide relief targeted to the estates of business owners, farmers and ranchers by increasing by $3 million (1) the amount of the value reduction under Section 2032A, (2) the amount of business value on which estate taxes can be deferred at a 2% interest rate under Section 6166 and (3) amend Section 2032A so that a farmer or rancher who enters into another business will not be disqualified from using special use valuation for the farm or ranch land
- Reform Section 2036 and similar estate tax provisions to provide fairness for family business owners by eliminating the higher estate tax that owners have to pay because they invested with family members rather than with strangers and allowing owners the flexibility to arrange their business succession plans as they choose without worrying that those plans could cause unexpected estate tax consequences shuttering their businesses
- Provide that the compromise will be fully effective on enactment

This compromise differs from other proposals in that they focus almost entirely on increasing the estate tax exemption. Because the revenue loss from increasing the estate tax exemption is so high, those proposals can only promise future estate tax relief, fail to provide greater fairness for family business owners, farmers and ranchers and are likely to lead to the enactment of "loophole closers" to bridge the revenue gap, which are likely to produce an estate tax that is less fair to the business owners, farmers and ranchers.

Discussion

Rather than merely promise future estate tax relief, the proposed compromise provides immediate relief. The compromise provides immediate relief by starting with current law with its $2 million estate tax exemption and 45% transfer tax rate. The perception that the estate tax is unfair comes more from the high estate tax rates, rather than from an exemption that is too small. Increasing the exemption puts a much greater burden on those who remain subject to the estate tax, and owners of small businesses expect that to eventually include them. No matter how small the business, the owners are unlikely to avoid the need for estate tax planning.

Eliminate Double Death Taxation. The stated 45% estate tax rate disguises a **real 82% estate tax rate**. Assume a decedent dies owning property valued at $10 million (without any estate tax exemption remaining), the estate tax will be $4.5 million (45%). "Estate" for federal estate tax purposes allows deductions for the decedent's debts, the expenses of estate administration, state death taxes and gifts to charities and spouses, but not for federal estate taxes. A more realistic definition of "estate" would exclude that portion of the decedent's assets confiscated by the government in the form of estate taxes. Defined this way, the estate would be $5.5 million, and the $4.5 million estate tax is **82%** ($4,500,000/$5,500,000).

Rather than simply cut the estate tax rate further from its current stated 45%, however, the proposed compromise would keep the same rate, but make the federal estate tax deductible, just as state death taxes now are deductible. By eliminating double death taxation, the effective estate tax rate would become about 31%. Although this deduction would lower effective estate tax rates, it would leave unchanged the gift tax rates. Gift taxes are already computed without also taxing the amount of gift tax paid ("tax-exclusive). On the other hand, the high estate tax rates have been disguised by charging an estate tax on the estate tax ("tax-inclusive"). The proposal would tax gifts and estates in the same common sense way – on the property the decedent or owner can actually give away, not the tax that has to be paid to do so.

Federal Estate Tax Rates Have Not Been Cut! One obstacle to cutting the estate tax rate is that many believe that the estate tax rate has been significantly cut already, but that is **not** true: only the treatment of state death taxes has been changed. For a decedent who dies in a state without a death tax, the estate's death tax rate has been cut by 10%, **but the federal government actually is collecting tax at a 6% higher rate**. The states bear the entire burden of the rate cuts. In those states that have enacted death taxes in response to the federal law change, the estate's total death tax rate has been cut only about 1%. Thus, the federal government is still taking an unfair share of the decedent's estate, 82% of the estate after taxes that the decedent can leave to heirs.

Unify and Simplify Transfer Taxes. This smarter rate cut will unify and simplify the transfer tax. Treasury and tax policy experts have sought unification since the Reagan administration. The compromise will complete this unification by setting the estate and gift tax exemptions equal to today's $2 million estate tax exemption.

Targeted Relief for Business Owners, Farmers and Ranchers. Rather than increase the estate tax exemption for everyone at an unaffordable cost, the proposed compromise provides specific targeted relief for businesses, farms and ranches similar to an increased exemption of $5 million. First, the proposal would increase the value reduction permitted farm and ranch land under Section 2032A by $3 million (the difference between the $2 million estate tax exemption under the proposal and a $5 million estate tax exemption). Next, although family business owners would not receive any additional estate tax cut, the proposal would allow the estate tax on an additional $3 million of estate tax value to be deferred for up to 15 years under Section 6166 at the favorable interest rate of 2%. This relief should allow the estate tax to be repaid from future business earnings, rather than a forced sale of business assets.

Finally, the proposal addresses a unique problem in rural areas. Because farmers and ranchers are often the most successful entrepreneurs in rural areas, they often diversify into local businesses such as banking, trucking and, most recently, bio-fuel production. Although these ag families continue to operate their farms and ranches, the values of their businesses can amount to more than half the estate, depriving those families of the opportunity to use Section 2032A. The proposal would count any trade or business interests of the decedent as defined in Section 6166 towards meeting the 50% of the estate qualified use test. However, only qualified real property (farm or ranch land) could be specially valued under Section 2032A.

Section 2036 Reform Will Make the Estate Tax Fairer to Family Business Owners. In 1990 in response to the concerns of the business community, Congress repealed Section 2036(c) that required estate inclusion as a result of certain family transactions and replaced estate inclusion with a set of special valuation rules for partnerships and corporations under Chapter 14. In decisions referred to by the name of the seminal case, *Strangi*, the courts nonetheless have applied Section 2036 to certain family investment partnerships where the decedent retained a substantial portion of the partnership interests until death. Although the *Strangi* decisions have been limited to atypical fact situations thus far, the Section 2036 rationale in those cases has no such limit and could be applied in the context of any family business or investment entity. The decisions are particularly concerning as they appear directed at minority and marketability discounts specifically approved by Congress when it enacted Chapter 14. The result is that those who invest with family members will pay significantly higher estate taxes that those who invest with strangers. These decisions are already putting a chill on business succession planning as owners and their advisers struggle to understand the limits of these decisions.

When Section 2036 can apply to a partnership or corporate interest, the final transfer tax consequences of a gift or other transaction cannot be known until death. Thus, the tax consequences of a business succession plan are never

settled until the owner's death when that section can apply. When the business owner, farmer or rancher dies, the IRS will look back at the period between the date of the gift and the date of death. Unless a lawyer polices every transaction in the business operation, the IRS might identify factors during the parent's life that suggest that the parent retained a prohibited control or interest (referred to as a "string"). The "strings" that result in estate tax under Section 2036 look a lot like the kind of control that a parent wants to maintain to ensure the business successfully passes to the next generation: voting control, how to divide the business between active and inactive heirs, how to divide the proceeds if the business is sold to fairly compensate the children active in the business, and perhaps a source of retirement income. Section 2036 most seriously affects those families with a concentrated ownership of the family business or farm, particularly those families with less wealth who cannot afford to cut the strings. When business owners engage in estate planning, it is the possible application of Section 2036 that prevents the parents from retaining the decision-making over the family business, or economic interests in the business, which they believe is necessary for the business's long term success or their financial future.

In addition to being subject to gift tax, the IRS argues that "strings" the parent might keep over a family business or investment entity means the same interests should be again taxed in the parent's estate, using date of death values. If the business has been successful, the IRS uses Section 2036 to argue for an estate tax on the higher value; if the business has failed, the IRS may go back and argue for a higher gift tax. Certainty demands that the IRS be able to look at a gift or business transaction only once: at the time it occurs, not years later when the owner dies.

In addition to providing that Section 2036 cannot apply to corporate or partnership entities, the reform of Section 2036 also would repeal Section 2036(b), which results in estate inclusion when a donor of stock in a controlled corporation retains the vote on that stock. Legislative history limits this provision to the use of trusts to retain the vote. In that legislative history and later in the legislative history of Chapter 14 Congress has repeatedly shown that it does not believe that a parent who retains control over a corporation or partnership when making gifts to descendants should have those gifted interests taxed in the parent's estate.

This reform of Section 2036 would provide the flexibility for business owners to shape their succession plans as they choose, without worrying that retained control or a retained interest would result in an unexpected and ruinous estate tax. No longer would business owners have to rely on contorted ownership schemes or trusts to avoid estate inclusion: the owners would be able to structure their affairs as appropriate for businesses of that type. Family business owners would enjoy the same freedom to operate their businesses as other owners.

Although the proposed reform would prevent the courts from applying Section 2036 to family partnerships and corporations, the reform would be unlikely to change the results in any of the *Strangi* cases. The courts chose not to apply transfer tax neutral valuation rules to reduce or eliminate the challenged valuation discounts, but rather required estate inclusion with its myriad of problems. For example, partnership interests are to be valued according to their real rights and restrictions; the courts are not bound by the paper ones. The willingness of the courts to disregard Chapter 14 and apply the anti-family business rules of Section 2036 leaves the reform of Section 2036 as the only option to protect family businesses from unfair and uncertain estate tax treatment.

The case can be made that "control" should not trigger estate inclusion in a trust any more than in a partnership or corporation; Congress has no desire to limit a parent from controlling a child's property. If retention of control did not result in estate inclusion, the gift tax rules could be revised to make any gift with retained control nonetheless complete and taxable for gift tax purposes. This reform would raise git tax revenue.

However, the gift tax revenue generated by adopting an easy to complete rule pales in comparison to the revenue that will be generated by eliminating the decade of transfer tax uncertainty. By putting fairness first, taxpayers who have delayed planning due to uncertainty will be able to plan, generating gift tax revenue that could be used to provide further estate tax relief, address revenue concerns and avoid the need for any "loophole closers."

tax analysts special report

Time Traveling to Strangle *Strangi* (And Kill the Monster Again), Part 1

By Richard L. Dees

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In part one of a two-part article, the author places the recent cases, such as *Strangi*, including some family limited partnership (FLP) interests in a partner's estate as part of the historic struggle between applying section 2036 to partnership and corporate interests and limiting its application to trust interests. Dees advances the novel argument that Congress resolved this question in 1990 when it enacted chapter 14 as a comprehensive statute addressing valuation issues with specific rules and rejected the estate inclusion approach of section 2036(c). Dees demonstrates that the *Strangi* cases create the same problems as section 2036(c), the Monster That Ate Estate Planning. As a result, the courts should never have applied section 2036 to partnership or corporate interests, and the author contends that it was a failure in drafting section 2704 in chapter 14 that led to the current section 2036 (Monster) Cases. Although chapter 14 should foreclose the application of section 2036 to partnership and corporate interests, Dees also considers other legal issues the courts have failed to address. Dees concludes by conceding that the unfavorable facts of the Monster Cases have led to those decisions. However, Dees offers an alternative test allowing the courts to reach nearly the same results without applying section 2036 or contradicting chapter 14.

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The plot has taken so many turns it has become a Gordian knot with no way out. The future looks dismal. But with a time machine — or Superman circling Earth faster than the speed of light — we can go back to where it all started to go wrong and fix it.

Oh, if only *Strangi*,[1] *Bongard*,[2] *Thompson*,[3] and those other cases applying section 2036 to family limited partnerships (FLPs) were a nightmare produced by overwork and bad food. Do-over anyone?

The courts in *Strangi* and the other section 2036 cases apparently were concerned about the valuation discounts

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[1] *Estate of Strangi v. Commissioner*, 115 T.C. 478, *Doc 2000-31014, 2000 TNT 232-12* (2000) (hereinafter *Strangi I*); 293 F.3d 279, *Doc 2002-14498, 2002 TNT 118-10* (5th Cir. 2002) (hereinafter *Strangi II*); 85 T.C.M. 1331, *Doc 2003-12584, 2003 TNT 98-16* (2003) (hereinafter *Strangi III*) (sometimes referred to by others as *Strangi II*); 293 F.2d 279, *Doc 2005-15234, 2005 TNT 137-12* (5th Cir. 2005) (hereinafter *Strangi IV*) (hereinafter collectively *Strangi*).

[2] 124 T.C. 95, *Doc 2005-5359, 2005 TNT 50-11* (2005).

[3] 382 F.3d 367, *Doc 2004-17577, 2004 TNT 171-8* (3d Cir. 2004) *aff'g* T.C. Memo. 2002-246.

claimed for partnership interests included in the decedent's estate. Rather than address the valuation issues directly, these decisions held that a portion of the partnership's investments were included in the decedent's estate, preventing any valuation discount. The result is that the courts are repeating the mistakes Congress made in enacting section 2036(c) in 1987. Many practitioners are willing to excuse the decisions in *Strangi* and other cases of its ilk as justified by bad facts and, therefore, limited to those facts. Section 2036(c), however, also began as a loophole closer directed at one specific business transaction: the preferred stock recapitalization. Yet by the very next year, 1988, section 2036(c) was being applied to nearly every business and estate planning transaction.

The breadth and vagueness of section 2036(c) prompted it to be named the "Monster That Ate Estate Planning, Installment Sales, Buy-Sells, Options, Employment Contracts and Leases."[4] By 1990, however, Congress had enacted chapter 14 of the tax code, rejecting estate inclusion in favor of special valuation rules for transfer tax purposes. Because *Strangi* and its ilk continue to apply the principles that Congress had rejected with the passage of chapter 14. These cases are referred to as the "Monster Cases." Nothing in the legal rationales of the various Monster Cases prevents the same principles from being applied to buy-sell agreements, leases, installment sale notes, and other business transactions. All one can say is that "it hasn't happened yet."

Just as quickly as section 2036(c) was expanded, Congress reversed itself, agreeing with critics that it was unfair to use an estate tax inclusion provision to solve what was a problem with valuing preferred stock for gift tax purposes. Chapter 14 repealed section 2036(c) retroactively and replaced it with a comprehensive set of valuation rules treating family members and nonfamily members alike under the transfer tax, unless special valuation rules were provided to address potential abuses.

The courts deciding the Monster Cases seem unaware that Congress had experimented with applying section 2036 to partnerships and corporations but soon decided that approach was problematic, limiting section 2036 to trusts. The courts repeat the computational problems with applying section 2036 to corporations and partnerships, which Congress and Treasury found impossible to fix. The Monster Cases are worse than section 2036(c) because Congress in the 1988 technical corrections act mitigated two of the worst aspects of estate inclusion — providing safe harbors for business owners who wanted to avoid its application and providing a fairer rule for treating consideration paid to the decedent.

However, the repeal of section 2036(c) and its replacement by chapter 14 is not merely a friendly object lesson on the perils of applying section 2036 to partnerships and corporations. Congress intended chapter 14 to be the exclusive transfer tax approach to difficult valuation questions presented by partnerships and corporations. If Congress has not provided special valuation rules under chapter 14, it intends for that to be the end of the matter. The courts are not authorized to treat partnerships and corporations like trusts and apply section 2036. Absurdity results when the courts disregard this congressional directive.

The courts are not authorized to treat partnerships and corporations like trusts and apply section 2036. Absurdity results when the courts disregard this congressional directive.

Not only have the Monster Cases failed to consider the impact of chapter 14 on their holdings, but they also disregard other legal authorities, which argue against applying section 2036. First, when section 2033 and another estate tax section can apply to the same interests, the estate tax favors inclusion under section 2033 rather than the other section, although the application of section 2033 might result in lower taxes. Second, the Monster Cases fail to properly limit their analysis to the decedent's retained rights when applying section 2036(a)(1) as required by the statute. Finally, the history of the phrase "possession and enjoyment" going back to an 1826 Pennsylvania statute requires a substantial retained interest rather than the limited rights to which the phrase has been applied under the Monster Cases. None of the Monster Cases appear to address these legal issues.

Congress does have a time machine, and in Part 2 of this article (to be published next week), we will consider how that time machine can be used to rescue taxpayers from the cyclical application of section 2036 to partnerships and corporations with all the problems discussed below. Moreover, the courts never had to resort to the use of section 2036 to reach the results they wanted in the Monster Cases. This article is not arguing that chapter 14 allows every lawyer with an FLP form to reduce clients' estate taxes by half. Rather, the article proposes a test that satisfies the requirements of chapter 14. Those principles could have been used to reach similar holdings in the Monster Cases without having to resort to estate inclusion with its many flaws.

As we can see from a flashback to 1972 and a study of the back story of section 2036, the Monster Cases are just part of the pendulum swing between its application only to trusts and its application also to corporations and partnerships, as detailed in the chart in the appendix.

Déjà Vu — The Scary Story of Section 2036

I. Retention of Voting Rights

A. The *Byrum* Case Sets the Stage

Understanding section 2036 requires starting with the IRS argument that a donor's retention of the vote over stock in a closely held corporation that has been given away results in the inclusion of the stock in the estate under section 2036. This theory was one of three the IRS

[4]Richard L. Dees, "Section 2036(c): The Monster That Ate Estate Planning, and Installment Sales, Buy-Sells, Options, Employment Contracts and Leases," 66 *Taxes* 876 (1988) (hereinafter Dees Monster Article).

pursued in the 1970s and 1980s to dramatically increase the estate taxes owed by family business owners.

The first theory reached the U.S. Supreme Court in 1972 in *United States v. Byrum*.[5] In that case, the decedent had given voting stock in a family company to a trust under which he continued to vote the stock. The original transfer of the stock was a completed gift, but the IRS argued that the value of the stock (which had appreciated substantially since the gift) should be included in the estate under section 2036. The IRS argued that the power to vote the stock allowed the decedent to select the board and officers of the corporation, thereby controlling the payment and timing of dividends within the purview of section 2036(a)(2). Also the IRS argued that retaining the vote of the stock was the equivalent of retaining the enjoyment of the stock within the purview of section 2036(a)(1).

The Supreme Court held that neither subsection of section 2036 applied and that the stock should not be included in the decedent's estate. The Court concluded that the powers to control the corporation through voting should not be considered the equivalent of the trustee-held powers to which section 2036 typically applied. The Court noted in an earlier decision that the power of the decedent as trustee to control the investments in a trust he created was not sufficient under section 2036 to include those trust assets in his estate.

The law in 1972 viewed the decision-making involved in operating a family partnership[6] or corporation that might affect family member owners differently than the decision-making of a trustee affecting trust beneficiaries, and *Byrum* reflected that view. This crucial distinction in section 2036 has been repeatedly erased only to be eventually restored. The Monster Cases are repeating this history as the pendulum has again swung to the application of section 2036 to partnerships.

B. The Anti-*Byrum* Legislation

In 1978 Congress accepted the Court's invitation and enacted section 2036(b), which treated the retained vote over a closely held company as the equivalent of the retention of the enjoyment of the property. One might assume that Congress had accepted the IRS argument that control over a family corporation was the equivalent of retaining distribution control over a trust. Congress in the legislative history, however, stated that section 2036(b) would not apply to a decedent who had given nonvoting stock to children while retaining all of the voting stock.

> **Example:** P wants to give P's wholly owned corporation to C, who is already running it. However, P believes that C may not appreciate P's importance to the success of the corporation, so P wants to retain control of the corporation until P's death. If P gives all of the corporation's stock to a trust of which P is trustee for C, P would pay a gift tax on the full value of the corporation. Because of section 2036(b), P's estate would also pay an estate tax on the appreciation in the value of the corporation between the gift and P's death. If P had a higher salary due to P's continued control, any money accumulating in P's estate would be subject to estate tax.

[5]408 U.S. 125 (1972).

[6]TAM 9131006 (Apr. 30, 1991) cited *Byrum* and applied it to an FLP.

P's lawyer, however, should tell P that using a trust was the wrong way of retaining control of the corporation. Rather, she should recommend that P recapitalize the corporation into voting and nonvoting stock with most of the corporation's economic value in the nonvoting stock. P gives away the nonvoting stock and pays a gift tax on its value. P keeps the voting stock until death. The voting stock, including its voting rights, is then subject to estate tax in P's estate under section 2033, but the nonvoting stock and most of the corporation's value is not included.

Congress had concluded that the same voting rights to control the corporation would result in section 2036 inclusion when the donor exercised those voting rights through a trust, but not when the donor exercised those rights through ordinary business means. The only possible justification anyone has ever offered for treating the same rights retention as different is that the value of voting rights retained by the donor as trustee would not have reduced the value of the gift to the trust, while the lack of a vote would have reduced the value of the nonvoting stock. When the donor died and the voting rights lapsed as trustee, however, the value of those rights would not be included in the donor's estate. But when the donor retains voting stock, the value of the voting rights is included in her estate as part of the value of the retained voting stock. Of course, the value of the business at the donor's death need not bear any relationship to the donor's retention of voting rights. The estate tax result would be the same whether the appreciated value of the business was due to the donor's continued control or the donee's efforts to build the business she now owned but did not control.

> ***Had the gift and estate tax been unified in 1978, Congress could have addressed the valuation issue more directly, with more certainty and with greater fairness.***

Congress in 1978 could have addressed the valuation issue more directly, with more certainty and with greater fairness. Congress could have valued P's retained voting rights at zero so that the full value of the corporation was subject to gift tax. When P died, the corporation would not be included in P's estate, but any increased salary or other benefits to P from retaining the control would be. Alternatively, Congress could have allowed P to subtract the value of the retained voting rights from the value of the corporation for gift tax purposes — that is, treat the voting stock as if it was nonvoting stock for valuation purposes. If that approach had been taken, the value of the retained voting rights would have been taxed in P's estate (the voting rights substitute for voting stock) when they lapsed (as under section 2704(a)).

Congress accepted the long-standing distinction between corporations and partnerships on one hand and trusts on the other. Congress identified the use of a trust for retaining voting control in a family company as possibly abusive, but it approved the use of traditional business techniques to pass on voting control even when the company was family owned. Business owners could still retain voting control by a more complicated means, assuming they were properly advised on the estate tax consequences.

II. 'Family Attribution'

A. The IRS Theory

The courts also frustrated the IRS when they tried to apply a second estate tax theory against family businesses: "family attribution." The IRS developed the family attribution theory to increase the estate taxes on owners of family businesses. It started from the proposition that the estate tax value of a corporation owned by one person was the estimated sales value of the corporation. One can see that with publicly traded stock: In a takeover the purchase price is sometimes twice as high as the aggregate of all stock at its trading value. Because an owner of publicly traded stock cannot force a sale, the reduction in the sales value to the publicly traded value represents the "minority interest" discount for the corporation. Publicly traded stock can easily be sold if an investor wants to change investments. If the identical shares are restricted from sale in the public market because of securities law restrictions, the shares would have significantly lower value. If the shares are nonmarketable, an investor is unable to realize the value of the shares quickly. The lower price that a purchaser of nonpublic stock will pay reflects a "lack of marketability" discount. Because a minority shareholder cannot force a sale or change in business operations and cannot easily sell the stock without a public market, another way to look at the discounted value is its "going concern" value.

Under its family attribution rule, the IRS treated the shares of individual family members as if they were all held by one person. If the corporation was wholly owned by the family, the value of each share represented a fraction of the corporation's value. Under this approach, the minority interest of a family member in a family company could be valued at twice the value of the same minority interest in a non-family-owned company. Obviously, if two identical interests can be taxed so differently under the family attribution rule, the rule is unfair to family members, particularly when family ownership makes it less likely the company would be sold.

B. Congress Rejects 'Family Attribution'

With the courts frustrating the IRS's attempts to impose the family attribution rule, in 1987 the IRS (through Treasury) approached Congress for statutory authority for its family attribution rule. The House passed a bill that initially contained a provision using the family attribution theory to deny discounts for minority interests in a family business and another provision, known as the antifreeze provision, to thwart the use of preferred stock recapitalizations. The Senate eventually rejected the family attribution rule, despite the House's offer to limit its application to property owned by a married couple. In exchange, the Senate accepted the antifreeze provision, which would become section 2036(c).

The decision of Congress to reject family attribution never resulted in statutory language enshrining that rejection, just as the legislative history to section 2036(b) permitting gifts of nonvoting stock was never included in legislation. However, after 1987 the family attribution rule no longer had any effect. As discussed below, section 2036(c) eventually was repealed and replaced by chapter 14 in 1990. The legislative history to chapter 14, however, repeatedly states that nothing in chapter 14 is intended to affect traditional minority and marketability discounts.[7] Until the decisions in the Monster Cases, both section 2036(c) and chapter 14 were interpreted as preserving the traditional valuation discounts at issue with FLPs.

C. Section 2036(c) Never Applied to FLPs

Statutory language was not required for the IRS and Congress to implement their decision to preserve minority and marketability discounts. A brief list should suffice to demonstrate the IRS's adherence to congressional policy. First, the regulations under section 2701 actually apply the family attribution rule as a starting point for valuing the company, but they provide that the value of equity interests must later be adjusted to reflect traditional discounts, thereby reversing the effect of the family attribution rule. Second, the literal language of section 2704(b) would have eliminated minority and lack of marketability discounts in wholly owned family companies and maybe others. Almost immediately after this glitch was discovered, Treasury and congressional staff agreed to interpret section 2704 narrowly so as to leave those discounts unaffected. For purposes of interpreting section 2704(b), at the very least, Congress's unwritten rule that traditional discounts were to be unaffected by chapter 14 — contained only in its legislative history — took priority over the actual statutory language. Finally, the IRS issued Rev. Rul. 93-12,[8] in which it conceded that family attribution would not be applied under the transfer tax. Congress never fully explained its reason for rejecting family attribution. However, in light of the other aspects of chapter 14, it is reasonable to conclude that Congress was persuaded that the family attribution rule was a form of unjustified transfer tax discrimination against family businesses.

III. Enactment of Section 2036(c)

A. The Preferred Recapitalization 'Abuse'

Although Congress rejected any limitation on traditional discounts, it did enact section 2036(c) to limit the abuses of preferred stock recapitalizations, which were often used as part of a succession plan for the retirement of the senior generation leadership of a family business.

[7] S. Stacy Eastland, "I.R.C. Section 2036 Defenses for the Family Limited Partnership Technique," State Bar of Texas, 31st Annual Advanced Estate Planning and Probate Planning, Chapter 18 (June 2007), at 25, collects the relevant legislative history.

[8] 1993-1 C.B. 201, *Doc 93-1173*, *93 TNT 19-15*.

Example of preferred recapitalization. Family Co. is valued at $20 million and is wholly owned by Parent P. P gives $2 million of common stock to Child C. Family Co. is recapitalized by giving P $18 million of face value preferred stock equal to the $18 million in common stock surrendered by P. The fair market value of C's common stock would be unchanged. Sometimes the preferred stock was noncumulative, meaning that unless the preferred dividend was declared and paid every year, P would forego her return.

The taxpayers and the IRS agreed that undervaluing the common stock P surrendered for preferred stock would result in an additional gift on audit equal to the excess. The IRS and taxpayers disagreed on how to value the preferred stock. Taxpayers used the retained control over the dividend policy of the corporation, and sometimes put, call, and conversion rights associated with the preferred stock, to argue that the preferred stock should be valued at its face value, even if preferred dividends were never paid. A similar theory used to claim that an interest-free loan was not a gift was rejected by the Supreme Court in *Dickman v. Commissioner*.[9]

In *Boykin Estate*[10] the Tax Court rejected the IRS's arguments. The IRS still had the option of arguing for a gift when it could establish that the preferred holder had failed to pay dividends or exercise rights in an arm's-length manner, but it declined to police these recapitalizations. The IRS and several commentators considered preferred stock recapitalizations abusive. Business owners, however, loved them. The preferred stock retained by the parents could keep the parents in control of the company, including its dividend policy. The preferred stock offered an annual opportunity to review whether the company could afford to pay a dividend on the preferred stock and whether the parents needed that dividend. Because the preferred stock was presumed to have its face value when the company was recapitalized, the parents had to pay gift tax only on the 10 percent to 20 percent of company value represented by the common stock, although the common stock would largely benefit from future appreciation. Also, the children could not demand dividends or the sale of the company allowing the parents continued control over the next generation's maturation process. Further, the preferred stock gave the parents security. If the company should falter, they and not their children would have first claim on the corporation's income and assets. When the parents died, the preferred stock was often valued at less than its face value, allowing substantial company value to escape transfer tax.

B. Section 2036(c) Closes the 'Loophole'

Turning from the importance of the provision in the 1987 House bill that never became law, we will consider the antifreeze provision that did. Because the antifreeze provision was directed at correcting a perceived abuse, the Senate was willing to accept it although it clearly was aimed at family businesses. The Senate turned the House bill into section 2036(c), which included the family business as part of the estate when its requirements were met. This testamentary approach was also the one Congress adopted when it extended section 2036 to retained voting rights in family corporations using section 2036(b).

Section 2036(c) drew immediate criticism for its vague language and inconsistency with existing transfer tax rules. The author's criticism was typical:[11]

> Section 2036(c) was enacted in 1987 to end estate freezes, because the IRS convinced Congress that it could not police the dividend nonpayment and the exercise or nonexercise of other rights. Rather than impose a gift tax solution to this gift tax problem, section 2036(c) imposed an estate tax solution which pulled back into P's estate all of the appreciation in the business. Section 2036(c) was developed without hearings or input from the business community. It ended all recaps whether legitimate or abusive. These were fundamental fallacies in section 2036(c).
>
> For the first time family members could deal with each other at arm's length and yet still have adverse estate tax consequences. This meant that shareholders of GM could engage in business transactions that owners of a GM dealership could not. It also meant that family member owners and nonfamily member owners of the same interests in the same businesses would be taxed differently for estate tax purposes. Family business owners were faced with an impossible choice — to continue engaging in normal business transactions and have section 2036(c) include in the owner's estate all of the appreciation in the business or to distort ordinary business transactions to avoid these potentially disastrous estate tax results. This discrimination against family businesses clearly was untenable.
>
> Section 2036(c) also contained concepts and terms which were incapable of explanation, such as "enterprise" and "disproportionate appreciation." Thus, almost immediately, section 2036(c) was extended beyond the targeted recapitalization — inappropriately and unfairly — to debt, employment agreements, leases, buy-sell agreements, and other common business arrangements involving family members. Thus, a statute directed at only a few business owners who utilized recaps suddenly affected all family business owners.
>
> The Technical and Miscellaneous Revenue Act of 1988 affirmed a broad application of section 2036(c). Rather than attempt to deal directly with the statute's fundamental fallacies, however, the 1988 act created a series of safe harbors for debt and certain other business arrangements. These safe harbors were arbitrary and ambiguous and thus offered

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[9] 465 U.S. 330 (1984).

[10] 53 T.C.M. 345 (1987).

[11] Dees, "The Slaying of Frankenstein's Monster: The Repeal and Replacement of Section 2036(c)," *Taxes*, Mar. 1991, p. 151 at pp. 152-153 (hereinafter Dees Slaying Article) (contemporaneous with statute); Eastland, *supra* note 7, at 20-28 (reviewing contemporary criticisms).

little relief from the draconian application of section 2036(c). Again the business community was not consulted on how the problems with section 2036(c) might be remedied.[12]

The enactment of section 2036(c) meant that Treasury and the IRS had finally achieved their objective of equating business and trust interests under the transfer tax, and they were determined to preserve section 2036(c) by addressing some of the criticisms. The primary focus of their efforts was in improving the statute in two ways. First, Congress enacted a series of safe harbors, which if complied with would except the transaction from section 2036(c). The safe harbors covered trusts, debt, annuities, loans, preferred stock, compensation arrangements, and leases. If the taxpayer followed the many technical rules under the safe harbors, they need not worry about estate inclusion. Although section 2036(c) applied to myriad business and estate planning transactions, family members were allowed only one way to do each transaction safely. Traditionally, it would have been sufficient to have an arrangement with arm's-length terms to escape any gift tax consequences. The safe harbors required arm's-length plus a whole series of technical requirements. If a business owner failed to comply with the requirements of the safe harbor, it would not matter whether the arrangement had the same terms as every other arms-length arrangement on Earth. As with the family attribution rule, the relationships between family members and nonfamily members could be exactly the same, but the transfer tax imposed on the family relationship could be many times greater.

The 1988 technical corrections applied to so many transactions and its rules were so vague that they contained the seeds of their own destruction.

Before 1987 one could escape the application of section 2036(a) and (b) by buying stock at its full FMV. A child could use an installment note to make the purchase if the note had a face value equal to market value and an interest rate at least as much as the applicable federal rates under section 7872. Section 2036(c) provided that paying full value was not enough. The appreciated value of stock would be included in the selling parent's estate unless the qualified debt safe harbor was satisfied. As originally drafted, only the face value of the note could be subtracted under section 2043 from the value of assets included in the estate, despite the payment having been made years before. Congress also realized that merely allowing a deduction for the amount paid for the stock was unfair. Thus, technical corrections created a pro rata consideration offset. If the amount paid was half the stock's value, only half the stock would be included in the estate. If the child paid the full FMV, the 1988 amendments would exclude the full value of the stock from the estate. Section 2036(c) also included a provision allowing an adjustment to avoid double taxation. Despite Congress's tinkering with section 2036(c) for three years, the most basic computational issues were never satisfactorily explained. For example, it was never quite clear whether section 2036(c) would include the note in the estate under section 2033 (as property in the estate) and the transferred stock under section 2036(c). The double tax adjustment seemed to work if the interest under the note was compounded, but not if interest payments were made.

IV. Chapter 14 Rejects Estate Inclusion

A. The Collaborative Process

The 1988 technical corrections applied to so many transactions and its rules were so vague that they contained the seeds of their own destruction. Congress quickly agreed with critics that it was unfair to use an estate tax inclusion provision to solve what was a problem with valuing preferred stock for gift tax purposes. Chapter 14 repealed section 2036(c) retroactively and replaced it with a comprehensive set of valuation rules treating family members and nonfamily members alike under the transfer tax, unless special valuation rules were provided to address potential abuses.

The reasons for Congress repealing section 2036(c) are clear:

> The Committee believes that an across-the-board [estate] inclusion rule is an inappropriate and unnecessary approach to the valuation problems associated with estate freezes. The committee believes that the amount of any tax on a gift should be determined at the time of the transfer and not upon the death of the transferor.... In developing a replacement for current section 2036(c) the Committee sought to accomplish several goals: (1) to provide a well defined and administrable set of rules; (2) to allow business owners who are not abusing the tax system to freely engage in standard intra-family transactions without being subject to severe transfer tax consequences; and (3) to deter abuse by making unfavorable assumptions regarding certain retained rights.[13]

Understanding the legislative history of chapter 14 can be a challenge because the statute went through five published iterations, many followed by public hearings addressing the drafts: the initial discussion draft;[14] the House bill;[15] the Senate bill;[16] the compromise bill,[17] reflecting the tentative agreement between the House

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[12]Dees Slaying Article at 152 (footnotes omitted).

[13]Senate Report, *Congressional Record*, vol. 136, p. 15679 (Oct. 18, 1990).

[14]House Ways and Means Committee Press Release No. 28 (Mar. 22, 1990).

[15]H.R. 5425, introduced by Rep. Rostenkowski, Aug. 1, 1990.

[16]S. 3113, introduced by Sens. Bentsen, Boren, and Daschle, Sept. 26, 1990.

[17]Sections 7209 and 7210 of the omnibus reconciliation bill passed by the Senate, so called because the Senate Finance Committee version reflected a tentative agreement with the House staff.

and Senate; and finally, the conference agreement,[18] which was part of the Revenue Reconciliation Act of 1990. Each iteration of chapter 14 could reflect a hearing with hundreds of pages of testimony shaping the next iteration.

Treasury stated late in 1989 that the replacement for section 2036(c) would be based on valuation rules and would not use section 2036 to tax freezes in the taxpayer's estate. Treasury was convinced that "a gift tax solution, rather than an estate tax solution, was needed for a gift tax problem." By then even Treasury appreciated the unfairness and uncertainty that results when section 2036 is applied to property transferred years earlier.

However, Treasury still wanted the new special valuation rules to apply to debts and leases as if they were equity. Family buy-sell agreements would receive the same estate inclusion treatment as under section 2036(c). By the time the discussion draft first appeared in 1990, the business groups agreed that their goal would be to ensure that Congress clearly recognized that family partnerships and corporations should be treated no differently than nonfamily businesses. Obtaining this objective, however, would require reversing the approaches of the early drafts. The business groups largely succeeded in this effort to shape chapter 14.

First, the discussion draft originally presumed that the equity interests retained by the parents in the partnership or corporation (or trust) would have no value unless they fit within certain parameters. The final version of section 2701 rejected the notion that all family-held rights should be suspect under the estate tax; rather, it reversed the assumption and treated all family-held rights as having a market value unless they were specifically identified as potentially abusive. Section 2701 specifically identified certain specific equity rights retained by the parent in preferred that would be valued at zero in determining the value of a gift of common to a child. The parent could avoid a zero valuation by agreeing to a special regime of estate and gift taxation designed to ensure that the preferred would always be valued according to the valuation assumptions used when the gift was made.

Second, the original discussion draft provided a single valuation provision for partnerships, corporations, and trusts. Recognizing that partnerships and corporations are inherently different from trusts under the transfer tax, section 2701 was limited to partnerships and corporations and section 2702 was limited to trusts. Congress reaffirmed that partnerships and corporations were not trusts.

Third, the final version of section 2701 was limited to preferred equity interests and did not apply to debt, leases, compensation agreements, and other arrangements with fixed payment terms. Section 2701 would exclude preferred equity if its payments were fixed in time and amount. Section 2701 was needed only because dividend rights and put, call, conversion, and liquidation rights were discretionary. Section 2701 was designed to ensure that the assumptions about the exercise of discretion were consistently applied both when the preferred was valued and when the rights were exercised. Congress required only that family arrangements evidence arm's-length terms, except when chapter 14 required the use of a special valuation rule.

Finally, Treasury's expectation of continuing a section 2036(c)-type rule for options and buy-sell agreements was ultimately frustrated by the enactment of section 2703 as part of chapter 14. Section 2703 did provide a broad rule disregarding some option and buy-sell arrangements among family members, but it provided almost an equally broad exception for family-business-agreement-contained terms comparable to those in arm's-length arrangements.

B. The Uncollaborative Process

1. Section 2704: For want of a nail.... Unlike the open and transparent process with repeated drafts and multiple hearings that produced sections 2701, 2702, and 2703, section 2704 was produced by a closed process that excluded all of the nongovernment technical experts who had helped develop the chapter 14 compromise.

> **Author's Note:**[19] All of us are familiar with the literary "lost nail" that caused the horse's loss and, ultimately, through a chain of events, the loss of the war. That lost nail was section 2704(b), the last subsection of chapter 14, designed to address the potential for abuse of FLPs. When the statutory language for section 2704(b) was released, I was in Washington to celebrate the end of the two-year ordeal that resulted in the repeal of section 2036(c) and its replacement by chapter 14. Within five minutes of reading section 2704(b), I foresaw a repeat of that ordeal — focused this time on section 2704 — as we sought to fix its problems in technical corrections.
>
> Read literally, section 2704(b) had revived the family attribution rule, at least for 100 percent owned family entities, despite the agreement to end that rule. The government quickly proposed a narrow interpretation of section 2704(b) largely consistent with the rest of chapter 14. Because the drafters of section 2704(b) misunderstood state partnership law, ironically, the narrow test failed to limit partnership planning in the way they expected.
>
> Had the technical experts had the opportunity to review section 2704 before enactment, these mistakes would never have been made. The sides would have worked out a compromise that would have clearly addressed the government's concerns, or Congress would have dismissed those concerns. Having just rejected estate inclusion, unlike the Monster Cases, Congress would have chosen any solution but estate inclusion.

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[18]Chapter 14 enacted as part of the Revenue Reconciliation Act of 1990 (hereinafter RRA '90) (section 11602 of RRA '90).

[19]The author was retained as a technical expert for the Coalition to Repeal Section 2036(c) after the publication of the Monster Article and appeared as an invited witness at the first hearing on section 2036(c).

I believe that the failure to address these issues under section 2704 led to the abuses of FLPs, and those abuses led to the courts' inappropriate application of section 2036. For want of a timely five-minute review, it is possible that the government and taxpayers have spent millions of dollars litigating the Monster Cases, the courts have spent thousands of hours deciding that litigation, and lawyers and accountants have published tens of millions of pages to explain that they do not know precisely what the section 2036(a) cases mean (or perhaps worse, that they do) and then charged clients tens of millions of dollars to fix up their plans to avoid litigation. Only time travel can reverse this failure.

Section 2704(b) provides that an applicable restriction shall be disregarded in determining the value of the transferred interest (for transfer tax purposes).[20] Section 2704(b)(2) defines an applicable restriction as any restriction that:

> effectively limits the ability of the corporation or partnership to liquidate, and
>
> with respect to which either of the following applies:
>
> > The restriction lapses, in whole or in part, after the transfer referred to in paragraph (1).
> >
> > The transferor or any member of the transferor's family, either alone or collectively, has the right after such transfer to remove, in whole or in part, the restriction.

2. Short-lived reinstatement of family attribution. If a partnership or corporation was wholly owned by a family, the family could liquidate the entity, effectively removing any limitation on liquidating.[21] Liquidation would effectively eliminate any "traditional" discounts contrary to the legislative history of chapter 14. So section 2704(b) reinstated a family attribution rule at least as to wholly owned family companies.

However, section 2704(b) also provided a planning opportunity. Section 2704(b) as written did not require that the nonfamily member have a specific minimum ownership to block the removal of the restriction provided under state law. Apparently, any ownership interest could be sufficient, provided the partnership agreement allowed that percentage ownership to block the removal of a liquidation restriction. As a result, some advisers began recommending nonfamily ownership, often by a charity, to take advantage of this exception.

3. The ultimate unimportance of section 2704:

a. The default law test. The narrowed test offered by the government would treat as an applicable restriction only a limitation on liquidation more restrictive than the default provisions of state law which would apply in the absence of the restriction. The government could argue that the partnership restrictions that were more restrictive than state law were "bells and whistles" added to the agreement, which could be disregarded consistently with the other provisions in chapter 14. That narrowed test, however, was not entirely consistent with the intent of chapter 14 to provide neutral transfer tax valuation rules for family corporations and partnerships; after all, nonfamily members seldom draft their partnerships by simply following the state law provisions that would apply in the absence of any agreement. Although state law provides default provisions that control if the partnership agreement is silent, partnership agreement provisions that vary or add to the default[22] provisions generally are given effect. Family members should have similar freedom.

b. What state law? Some commentators argue that the way around any local state law problem under section 2704(b) is to find a state with favorable partnership law and use that state's laws to form the limited partnership. The author believes that a court is more likely to reject non-arm's-length forum shopping for favorable transfer tax results than provisions inserted for legitimate business reasons. Thus, the author would rather use Delaware law than some other state's laws with no connection to the transaction and run the risk that the IRS may argue that a term in a partnership or a provision is an applicable restriction. Nonetheless, states have outbid each other to change their laws in a way that will attract more family entities to pay to be established there.

Treasury apparently intended to tackle the issue of state law in its section 2704 regulations. Reg. section 25.2704-2(b) provides: "see [section] 25.2704-1(c)(1)(B) for a discussion of 'State law.'" The cited regulation does not actually exist.

c. The basic fallacy of the narrowed section 2704(b) test. The question of which state law should apply, however, turns out not to be that important. Most states have the Revised Uniform Limited Partnership Act (RULPA) and similar provisions on withdrawal and liquidation.[23] The default provisions of limited partnership law in nearly every state provide that a general or limited partner may not transfer (or cash in on) the value of the management rights associated with that partner's interest.

Under state law, for example, a general partner can always withdraw from the partnership so as to limit the general partner's liability for the partnership's debts. Such a withdrawal might be a breach of the partnership agreement, however, for which damages would be due. Nonetheless, under section 2704(b), a partnership agreement provision limiting withdrawal or charging damages would be ignored for purposes of valuing the general partner's partnership interests. Similarly, a provision converting a general partner to a limited partner on

[20] Because section 2704 does not require a transferee, it appears section 2704 may not apply for all generation-skipping tax purposes.

[21] The company would not have to be wholly owned by the family if the family held sufficient interests to liquidate the entity. For example, a Delaware limited liability company will liquidate with a two-thirds vote.

[22] Reg. section 25.2704-1(c)(2)(i)(B) implements this narrowed test.

[23] The statute refers to restrictions on the ability of an entity to liquidate, but the statute is generally applied as to the ability of an owner to liquidate her interest in the entity.

withdrawal would be an addition to the default provisions of most state laws. Under most state statutes, general partners are entitled to be paid for their partnership interests on withdrawal. However, if the partnership is structured as a limited partnership at the outset, the partner can be both a limited and a general partner.

Is drafting the partnership with a set term the creation of a liquidation restriction prohibited under section 2704(b) in a state with RULPA?

As to the general partner interests, the state law ordinarily requires that the interests of the general partner also be purchased at the fair value of the distribution rights attributable to the general partner interests.[24] As to any limited partner interests the general partner owns, state law default provisions that limit a limited partner from withdrawing would apply. RULPA section 17-603 restricts a limited partner from withdrawing from a limited partnership. With a set term, the limited partner may not withdraw before dissolution of the partnership. Without a set term, six months notice is required. Delaware has amended its statute to prohibit withdrawals entirely.[25] Furthermore, Del. RULPA section 17-801 provides that any specified percentage can continue the partnership after a dissolution event or, if no percentage is specified in the agreement, a vote of more than 50 percent.

Is drafting the partnership with a set term the creation of a liquidation restriction prohibited under section 2704(b) in a state with RULPA? Commentator S. Stacy Eastland argues persuasively that putting a fixed term on a partnership cannot be considered a restriction on liquidation; rather, it is a limitation on *not* liquidating.[26] LTR 9842003 states that the term is a liquidation restriction because it restricts the partner from liquidating his interest. Another important state law provision that needs to be in the partnership agreement, however, cannot be so easily distinguished on a linguistic basis from a liquidation restriction. Del. RULPA section 17-801(3) provides that the withdrawal of a general partner from the partnership will dissolve the limited partnership unless the agreement provides that the remaining general partners can continue the partnership. This provision makes partnership liquidation less likely. Does that make the provision a liquidation restriction under section 2704(b)? No authority exists, and unlike other arguments, the IRS has not raised this one.

The legislative history of chapter 14 indicates that the drafters of section 2704(b) understood that both the Revised Uniform Partnership Act (RUPA) and RULPA provided a general partner with the right to withdraw and be paid the *FMV* of his interest. However, the statutes actually provide that the buyout price is "an amount equal to the fair value of such partner's economic interest as of the date of disassociation based upon *such partner's right to share in distributions* from the partnership" (emphasis added).[27]

The general partner in a limited partnership has no more right to transfer or receive the value of the general partner's management rights than a limited partner. Because the default limited partnership provisions in nearly every state restricts a partner from transferring management rights, including the right to sell and distribute partnership assets, section 2704(b) would have no effect on partnership valuation once its narrow interpretation was adopted, nor should it. When unrelated people create a limited partnership, they are generally committing to the continuation of its business, not to the sale of its assets and liquidation. This reason for using a partnership is so strong that the default provisions of most state laws require this result. Partnership interests should be valued based on future distributions from the partnership, a going concern value, rather than on a value tied to what a partner would receive if the partnership sold its assets and liquidated. Chapter 14 requires that the transfer tax valuation of a partnership interest not change merely because the partners are related to each other.

Living Under Chapter 14

I. Estate Planners Develop the FLP

Because chapter 14 provided a specific set of valuation rules for family partnerships, corporations, and trusts to replace the ambiguous concepts of section 2036(c), practitioners were confident they understood how to plan for their clients. Because chapter 14 had restored the differences between corporations and partnerships on one hand, and trusts on the other, practitioners were confident that families could use the partnership for investing together without the worry that the appreciation in partnership assets would later be dragged back into the estate under section 2036.

An FLP was an attractive vehicle for educating young family members on investing and managing family assets. Because of the restrictions under state law, the recipient of an interest in an FLP could not turn the interest into cash to fund a lavish lifestyle. The FLP interest protected against the claims of creditors and divorcing spouses. By pooling financial assets, the family could reduce risk, diversify more easily, and obtain better investment advice at better rates. Because the FLP was a partnership and not a trust, the parents were able to decide whether to reinvest income or distribute it to the

[24]*See* Del. RULPA section 17-604.

[25]*See* Del. RULPA section 17-603, now providing that no limited partner may withdraw unless provided otherwise in the partnership agreement, and providing that a partnership agreement may prohibit assignments. This change applies to partnerships filing limited partnership certificates after July 31, 1996.

[26]Eastland, "Family Limited Partnerships," *Probate & Property* 59, 61 (July/Aug. 1993).

[27]Del. RUPA section 15-701(b). *Compare* Conf. Agreement: "Under the Uniform Partnership Act . . . if the decedent had waived in the partnership agreement the right to be redeemed at *fair market value* under that Act." (Emphasis added.)

partners. Usually the parents continued to make investment decisions, but the parents could have retained investment and management rights in a trust without section 2036(a) including the trust assets in a parent's estate.

These benefits of an FLP would be enough for some; for others, the attraction would be that the value of their partnership interests would be less than the value of the assets they would contribute to the partnership. As discussed above, a partnership is a long-term commitment to jointly invest or operate a business (including an investment business). Because of that commitment, the valuation of partnership interests initially is usually less than the value of the assets contributed. The contributing partner has given up the right to sell the assets and enjoy the proceeds in exchange for the right to participate in future partnership distributions. The immediate loss in value is not imaginary.

The Monster Cases seem oblivious to the ability of the decedents and their families to choose other means of estate tax reduction.

The Monster Cases seem oblivious to the ability of the decedents and their families to choose other means of estate tax reduction. Not in every case, but in many cases, the FLP was chosen over possible estate tax savings devices because it reflected the family's value of investing together for the long-term over current consumption. Yet the courts in the Monster Cases seemed shocked to find the FLPs were being used as part of an overall plan to reduce estate taxes. In the family business context, it is neither possible nor desirable to isolate business decisions from family decisions.

Although the ultimate decision-making may have rested with the general partner, often the FLP could be the vehicle for involving the entire family in the financial undertaking. If one child had particular expertise or identified a particular investment, the child would have to bring the idea to the partnership, as the child would have limited investment assets outside the FLP. Clients who dislike creating trusts with third-party trustees because they want direct family member involvement, nonetheless appreciate that the FLP provides some limited creditor and divorce protection.

Critics will say that these considerations have nothing to do with the FLP interests retained by the parents until death. The author certainly will not defend the situation in which the client transfers nearly all assets to the FLP or even ignores the need for liquidity to pay estate taxes at death. However, the idea that the parent could not put most of her long-term financial investments into the family partnership because estate taxes might be reduced is equally outrageous.

When aftermarkets exist for the sale of limited partner interests in real estate investment partnerships or venture capital funds, the sales price of the partnership interests are often much less than the value of the underlying assets. A partnership represents a long-term commitment; it should not be a surprise that a partner would have to take a loss if she bails out early. A bank certificate of deposit cashed in before it matures will usually result in a penalty.

II. The Courts' Reaction to the FLP

A. The Monster Cases Apply Section 2036

Without any doubt, taxpayers and their advisers have tested the limits of chapter 14 with the FLP. One familiar pattern arose. An elderly parent would create a limited partnership, transferring most of the parent's assets to the partnership. The children would put in only a few assets or the parent would give interests to the children. Sometime soon thereafter, the parent would die. The parent's estate would value the partnership interests received in exchange for the contributions at a discount from underlying asset value. Initially, the IRS sought to value the partnership interests at underlying asset value by arguing that the partnership restrictions should be disregarded under chapter 14.

The first FLP case to be litigated was *Strangi*. Not only did *Strangi* have unsympathetic facts, but the parent in the case was disabled and the FLP was created by a relative acting under a power of attorney. Chapter 14 obviously would not allow the IRS to value the interests of the decedent at underlying asset value. If no written partnership agreement existed, state law would have provided a restrictive one. It was not the "bells and whistles" at which chapter 14 was directed that resulted in the valuation discount; it was the inherent nature of the partnership. The IRS argument thus devolved into an argument that family members could not form an investment partnership — a concept clearly inconsistent with chapter 14.

If the failure of the chapter 14 arguments was no surprise, what happened next certainly was. At the Tax Court's invitation, the IRS argued that the decedent in *Strangi* had retained sufficient strings over the partnership assets to include those assets in the decedent's estate under section 2036. The court agreed and the Fifth Circuit affirmed, but the two courts used different theories to reach their results. Both courts also agreed that the partnership interests received by the decedent when the partnership was created were not "full and adequate consideration" for purposes of section 2036. Again the courts disagreed on the reason, but the result was the same. This latter result was even more surprising in light of chapter 14 because the partnership interests were identical to what unrelated persons would have received had they formed an investment partnership, including the restrictions of withdrawal. Several courts in the Monster Cases have now concluded that section 2036 can apply to an FLP and that FLP interests are not full and adequate consideration.

B. The Unknown Scope of the Monster Cases

Many commentators have been willing to dismiss the Monster Cases as limited to their facts, and for the most part those facts have been unhelpful to taxpayers. Other commentators have been unwilling to criticize the application of section 2036 to partnership interests because

they agree with the results. Practitioners have also been reading into the Monster Cases their own views on what the law should be.

Commentators have said that the Monster Cases turn on the investment powers and the distribution powers retained by a decedent as general partner. As discussed in *Byrum*, section 2036 does not apply to investment and management powers held as trustee,[28] and certainly not those held as general partner. Other commentators pointing to section 2036(a)(2) have said the problem is the retention of the powers of the general partner over income distributions. But the decedent in *Strangi* was not the general partner. *Strangi III* held that it was sufficient for the decedent to be one of the partners who could participate in a decision to liquidate the partnership for section 2036(a)(2) to apply. However, any owner of a partnership or corporate equity interest always has a right to participate in a decision to liquidate the company, even if it is a publicly traded company. Unlike a trust, the owners of a partnership or corporation can agree on any decision. The court gave no guidance regarding how to determine how much participation is too much participation.

None of the Monster Cases has yet involved a partnership with an operating business. The FLPs are usually investment partnerships sometimes holding real estate. *Bongard v. Commissioner*,[29] however, involved two holding companies for an operating business. Unlike other Monster Cases, the holding companies in *Bongard* appeared to be largely operated in accordance with arm's-length principles and consistently with the agreements. In *Bongard* the court concluded that one holding company should not be included in the decedent's estate under section 2036 but that the other one should. The court apparently was concerned about the taxpayer taking two discounts for layered ownership of the holding companies.

> ***The Monster Cases give no assurances that they would not apply in other contexts or to other estate planning techniques.***

The Monster Cases give no assurances that they would not apply in other contexts or to other estate planning techniques. One can simply substitute "section 2036(a)" in all of the criticism of "section 2036(c)" to understand the threat the Monster Cases present. The history of section 2036 demonstrates that periodically, estate inclusion is used to resolve difficult valuation issues in family companies. The purpose of this section of the article is to explain why the passage of chapter 14 precludes the application of section 2036 to partnerships and corporations.

[28]*Byrum* at 132-135, *citing Reinecke v. The Northern Trust Co.*, 278 U.S. 339 (1929); *see also Estate of King v. Commissioner*, 37 T.C. 973 (1962); *Jennings v. Smith*, 161 F.2d 74 (2d Cir. 1947).

[29]*Supra* note 2.

C. Keeping the Courts in the Dark

The government should have alerted the courts that chapter 14 prohibited the application of section 2036 to partnerships and corporations. Commentators frequently ask why it took the IRS so long to raise section 2036 in the *Strangi* cases. The Tax Court practically had to order it to raise the argument. To win *Strangi*, the government abandoned its tax principles. The taxpayer's representatives may have many reasons for this failure to focus the courts on the impact of chapter 14, but the IRS litigators have no such excuse. As an institution, the IRS has recognized that Congress intended for chapter 14 to preserve minority and marketability discounts and to preclude the application of section 2036 to partnership and corporate interests, and the IRS has participated in each step of that process.

If you doubt the IRS's understanding of chapter 14, you only need to consider the examples that show the government understands the impact of chapter 14 beyond its literal statutory language. First, Treasury and the IRS wrote the regulations under chapter 14 to protect traditional discounts. Second, they wrote the regulations under section 2704 so as to implement the narrow interpretation of the section to avoid adversely affecting discounts in family entities that contained arm's-length terms. Third, they issued Rev. Rul. 93-12, rejecting the use of family attribution. Fourth, they issued private guidance to taxpayers acknowledging that general and limited partner interests were comparable to voting and nonvoting stock consistently with the legislative history (not statutory language of chapter 14).[30] Fifth, Treasury amended final reg. section 1.701-2,[31] which provided that the secretary could disregard a partnership entity when its purposes were inconsistent with subchapter K. The final regulations, unlike the proposed regulations, applied for both income and transfer tax purposes. Examples 5 and 6 in those regulations involved the disregard of a partnership entity for transfer tax purposes. Treasury took the unusual step of amending the final regulations in Treasury Decision 8592 to limit the application of the regulations to income tax issues and to delete examples 5 and 6. Further, the regulations as amended provide that "subchapter K [the partnership provisions] is intended to permit taxpayers to conduct joint business (*including investment*) activities through a flexible economic arrangement without incurring an entity-level tax" (emphasis added).[32] Finally, the IRS's litigation posture in *Strangi* shows that it understood chapter 14 to preclude the use of section 2036 in that case. Only after its argument that the entire partnership in *Strangi* should be disregarded under chapter 14 failed did the IRS pursue the use of section 2036 at the invitation of the Tax Court.

[30]TAM 9131006 (Apr. 30, 1991); LTR 9415007, *94 TNT 74-22*; LTR 9332006, *93 TNT 170-42*; LTR 9310039, *93 TNT 59-43*.

[31]Treasury Decision 8588, *Doc 95-139, 94 TNT 255-1* (Dec. 29, 1994).

[32]Reg. section 1.702-2(a). The parenthetical language did not appear in the proposed regulations but was added in response to comments in the final regulations.

D. Why the Monster Cases Are Wrong

1. Chapter 14 is comprehensive, precluding the application of section 2036 to partnerships. As the IRS and Treasury well know, chapter 14 provided a comprehensive set of transfer tax valuation rules for trusts, partnerships, and corporations. When Congress has enacted a comprehensive set of rules, those rules need to be considered as guiding all similar situations, although the statutory language may not specifically encompass a particular transaction. The most evident example of a comprehensive set of transfer tax rules is section 7872,[33] which contains a set of comprehensive rules for low interest loans.

According to its terms, section 7872 applies to loans that have no interest or have an interest rate less than a statutory minimum (the AFR). Thus, under its terms, section 7872 does not apply to loans that have an interest rate in excess of the AFR. Section 7872 does not purport to limit the IRS from applying other concepts to low-interest loans. Because it imputes an interest rate based on Treasury rates, the AFR always understates what would be a market rate of interest. Those who might want to perfect the tax laws can argue that section 7872 is always too generous to taxpayers.

Congress and, to the extent not contradictory with congressional intent, the IRS, can adopt practical rules that do not wring every last cent from taxpayers but are fairer and easier to administer. The courts, however, are limited to determining congressional intent as properly modified by Treasury and the IRS.

How do these principles apply in the context of a comprehensive statute like section 7872? The courts have already been faced with the question whether a farm sale between family members using a installment note at 6 percent interest avoided the imputation of gift tax consequences when the AFR was higher. The taxpayer relied on an exception in section 7872 for low-interest loans governed by section 1274 (loans for the sale of property). The courts, however, limited the use of the 6 percent interest rate for income tax purposes and applied section 7872 for gift tax purposes.[34] Rather than follow the literal language of section 7872, the courts considered what approach was most consistent with congressional intent in enacting the low-interest loan rules. The IRS has threatened to use the exception for loans governed by section 1274 to impose a gift when a note payable at the proper AFR is exchanged for property, despite the face value of the note being equal to the FMV of the property. The IRS theory would be that the AFR rate was less than a true market rate and, therefore, the note should be discounted. Thus the purchased property would exceed the FMV of the note, resulting in a gift. The IRS has never advanced this argument in court as far as the author knows, but a court would surely conclude that the AFR rate was intended to be a safe harbor interest rate for debt and not allow the IRS to do an end run around section 7872.

[33]Section 7872 also applies to impute interest for income tax purposes.

[34]*Frazee v. Commissioner*, 98 T.C. 554 (1992).

Congress conceived of chapter 14 as playing a similar comprehensive role in valuing interests in family entities. Thus the courts' resorting to section 2036 to resolve the Monster Cases is inconsistent with chapter 14, and accordingly, the cases reach absurd results when considered under that chapter. Because Congress believed that FLPs and other straight-up partnerships were not as abusive as freeze partnerships, Congress chose not to apply section 2036(c) to partnerships like those in the Monster Cases, believing that minority and marketability discounts should be preserved. The Monster Cases apply only to those straight-up partnerships that Congress considered nonabusive. Indeed, adding the preferred equity interests to a straight-up partnership should prevent the application of section 2036 to the partnership; otherwise, the repeal of section 2036(c) and its replacement with section 2701's special valuation rule would be meaningless. Some commentators have argued that one can avoid the result in the Monster Cases by drafting a partnership agreement like a trust, with distributions occurring only under a strict standard. In other words, the families in the Monster Cases were at fault because they made their business arrangement only *partly* like an estate planning device: They should have made their business arrangement *entirely* like a trust to avoid the application of section 2036. Congress enacted chapter 14 to allow family corporations and partnerships more flexibility in shaping their agreements to be consistent with terms of nonfamily member agreements. The Monster Cases lead to the opposite result: To avoid application of section 2036, the agreements need to be more like trusts, not more like arms-length partnerships.

When Congress considered the problems with applying section 2036(c) to business and investment arrangements, it saw as necessary two provisions that it added in 1988 technical corrections: safe harbors and a revised consideration offset. We previously discussed the inadequacy of the safe harbors, but at least they offered a clear pathway to undertake common business transactions without transfer tax risk. The courts are incapable of providing safe harbors.

More importantly, Congress recognized in 1988 that section 2036 originally provided only a very limited offset for consideration paid in the transaction. Not only was the appreciated value of the transferred asset brought back into the estate, but all income and appreciation on the consideration paid for by the asset also remained in the estate (only the actual amount of consideration paid would be deducted).

> **Example of section 2036(c) consideration offset.** The effect of the 1988 amendment can be understood by considering its effect on one of the examples used to point out the problems with section 2036(c): the writing of *The Great American Novel*. A parent loaned a typewriter to his child, who then wrote *The Great American Novel*. Under section 2036(c), the entire value of the novel could have been included in the parent's estate. If the child had paid $50 in rental for the typewriter and the FMV rental was $100, only half the value of the novel would be included in the estate ($50/$100=50%) after the 1988 technical corrections was enacted.

However, under section 2036 as applied by the Monster Cases, the full value of the novel would be in the estate and only the $50 subtracted, or maybe not. The Monster Cases ignore the partnership interests received by the decedent at the creation of the partnership, although the very same interests received by the decedent in a partnership with unrelated individuals would be full and adequate consideration.

The need for a consideration offset is tied to the inherent problem of applying section 2036 to partnership and corporate interests: Are the interests and/or the assets included in the estate and how is double taxation to be avoided? Despite repeated tries, section 2036(c) never got this straightened out.[35] The courts in the Monster Cases apparently have been left in the dark on these issues as well. The taxpayer's representatives are reluctant to explain how the courts' decisions might result in their clients paying double tax. The IRS's litigators have been reluctant to argue for an obviously unfair result as possible double taxation was one of the factors that frustrated their efforts to preserve section 2036(c).

2. The Monster Cases also fail to follow existing legal authorities. Not only do the Monster Cases fail to follow chapter 14, they fail to follow existing authorities. Again, reading the decisions does not demonstrate that the courts were aware of the authorities relevant to a proper analysis of section 2036.

a. The Monster Cases fail to acknowledge that section 2033 inclusion has priority over section 2036. Stacy Eastland has presented one of the strongest arguments against the application of section 2036 to FLPs. The entire argument will not be repeated here, but an understanding of the argument is crucial to anyone litigating a Monster Case.[36] In those cases, the issue is whether the decedent's retained partnership interests should be included in the estate under section 2033, or whether the assets of the partnership should be included in the estate under section 2036.

The strongest evidence of how this issue should be resolved is the treatment of life insurance on the decedent's life payable to a partnership or corporation of which the insured is an owner. The regulations provide that the interests in the entity will be included in the estate under section 2033 (with the company's value increased to include the value of the life insurance proceeds received on the insured's life), rather than the life insurance being included in the insured's estate under section 2042.[37] Whenever partnership or corporate interests are included in an estate under section 2033, that provision applies rather than a provision including the company-owned life insurance in the estate. That is not an offset rule; only the equity interests are included in the estate under section 2033. Further, the rule does not produce the highest estate taxes. If the decedent owned all the voting stock in the corporation, which represented 1 percent of the value of the corporation, but none of the nonvoting stock, the decedent would be able to exercise all the incidents of ownership under the life insurance policy, but only 1 percent of the proceeds would be included in the estate. Section 2042 could have been applied to tax all of the life insurance proceeds in the estate.

With the exception of that period during which section 2036(c) had effect, section 2036 would not apply to include any of the assets of a partnership in the estate when the partnership interests were already included in the estate under section 2033. That difference is consistent with the treatment of a beneficiary's interest in a trust not as a separate taxable interest in the beneficiary's estate but as an interest in the underlying trust assets. Interests in a partnership or corporation, however, are considered not as interests in the underlying assets but as separate ownership interests. This long-standing distinction is an important reason why section 2036 applies to trusts but not to partnerships and corporations.

b. The Monster Cases disregard important distinctions between section 2036(a)(1) and (a)(2). In relevant part, section 2036 includes in the gross estate property transferred by the decedent:

> under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death —
>
> (1) the possession or enjoyment of, or the right to income from, the property, or
>
> (2) the right, *either alone or in conjunction with any person*, to designate the persons who shall possess or enjoy the property or the income therefrom. (Emphasis added.)

If the decedent doesn't have the unilateral right to enjoy the property or receive the income, section 2036(a) cannot apply. My review does not reveal a single Monster Case in which the court focused only on the decedent's ability to enjoy the property (that is, without the cooperation of the other partners). Yet, except for *Strangi III*, the courts purport to apply (a)(1) rather than (a)(2).

The transfer tax analysis is different if the other partners merely acquiesced in the decedent's actions that were inconsistent with his rights under the agreement. For example, if the decedent continued to live in a residence contributed to the partnership rent free, the other partners might have the right to force the partnership to collect rent from the decedent. If so, the failure to do so was a gift by the other partners to the decedent to the extent of their interests. Of course, a court might find that the children had secretly agreed in advance to continue to use his residence rent free, but that would seem to be meaningless under section 2036(a)(1) unless that agreement was enforceable by the decedent.[38]

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[35]Dees Monster Article at 181-182.

[36]Eastland, *supra* note 7 at 13-15.

[37]Reg. section 20.2044-1(c)(6).

[38]This requirement of enforceability would seem to be contradicted by *Estate of Maxwell v. Commissioner*, 3 F.3d 591 (2d Cir. 1993), and *Guynn v. United States*, 437 F.2d 1148, 1150 (4th Cir. 1971), in which the court states: "an interest retained pursuant to an understanding or arrangement comes within Section

(Footnote continued on next page.)

c. The Monster Cases ignore the history of the statutory term 'possession or enjoyment.' Their silence on the requirement of section 2036(a)(1) that the decedent unilaterally retained the possession, enjoyment, or income from the transferred property is stunning. Just as stunning is the absence of any discussion of the meaning of possession or enjoyment. Although the decisions purport to distinguish *Byrum*, they seem to ignore the Court's understanding of the meaning of possession or enjoyment:

> "possession and enjoyment" . . . were used to deal with situations in which the owner of property divested himself of title but retained an income interest or, in the case of real property, the lifetime use of the property.[39]
>
> . . . the statutory language plainly contemplates retention of an attribute of the property transferred — such as a right to income, use of the property itself, or a power of appointment with respect to either income or principal.[40]

The first quote above suggests that for intangible assets to be included in the estate under section 2036, the decedent must have retained the income from the property, while with tangible property, the decedent need to have only retained possession or enjoyment. The Court relied on the above analysis in concluding that the retention of the right to vote could not be the retention of "enjoyment" of the stock.

The second quote reflects an analysis of the history of the phrase "possession or enjoyment" that is not fully reflected in the *Byrum* opinion but the author hopes to recreate here. The Court cites *Comm. v. Estate of Church*[41] discussing a note in the *Yale Law Journal* tracing the history of these words back to an 1826 Pennsylvania inheritance tax statute.[42] Of course, like most states, Pennsylvania did not have a corresponding gift tax, so it was important to distinguish between transfers that were truly lifetime transfers and testamentary (or at-death) transfers masquerading as lifetime transfers. For example, the New York tax law of 1892 provided the following definition of testamentary transfers:

> in contemplation of or intended to take effect in possession or enjoyment at or after his [the decedent's] death.

Used in that manner, it is easy to understand that possession or enjoyment was used to represent the totality of the rights associated with the transferred property rather than the mere right to vote stock or any other limited or special right. If the decedent had given up all of the economic rights in the property during life, it is unlikely that a court would have treated the transfer as testamentary because of the retention of a power.

The change from the donee's acquisition of possession or enjoyment to the decedent's retention of the same resulted from the infamous Supreme Court decision in *May v. Heiner*.[43] The Supreme Court held that possession or enjoyment did not pass at the decedent's death when the decedent retained a life estate. That holding, contrary to all of the state court decisions construing similar language, prompted Congress to pass, and the president to sign, the Joint Resolution of March 3, 1931, reversing the result. The method Congress chose to reverse the result in *May v. Heiner* was to change the language of the statute to refer to the donor's retention of "possession or enjoyment of," or income from, the transferred property, rather than its passage to the donee.[44] Because the same words were used, it is unlikely that Congress intended to change the definition of possession or enjoyment to mean essentially *any* retained right or power, as the Monster Cases assert.

3. Unique flaws in *Strangi III*'s application of section 2036(a)(2). *Strangi III* held that the powers that the decedent held in the partnership were taxable under section 2036(a)(2) as well as (a)(1). Other courts have applied (a)(1) and have not found the need to consider (a)(2). As noted above, the courts in the (a)(1) decisions have improperly focused on the actions of the parties other than the decedent, while (a)(1) applies only to the decedent's retained interests.

Although (a)(2), unlike (a)(1), does permit the courts to consider jointly held rights, it does not permit the courts to apply section 2036 to partnerships and corporations. Rather, it too is limited in its application to trusts. Section (a)(2) speaks of the right to "designate the persons who shall possess or enjoy the property or the income therefrom." In a typical trust, the current beneficiaries are entitled to distributions on a standard within the trustee's discretion. Generally, the trust does not permit the beneficiaries to sell or even give away their interests. Accordingly, if a trustee refuses to make a distribution to a particular beneficiary, the beneficiary may die before the distribution is made to him. In a trust with multiple current beneficiaries, the distribution might be made to another beneficiary. In a trust with only one current beneficiary, withholding the distribution may still mean it will pass instead to a future beneficiary. A trustee selecting among potential beneficiaries seems more like designating the persons to enjoy the property than controlling the timing of partnership distributions.

A partnership or corporation does not select among its owners to pay out income and capital on a discretionary

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2036." The Supreme Court, however, distinguished cases such as these as involving the retained use of real estate in *Byrum* at p. 147, n.30. The Court held that section 2036 would require a "substantial present economic benefit." This unilateral retention would exist if the understanding approved the retention of the enjoyment in advance, but not if the decedent had no right to exercise the enjoyment absent the consent of the other partners.

[39] *Byrum* at 147.

[40] *Byrum* at 149.

[41] 335 U.S. 632, 637 (1949).

[42] Leighton, "Origin of the Phrase, 'Intended to Take Effect in Possession or Enjoyment at or After . . . Death,'" 56 *Yale Law Journal* 176 (1946).

[43] 281 U.S. 238 (1930). *Commissioner v. Church Estate*, *supra* note 41, overruled *May* but Congress did not choose to apply section 2036 retroactively.

[44] *See* discussion in Dodge, "Transfers With Retained Interests and Powers," *BNA Portfolio* 50-5th at A-12.

basis; all equity interests of the same class receive distributions proportionately. Each owner's rights in capital and income are specified. However, a partnership or corporation usually[45] controls the timing of its income distributions or dividends. Unlike the trust in which the identity of the remaindermen are known by name or class, an owner of a partnership or corporate interest could sell or give away the interest to an unknown person before the income or capital was distributed. The ability to sell the interest means that a current owner could avail herself of the value of the deferred distribution through a sale when the price would reflect the deferred distribution.[46]

The most troubling part of Strangi III is the very limited 'control' retained by the decedent that the opinion concludes was sufficient to trigger section 2036(a)(2).

The most troubling part of *Strangi III* is the very limited "control" retained by the decedent that the opinion concludes was sufficient to trigger section 2036(a)(2). Because the opinion literally requires only the participation in the decision to liquidate the partnership, most commentators ignore the opinion's literal language and substitute their own judgment as to what control should be sufficient. Some commentators advise against having a client act as a general partner so as not to participate in the timing of income distributions normally within the control of the general partner. In *Strangi III*, however, the decedent was not the general partner and had no right to participate in the decision to distribute profits or capital from the partnership. Rather, the court focuses on the ability of the decedent to participate in but not control the liquidation of the entity as a limited partner. In response, commentators recommend that the partnership agreement specifically prohibit the major funder of the entity from participating in any decision to make distributions or to liquidate. That approach also has two flaws.

First, if the section 2036(a)(2) applied to all partners who could participate in liquidation, no partner could avoid its application unless all of them did. Who then would make those decisions?

Second, if the agreement forbids a partner's participation in distribution and liquidation decisions, the partner still has that power with all the other owners in the entity to agree to any change in the agreement. It would not be enough to provide in the partnership agreement that a particular partner could not participate in any liquidation or distribution decision. Thus, the only way to avoid the section 2036(a)(2) problem, in my view, is to put all the partner's interests in an irrevocable trust with an independent trustee and unknown beneficiaries who nonetheless have sufficient interests in the trust that a court would protect against an effort by the donor, the trustee, and the current beneficiaries to revoke the trust.[47]

However, bulletproofing a client's FLP interests against the application of section 2036 could not stop at just family controlled companies: A shareholder in a public company has identical rights to participate in the liquidation of that company. It seems unlikely that section 2036 would be extended that far, yet the opinion gives us no hint on how to draw the line as to whether the section should apply or not. If that line leaves only family companies subject to section 2036, *Strangi III* has essentially reinstated the family attribution rule that both Congress and the IRS have rejected.

Although the *Strangi III* court was unwilling to indicate where lines should be drawn in the application of section 2036(a)(2), the court was willing to say that that charity's fractional ownership in the general partner corporation was not important enough to fit within *Byrum*. In doing so, the court ignored one of the most important parts of the *Byrum* decision. The Supreme Court in *Byrum* was less impressed with its abilities to draw the kinds of lines drawn in the tax court memorandum decision:

> Congress is better equipped than a court to define precisely the type of conduct which results in tax consequences. When courts readily undertake such tasks, taxpayers may not rely with assurance on what appeared to be established rules lest they be subsequently overturned. Legislative enactments, on the other hand, although not always free from ambiguity, at least afford the taxpayers advance warning.[48]

Most courts have attempted to avoid the application of section 2036(a)(2), preferring instead to rely on section 2036(a)(1). Avoiding (a)(2) requires drafting the partnership agreements in ways that arm's-length parties would never do. Congress enacted chapter 14 to ensure that arm's-length arrangements in family entities would be respected for transfer tax purposes, but the Monster

[45]Some freeze partnerships, for example, might require that available cash be distributed. A guaranteed payment in a partnership under section 2701 is by definition payable in a fixed time and amount.

[46]*See also* Eastland, *supra* note 7 at 39.

[47]While the donor would retain an interest in the income from the partnership interests, the donor is not treated as retaining an interest subject to an independent trustee's discretion, even when the trustee has paid income to the donor. *See Commissioner v. Irving Trust Company*, 147 F.2d 946 (2d Cir. 1945), and *Sherman v. Commissioner*, 9 T.C. 594 (1947).

[48]*Byrum* at 135. *Strangi III* disregarded the Court's decision when it concluded that the charity's interest in the general partner corporation was insufficient to prevent the family member partners from disregarding the terms of the partnership. It also ignored Congress, which had provided that a single nonfamily member could block the removal of a liquidation restriction, when it had defined the term "lapsing restriction." Section 2704(b)(2)(B)(ii). However, the charity's interest was in the general partner corporation rather than in the partnership, meaning that it did not fit within the literal language of this section. As one can see from the discussion of section 2704, this failure is meaningless because the default provisions of state law provided that the withdrawing partner could receive only fair value of the partner's distribution rights.

Cases require the opposite result: The agreements will be respected only if they are drafted with estate planning being the most important consideration.

The courts, we hope, will be able to avoid a test that penalizes families for the type of cooperation that helps ensure the longevity of some family business ventures. For example, the Monster Cases emphasize as one of the reasons to apply section 2036 the failure of the family members to retain separate lawyers to represent them. Although lawyers may appreciate the logic of that view, sending everyone to hire their own lawyer is not only likely to shorten the longevity of the enterprise, it is likely to end it. The Monster Cases also emphasize the failure of family members to contribute to the FLP. However, there are at least 10 good reasons to limit family contributions to the FLP — at least initially.[49]

III. Deciding the Monster Cases Without Inclusion

A. *Strangi III* Is Unique

This outline is critical of the decision of the courts to resort to section 2036 to resolve the valuation issues presented by the facts in the Monster Cases, especially given Congress's recent decision to reject the use of section 2036 to resolve valuation issues. Obviously, the courts are troubled by the facts in the Monster Cases, but the courts can reach the same results without running afoul of chapter 14.

As discussed above, taxpayers can obtain valuation discounts with FLPs by having the creator of the FLP transfer all the interests to an irrevocable trust with an independent trustee. The trust could include the creator as a trust beneficiary. The creator also could retain a lifetime and testamentary limited power of appointment to direct the distributions among family and charity. The creator could reserve the right to direct the investments of the FLP as long as those decisions had no impact on the timing of distributions or liquidation. No gift would result at the creation of the trust due to the retained powers. The trust would be includable in the creator's estate under section 2036, but the units in the trust would be valued after applying traditional discounts.

If this trust and estate planning arrangement entitles the creator to valuation discounts, how can anyone justify the use of section 2036 to end the abuses of FLPs? Although the courts in the Monster Cases purport to be denying valuation discounts to FLPs created for no other reason than estate planning, the taxpayers could have avoided the negative results of the Monster Cases by doing *more* estate planning. The principal problem with the Monster Cases is that they, like section 2036(c) a decade ago, preclude family members from arranging their business and investment affairs on the same basis as unrelated parties with the same transfer tax consequences. Until now the IRS and the courts have been able to surprise taxpayers by disregarding chapter 14 and applying section 2036 to FLPs; however, going forward, those taxpayers who are only interested in obtaining estate tax discounts will be able to use estate planning to obtain those discounts. Section 2036 will apply only to those taxpayers who thought that they had a good justification for the creation of the partnership and were not worried about section 2036 or were advised by estate planners still living in the 1990s who had never heard of the Monster Cases. Applying section 2036 in either case would be contrary to good tax policy.

Because the courts have applied section 2036 to address a valuation issue rather than address the valuation issue directly, aggressive taxpayers can avoid the Monster Cases and protect their valuation discounts in FLPs. Congress learned that lesson when it had to repeal section 2036(c) and replace it with chapter 14. Because estate planners know exactly how to avoid section 2036 using trusts, they can arrange their clients' affairs to avoid its application, leaving the FLP valuation issue that concerned the courts unaddressed. For that reason, this article proposes an alternative test for FLPs that tackles the valuation issue directly.

Some commentators defend the Monster Cases as limited to investment partnerships as opposed to business partnerships, but what justifies that distinction?

Some commentators defend the Monster Cases as limited to investment partnerships as opposed to business partnerships, but what justifies that distinction? Although Treasury floated the idea that business and investment entities should be treated differently under chapter 14, Congress ultimately drew no such distinction applying the same valuation rules to all partnerships and corporations. Also, legislation has been proposed that would limit discounts when the partnership or corporation holds marketable securities, but Congress has never adopted that legislation. As noted before, while Treasury amended the section 701 final regulations to preclude their application for transfer tax purposes (deleting examples similar to the Monster Cases), those regulations make clear that investment management is to be treated like any other business activity. The courts are not permitted to substitute their judgment for that of Congress. The alternative test does not rely on the nature of the business of the FLP to prevent abusive valuation discounts.

The alternative test offered by this article also applies equally to family and nonfamily entities. As noted above, chapter 14 intended to allow taxpayers to operate their

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[49]Dees, "Using a Partnership to Freeze the Value of Pre-IPO Shares," 1999 *Miami Est. Plan. Inst.* 11-1, para. 1102.3: "Planners continue to recommend a gift of assets followed by a contribution of those assets to a new frozen partnership. This section examines why that approach appears to be bad advice in nearly every case." The reasons cited include the partnership investment rules under the federal income tax, the possible application of section 2036(b) if the partners contribute closely held shares, the risk that some partnership income tax rules will apply, the potential overvaluation of the residual interests due to section 2701 being higher than FMV, the possible risk that the children could upset the partnership under the federal securities law, and a potential gift on formation that is avoided if the parent alone creates the partnership.

family entities without unjustified transfer tax distinctions that result in discrimination against such family entities. Under the alternative test, the same valuation rules would apply to both family and nonfamily entities.

B. A Test Based on Arm's-Length Principles

Strangi is easy to decide without resorting to section 2036. The partnership in *Strangi* was created by an agent using the principal's assets. If the principal recovered, does anyone doubt that the principal would be able to regain his assets despite the partnership terms? If the principal did not recover but the court appointed a guardian for the principal, what interest of the principal would justify the agent putting nearly all of the principal's assets permanently beyond the guardian's reach? The real terms of the deal were not contained in the partnership agreement, because the decedent could have voided the partnership or because the other partners understood the decedent would need unrestricted access to his assets in the partnership to provide for his future needs.

If Mr. Strangi had been competent, he could have chosen to transfer his assets to a partnership with his children, thereby limiting his access to and control over those assets. But Mr. Strangi was incompetent, and it is doubtful that his agent would have been permitted to give up such valuable rights on his behalf, let alone do so for nearly all of Mr. Strangi's assets. Indeed, the facts make clear that the agent did not give up those rights even for the few short months of the partnership's existence. Mr. Strangi continued to use his home without paying rent to the partnership, accessed partnership funds to pay his personal expenses, and otherwise enjoyed the partnership assets inconsistent with the partnership's terms.

Any estate planner who has struggled with clients to develop a plan that meshes the client's business and investment goals with the strengths and weaknesses of that client and the client's family had to be offended by the notion of Mr. Strangi's "Tax Cut in a Box" estate plan. It was inevitable that the Strangi family would continue to operate as it wanted without regard to the actual terms of the partnership agreement.

In *Strangi* and some of the other Monster Cases, the decedent contributed nearly all of his assets to the FLP, which meant the decedent could no longer access the funds. That unusual behavior justifiably raises one's suspicion that the terms of the deal are not those in the agreement. However, the other partners in the partnership need not have been family members to raise a suspicion. If the decedent, shortly before death, had entered into the same kind of relationship with Big Bank as the investment manager, one should suspect that the real deal is not that the decedent is unable to access any of those assets. The FLP cases need not turn on the family member relationship, if any, among the partners nor require the use of section 2036, both of which are forbidden by chapter 14.

The facts of the other Monster Cases might not be as straightforward as *Strangi*, but in all of the cases the taxpayer lost, some facts demonstrated that the real agreement among the partners was not the same as that on paper. Accordingly, the valuation of the decedent's partnership interest should not be discounted much, if at all, from the underlying asset value at the date of death.[50] In *Bongard*, in which the concern was a double discount for using nested holding company ownership, the proper issue was to what extent, if any, did ownership by the second holding company restrict the decedent's control and liquidity? If the taxpayer simple-mindedly applied the same discount twice, obviously that approach was flawed.

C. Justifying the Court's Broad Factual Review

This new approach would convert the Monster Cases to valuation cases, which the courts are well equipped to decide and which the taxpayers and the IRS are well equipped to settle. Valuation cases encourage the taxpayer and the government to adopt reasonable positions on the value of the interests in question, because the courts are prepared to split the difference if both sides are reasonable or to select the other side if one side is unreasonable. The valuation analysis does not discriminate against investors in a family business; an equity interest in any partnership or corporation should be valued in accordance with its actual terms rather than its purported terms. Once the actual terms of the arrangement are determined, value will depend only on those terms, not on the relationships among the investors.

Congress has placed the responsibility on the courts to police the inevitable valuation disputes arise under the transfer tax due to the importance of determining FMV. While the transfer tax exists, this burden will fall on the courts, which should make every effort to encourage the litigants to resolve the issue. The courts have lots of discretion in valuation cases, but they do not have the option to convert valuation cases into estate tax inclusion cases.

D. The 'Value' of Valuation Cases

Judges tend to bemoan valuation cases because the variations in values seem so great. That variation no more condemns the valuation process than *Antiques Roadshow* condemns the entire American free market system because a buyer can pay $5 for a vase one day and find out it is really worth $5,000 the next. Because the valuation of the family business is so crucial to the transfer taxes that will be owed, clients often nervously join in the criticism. In my view, it is the "bet the farm" aspect of valuation that concerns clients. If one could avoid having the very life of the business at risk by the valuation decision, business owners could approach the valuation process with the same practicality and common sense they use every day. If the price at which products sell every day had to be as perfect as tax lawyers think tax payments need to be, commerce would grind to a halt.

If all of those involved in these cases put more emphasis on reaching a "fair" result rather than a "perfect" result, the parties could avoid most litigation. When litigation cannot be avoided, the courts need to make clear that when one party is being unreasonable (based on past decisions), the other party is going to win

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[50] Eastland, *supra* note 7 at 12-13, proposes a similar test.

completely. If the courts are forced to split the difference between the parties, they have not succeeded in getting the right message to them to settle. Of course, before this is possible, the courts are likely to have to set forth reasoned decisions explaining exactly why they reached the valuation results they did.

What would happen if the courts adopted this alternative test? Those clients who are interested only in the estate tax discount would be less inclined to form an FLP without a known benefit, particularly if they understood that ignoring the formalities of operating a business would lead to the courts ignoring the restrictions written into the agreements. Those clients really wanting to operate a family business, including an investment business, would not let the discount affect their thinking: The joint family enterprise would produce the discount, rather than the discount producing the joint family enterprise. Business owners and farmers would be free to engage in legitimate business transactions without concern those transactions later will be viewed differently with calamitous tax results.

The courts could change their approach to the Monster Cases tomorrow, just as Congress realized it was wrong to enact section 2036(c) and repealed it within two years. Whether the courts will display the same willingness to push back against the pendulum that they started swinging as Congress did by enacting chapter 14 has yet to be seen. If the courts are unwilling to do so, the IRS and Treasury might consider reverting to their original position of applying only chapter 14 and not section 2036 to partnerships. The government should have a stronger interest in the proper administration of the tax laws than just "winning" cases.

If the Monster Cases were decided on the basis of valuation principles, the actions of the partners, the operation of the partnership before death showing liberal benefits from the partnership for partners (all partners would have to be treated similarly to avoid a breach of fiduciary duty), and to a limited extent, the postdeath actions of the partners would all be relevant. A valuation test would avoid the limits that section 2036(a)(1) places on considering only the owner's unilateral interests.

A Look Ahead

Although the Monster Cases are ill-conceived and inconsistent with existing legal authorities, the cases nonetheless have momentum because of their unsympathetic facts. However, by applying section 2036, rather than addressing the valuation issues directly, the courts will trap unwary taxpayers while allowing abusive transfers. Next week, in Part 2 of this article, we will consider how Congress can end the cyclical application of section 2036 to partnerships and corporations.

(Appendix on the next page.)

Appendix: The Section 2036 Pendulum

2036 Limited to Trusts	2036 Applied to Partnerships and Corporations
1932: Congress in response to the *May v. Heiner* decision treating a retained life estate (trust equivalent) as not testamentary in nature enacts Joint Resolution of March 3, 1931.	
	1972: IRS argues in *Byrum v. United States* that the retention of the vote in a corporation is the equivalent of the retention of enjoyment for purposes of section 2036(a).
1972: U.S. Supreme Court holds in *Byrum* that section 2036(a) does not apply to rights in a family business; it limited the application of section 2036 to trusts.	
	1978: Congress passes section 2036(b) (anti-*Byrum* legislation) treating the retained vote as enjoyment for purposes of section 2036(a).
1978: The legislative history to section 2036(b) makes clear that business owners can avoid the application of section 2036(b) by creating and giving away nonvoting stock while keeping voting stock, limiting section 2036(b) to when trusts are used to retain the vote.	
	1987: Congress passes section 2036(c) intended to limit abusive preferred stock recapitalizations; legislative history declares that family business owners use entities for estate planning just like others use trusts.
	1988: In technical corrections, Congress affirms a broad application of section 2036(c) to all types of trusts, family business and investment entities, and business agreements and transactions.
1989: Business groups' opposition to section 2036(c) leads to a Senate Finance subcommittee hearing on its repeal; the business groups' primary concern — that section 2036(c) would be used to attack the retention of voting stock or voting control in family entities — is shown to be unwarranted as no one, not even the IRS or the most liberal senators, adopts the posture that a family business was a substitute for a trust.	
1990: Opponents succeed in having Congress repeal section 2036(c) while replacing it with chapter 14, which contains a set of special valuation rules dealing with potential abuses but NO estate inclusion.	
	2000: Despite the enactment of chapter 14 only a decade before, the Tax Court applies section 2036(a) not to a trust but to a partnership in *Strangi*; the Fifth Circuit affirmed and a number of courts followed using various theories.
? <-- Although this article is intended to alert the courts to a number of important arguments not reflected in the *Strangi* cases, it seems likely that the courts will acknowledge that section 2036 is not to be applied to partnerships and corporations. It is time for Congress to act to eliminate these swings permanently.	--> ?

tax analysts special report

Time Traveling to Strangle *Strangi* (And Kill the Monster Again), Part 2

By Richard L. Dees

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In Part 2 of this article, the author argues that the solution to the problems of the *Strangi* cases detailed in Part 1 (see *Tax Notes*, Aug. 13, 2007, p. 563) is repeal of section 2036 and the other estate tax sections that include in the estate gifts made with retained "strings." The author proposes that repeal of these estate tax provisions will end for all time the problematic application of section 2036 to partnership and corporate interests. The author proposes coupling repeal with a change treating most irrevocable transfers with "strings" attached as complete for gift tax purposes. The author believes that the opportunity to establish flexible succession plans without running afoul of section 2036 will encourage business owners, particularly small business owners, to make gifts implementing those plans. Thus the author's change is likely to produce gift tax revenue to help offset other reductions in the estate tax. The author also considers some of the technical issues in implementing his proposed tax changes.

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In Part 1 of this article[1] we considered the problems with *Strangi* and the various other decisions applying section 2036 to partnerships. We placed those decisions (referred to as the "Monster Cases")[2] in the context of the history of section 2036 swinging between its application only to trusts and also to partnerships and corporations. Part 1 bemoaned the lack of a time machine able to go back and prevent the courts from embarking on applying section 2036 to partnerships.

Congress does have a time machine. It needs to be sent back to when "the nail was lost." As discussed in Part 1, that lost nail was section 2704(b), the last subsection of chapter 14, designed to address the potential for abuse of family limited partnerships (FLPs). However, the Monster Cases prove that merely tweaking chapter 14 will never be enough to prevent the courts and IRS from periodically resurrecting the Monster Cases to apply to partnerships and corporations.

Chapter 14 contained the ultimate do-over: Congress repealed section 2036(c) retroactively. Congress considered the application of section 2036 to partnerships and corporations to be such an abject failure that even those taxpayers who completely disregarded the law were never subject to section 2036. Rather than wait years for the courts to self-correct, Congress should immediately repeal section 2036 and the other estate tax "string" provisions. Other conforming changes to the transfer tax would be necessary.

As explained in Part 1, the courts never had to resort to the use of section 2036 to reach the results they wanted in the Monster Cases, and repeal will not leave the courts at a loss to address any potential abuse. The test proposed in Part 1 will prevent the abuses concerning the courts in the Monster Cases without applying section 2036 or requiring the targeting of family business and investment entities.

Repeal of section 2036 should generate significant current gift tax revenue while making the estate tax fairer to family business owners and farmers. Repeal and the revenue it will generate could kick-start the negotiations over a compromise estate tax bill. Currently, it appears that Congress may look to loophole closers, like section 2036(c), to offset the proposed revenue losses. However, these so-called loophole closers invariably produce

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[1] *Tax Notes*, Aug. 13, 2007, p. 563, *Doc 2007-16792*, *2007 TNT 157-32*.

[2] The section 2036 FLP cases are referred to as the Monster Cases because they contain the same vagueness and uncertainty as section 2036(c), enacted in 1987 and repealed in 1990. *See* Dees, "Section 2036(c): The Monster That Ate Estate Planning, and Installment Sales, Buy-Sells, Options, Employment Contracts and Leases," 66 *Taxes* 876 (1988).

greater unfairness, particularly for family business owners. An estate tax that exempts smaller estates from paying any estate tax while leaving only large estates — many of which will be the most successful family businesses in this country — to bear the burden of an estate tax that is less fair is unlikely to be well received.

I. A Stake in the Monster's Heart

The story of the Monster Cases discussed in Part 1 could serve as a plot for a horror movie. Evil taxpayers loose the FLP Monster on the federal fisc. The White Knight courts in response resurrect the section 2036 Monster to defeat the FLP Monster. However, the section 2036 Monster not only destroys FLPs, it threatens the village merchants as it continues to rage. The White Knights, being of many different minds, are unsure how to rein in the section 2036 Monster, leaving it to do damage far beyond that intended. Congress could be the handsome scientist who kills the section 2036 Monster now and forever. At the same time, the Scientist and the White Knights could develop a way to kill bad FLPs while allowing the good FLPs to live. The country prospers and security fills the kingdom's coffers.

Congress could accomplish those cinematic miracles by repealing sections 2036, 2037, and 2038, which include in a donor's estate property the donor has previously given away. Experts in tax policy have sought the repeal of those sections for years. Those experts understand that repeal will accelerate the collection of gift tax revenues. What no one seems to appreciate is that repeal of section 2036 and those other sections will make the estate tax substantially fairer for business owners and farmers, particularly those with smaller enterprises.

Sections 2036, 2037, and 2038 are derived from estate tax provisions that predate the gift tax. The sections identified those lifetime gifts that Congress believed looked more like testamentary (at death) gifts so that the transfers could be subject to estate tax. After the gift tax was enacted, the sections served the purpose of ensuring that lifetime gifts that were more like testamentary gifts were subjected to the higher estate tax rates rather than the lower gift tax rates. When both the estate tax and the gift tax are imposed at the same rate, those sections are no longer needed.

II. Fairness for Business Owners and Farmers

Repealing section 2036 will make the estate tax simpler, but more importantly, it will make the estate tax fairer for family business owners and farmers. If the donor of a gift retains some specified interests, often called "strings," section 2036 uses those strings to pull back into the owner's estate the assets that have been given away, thereby increasing estate taxes. Section 2036 has two categories of strings: First, the donor retains the income or use of property (section 2036(a)(1)) or, second, the donor retains control over which, or even when, the donees will receive the property (section 2036(a)(2)). Retaining either string is sufficient under section 2036 to result in estate inclusion.

> **Example of section 2036.** A farmer, F, owns Farm. F wants to give Farm to his daughter, D, who farms with F. F needs the income from Farm, so F keeps a life estate and gives the remainder interest to D. F's retained life estate means F keeps all of the income from Farm until F dies. At F's death the Farm passes to D. The remainder interest is property and D could give it away or die owning it and paying estate tax on its value. It turned out that F actually did not need the income to live on, so D also inherited an investment account from F in which the income had been reinvested for D's benefit.

If you are not an estate planner, the gift and estate tax consequences of that transaction might surprise you. Because F cannot change who gets the property, the gift of the remainder is a completed gift subject to gift tax. Assume that under the IRS actuarial tables the remainder interest was worth 40 percent of the value of Farm at the time of the gift. However, section 2702, part of chapter 14 of the code, does not allow F to subtract the value of the life estate for gift tax purposes. F is treated as giving away the whole farm and pays a gift tax on its full value. When F dies, the entire value of Farm is included in F's estate under section 2036 because F retained the income from Farm. Normally the values of all lifetime gifts are added back to the estate when computing the estate tax, but not if the property that was given away is also subject to estate tax, as in this case. If Farm's value is exactly the same at F's death as it was at the time of the gift, these cancel out and no additional estate tax would be due on Farm. However, the account with all the accumulated income is fully taxed in F's estate without any offset, so F is paying transfer tax on the income that was kept by F, because F thought he might need the income. Because F's retained life estate was valued at zero for gift tax purposes, that income is being double taxed.

If farmland values change between the date of the gift and the date of F's death, the tax consequences would be very different. The value change, however, will not affect the double transfer taxation of the investment account. Farm could have declined precipitously in value. In that case, F's estate would not owe any more estate tax, but if F was unaware that the remainder gift was subject to gift tax and failed to file a gift tax return, the IRS could go back, even years later, and argue that Farm's value at the time of the gift was much higher than the parties thought. If the IRS succeeded in proving that Farm's value was higher at the time of the gift, it could collect gift tax on the entire value of Farm. If Farm had appreciated in value, the IRS instead would argue that Farm is worth considerably more and that F's estate owes estate tax on that appreciation. The adverse estate tax result would be the same whether the appreciation was due to inflation or to the great care with which D had tended Farm during F's life.

If F had not needed the income and did not want to tie D's hands, F could have simply given Farm to D, producing very different transfer tax results. F still would have had to pay gift tax on the full value of Farm. When F died, however, D would be the one with the investment account, not F, so the income would not be double taxed. Of course, F's estate could still not get a gift tax refund if the value of Farm declined. However, D would not have to worry about increases in the value of Farm being subject to estate tax.

One can see from this example how section 2036 affects less-wealthy taxpayers more than the very wealthiest. Less-wealthy taxpayers simply do not have enough assets to give away without retaining some assets to produce income. If the business or farm is the principal source of wealth, the owners may also need to look to their businesses for a source of retirement income. Wealthy taxpayers can give assets away and still have sufficient income from the assets they keep.

However, section 2036 adversely affects all business owners and farmers, including those with sufficient income from other sources. The most important objective of many family business owners and farmers is to pass their business to the next generation. For many of them this means being involved in the operations of their businesses or farms for as long as they live. The owners believe that to successfully transfer their businesses to the next generation, they will need to continue to train and guide their children and protect those children against their own impulsiveness. Sometimes the owners want the children active in the business to own the business if it continues, but they want all the children to share in the proceeds if it is sold.

Under section 2036, these practical interests that a parent might want to retain as she helps her children to succeed could be considered retained strings, which could result in inclusion in her estate of business interests owned by the children. Business owners and farmers seem to feel the need to retain these strings more than most. Business owners want to put a succession plan in place to ensure the continuation of the family business, but accommodating the need to limit estate taxes often means the parents have to be written out of the succession plan. Section 2036 poses unnatural obstacles to proper succession planning, and repeal will remove those obstacles.

Business ownership invariably involves risk, but business owners are not gamblers. They do not play dice with their enterprises. Rather, they try to reduce risk whenever possible to increase their chances of success. For them, planning is a process of eliminating the risks when possible and identifying the scope of the risk when elimination is impossible. Section 2036 is the antithesis of certainty and predictability. If section 2036 applies at an owner's death to a transaction that occurred many years earlier, as we have seen, the tax consequences of that transaction might be completely changed for the worse. Careful planning can usually avoid that adverse tax result, but it is more complicated and more frustrating to small-business owners than simply retaining the rights they think they need.

If section 2036 is repealed, for the first time in almost 30 years a parent could give stock in the family business to children while retaining the vote without the stock being taxed in her estate. The parent would pay gift tax on the full value of the stock when given away. The parent would know the precise tax cost of that gift rather than have to wait to see how well or poorly the business does. The children would not be discouraged from operating the business successfully in light of possible estate taxes on its success.

Repeal would allow small-business owners to implement succession plans now, when the tax cost can be known, rather than opt to postpone the tax until death, when timing and business values are unpredictable. Because the business or farm could be transferred to the next generation while retaining rights to income or control, the parent is likely to be willing to part with ownership now rather than waiting until death. As under current law, the retained strings generally would not reduce the value of the gift.[3] Today the same assets might be transferred in a more convoluted, less transparent manner, with the same tax result. The repeal of section 2036 would make such complicated planning unnecessary.

Of course if you are a business owner, certainty will never be possible under the transfer tax because the valuation of your business can never be known with certainty. However, the uncertainty of valuation is exactly the type of risk that business owners can understand. Because business owners understand that valuing the business now is more certain than waiting until they die, business owners will be more willing to engage in succession planning now. Repealing section 2036 is likely to generate gift tax revenue that could be used to provide further estate tax relief. Small-business owners and farmers will appreciate the importance of repealing section 2036 just from being able to make gifts without so much lawyering and so much uncertainty.

III. Technical Aspects for Implementing Repeal

A. 'Easy' vs. 'Hard' to Complete Gift

Once the decision is made to apply only the estate or gift tax to a particular transaction, the next step is to decide which transfer tax to apply. The question is sometimes expressed as whether the law should provide an "easy to complete" or "hard to complete" gift tax rule. If a transaction is subject to an easy to complete rule, the transaction will be taxed under the gift tax rather than the estate tax. However, if the transaction is subject to a hard to complete rule, the transaction will be taxed under the estate tax rather than the gift tax.

B. Retained Powers

Because one reason for repeal of section 2036 is to increase gift tax revenues, generally an easy to complete rule would be favored, unless compelling reasons require a different rule. Current law taxes the donor's retained economic interests in transferred property as subject to both gift tax and estate tax, with a rule intended to provide limited relief from double taxation. Section 2702 enacted as part of chapter 14, however, prevents the value of the gift from being reduced by a retained life estate so that the entire property is treated as given away despite the donor's retention of all future income from the property. On the other hand, current law provides that the donor's retention of the power to change donees

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[3]Section 2702 provides that a gift to a trust will not be reduced in value by a retained income interest. As under the charitable rules, retained unitrust or annuity interests may be valued under the IRS's table. Section 2701 provides comparable rules for partnerships and corporations. Those rules are discussed in more detail below.

will make the gift incomplete, although the donor may retain no economic interest in the transferred property. That rule dates to a 1939 Supreme Court decision[4] that reached that conclusion partially in reliance on the inclusion of the transferred property in the donor's estate under the predecessor section of 2038.

C. Retained Economic Interests

Treasury I, which originally proposed the repeal of section 2036, also proposed reversing the easy to complete/hard to complete rules of current law. If the decedent retained an economic interest in the transferred property, such as a life estate, under Treasury I the gift would be incomplete and the property would be subject to the estate tax. However, under Treasury I the mere retention of the power to change donees would not defer gift tax nor result in estate taxation.

The rule of Treasury I that a retained power will not make the gift incomplete should remain valid. However, the rule under Treasury I that treats a gift in which the donor retains an economic interest as generally complete is no longer valid. Chapter 14, which was enacted long after Treasury I, provides special valuation rules as an alternative to estate inclusion. Consistent with chapter 14, any irrevocable gift should be subject to gift tax rather than estate tax, despite the donor's retention of an economic interest in the transferred property.

It cannot be said too often (although perhaps this article tries) that one motivation for discarding the estate inclusion approach is to avoid discriminating against less-wealthy taxpayers. The ultrawealthy can afford to sever all retained interests in the transferred property while the less wealthy or those with business assets cannot. By imposing a gift tax on the full value of the property under section 2702 and allowing the transferred property to escape estate tax despite any retained strings, Congress provides the same transfer tax treatment as a completed gift.

Thus, gifted property in which the donor has retained an economic interest will be considered a completed gift, with the valuation of the gift determined under section 2702. A gift of property with a retained life estate would be a completed gift of the entire value of the property. When the decedent passes away, no estate tax will be imposed on the property in which the donor retained the life estate. However, this solution is not perfect, because any income not spent during the donor's life would still be subject to estate tax.

Had the donor retained a qualified annuity or unitrust interest in the transferred property rather than a life estate, the value of the gift would be reduced by the value of the retained interest. Section 2702 provides a different rule because the annuity or unitrust interest, unlike the income interest, is not subject to manipulation. For the same reason, the compromise would subject the transferred interest to gift tax but the retained interest given value to estate tax. If the annuity is retained for a term and the donor survives that term, it might seem that nothing is taxed in the donor's estate. However, the annuity payments will be in the donor's estate under section 2033. Because they cannot be retained, section 2702 allows the annuity and unitrust interests to be given value. If the donor dies while receiving the annuity interest, the annuity should be valued and taxed under section 2033 as property. No other code section should apply. If the annuity ceased at the donor's death, no portion of the annuity would be taxed under section 2033, as the subtractive value of the annuity at the time of the gift would have been reduced to reflect the payments ending at the donor's death. If the annuity continues to be paid to the decedent's estate, its actuarial value would be included in the estate under section 2033.

D. Avoiding 'Consideration' Valuation Problems

By making all irrevocable gifts complete for gift tax purposes, Congress would avoid one of the most difficult issues in connection with estate inclusion of transferred property: the proper consideration offset if the transferred property was purchased by the donee. Under the Monster Cases the courts give an offset under section 2043 only for the amount actually paid at the time of the transfer. Because the consideration received would have been invested during the donor's life, that offset is inadequate. Congress addressed this issue in the technical corrections to section 2036(c), providing a pro rata exclusion based on the amount paid relative to fair market value at the time of the initial transfer. Because the consideration paid is measured against the value of the gift at the time the gift occurs, not years later, an easy to complete rule entirely avoids the problems with valuing the consideration.

E. Gifts Subject to Revesting

A gift should be incomplete only to the extent that the donor retained the right to revest the property in her estate,[5] whether held in a fiduciary or individual capacity. The gift would be incomplete if the donor jointly held the power to revest property in herself. That would be considered the equivalent of the ownership of the property for purposes of section 2033, just as under current law property held in the decedent's revocable trust is provided equivalent treatment to estate property. Also, any condition preceding the donor's ability to revest property in herself would be ignored; the gift would not be complete and the transferred property would be subject to estate tax under section 2033 without any reduction for the delay or uncertainty imposed on the right to revest.

F. Transition Rule

A transition rule would be needed for property transferred before enactment. If the transfer of the property was an incomplete gift under the law in effect at the time of the transfer, the repeal of the estate tax string provisions would not apply. The donor could elect to treat the gift as complete on the day of the election, provided the

[4]*Sanford Estate v. United States*, 308 U.S. 637 (1939).

[5]It would not be sufficient to defer the gift for the donor to pay the income to herself or to control the disposition of the property under a power, unless the donor was an object of the power.

election was made in the first gift tax return filed after enactment and before the donor's death. If the donor made that election, the transferred property would not be included in the estate. The donor's estate could not make the election.

Conclusion

Part 1 of this article placed the Monster Cases in their context of the cyclical application of section 2036 to partnerships and corporations, despite the many problems in preceding cycles. Repealing section 2036 and the other estate tax string sections is the only way for Congress to end this troubling cycle. Repeal will mean more gift tax revenues, a fairer and simpler estate tax, and more certain succession planning for family business owners and farmers.

tax analysts special report

Time Traveling to Strangle *Strangi* (And Kill the Monster Again), Part 3

By Richard L. Dees

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The author completes a three-part article by proposing the unification of the estate tax. In the first part of the article (*Tax Notes*, Aug. 13, 2007, p. 563, *Doc 2007-16741*, or *2007 TNT 157-32*), the author criticized *Strangi* and other recent decisions including certain partnership interests in the deceased owner's estate using section 2036. Part 2 (*Tax Notes*, Aug. 20, 2007, p. 657, *Doc 2007-16792*, or *2007 TNT 162-29*) proposed that Congress repeal section 2036 and the other estate tax "strings" sections and replace estate inclusion with an "easy to complete" gift rule that would be fairer and generate tax revenue. Part 3 spends some of that revenue by proposing that the computation of the federal estate tax be changed so that it is computed *net* of all death taxes.

The author advocates this change for three reasons: (1) the change would cut effective estate tax rates without changing the current 45 percent rate, (2) it would eliminate the unfairness of double death taxation, and (3) it would unify the transfer tax, meaning that the gift and estate taxes would be imposed in the same way. The author takes on common misunderstandings to justify this change, including explaining why in more than half the states, the federal estate tax rate has not been *cut* but *increased* by 6 percent. He also argues that fairness should be the primary objective of an estate tax compromise and that any proposed estate tax change needs to be considered in light of its revenue cost.

The author concludes that increasing the estate exemption or providing multiple estate tax rates both fail this fairness-cost analysis. Instead of increasing the estate tax exemption for everyone, the author proposes benefits targeted to small business owners, farmers, and ranchers.

The opinions expressed in this article are the author's alone and should not be attributed to his firm or any of its members, any clients, or any associated organization.

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In 1990 Congress repealed section 2036(c), which included in the gross estate for federal estate tax purposes assets that the decedent had given away during life, perhaps many years before, in business or estate planning transactions. Congress originally enacted section 2036(c) in 1987 to deal with a rare type of business transaction — the preferred stock recapitalization. By the very next year, its limitations were applied to nearly every estate planning and family business transaction, earning the sobriquet "The Monster That Ate Estate Planning, Installment Sales, Buy-Sells, Options, Employment Contracts, and Leases."[1]

While section 2036(c) included previously gifted property in the federal gross estate, Chapter 14, which replaced it, provided a set of special valuation rules for transfer tax purposes. Rather than discriminate against all family business and estate transactions or entities for transfer tax purposes as section 2036(c) had, Congress supplied an exclusive set of rules to deal with specific valuation abuses. However, for cases in which Congress had not provided an antiabuse rule, Congress intended that the courts and IRS were to treat family and nonfamily entities and transactions alike. Chapter 14 also reaffirmed the traditional rule limiting the application of section 2036 to trusts, excluding business and investment entities already subject to estate tax under section 2033.

Just as those who don't know history are bound to repeat it, those who didn't know the section 2036(c) Monster during its short life seem destined to resurrect its problems. A series of court cases have applied section 2036(a) to include in a decedent's estate the assets of some family limited partnerships (FLPs), rather than directly address the courts' underlying valuation concerns. In Part 1 of this article (*Tax Notes*, Aug. 13, 2007, p. 563, *Doc 2007-16741*, *2007 TNT 157-32*), I criticized those

[1]Richard L. Dees, "Section 2036(c): The Monster That Ate Estate Planning, and Installment Sales, Buy-Sells, Options, Employment Contracts and Leases," 66 *Taxes* 876 (1988) (hereinafter Dees Monster article).

decisions — sometimes referred to as the *Strangi* decisions after the seminal case, but referred to there as the "Monster Cases" for their shared flaws with section 2036(c) — as a direct affront to Chapter 14 and contrary to other long-standing legal principles.

Part 2 of this article (*Tax Notes*, Aug. 20, 2007, p. 657, *Doc 2007-16792, 2007 TNT 162-29*) proposed that Congress repeal section 2036 to prevent the problems of the Monster Cases from ever arising again.[2] Part 2 proposed replacing these estate tax "string" sections with an easy-to-complete gift rule resulting in gift tax when the irrevocable transfers are created, rather than estate tax when the creator dies. Part 2 saw two advantages to imposing gift tax rather than section 2036 to transactions: first, fairer treatment for family business owners and farmers who would have more flexibility in designing a succession plan and, second, increased gift tax revenues that could be used to provide estate tax relief and help shape an estate tax compromise.

A few well-informed critics of this proposal to repeal section 2036 argue that imposing a gift tax on irrevocable transfers with retained strings is not an acceptable substitute for imposing an estate tax as long as gifts receive more favorable tax treatment over inheritances. I agree that estates and gifts should receive comparable tax treatment, usually referred to as "unifying" the estate and gift taxes. Accordingly, this Part 3 of the article proposes to unify the gift and estate taxes as well as the generation-skipping transfer tax, but in a dramatically different way than has been proposed before. The estate tax compromise proposal in this part consists of two principal parts: unification of the transfer tax (discussed below) and repeal of section 2036 (discussed in more detail in Part 2). Before considering this two-part estate tax compromise proposal, we need a deeper understanding of current law to catch up with the critics.

I. Today's 82 Percent Estate Tax Rate

Those familiar with the transfer tax (the combined gift, estate, and generation-skipping transfer taxes[3]) usually believe that the transfer tax was unified in 1976. Gifts were added back into the estate for purposes of computing the estate tax. Gift tax rates were made equal to estate tax rates. The 1976 changes also enacted a GSTT intended to tax transfers in trust at the death of the trust beneficiary as if the beneficiary owned the trust assets at death.[4] As we will see, however, the 1976 changes left the gift and estate taxes substantially different in one important way.

The transfer tax is not an income tax, but rather a tax on the privilege of a person to make donative transfers.[5] Current law provides a 45 percent federal transfer tax rate for gifts, estates, and generation-skipping transfers. The gift tax is 45 percent of the value of the property a donor voluntarily gives away, a tax on that privilege measured by the fair market value of that property. The gift and estate taxes are not unified under current law, because the gift tax is 45 percent of the fair market value of the property the *donor* voluntarily transfers, while the estate tax is 82 percent of the FMV of the property the *decedent* voluntarily transfers. This 82 percent rate is disguised because the estate tax is usually stated as 45 percent of the entire estate, including the part confiscated by Treasury as estate taxes.

A fairer definition of "estate" would allow a deduction for the federal estate taxes that must be transferred to the government. Fairness already dictates that the "taxable estate" is computed after deducting all of the decedent's debts and the costs of administering the estate. The estate also is allowed to deduct state death taxes. The compromise would complete the change to a tax on the estate the decedent can voluntarily transfer by allowing a deduction for *federal* estate taxes as well as *state* death taxes.

> **Why an 82 percent estate tax rate?** Assume the current federal transfer tax (estate, gift, and GSTTs) rate of 45 percent and no state gift tax or death tax and that no estate or gift tax exemption is available. If Parent P died with a $10 million estate, P's estate would owe 45 percent of the estate or $4.5 million in federal estate tax. P's child, C, inherits the rest of the estate or $5.5 million. What is the tax on the privilege of voluntarily transferring property to C? The transfer tax, $4.5 million divided by the value of property transferred to C, $5.5 million, or 45/55, is 0.81818181 (rounded to 82 percent).

In Treasury I, the proposals by the Reagan administration to reform the federal tax system, Treasury proposed unifying the estate and gift taxes by stating the gift tax rate paid by the donor as high as necessary to produce equivalent estate taxes. Under current law, the gift tax rate required to unify the transfer tax would have to be raised from 45 percent to today's 82 percent estate tax rate. Such a high gift tax rate is obviously unfair and

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[2]The appendix in Part 1 at p. 581 contained a sentence in the last row stating that "it seems likely that the courts will acknowledge that section 2036 is not to be applied to partnerships and corporations." I intended to say that "it seems *un*likely that the courts will acknowledge. . . ." Of course, the anticipated failure of the courts to self-correct is what led the author to propose repealing section 2036 in Part 2 of this article. This typo is attributable to my error and I apologize to readers.

[3]The term "generation skipping" is confusing because the GSTT applies to gifts in trust for children when trust property passes to a grandchild or more remote descendant, not just to gifts that go to grandchildren, skipping children entirely. The purpose of the GSTT is to ensure that property is subject to transfer tax every generation. Of course, it does not have that effect, as the same GSTT is paid whether a gift is made to a grandchild or great-grandchild.

[4]The 1976 GSTT never went into effect; it was repealed retroactively and replaced prospectively by a new GSTT in 1986 in Chapter 13 of the code.

[5]Calling the estate tax a "death tax" served the purposes of the advocates of estate tax repeal in highlighting the unfairness of the estate tax in applying at a time that is uncertain and when the family is likely to experience emotional distress and a business is likely to experience financial distress. Now that repeal is no longer possible, the continued use of "death tax" is counterproductive. As this part of the article explains, the author believes that unifying the *transfer* tax will produce the greatest improvement to the *death* tax.

therefore has not been enacted in the decades since Treasury I. How ironic that the estate tax, which unlike the gift tax is involuntary, is imposed at the 82 percent rate simply because it has been disguised as 45 percent of the taxable estate.

Thus, I propose to unify the transfer tax not by raising the gift tax rate to 82 percent, but by lowering the estate tax rate from its current 82 percent to 45 percent of the estate after taxes, meaning 0 percent tax on the estate property involuntarily confiscated as estate taxes by the government. Repealing section 2036 will make the estate tax fairer for family business owners, farmers, and ranchers but unification will improve the transfer tax for everyone. The proposal achieves this transfer tax unification by making the federal estate tax a deduction for purposes of computing the tax.

II. Eliminate Double Death Taxation

A. Operation of the Double Death Tax Deduction

At the heart of the proposed estate tax compromise is unifying the transfer tax and cutting the current 82 percent estate tax rate by eliminating double death taxation. Once both the estate tax and gift tax are applied only to the value of property voluntarily transferred, the transfer tax will be unified.[6] The compromise eliminates the unfair "tax on tax" of the current estate tax by adding four words to the current state death tax deduction under section 2058 permitting this deduction for death taxes paid to the states "or the United States." The compromise adopts current law, which contains a $2 million estate tax exemption and a 45 percent transfer tax rate, but provides this expanded death tax deduction to unify the transfer tax.

B. The Case for No Double Death Taxation

1. An effective estate tax rate cut

a. How the rate cut works. If double death tax is eliminated as proposed in this article, the IRS will still get its $450,000 in estate tax on the $1 million net estate (a true 45 percent rate), but it would no longer be able to collect estate tax on the amount paid in estate taxes too (a true 82 percent rate).

> **Example of Death Tax Relief.** If P in the above example had an estate of only $1 million to leave to C, P's estate would pay $450,000 to the IRS in estate tax and C would receive the $550,000 of the estate left after taxes. Estate tax of $450,000 divided by a $1 million estate produces the 45 percent estate tax rate under current law.
>
> Under the compromise, P would pay a 45 percent tax only on the remaining estate after all death taxes are received. Using algebra to find the tax amount that will equal 45 percent of the after tax estate rather than 45 percent of the total estate, the estate tax would be $310,345. If we repeat the above calculation of dividing $310,345 by $1 million, we find that the estate tax would become 31.0345 percent (rounded to 31 percent) of the estate, when stated as in current law as a percent of the estate before subtracting federal estate taxes on (45 percent).[7]

Eliminating double death taxation provides immediate estate tax relief. Moreover, it is easier to understand why eliminating double death taxation is fair than to debate what estate tax rate is "fair." Once understood no one would consider today's 82 percent to be fair. Moreover, the higher a future Congress raises the estate tax rate, the greater the tax benefit from having eliminated the double death tax, thus providing a natural brake on future Congresses that may wish to increase the estate tax rate.

b. Federal estate tax rates have barely been cut despite popular understanding to the contrary. One of the most substantial obstacles to cutting the current 82 percent estate tax rate is the widespread misunderstanding that federal estate tax rates have already been cut substantially. The current stated 45 percent federal transfer tax rate is seen as substantially lower than the 55 percent rate imposed before 2001. While the top federal estate tax rate before 2001 was 55 percent, for estates of more than $10.1 million, the federal rate incorporated a credit of 16 percent for the state death tax paid. In other words, before 2001, of the 55 cents in death taxes paid on each $1 of estate assets, only 39 cents went to the federal government while 16 cents went to the states. Because imposing a state death tax did not cost its residents any more in death taxes, all of the states imposed a death tax equal to the maximum state death tax credit (a "pick-up tax").

States have responded differently to this 16-cent loss in tax revenue due to the 2001 federal estate tax changes. Twenty-seven states have not replaced their death tax. Residents of those states pay 45 cents to the federal government on each $1 of estate value. Those residents have had a total estate tax cut, but the federal government actually collects 6 cents more per $1 value than it did before 2001. Those estates are saving 10 cents in death taxes on each $1 of estate value, but the states (not the federal government) have completely funded their tax cut. Another way of saying this is that the *federal* estate tax rate on large estates has been *raised 6 percent, not cut.*

Because the state death tax credit was replaced with an estate tax deduction for state death taxes paid, the computation of the federal rate is more difficult in the 23 states that have enacted a replacement death tax. Depending on the nature of the state death tax, the federal portion of the total death tax on each $1 of estate value might be as low as 38 cents. In most states the effective federal tax cost would be more than 38 cents. But the residents of those states are likely to pay 16 cents of each $1 of estate value in state death taxes. That means that for many U.S. citizens, the combined death tax cost for each $1 of estate value would be 54 cents — just a penny less

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[6]Corresponding changes will be required in the GSTT to make it consistently tax-exclusive.

[7]A shortcut method to change a tax-exclusive rate to a tax-inclusive rate, in case the stated transfer tax rate changes, is to divide R by (R+1), where R = the current estate tax rate stated as a decimal (0.45).

than the 55 cents they paid in total before 2001. In other words, the federal estate tax rate cut for those estates is only about 1 percent. **The federal rate cuts essentially have cost little or no federal revenue, meaning that any federal revenue losses relate almost entirely to increases in the estate tax exemption, not lower rates.**

Apparently it has served the political purposes of both the proponents and opponents of estate tax repeal for it to appear that estate tax rates have been dramatically cut. Proponents of repeal have been able to claim dramatic estate tax rate cuts when federal tax revenues were actually going up and the states were bearing the burden of the estate tax cuts. On the other hand, opponents of estate tax repeal have argued that estate tax rates already have been cut substantially and that it is the rate cuts that are generating the revenue losses. Of course, neither side of the debate has been completely honest. As we will see in greater detail in the next section, increases in the estate tax exemption, not rate cuts, are responsible for estate tax revenue losses.

c. Increasing the estate tax exemption makes the estate tax less fair.

i. Increasing the exemption causes disproportionate estate tax revenue losses. Because both opponents and proponents of estate tax repeal can agree on increasing the estate exemption, most estate tax compromises start from a higher exemption rather than lower rates. Because those compromises would increase the exemption substantially, they lose a lot more revenue than they would if they cut the estate tax rate substantially. Faced with the high cost of raising the exemption, most compromises defer *any* estate tax savings for years. My compromise would put the double death tax deduction in effect immediately, cutting the estate tax rate from 82 percent to 45 percent and providing immediate estate tax relief. By leaving the current $2 million estate tax exemption unchanged, the compromise can afford to provide immediate relief from unfairly high estate tax rates and double death taxation. Any further increase in the estate tax exemption should depend on identifying additional revenue that can offset the costs of the exemption increase.

That truth — that raising the estate tax exemption costs much more revenue than lowering the rates — is hard to find. Interestingly, it can be found in MISC-LEG-DOC 2006ARD 118-103, prepared by the Congressional Research Service (updated June 12, 2006). Although the report says that "most of the revenue from the estate tax comes from taxing the largest estates at high marginal rates," the data contradicts that statement and similar statements from both sides of the debate.

Although the revenue estimates in that report are sparse, the second line in Table 2 does analyze the bill introduced by Sen. Thomas Carper, D-Del., that freezes the estate tax at the 2009 exemption of $3.5 million and the 2009 rate of 45 percent. The first line in that table shows the revenue that would be generated in 2011 if pre-2001 law applied. The above discussion explained how the effective rate under pre-2001 federal estate tax law for large estates was actually 39 percent. Recall that in 27 states the current effective federal rate is actually 6 percent higher today than in 2000, and in the rest of the states the federal effective rate is no more than 1 percent less. Thus, under the Carper bill, the cut in the top rate from 55 percent with a state death tax credit to 45 percent with a state death tax deduction probably increases estate tax revenue, and certainly would not substantially decrease revenue when compared with pre-2001 law.

Table 2 in the report, however, shows that the Carper bill would lose $22.4 billion in 2011 when compared with pre-2001 law. That loss therefore would have to relate almost entirely to the bill's proposed increase in the estate exemption from $1 million to $3.5 million. If the pre-2001 rate was properly discussed as being 39 percent, rather than 55 percent, lowering the effective federal rate to 30 percent or 35 percent would not seem like such a dramatic change. After all, many taxpayers are paying about the same combined death tax rate as they paid before 2001.

ii. A lower rate is fairer than a higher exemption. The article's proposed compromise would eliminate double death taxation as a matter of fairness, which also lowers the effective estate tax rate. Without regard to the fairness of eliminating double death taxation, generally lowering the estate tax rate is more important, particularly to family business owners and farmers, than increasing the size of the exemption.

When estate tax repeal is the primary objective, one might argue that reducing estate tax revenues is the most important goal. The lower the revenues produced by the transfer tax, the easier future repeal becomes. In such a situation, it makes sense to take whatever estate tax reduction is offered.

Repeal, however, is no longer an option, and the votes needed to pass an estate tax compromise depend on limiting the revenue loss from any compromise. That change in objective requires reevaluating all of the possible estate tax reforms in light of their revenue loss to determine what combination of reforms and tax relief is fairest. Because understanding those options can require substantial technical knowledge, leadership is required to muster the technical experts, reduce that technical information to understandable principles, and educate elected officials and the public on the reasons for supporting the proposed changes.

The case for providing estate tax rate relief by cutting the current estate tax rate from 82 percent to 45 percent and eliminating double death taxation, rather than raising the estate tax exemption, is unassailable. For family business owners, farmers, and ranchers, inertia is the only serious argument for increasing the estate tax exemption rather than providing the proposed estate tax rate reduction. For those concerned about the corrosive effect of the estate tax on family businesses and farms, supporting an increase in the estate tax exemption sounds good now, but is likely to produce very angry owners, farmers, and ranchers, even those with small businesses within a year.

If an increase in the estate exemption would relieve small-business owners from the need to do estate planning, the resulting simplification might justify an increase. However, it is difficult to imagine a business in which a $5 million exemption would relieve the owner of the need to plan for the estate tax. The increased exemption may tempt business owners to forgo any planning

only to find their businesses suddenly much more valuable and that it's too late to do any planning. Moreover, business owners need to plan for succession whether or not that succession involves planning to reduce estate taxes. Because they will be able to structure their succession plans as they choose, at today's values if they want, repeal of section 2036 as advocated in Part 2 of this article should be much more important to business owners, farmers, and ranchers than increasing the exemption. Repeal of section 2036 also has the advantage of raising transfer tax revenues rather than reducing them.

Estates of all sizes benefit from the exemption of gifts and inheritances from the income tax and benefit from the stepped-up basis in estate property at death. When an estate tax compromise proposes raising the estate tax exemption higher than the current $2 million, the compromise is saying that those with taxable estates should pay for the tax breaks for all. It seems fairer for more Americans to share in the cost of this income tax exemption, rather than require only a few to bear the entire cost at unfairly high estate tax rates. If Congress believes that a higher exemption is important, it should pay for that exemption with more broadly based tax revenues, not by imposing unfairly high taxes on the few estates remaining subject to the estate tax, many of which will be family businesses, farms, and ranches.

iii. Family business groups are likely to find any enthusiasm for a higher estate tax exemption shortlived. If a higher estate tax exemption is enacted into law, any enthusiasm that family business owners might have for the higher exemption will likely evaporate quickly when their estate planners and tax advisers discuss the details. If the exemption increase is funded from forgoing other estate tax relief, or worse, by enacting so-called loophole closers requiring the fewer families subject to the estate tax to pay substantially higher taxes, most family business owners will find themselves facing an estate tax, which is less fair. A higher exemption means fewer families — and a higher portion of those remaining families will own businesses, farms, and ranches — subject to estate taxes. If the estate tax burden was shared more broadly, a future Congress would be unlikely to reverse the principles of this compromise.

Although not acknowledged explicitly, past compromises implicitly acknowledge the high cost of increasing the estate tax exemption by their including an inevitable delay in the increase. Some politicians (and unfortunately some of the groups seeking estate tax repeal) believe business owners are fooled by Popeye's friend Wimpy: "I will gladly give you an increased estate tax exemption tomorrow for an 82 percent estate tax rate today." An increased estate tax exemption is unlikely to satisfy business owners when they understand it is still a long time coming and was bought with an estate tax less fair to those remaining subject to the estate tax.[8]

d. The problem with multiple rates. Because federal rates have not decreased much and many states have enacted replacement death taxes that eliminate almost the entire rate cut, any estate tax deal should focus on producing the lowest possible estate tax rate. Rather than arguing for the lowest possible estate tax rate, some business groups have advocated for multiple estate tax rates. Multiple rates have the same problem as a higher exemption: an unfairly high revenue cost compared with cutting the 82 percent estate tax rate for everyone. Taxing larger estates at rates twice that imposed on smaller estates as in last year's bill does not generate much revenue. The high rate is punitive, and it is doubtful that any business owner would support penalizing the most successful family businesses, even if it meant an estate tax break for that owner. Doubling the rate on larger estates, as last year's House bill proposed appears to produce revenues of less than $1 billion a year.

Unlike an increased estate tax exemption, however, multiple rates complicate the succession planning process. Multiple rates force business owners to choose between a spouse and children. Multiple rates require more complicated planning. Multiple rates may also prevent a business owner from creating trusts to protect the inherited interests in the family business. Finally, the ability of a business to pay an estate tax has no relationship to the business's size. Because estate tax relief cannot effectively be targeted to those businesses that need it most, the goal should be to establish the lowest possible single rate so that all businesses benefit from estate tax relief.

Moreover, the existing $2 million estate exemption lowers the rate more for smaller estates, meaning smaller businesses will effectively pay a lower rate than larger ones, without adding the complexity of multiple rates.

> **How the exemption produces progressivity even with a single tax rate.** If the estate tax remained at 45 percent computed in the traditional way (rather than as proposed by this compromise), the effective rate for an estate of $5 million when the estate exemption is $2 million would be determined by dividing the estate tax [($5 million - $2 million) × 45 percent = $1.35 million] by the total estate, producing an effective estate tax rate of 37 percent [$1.35 million divided by $5 million = 37 percent]. The same computation for a $30 million estate produces a rate of 42 percent {[($30 million - $2 million) × 45 percent] divided by $30 million = 42 percent}. The estate exemption means that even a flat rate transfer tax is effectively graduated.

As one can see from that example, an increased exemption is much more effective in providing a progressive tax than a lower rate, as the exemption's effect increases the tax rate incrementally for every dollar of estate increase. Thus, using a lower rate to give relief to small-business owners and farmers is always a mistake.

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[8]Avoiding a dramatic future increase in the estate exemption may also prevent the ghoulish scenes produced when surviving until the following year produces substantial estate tax savings. The reporting concerning the effect of those scenes is likely to undermine public confidence in any estate tax compromise, (Footnote continued in next column.) resulting in disrespect for a Congress that would enact such legislation and in disgust at the few wealthy persons and their advisers who might consider such planning.

Lower effective rates on smaller estates always should be achieved by increasing the estate tax exemption, as seen in the example, while keeping a single rate. Multiple estate tax rates merely complicate planning. Past compromises have included a lower-rate bracket because of an appearance of relief, rather than considering the changes that might provide real relief and a fairer estate tax. Although a low rate for smaller estates may seem attractive to small-business owners, farmers, and ranchers, once they meet with their advisers they would soon understand the complexity created by the low-rate bracket and the resulting cost to plan for it.

e. The compromise leaves gift tax rates unaffected. Because the compromise lowers the effective estate tax rate by eliminating double death tax deduction — putting it on a par with the gift tax — the compromise leaves the gift tax rate unchanged. Simply lowering the 45 percent transfer tax rate without unifying the transfer tax would also lower gift tax rates. Because the method of taxing gifts and estates would be the same under the compromise, the change lowers the effective estate tax rate without reducing the gift tax rate, unlike any other proposal. Gift taxes are most likely to be paid by the wealthiest taxpayers with liquid assets rather than by farmers and business owners who lack liquidity. Thus, this change benefits those who need estate tax relief the most, without giving rate relief to those with the liquidity to pay gift taxes.

f. How to implement the proposed estate tax compromise. Although I have used all of the available sources to assess the revenue effects of lowering the estate tax rate from 82 percent to 45 percent and repealing section 2036, the only way to judge whether that analysis is correct is for a tax bill immediately implementing the proposed changes to be introduced and scored. That scoring also would assess the impact of the projected increase in gift tax revenues from the adoption of an easy-to-complete gift rule as detailed in Part 2 of this article. If sufficient revenue is generated, that revenue could be used to increase the estate tax exemption. However, Congress could target specific relief to family business owners, farmers, and ranchers with estates worth between $2 million and $5 million, which would not be as costly as raising the exemption for everyone.

Farmers and ranchers have unique estate tax problems, particularly when their farms and ranches are located in an area with substantial real estate development or speculation. Congress should target specific relief to estates of farmers and ranchers by increasing the maximum section 2032A use value reduction by $3 million, reflecting that the estate tax exemption was kept at $2 million rather than increased to $5 million as some have proposed. Increasing the section 2032A value reduction is more attractive than a general increase in the estate tax exemption for several reasons: First, section 2032A has strict provisions ensuring that relief goes only to farmers and ranchers with little liquidity; second, if the farm or ranch is sold within 10 years, the estate tax savings has to be repaid; and finally, the proposed increase is unlikely to cost much revenue.

Congress could also provide family business owners greater relief by liberalizing the provisions of section 6166, which allow family business owners, farmers, and ranchers to pay estate taxes in installments by paying interest on those deferral taxes. Rather than increase the estate tax exemption, Congress could increase the amount of tax that can be deferred at a highly favorable 2 percent rate to the amount of estate tax imposed on $3 million more. By targeting relief to small business owners, farmers, and ranchers rather than increasing the exemption for everyone, Congress can limit the cost.

2. Transfer tax unification. Eliminating double death taxation would mean that both inheritances and gifts would be taxed in the same common-sense way — only on the value of the property actually received by the donee or heir. Eliminating double death taxation therefore achieves another long-term and important tax policy goal: the true unification of the estate and gift taxes. Both Republican and Democratic administrations have sought to unify the estate and gift taxes as a matter of good tax policy since 1976, but never have because of the different ways the taxes were computed. The other transfer tax, the GSTT, would be conformed to this way of calculating the tax.

The compromise also completes this unification by setting the gift tax exemption equal to the current estate tax exemption of $2 million. Because estate tax repeal would have created an incentive to make gifts to avoid income taxes, Congress for the first time since 1976 raised the estate tax exemption without raising the gift tax exemption. With an estate tax rate more than twice as high as the capital gains rate, no such incentive exists, and the three transfer taxes should have the same exemption.

Moreover, the benefits of increasing the gift tax exemption will go mostly to smaller-business owners. An individual with an estate of $200 million would be able to transfer free of gift tax only 1 percent of the estate, but the owner of a $10 million business would be able to transfer up to 20 percent free of gift tax. The cost of making an additional $1 million dollar gift under the proposal would be $450,000. Someone with $20 million mostly tied up in her business will benefit more from saving $450,000 in gift tax than someone with $200 million in marketable securities, although for both the exemption was $2 million.

While it is important that any transfer tax change losing revenue be considered in light of its fairness, increasing the gift tax exemption is unlikely to make much of a difference in gift and estate tax revenue. A taxpayer is likely to be willing to incur the same amount of gift tax whatever the size of the exemption. Because the value of lifetime gifts is added back to compute the estate tax, gifts do not reduce estate taxes immediately. Estate tax revenues, therefore, are reduced only after the gift has appreciated substantially.

One of the biggest benefits from the unification of the transfer tax is the one discussed in Part 2 of this article: repeal of section 2036 and the other "string" retention sections. I will not repeat the arguments from Part 2 regarding why repeal would substantially benefit family business owners and farmers, as well as make the estate tax fairer to them.

III. The Principal Objective: A Fairer Estate Tax

The article's proposed approach of cutting rates by unifying the gift and estate taxes, while retaining the current estate and gift tax exemptions at $2 million, is different than other estate tax proposals. This difference is based on three observations of the estate tax repeal and reform debate that are not well understood. First, federal estate tax rates have not been cut very much, despite a general impression to the contrary. Second, estate tax revenue loss largely depends on the size of the estate tax exemption, not on the federal estate tax rate. The two sides start from the politically popular proposition that the exemption should be increased above the existing $2 million. Once the estate exemption is increased, however, the estate tax does not raise enough revenue to provide any further rate or other estate tax relief, despite deferring the increase for years. That creates a temptation to find loophole closers, which will be used to offset the substantial revenue loss from the increased exemption. Finally, the loophole closers are likely to feed family business owners and farmers' dissatisfaction with the transfer tax system.

Family business owners, farmers, and ranchers have pushed hard for estate tax repeal for three important reasons: The government simply takes too big a share of the estate at their deaths through high rates (a higher estate tax exemption is not a substitute for rate relief), they justifiably perceive the estate tax as unfairly targeting business owners and farmers, and they chafe under what they perceive as the unnecessary transfer tax uncertainty they associate with any family business transaction.

The compromise takes on this issue of unfairness in three ways. First, eliminating double death taxation is not only fair, it also cuts an unfairly high 82 percent estate tax rate. Second, the repeal of section 2036 and the other string sections would help level the playing field between a person who invests in a family business or farm and a person who invests with strangers. Finally, the compromise also provides certainty by having the law go into immediate effect without delay and by providing more certain rules governing family business transactions.

Family business owners and farmers would be willing to pay slightly higher taxes under a fairer system, but the greater certainty and fairness as discussed in the last article is likely to produce a dramatic increase in gift tax revenue as taxpayers take advantage of the greater certainty. This additional revenue could be used to increase the estate exemption further. However, it remains important that any increased exemption or other estate tax relief go into effect without delay.

Increasing tax revenues by changes that are good tax policy or simply fairer to taxpayers makes more sense than adding additional loophole closers. If changes are needed, they should be added because they are good policy, not simply because they offset revenue losses. Loophole closers have repeatedly demonstrated that they are flawed. For example, section 2036(c) was enacted to limit the perceived abuses of the preferred stock recapitalizations, but it ended up subsuming the entire field of estate and family business planning. Because well-advised taxpayers will alter their behavior to avoid the effect of the loophole closer, the burden often falls on the ignorant or ill-advised. Meaning also that revenue expectations are never met.

Further, withholding a costly estate tax exemption increase would allow for estate tax relief targeted at family business owners, farmers, and ranchers with estates between $2 million and $5 million.[9] For farmers and ranchers, the value reduction under section 2032A would be increased by $3 million. For family business owners (including farmers and ranchers), section 6166 would be liberalized for all family businesses and the amount of tax deferrable at 2 percent interest would be increased by the estate tax owed on $3 million. Farmers could take advantage of both sections 2032A and 6166.

Finally, the compromise would provide specific relief for a phenomenon unique to rural areas that deserves encouragement. Because farmers and ranchers are often the most successful entrepreneurs in rural areas, they often diversify into local businesses such as banking, trucking, and most recently, biofuel production. Although those families continue their operations on the same land, the values of those businesses can amount to more than half the estate, depriving those families of the opportunity to use section 2032A. The proposal would encourage the development of rural businesses by counting any privately held trade or business interests of the decedent toward meeting the 50 percent of the estate "qualified use" test under section 2032A. However, the proposal would still allow only "qualified real property" (farm and ranch land) to be specially valued under section 2032A.

IV. Conclusion

The effort to repeal the estate tax has resulted in a current estate tax law providing that (1) if an owner's death occurs before 2009, the estate will pay 45 percent on assets in excess of $2 million on assets; (2) if death occurs in 2009, the estate will pay 45 percent in excess of $3.5 million; (3) if death occurs in 2010, the estate will pay no estate tax; and (4) if death occurs in 2011 or thereafter, the estate will pay as much as 55 percent on assets in excess of $1 million.[10] The proponents of repeal have conceded that repeal is no longer possible in the current political climate; yet the two sides have been unable to agree on a workable compromise. Meanwhile, business owners are unable to plan properly for one of the most important issues for them — passing those businesses, farms, and ranches to future generations.

I seek to provide a compromise, with a central premise of increased fairness, that both sides would be willing to accept. Although family business owners may not receive all of the estate tax relief they believe they need, the proposed compromise offers substantial estate tax relief by cutting the estate tax rate from its current 82 percent to

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[9]With proper planning, the exemptions are doubled for married couples.

[10]Of course, as discussed above, 2010 would also revive the state death tax credit, meaning substantially higher death taxes in the 27 states without a death tax today, but not much difference in the 23 states with a replacement tax.

its stated 45 percent. Allowing a deduction for the federal estate tax paid as well as the state death tax paid will prevent double or triple death taxation. By unifying the transfer tax, the compromise also is able to reform the estate and gift taxes in ways that both business owners and tax policy experts have sought for some time by repealing section 2036 and the other estate tax string inclusion provisions. Those reforms complete the process begun by Chapter 14 to provide comparable transfer tax treatment whether family members invest in the family business or invest with strangers. The compromise also structures those reforms to produce additional gift tax revenue in the next five years, which could be used to provide additional estate tax relief, particularly raising the estate tax exemption from its current $2 million.

Finally, and perhaps most importantly, the compromise contains the ingredients missing in other proposals thus far: permanent, practical, and common-sense estate tax reform. Proponents of estate tax repeal look romantically to 2010, when repeal would go into effect for one year. Opponents of repeal look expectantly to 2011, when the estate tax is to revert to its pre-2001 status. Rather than place any importance on how much estate tax relief can be promised, the compromise makes no such promises; all of its benefits would begin on enactment. The compromise provides the certainty that has been lacking for a half-dozen years. The key to this certainty is deemphasizing an increase in the estate tax exemption, which is so costly in lost revenue. Rather than adopt the approach of other estate tax compromises that have paid for the increased exemption with increased estate tax unfairness, the compromise's primary focus is on making the estate tax fairer for family business owners, farmers, and ranchers.

Testimony for the Record

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U.S. Senate
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Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley and members of the Committee: I am pleased to present testimony on the death tax and how it has affected – and short of repeal, will continue to affect – my business.

Drummond and Company, a coal mining operation based in Alabama, is a great example of the American virtue of hard work and delayed gratification. My father started the company in 1935 with nothing but the land he inherited and his own hard work. He had been a foreman in another mine until he realized that he might be able to run his own mine as well, if not better, than his employer. Because he lacked access to capital, he was forced to incur major debt and leverage the majority of the business. He took this risk because he believed that our small town of Sipsey could support a major coal mining operation. Seventy years later, I can tell you that he was right.

Today, Drummond and Company employs over 3,600 workers directly, plus other 1,500 contractors, and grosses nearly $2 billion annually. We have expanded our efforts internationally to Colombia, where we are one of the two largest miners of Colombian coal. We arrived here because a depression-era mining foreman had the courage to take a risk and put his entire effort behind it. In my father's tradition, we continue to work hard, and reinvest 100% of our assets in the business. We also take great pride in our community, and are dedicated to making it stronger. Our corporation alone has donates over $1 million to charity every year.

Our company is a great example of the very achievement promised by the American dream to those who work hard. My father believed that he had the right to maintain, use, and bequeath the fruits of his labor to another generation. However, as he came to learn later in life, and I know only too well, the American dream does not apply to the death tax. Not long after my father's death in 1956, my family and I were greeted by an IRS agent who drove up to our house in an expensive sports car – the kind of possession that

my father would have considered an unnecessary extravagance. I find no humor in the irony that the very tax which punishes hard-work and frugality, was administered by someone who obviously enjoys the material benefits of wealth.

Paying the death tax has placed the business in considerable financial duress in the years following my father's death. We were forced to reallocate useful assets in order to make cash available for our yearly payments. This is due to the fact that coal mining is a very capital intensive business. All cash must be reinvested in purchasing the best equipment, exploring new sources, and employing workers to extract the material. Retaining cash in order to pay for the death tax prevents reasonable expansion and investment and results in fewer new jobs created.

I would like to point out that the harm of this tax does not only fall on the owners of a business such as Drummond and Company, but the employees and their families as well. If we are forced to sell our business at the next generation's death, it is very likely that it will go to a large corporation who would sell off much of the assets and consolidate the operation. Many of our employees who have been with the company for years would be out work. These men and women have families who depend on their jobs. They do not have the kind of wealth that would make them a liability for the death tax. However, by contributing their effort to our business, they have unwittingly made themselves incidental potential victims.

In conclusion, please understand that business owners such as my father and I are asking for no special consideration. All we want is the freedom from a confiscatory tax that unfairly falls on our livelihood and punishes us for our hard-work. We have no objection to contributing our share to the federal government. We do have a problem with a tax which confiscates over half our earnings at death if we saved and invested it, rather than spent it on material consumption.

The members of the Senate Finance Committee have a special opportunity to make a difference for hard-working business owners such as myself and the over 5,000 employees on our payroll, by permanently repealing the onerous death tax. I encourage the committee to support legislation to this effect immediately.

Respectfully submitted:

Larry Drummond

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November 9, 2007

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Re: Upcoming Committee Hearing on the Estate ("Death") Tax

Dear Chairman Baucus and Ranking Member Grassley:

I understand that you will be holding a hearing on November 14 concerning the problems related to the existence of the federal estate ("death") tax. As someone who operates a small American business – and as Chairman of the Board of Directors for AMT – The Association For Manufacturing Technology – I hope you will allow me to briefly weigh in on this issue and that you will allow this letter to be part of the official record of the hearing.

The estate tax is among the most complicated and irrational of all federal taxes, and its effects are particularly pronounced in equipment- and facilities-intensive industries such as ours. Many family-owned businesses are forced to spend significant resources on complex estate planning to mitigate the tax's effects – or are forced to liquidate altogether in order to pay the tax. In many cases, these businesses are cash poor but land/building/inventory rich – which means that the spouse and/or children of the owners are forced to sell the businesses in order to cover a federal tax based essentially on the paper worth of the estate.

The legislation enacted in 2001 has allowed the estate tax rate to decrease and the exemption to increase. This has helped ease some families' angst about the fate of their family-held businesses. Under the law, the entire tax is to be repealed in the year 2010 – a development that would be a blessing. But, as you know, if the Congress takes no further action, this federal tax will reappear in 2011 and return to its punitive pre-2001 levels.

I sincerely hope that you and your colleagues will allow this onerous tax to die, once and for all. But if that is not possible, I would at least urge you to maintain a low tax rate and an exemption high enough to take into account the countless businesses in our country that are owned by families that have very little cash resources to cover the tax.

There is no other federal tax that I can think of that forces someone to sell the very thing on which the tax is levied just to cover the tax.

Our own business, Erie Press Systems, has been in my family for 112 years and is one of those that could be devastated if the estate tax remains on the books as a destructive tax. We operate out of Erie, PA, and have 60 employees. We are one of the very few surviving U.S. designers and builders of large, custom designed, hydraulic and mechanical presses. Our presses are used by larger manufacturers in the aerospace, automotive, agricultural, power generation and other industries. If the estate tax remains and has an unreasonably low exemption level and too high a tax rate, my company will have a difficult time surviving me and could well leave our employees without jobs and my family without a company that has been with us for more than a century.

As an American businessman, and as board chairman of an association that represents more than 400 machine tool companies – many of which potentially face similar devastation as a result of the estate tax – I appreciate any relief and help that you can offer all family-owned businesses in our country.

Sincerely,

Dougald A. Currie II

Dougald A. Currie, II
President and CEO
Erie Press Systems

Statements for the Record:

Blake Sullivan
Chairman,
Government Affairs Committee
Forest Landowners Association
900 Circle 75 Parkway, Suite 205
Atlanta, GA 30339

Henry Barclay, CPA
Chairman of the Board
Forest Landowners Tax Council
P.O. Box 784
Alexandria, VA 22313

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007, at 10:00 a.m.
215 Dirksen Senate Office Building

"*In a free society with private property rights and a market system, private property is a condition of functionality. Government intervention creates distortion.*"-- Adam Smith "Wealth of Nations."

"*When a society wants less of something they tax it: The estate tax is a tax on American capital... a tax on the economic mechanism that produces income. Do we truly want to reduce our means of income production in the United States?*" -- Vernon Smith, Nobel Laureate, "U.S. Treasury Roundtable on the Estate Tax" 2003

Chairman Peterson, Ranking Member Goodlatte, Members of the Committee, on behalf of the Forest Landowners Association and the Forest Landowners Tax Council we thank you for the opportunity to submit this written testimony on the implications of the estate tax for almost 11 million U.S. citizens who are non-industrial private forest landowners. More specifically, the implications and opportunities non-industrial private forest landowners see for elimination or refinement of that onerous tax statute. Many of you have spent a lot of time on this issue and we in the forestry community appreciate it.

We are:
J. Blake Sullivan *holds a Masters of Forestry from Duke University and a Bachelors of Business Administration from Columbus State University. He is Chair of the Governmental Affairs Committee, on the Executive Committee, a Board Member of the* <u>*Forest Landowners Association*</u>. *His other leadership experience includes a presidency with the Georgia Forestry Association, board chairmanship of the Georgia Forestry Foundation, and executive committee membership for the Coalition for Fair Lumber Imports. He was honored in 2002 with the Forest Landowners Association's Forest Landowner of the Year Award and in 2004 with the Wise Owl Award from the Georgia Forestry Association. Since 1986, he has served as the President and owner of Sullivan Forestry Consultants, Inc., a multi-disciplinary forestry consulting firm that provides forest management and real estate brokerage services for a diverse group of clients.*

Henry Barclay *is the managing partner of Lehmann, Ullman and Barclay LLP which has been involved in timber related services almost since its inception in 1912. He attended Tulane University and was graduated from the University of Alabama. He is a frequent speaker and seminar leader on timber business and income and estate tax issues. Henry is a Board Member and Chairman of the* <u>*Forest Landowners Tax Council*</u> *and is*

Treasurer and a Board Member of the Forest History Society. He is immediate Past President of the Alabama Forest Owners' Association and contributes a quarterly tax review for their newsletter. He is a member of the Forest Landowners' Association, the Alabama Forestry Council, the American Institute of Certified Public Accountants, the Alabama Society of Certified Public Accountants and its Birmingham Chapter, the Birmingham Estate Planning Council and the Birmingham Tax Forum.

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America's non-industrial private forest owners -- who own 59 percent of America's forestland, including family farms -- are bearing more responsibility than ever before for the nation's environmental quality and sustainable timber production. However, the possibility of untimely timber harvests and disruption of established forest management programs due to federal death tax policy is becoming increasingly pervasive as timber and land values continue to rise. This trend is counterproductive to society's goals of sustainable forestry and environmental quality. Succinctly put, the Forest Landowners Tax Council position on the death tax is that it should be immediately and permanently eliminated.

The estate tax generates approximately 1.5 percent of annual federal revenues but affects persons of similar net worth in dramatically different ways. For example, an heir faced with a sizable estate tax bill who has inherited fairly liquid assets such as stocks or bonds will find it much easier to pay such bills compared to an heir who inherits relatively illiquid assets such as forest property, the sale of which could eliminate a family's heritage or result in a substantial environmental cost.

We are troubled by the arcane and misleading methods used by the Joint Committee on Taxation and by their failures to produce transparency in those methods. This concern includes but is not limited to a simplistic "scoring" of legislative proposals relative their effect on the U.S. Treasury, while ignoring those proposals' effects upon the U.S. economy as a whole. The results of what has been called their "static economic analyses" fail to account for our dynamic economy and the positive revenues that can be generated to the Treasury by leaving funds in that economy to multiply through capitalistic enterprise. Using a dynamic approach to scoring the elimination of the estate tax, in 2003 the CONSAD Research Corporation[1] calculated that rather than a net loss to the Treasury there would in fact be a net gain to the Treasury of approximately $38 billion over a 10 period.

The estate tax provides a disincentive for heirs to retain their family forestland or to continue to sustainably manage their forests even if not sold. The federal estate tax can also cause an estate faced with a substantial tax bill to harvest timber in an environmentally insensitive way, disregard a long-term professional forest management plan, forfeit ownership, or parcel out portions of the property -- thus breaking up

[1] "THE EFFECTS ON GOVERNMENT REVENUES FROM REPEALING THE FEDERAL ESTATE TAX AND LIMITING THE STEP-UP IN BASIS FOR TAXING CAPITAL GAINS", CONSAD Research Corporation, 121 North Highland Avenue, Pittsburgh, Pennsylvania 15206, (412) 363-5500, July 16, 2003.

ownership, fragmenting forested landscapes, and encouraging alternative development patterns that often have negative impacts on the environment and forest management. This problem may become even more widespread in the near future, as about half of today's non-industrial private forest landowners are over the age of 60.

Nearly 11 million non-industrial private forest owners hold 59 percent of the nation's commercial forestland base. These landowners hold their forests for a variety of reasons including, but not limited to, recreation, wildlife habitat, preservation, timber production, and investment. Most do not rely on their forest property as a primary income source but often receive periodic economic benefits from forestland ownership. These lands provide 49 percent of the nation's timber supply and 53 percent of outdoor recreational opportunities.

In 2000 at a Forest Service conference on fragmentation of U.S. private forestlands, John Greene[2] (Law and Economics Research, U.S. Forest Service, New Orleans, Louisiana) brought data from the only research that has been done regarding the effects of the estate tax on forestland ownership. He said: "It appears that in about two-fifths of the cases where federal estate tax is due, timber or land is sold to pay part or all of the tax. A large fraction of these sales are forced, because other estate assets are not adequate to pay the tax. Ownerships forced to sell timber or land to pay the estate tax range from under 100 acres to several thousand acres of forestland, and average in the large size class. It appears that 2 million acres of forestland must be harvested and over 1 million acres must be sold each year to pay the federal estate tax. Of the acres that are sold, it appears that several hundred thousand each year are converted to other, more developed, uses." [*emphasis added*]

Co-author, Blake Sullivan, is currently working on an estate: "A widow died this past June and the farm owned by her family for over 50 years is now having to harvest timber to come up with money to pay the death tax. Her beneficiaries now become 'land rich and cash poor'. Since all of the cash is going to pay the death tax the family will be forced to sell land to produce income necessary to support the ongoing operations of the farm. The farm she dreamed of leaving her family will now be so much less than she ever envisioned. As the World War II generation dies off, our rural lands which have ingrained and supported American ideals and values are disappearing. Often the death tax is the single greatest force causing this change."

The federal estate tax provisions represent a great burden to many individuals who inherit forestland. The current law presents a difficult target for planning purposes. Also, heirs to a taxable estate have but nine months after the owner's death to convert timber and/or timberland assets to cash for estate tax payments; a relatively short-term response for a crop that ranges from 15 to 60 years to mature. In response to this substantial tax and short payment schedule, many heirs are forced to disrupt forest management programs, prematurely harvest timber, and otherwise engage in unsustainable forest practices that can degrade the quality of both the environment and the land, thus limiting future forest

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[2] September 19, 2000, A conference entitled "Forest Fragmentation 2000: Sustaining Private Forests in the 21st Century" held in Annapolis, Maryland.

management options. The tax may also force the estate to subdivide or sell all or portions of the family land that might otherwise be managed in a sustainable manner, in order to meet the estate tax obligation. The conversion of forestland to other uses or the unsustainable harvest of its resources is of major concern to the American people and forest landowners.

Co-author, Henry Barclay, makes the following observation: "Most, if not all, forest landowners have tended their investment in land and timber well. Currently, those investments of land and timber are more valued than ever by society. However, to pay death taxes, many executors and beneficiaries find it necessary to interrupt their management plans by cutting timber early or by selling timberland. There are many instances of farms and forests that are damaged by this onerous tax. But, here's what we find most interesting: the repeal of the death tax is supported by about 70 percent of our fellow citizens, but some who oppose death tax repeal, for example Warren Buffet, have become wealthy from this tax by investing in life insurance companies which feed off of ordinary Americans' fear of this devastating tax."

The special use valuation provisions of the federal estate tax law are of little help to forest landowners. Although technically applicable to forestland and timber, they were written primarily to apply to agricultural production. The eligibility and valuation rules are largely incompatible with the reality of non-industrial forest management and can only be used by timber estates with the greatest of difficulty. For example, specially valued timber cannot be harvested for 10 years after the owner's death, even if required as part of an ongoing forest management plan or for salvage purposes because of insect, disease, or fire damage. Even for those forest estates that qualify, the current $940,000 limitation on reduction below fair market value effectively excludes substantial acreages.

Quick Points on the Estate Tax:

- The estate tax brings in less than 1.5 percent of total revenues, and it is estimated that enforcement of the tax costs the federal government 65 cents for every dollar it raises.
- According to the Joint Economic Committee, in this century the estate tax has reduced stock of capital in the economy by $497 billion, a 3.9 percent reduction (The Economics of the Estate Tax, December 19, 1998)
- Family businesses could better use their resources to modernize equipment, expand operations and create new jobs, rather than spend hundreds of thousands of dollars for lawyers, accountants and insurance to deal with the estate tax.
- A person who works hard, pays taxes along the way – both corporate and income taxes – and invests and saves money should not be penalized with a punitive tax at his or her death. Through this onerous tax the federal government is sustaining a public policy that undermines the fundamental principles that our nation supports – hard work, savings and fairness.
- Death should not be a taxable event.

###

Don Root
Chairman and CEO
GM Nameplate
2040 14th Avenue West
Seattle, WA 98119

Statement for the Record:

U.S. Senate
Committee on Finance
Washington, DC 20510

November 14, 2007

Federal Estate Tax: Uncertainty in Planning Under the Current Law

Chairman Baucus, Ranking Member Grassley, and members of the Committee: It is my honor to share my experience with the death tax, and reasons for repeal.

Undoubtedly, you have heard from many well-intentioned individuals, such as Warren Buffett, who have told you that the death tax does not pose a real threat to family-owned, private businesses. Mr. Buffett and other billionaires claim that private businesses can pay the tax without needing to sell assets. They do not see the difference in their highly liquid, billion dollar assets based in publicly-traded stock, and the thousands to millions in fixed, non-liquid assets, owned by family-businesses of various sizes. While I wish this was the case, the facts of my story and countless others in Washington State and every other state prove otherwise. Let me share some background about our company, which will shed light on why the death tax is such an ominous event.

As I want you to see first hand what the assets look like in a fairly large family business, I am enclosing the audited balance sheet and income statement from our company, GM Nameplate. I hope your committee will look at these documents and ask any questions that come to mind. If you would like to look at other family-owned business financial statements, I would be glad to take on the task of obtaining the information for you through organizations that understand the problems the death tax creates (National Association of Manufacturers, National Federation of Independent Business, U.S. Chamber and the American Family Business Institute, to mention just a few).

If you look, you will see that the typical family-owned business has no way to pay a death tax with cash on hand and no way to borrow enough to pay a tax and still stay competitive. The tax has to be eliminated if you care at all about family-owned businesses. All inherited assets should be taxed when sold just like any other capital gain with no pressure from a death forcing a sale. When a family intends to continue to operate the business or farm, no tax should be due except on the profit from the business.

GM Nameplate celebrated its 52nd anniversary this year. I was the 14th employee of GM Nameplate right out of college in 1962. In 1977 the owners and original founders

were ready to retire and wanted to sell the business. Four of us scraped together a down payment and convinced a bank to loan us the rest of the money needed for the purchase. At the time, the company employed 60.

We have been fortunate. By a lot of hard work, constant reinventing, and reinvesting all we made in the good years, we have built the company to one that can and does provide employment to over 850 fellow Americans. These employees produce nearly $90,000,000 in nameplates, labels, electronic control panels, and flexible circuits used in aircraft, medical devices, automobiles, consumer appliances and computer devices and systems.

Today, 30 percent of the company is owned by non-family member employees and 70 percent is owned by our family. All four of our sons have worked for the company from the time they reached working age.

In a typical year, our payroll and payroll taxes total $39,000,000. Medical insurance provided to all employees and their families cost us $2,300,000 and will increase another 20 percent next year we are told. We have contributed millions of dollars to our employees 401k/profit sharing retirement plan and will contribute millions more as long as we can stay in business and make a profit.

It has taken 52 years to build a business that can accomplish this. How can it make any sense to have a tax that works to tear down what has been accomplished?

Eliminating the death tax is really about JOBS. Just the largest 150 privately owned businesses in Washington State provide more jobs than two of the state's largest public companies together, Boeing and Microsoft. Would it make any sense to have a tax that would kill them or set them back 25 years if their Chairman or President died? Obviously not!!! The same concern should exist for family-owned and privately-owned businesses.

Then, there is the argument that the Death Tax is needed to redistribute the wealth. That argument is seriously flawed, unless the intention is to redistribute the wealth to billionaires and huge corporations. Under the present system, they are the only ones who have the resources to quickly buy out heirs or to buy companies whose owners are attempting to solve estate tax problems before they die.

Taxes are essential to run this great country we all live in but they must be collected on earnings and profits. There is no profit in death. I ask that you think of the employees, their families, the communities, and the on-going tax revenues that are all dependant on companies like GM Nameplate remaining in business, and permanently eliminate the tax based on death.

Sincerely yours,

Donald Root
Chairman and CEO
GM Nameplate

GM NAMEPLATE, INC. AND SUBSIDIARIES

INDEPENDENT AUDITOR'S REPORT

AND CONSOLIDATED FINANCIAL STATEMENTS

APRIL 30, 2007

INDEPENDENT AUDITOR'S REPORT

Board of Directors
GM Nameplate, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheet of GM Nameplate, Inc. and Subsidiaries as of April 30, 2007, and the related consolidated statements of operations, stockholders' equity, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of GM Nameplate, Inc. and Subsidiaries as of April 30, 2007, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Moss Adams LLP

Everett, Washington
October 12, 2007

GM NAMEPLATE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
APRIL 30, 2007

ASSETS

CURRENT ASSETS	
Cash and cash equivalents	$ 2,030,112
Accounts receivable, net	8,860,505
Inventories	
Raw materials	3,639,971
Work-in-process	4,538,328
Prepaid expenses and other	711,167
Notes receivable	437,717
Current portion of deferred income taxes	576,930
Total current assets	20,794,730
PROPERTY, PLANT, AND EQUIPMENT	
Land and improvements	796,356
Buildings and improvements	15,194,694
Plant equipment	40,108,295
Computers, furniture, and fixtures	3,488,946
Automobiles	1,209,582
Construction in progress	162,714
	60,960,587
Less accumulated depreciation	(45,622,104)
	15,338,483
DEFERRED INCOME TAXES	362,036
GOODWILL	3,098,930
INTANGIBLE ASSETS	42,618
OTHER ASSETS	123,720
	$ 39,760,517

GM NAMEPLATE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
APRIL 30, 2007

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES	
Lines of credit	$ 6,103,920
Accounts payable	4,529,937
Accrued expenses	3,314,463
Income tax payable	293,183
Deferred revenue	79,221
Current portion of long-term debt	378,560
Total current liabilities	14,699,284
DEFERRED GAIN FROM SALE LEASEBACK OF BUILDINGS	2,366,570
LONG-TERM DEBT, net of current portion	4,064,170
STOCKHOLDERS' EQUITY	
Class A common stock, no par value; authorized 250,000 shares; issued and outstanding, 166,795 shares	1,839,867
Class B common stock, no par value; authorized 100,000 shares; issued and outstanding, 50,123 shares	712,095
Class C common stock, no par value; authorized 2,000,000 shares; issued and outstanding, 1,493,714 shares	55,800
Retained earnings	15,437,631
Accumulated other comprehensive income, net of tax	585,100
Total stockholders' equity	18,630,493
Total liabilities and stockholders' equity	$ 39,760,517

See accompanying notes.

GM NAMEPLATE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
YEAR ENDED APRIL 30, 2007

	AMOUNT	PERCENT
NET SALES	$ 81,238,392	100.0
COST OF SALES	55,011,621	67.7
GROSS PROFIT	26,226,771	32.3
SELLING, GENERAL, AND ADMINISTRATIVE EXPENSES	25,915,031	31.9
DEFERRED GAIN ON SALE LEASEBACK OF BUILDING	994,835	1.2
GOODWILL IMPAIRMENT EXPENSE	202,507	0.2
INCOME FROM OPERATIONS	1,104,068	1.4
OTHER INCOME (EXPENSE)		
Interest expense	(1,150,422)	(1.4)
Interest income	110,803	0.1
Other expense, net	(43,637)	(0.1)
Amortization of deferred gain		
Loss on disposal of property and equipment	(7,481)	(0.0)
Total other expense	(1,090,737)	(1.4)
INCOME BEFORE INCOME TAXES	13,331	0.0
INCOME TAX PROVISION	(374,079)	(0.5)
NET LOSS	$ (360,748)	(0.5)

See accompanying notes.

Bruce Nevins

CEO and Owner

Grande Harvest Wines

33 Grand Central Terminal

New York, NY 10017

Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley and Members of the Committee, I appreciate the opportunity to share my concerns about the death tax.

I am one of many business owners throughout America who is almost exclusively invested in my business – a business my heirs will likely be forced to sell in order to pay the death tax. The irony is that as an entrepreneur and small business owner, I am the very kind of business that every member of congress claims to protect. Please take the time to read my testimony, and understand that the death tax does more to harm small-to-medium sized operations like mine than it does to redistribute the wealth of billionaires.

My company, Grande Harvest Wines, is a retail merchant of fine wine and spirits with stores located in New York and Connecticut. The main store of Grande Harvest Wines is located in Grand Central Station, New York City. I have opened a premium cigar store in Grand Central Station as well, and have plans to open a restaurant in Connecticut. My "wealth" – as far as the IRS will be concerned at the time of my death – is in the building space I rent, the employees on my payroll, and the shelves of wines and spirits I sell. All of the company's cash assets are reinvested in the company in order to maintain our large inventory.

Due to the complexity of the various state alcoholic beverage laws, I maintain multiple corporate entities to handle my business's trade with certain states. This means that my already limited capital is spread throughout my business in such a way as to make it near impossible to quickly raise substantial cash. My sons will have no easy way to pay my death tax liability. This will make it necessary to sell substantial assets in order to raise

the capital needed. The nature of the business is such that if a significant percentage of the company's assets were sold, the entire business would become unsustainable and would quickly go under.

I am aware of the need to find alternative sources of cash so that my sons are not burdened by this event. I have taken out multiple life insurance policies, which of course are costing our company a fortune. This is money that we would prefer to invest in expansion and improvement – actions which would lead to more jobs and a stronger local economy. Unfortunately, after spending precious resources on life-insurance, we are coming to the realization that even this will not be enough to meet the death tax's demands.

Obviously, I will look into further estate planning techniques and hope to find other means by which to preserve Grande Harvest Wines. It is not simply for my sons – three of whom work in the company – but also for our employees and their families that I want to keep the business in operation. Except for my death tax liability, I foresee no reason why the company will not continue to grow and expand under my sons' leadership. They are already learning the complicated business of importing and retailing wine from around the world. In time, they will take over for me, assuming we have found a way to deal with the death tax.

I find it strange that Congress has not yet addressed a tax which falls so harshly on small business owners such as me. I am certainly no billionaire and have inherited no wealth. This tax will not break up the wealth of a landed family – it will destroy the legacy of an entrepreneur.

The only way to completely eliminate the death tax's unfair burden on business-owners such as me is to permanently repeal it. My company is valued at close to $6 million, well over the highest proposed exemption amount. With further expansion and the addition of the restaurant, the estimated value of my enterprise will only climb higher. Even so, I am still a "small" business and my personal wealth is minimal. The death tax will continue to threaten Grande Harvest Wine's viability until it is repealed.

I have worked hard my entire life, paid enormous amounts of taxes - both corporate and personal, have served my country in time of war in Vietnam as a member of the U.S. Army, and have generously contributed to the communities in which I have lived and done business. I employ more than twenty people, providing them with a good living and health benefits. It is an outrage that after a lifetime of paying taxes on my hard earned money, I have to worry about my government threatening to put my heirs (who work hard to grow this company) out of business (and consequently eliminate jobs) due to this horrible and greedy death tax - the most unfair and un-American tax ever instituted!

I urge the Members of the Senate Finance committee to draft and recommend passage of legislation to permanently abolish the death tax.

Kevin Hancock

President and CEO

Hancock Lumber

P.O. Box 299

Casco, ME 04051

Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee:

As a sixth generation private business owner, it is an honor to provide you with my testimony concerning the matter of the federal estate tax, also known as the "death tax." I am the President and CEO of Hancock Lumber, a family-owned and operated business in southern Maine. I want to share with you how the death tax will harm, if not destroy, not only our family's business, but also a large forest. To begin, allow me to share some background about our company.

Hancock Lumber engages in three distinct but tangential operations. Our first operation is the management of 30,000 acres of timberland, primarily Eastern White Pine. This tree has a long and noble history, as its lumber was used over 200 years ago by the British Royal Navy to construct the masts for their vessels. The Eastern White Pine takes 80-100 years to reach maturity, meaning a forest owner must take a long-term, multi-generational approach. The trees which have taken seed during my life will not be ready for harvesting till my grandchildren are running the business. It is important to note that these forests, though privately owned and maintained, are open to the public for hiking, camping, skiing, and in season, hunting.

Our second operation is our saw mill business, which we operate through mills owned in the communities of Bethel, Pittsfield, and Casco. Between these three saw mills, we are the largest manufacturer of white pine lumber in the United States. We produce over 85 million board feet of lumber each year. Our third and final operation is our retail business, which we run out of 10 stores throughout the state. We sell our retail to both professional builders and homeowners.

Hancock Lumber employs 550 workers and holds $50 million in illiquid assets, as well as added millions in forestland. The value of this land is subjective to an owner who has local saw mills and a lumber retail business. If sold on the open market, our forests – which are near the sprawling suburbs of southern Maine – would invariably be developed. The forests are of minimal marginal value if you are not also the owner of a mill and do not have a branded retail name from which to sell the lumber. Finally, it is important to note that we hold no cash reserves and my family has no major investments outside of the business.

When my mother dies, the estate tax will be a major event for both the business and my entire family. Because we have no liquid assets within the business or outside it, paying the death tax will be very difficult. We are spending $75,000 a year on life insurance, but we have been advised that this will not be enough. This means that to pay the death tax, will be forced to sell part or all of the business, depending on the valuation of the company. Either way, some of the forestland will likely be the first to go, since we can more easily recoup those losses than our mills or retail stores.

As I explained above, our forests are not simply potential lumber, but are natural areas on which wildlife thrives and humans are able to enjoy outdoor recreation. I have no doubt that when they are sold, they will go to a developer. Once it has been sold to a developer, it will be parceled off and will no longer be maintained as publicly-open forests. This is particularly a shame in southern Maine, where green-space and curtailment of sprawl is a major political issue. Unfortunately, the death tax has been a leading cause of green-space and forest loss in Maine, as multiple private forests have been sold in order to pay the death tax. It saddens me that the death tax will likely result in our land being removed from forest to housing development.

As you hopefully can understand, my family takes great pride in a business that was built on hard-work and stewardship. We are not wealthy, and did not build our business through overnight marketing gimmicks. My great, great, great-grandfather started this business with faith that his initial hard-work would be paid off to future generations, who would care for the land that he tended and the business he started. That same work-ethic has been passed down through our family, and I have every hope of being able to pass it on to my children and grandchildren. I would like to think that 30,000 acres of forests, 550 jobs, and the fruits of six-generations of family labor will be secure long after my death.

Members of the committee, I respectfully request that you support legislation to permanently address the death tax. Doing this will remove one of the major impediments

to the survivability to family-owned businesses, and will encourage the preservation of forest-land which cannot be created overnight, but which can easily be destroyed in a few days. For the sake of my children and grandchildren, the Eastern White Pine forest which we manage, and 550 employees, please pass legislation to address the death tax.

Statement of Independent Sector

Hearing before the Senate Committee on Finance

Federal Estate Tax:
Uncertainty in Planning Under the Current Law

November 14, 2007

The role of charities and foundations, which now number 1.4 million, is far too valuable in American civic life to be overlooked in the national conversation about estate tax reform. From hospitals to homeless shelters to art museums and little leagues; from religious congregations to universities, the charitable sector manages to reach every aspect of American life. Therefore, on behalf of Independent Sector, a coalition of charities, foundations and corporate giving programs, we ask that the impact on nonprofit organizations be kept in mind as this Committee considers the implications of reforms to the federal estate tax.

The federal government and the charitable sector share a unique partnership in addressing many social concerns. Repeal of the estate tax would cost about $1 trillion in federal tax revenues in the first ten years, once the added interest on the federal debt is taken into account. Revenue losses this big would significantly worsen the already severe federal budget problems the nation faces. Many charitable organizations serving the most vulnerable among us, particularly health and human services organizations, rely on state and federal government funding to support community programs. Those revenues are already at risk, and a full repeal of the estate tax will only serve to further dry up funding for these critical services.

Americans have always supported a strong and independent charitable sector. Policy makers have long recognized the vital role tax incentives play in encouraging Americans, particularly wealthy taxpayers, to give back to the community. According to the Internal Revenue Service, in 2006 almost two-thirds of charitable bequests came from estates valued at over $10 million, and three-quarters of bequests came from those valued at over $5 million. In this context, it is clear that a repeal of the estate tax would be very disruptive. The Congressional Budget Office has estimated that if the federal estate tax had not existed in 2000, charitable donations would have been reduced by a stunning $13 to $25 billion that year. This massive potential loss in donations is more than the total amount that all corporations gave to charity in 2000. The CBO study, like a number of earlier studies, found that the estate tax leads affluent individuals to donate more than they otherwise would, because such donations – whether made during life or as bequests at death – sharply reduce estate tax liability.

If the estate tax were retained in a smaller form, the CBO study indicates that the drop in charitable giving would be much smaller. An exemption of the first $2 million to $3 million of an individual's

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estate (and twice that amount for couples) would have reduced charitable giving by just $1 billion to $6 billion in 2000. Again, this is compared to a drop of up to $25 billion if the tax were entirely eliminated.

Tax incentives are a basic part of the nation's charitable infrastructure, and the estate tax has for decades been one of the most important of these incentives. Retaining a smaller, reformed estate tax would be a sensible way to preserve charitable donations and protect federal and state budgets, while responding to the criticism the current estate tax has engendered.

Permanent repeal or irresponsible reform of the estate tax would benefit the few at the expense of the many. Repealing the estate tax would seriously damage the power of hundreds of thousands of individuals who work with the nonprofit community to improve the public good through charitable contributions, volunteering and advocacy. The solution is to protect family farms and small business owners while also ensuring adequate federal revenues and encouraging charitable contributions that help nonprofits implement, complement and enhance services provided by government and business. We urge you to protect individual legacies while safeguarding the legacy of a better future for all.

We ask that you give serious consideration to the impact on charitable giving of each estate tax proposal. Both the federal government and the charitable sector need sufficient resources to meet the diverse challenges of the 21st Century. Careful and reasonable reform of the estate tax will make that possible.

Patricia Read
Senior Vice President, Public Policy and Government Affairs
Independent Sector

Statement for the Record of
Stephen J. Entin
President and Executive Director
Institute for Research on the Economics of Taxation

Before the
Senate Finance Committee

Hearing on

Federal Estate Tax: Uncertainty in Planning
Under the Current Law

November 14, 2007

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The Federal unified estate and gift tax (a.k.a. the Death Tax)

The Federal government imposes a unified estate and gift tax on transfers of property by lifetime gift or at death, above certain exempt amounts. (See Chart 1.) The rates are graduated. Prior to the Economic Growth and Tax Reconciliation Act of 2001, the bottom marginal tax rates were offset by a credit (exempting the first $625,000 of an estate in 2001), but once the estate reached taxable levels, the tax rates started at 37%. The estate tax had a flat top rate of 55% on the largest estates. (The lower graduated tax rates on estates below $3 million were offset by a higher rate of 60% — i.e., 55% plus a 5% surtax — applied to estates between $10 million and $17.184 million). Beneficiaries were allowed a "step-up in basis" for future capital gains on inherited assets. That is, their acquisition price was assumed to be the market value of the assets at the death of the decedent (or at the time of receipt by the beneficiary), rather than the original purchase price of the decedent. This effectively prevented the double taxation of the asset by the capital gains tax as well as the estate tax.

Chart 1
Marginal Tax Rate Schedule Of Federal Estate And Gift Tax

For 2001

If Taxable Estate/Gift is: Over:	But not over:	The Marginal Tax Rate is:
$ 0	$10,000	18%*
10,000	20,000	20%*
20,000	40,000	22%*
40,000	60,000	24%*
60,000	80,000	26%*
80,000	100,000	28%*
100,000	150,000	30%*
150,000	250,000	32%*
250,000	500,000	34%*
500,000	750,000	37%*
750,000	1,000,000	39%
1,000,000	1,250,000	41%
1,250,000	1,500,000	43%
1,500,000	2,000,000	45%
2,000,000	2,500,000	49%
2,500,000	3,000,000	53%
3,000,000	10,000,000	55%
10,000,000	17,184,000	60%
Over 17,184,000		55%

* A Credit offsets the tax on the first $675,000 of lifetime transfers in 2001, effectively making the tax rate zero on transfers below $675,000.

Changes in Future Years

	Estate Tax		Gift Tax	
Year	Top Tax Rate	Lifetime Amount Exempted by Credit	Top Tax Rate	Lifetime Amount Exempted by Credit
2001	60%	675,000	60%	675,000
2002	50%	1,000,000	50%	1,000,000
2003	49%	1,000,000	49%	1,000,000
2004	48%	1,500,000	48%	1,000,000
2005	47%	1,500,000	47%	1,000,000
2006	46%	2,000,000	46%	1,000,000
2007	45%	2,000,000	45%	1,000,000
2008	45%	2,000,000	45%	1,000,000
2009	45%	3,500,000	45%	1,000,000
2010	Estate Tax Repealed†		35%*	1,000,000
2011	Old Estate and Gift Tax Returns‡			

Estate Tax Credit reduced by amt of Credit used against Gift Tax.

*Gift tax only
† Estate Tax repealed but bequests may be subject to capital gains tax.
‡ 2001 Tax Act disappears at end of 2010, unless extended or made permanent.

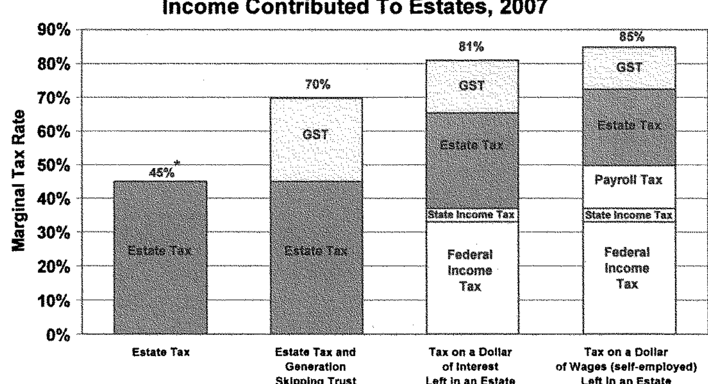
The 2001 Tax Act provided for a gradual lowering of the tax's top rate, an increase in the credit, and the elimination of the 5% surtax. In 2007, the top marginal rate is 45%, and the amount of estate exempted from the estate tax is $2 million (but the exemption for the gift tax is only $1 million). Under the 2001 Tax Act, the estate tax (but not the gift tax portion) will vanish in 2010, but it will reappear in 2011 – at the old, extremely high rates – as the 2001 Tax Act

sunsets, unless the Congress votes to extend the 2001 provisions. In 2010, beneficiaries will lose the step-up in basis. It will be replaced by a capital gains basis adjustment of $1.3 million per estate, plus $3 million for a surviving spouse.

Generation skipping tax

There is an added tax, called the generation skipping tax (GST), if a bequest goes to a grandchild or other relative more than one generation removed from the decedent. The GST rate is equivalent to imposing a 45% tax on the estate as if it had gone to a child, and then imposing another 45% rate on the remaining 55% of the estate as if it had gone from the child to the grandchild. Congress didn't want to miss out on any potential revenue by letting anyone's death go untaxed! In 2007, the combined GST/death tax rate can reach nearly 70% (69.75%, to be exact). Prior to the 2001 Tax Act, the top rate with the GST was just under 80% (79.75%, to be exact). (See Chart 2.)

Chart 2 Marginal Tax Rates On Estates And Income Contributed To Estates, 2007



** 45% Estate Tax Rate becomes effective in 2007.*
Assumes married couple in 33% tax bracket, who are self-employed, with a 6% state income tax.
Computed prior to Estate Tax Repeal, which is now scheduled for 2010.

Saving or working to add to an estate brings higher tax rates

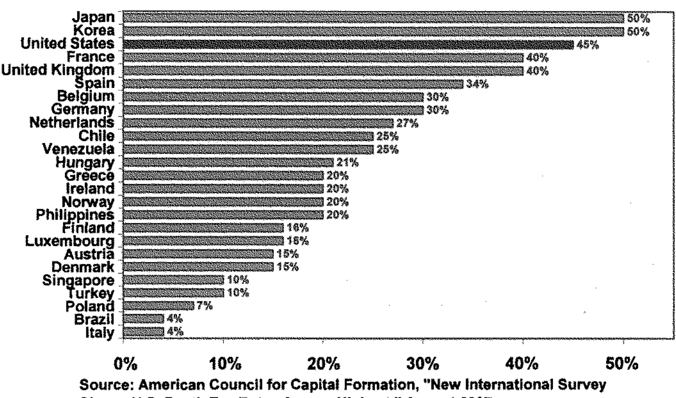
Suppose that a near-to retirement, self-employed, upper-middle income couple, in the next-to-the-top rate tax bracket, were thinking of working an extra year just to add to an estate. Prior to the 2001 Tax Act, their federal income tax rate would have been 35%, and their combined federal and state income, payroll and estate tax rates could have easily exceeded 78% (or even 90% with the GST). That produced quite an incentive to retire instead of continuing to work or to reinvest interest or dividends in an estate. In 2007, the same worker in the current

33% bracket would face tax rates of over 72% (nearly 85% with GST). These rates are scheduled to rebound to the pre-2001 rates in 2011. (See Chart 2.)

The U.S. death tax rate among highest of industrial nations

Chart 3 shows that the United States death tax rate is one of the highest in the world. Many leading nations have no death tax, including three of the big-four emerging tigers, Russia, China, and India. Brazil has a top estate tax rate of 4%. Some of the other nations without estate taxes include Canada, Mexico, Sweden, Australia, and New Zealand.[1]

Chart 3
U.S. Death Tax Rate Among World's Highest



Source: American Council for Capital Formation, "New International Survey Shows U.S. Death Tax Rates Among Highest," August 2007

An added tax on capital formation

The U.S. tax system punishes the saving and investment that creates jobs and makes the country grow. Income that is saved is taxed more heavily than income that is used for consumption. The income tax raises the cost of saving by more than the cost of consuming, and tilts behavior away from saving. There are at least four layers of possible tax on income that is saved.

- 1) Income is taxed when first earned. If you use the after-tax income to buy food, clothing, or a television, you can generally eat, stay warm, and enjoy the entertainment with no additional federal tax (except for a few federal excise taxes).

- 2) But if you buy a bond or stock or invest in a small business with that after-tax income there is another layer of personal income tax on the stream of interest, dividends, profits, or capital gains received on the saving (which is a tax on the "enjoyment" that you "buy" when you save).

- 3) If the saving is in corporate stock, there is also the corporate tax to be paid before any distribution to the shareholder, or any reinvestment of retained after-tax earnings to increase the value of the business. (Whether the after-tax corporate income is paid as a dividend, or reinvested to raise the value of the business and create a capital gain, corporate income is taxed twice.)

- 4) If a modest amount is left at death, it is taxed again by the estate and gift tax.

Every cent saved to create an estate has either been taxed already when the decedent (and the companies she or he may have owned shares in) paid income taxes, or, if the saving is in a tax-deferred retirement plan, it will be subject to the heir's income tax. The estate tax is always an extra layer of tax.

Taxing capital hurts labor by reducing productivity and wages

Charts 4 and 5 illustrate how taxes reduce the quantities of labor and capital. When you tax something, you get less of it. Any tax is borne in part by the supplier and in part by the

Chart 4 Effect of Tax On Labor

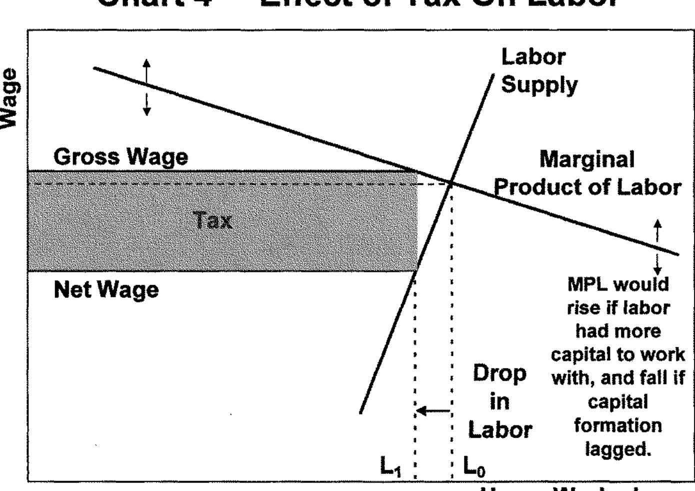
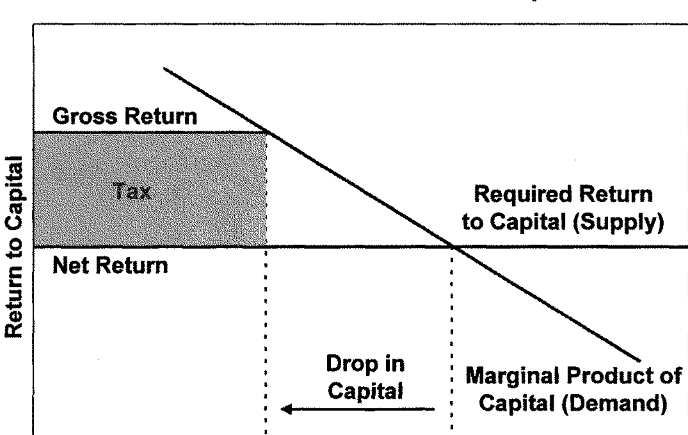


Chart 5 Effect of Tax On Desired Capital Stock



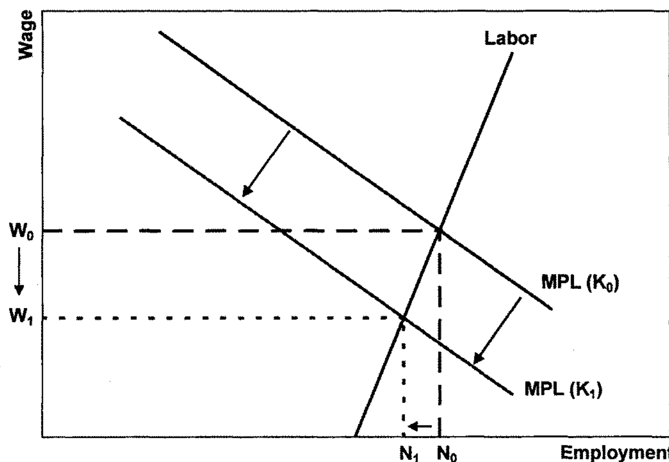
consumer or employer of the taxed item, but the split can vary depending on behavior. Furthermore, taxing one factor of production can hurt other factors. Taxes are often shifted from where they are imposed to others in the economy.[2]

The supply of labor is rather inelastic. Primary workers have limited ability to vary their hours worked or participation in the work force, and such workers are assumed to bear most of any taxes imposed on labor, including the income tax and the entire payroll tax, both the employee and employer shares. Second workers in the family, the self-employed, teenagers, and wealthier individuals have somewhat more flexibility, but even they bear most of the tax on their labor income.

The quantity of capital is far more sensitive to taxes than is the quantity of labor. It is easy and enjoyable to consume instead of save, or invest abroad instead of in the United States, if the rate of return on saving and investment is driven down by rising taxes. When we tax capital, the amount of plant, equipment, and buildings shrinks until it is again earning a normal rate of return, after tax.

Chart 6 shows that the shrinkage of the capital stock in the presence of high tax rates reduces the productivity of labor, the wage, and the number of jobs. Workers bear the bulk of the taxes imposed on capital.[3] Modern economists have shown, through numerous studies, that the work force is better off if taxes on capital income are reduced or eliminated.[4]

Chart 6 A Smaller Stock Of Capital Reduces Wages



Death tax, killer of growth and killer of revenue

The estate tax is one of the most egregious destroyers of investment, because its rates are so very high at the margin. It is one of the most inefficient of all taxes. The heirs do not bear the full cost of the estate and gift taxes. These taxes add to the tax on capital formation, and result in a reduced stock of capital. The economic consequences of the reduced capital stock are largely borne by the labor force.

In spite of (or because of) its horrendously high tax rates, the death tax probably doesn't raise any net revenue for the government. Professor B. Douglas Bernheim of Stanford estimates that avoidance of the estate tax by giving assets to children, most of whom are in lower income tax brackets than their parents, costs more in income tax revenue on the earnings of the assets than the estate tax picks up.[5] Gary and Aldona Robbins of Fiscal Associates estimate that the reduced saving and capital formation lower GDP and wages by so much that the resulting reductions in income and payroll tax collections exceed the estate tax take.[6] If Bernheim and the Robbinses are each even half right, the tax loses money. Estate repeal would pay for itself, and would encourage wealth and job creation.

We estimate that eliminating the death tax would add about 1.1% to the private sector GDP. Restoring it would eradicate that gain. In today's terms, it would deprive us of $120 billion per year in lost income, on which the federal government would collect more than $35

billion in taxes. That is more than the current death tax brings in (about $26 billion in 2007) and more than the peak take in 2001 (about $29 billion).

Taxes that reduce jobs, income, and GDP so much that they actually lose money are insane.

Endnotes

1. American Council for Capital Formation Special Report, "New International Survey Shows U.S. Death Tax Rates Among Highest." Washington, DC, August 2007.

2. For more on the economic burden of taxation, see Stephen J. Entin, "Tax Incidence, Tax Burden, and Tax Shifting: Who Really Pays the Tax?" Bulletin 88, Institute for Research on the Economics of Taxation, Washington, DC, 2004.

3. Taxing capital hurts labor a lot. For example, consider a small trucking company with five vehicles. Suppose that the rules for depreciating trucks for tax purposes change, with the government demanding that the trucks be written off over five years instead of three. The owner has had enough business to run four trucks flat out, and a fifth part time. He is barely breaking even on the fifth truck under old law. It is now time to replace one of the trucks. Under the new tax regime, it does not quite pay to maintain the fifth truck. The owner decides not to replace it, and his income is only slightly affected. But what happens to the wages of the fifth truck driver? If he is laid off, who bears the burden of the tax increase on the capital?

4. Andrew Atkeson, V.V. Chari, and Patrick J. Kehoe, "Taxing Capital Income: A Bad Idea," *Federal Reserve Bank of Minneapolis Quarterly Review*, Vol. 23, No. 3, Summer 1999, pp. 3-17.
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5. B. Douglas Bernheim, "Does the Estate Tax Raise Revenue?" in *Tax Policy and the Economy*, vol. 1, ed. Lawrence H. Summers (Cambridge, MA: MIT Press, 1987) pp. 113-138.

6. Gary Robbins and Aldona Robbins, "The Case for Burying the Estate Tax," *IPI Policy Report,* No. 150, Institute for Policy Innovation, Lewisville, TX, 1999.

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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee:
Death taxes (Estate Taxes) put more family businesses "out of business" than even Wal-Mart. Death Taxes are the greatest threat to the continued growth of our family owned business. My father founded our foodservice distribution business in 1946. For 58 years he plowed back 98% of the profits into growing the business, creating over 1000 jobs that support some 5000 employee family members.

Even though we have implemented all known estate planning techniques (at a very high cost), my father's death and the resulting death tax liability have resulted in a millstone being tied to the expansion of our business. After a long legal battle, the IRS finally accepted the valuations of our estate by our valuation firms, estate attorneys, and tax accountants. Now, our family must pay this onerous tax. The financial effect on our

family business is going to be devastating to the point of endangering its on going existence. We previously had plans for considerable expansion within both the state of Tennessee and the southeast region generally, but the death tax has placed these plans in serious jeopardy and debilitated management decision making.

It is important to note that large corporate entities do not face a death tax, thereby putting family-owned businesses at a very unfair disadvantage. Moreover, it is family-owned businesses, such as my fathers, which are responsible for the majority of new jobs. One of the best ways Congress could support long-term job growth is to get rid of this obstacle to growth and prosperity of family-owned businesses.

Death taxes are double taxation that penalizes those thrifty Americans that choose to save and invest as opposed to those that choose to spend and not invest in our economy. Isn't there something ironic – and sad – in the fact that if my father had gambled away his wealth, he would have had no death tax liability? Instead, a man who worked hard and lived frugally throughout his entire life is punished for wanting to pass on his business to his children. I believe it should be the policy of the US Congress to promote savings by instituting laws friendly to capital employed in local economies.

All of us who are familiar with the calamitous effect of the death tax have heard much - maybe all of the above. The worst part of the death tax is there is no way to really prepare for it. Why? Because as a business becomes more successful, the tax becomes increasingly onerous and more threatening to the company's future survival. Even though I believe our tax burden is excessive, I would much rather pay additional annual income tax that try to pay the death tax.

Family businesses deserve better. I encourage the members of the Senate Finance Committee to pass legislation permanently repealing the death tax.

Testimony for the Record

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U.S. Senate
Committee on Finance
Washington, DC 20510

November 14, 2007

Federal Estate Tax: Uncertainty in Planning Under the Current Law

Chairman Baucus, Ranking Member Grassley and members of the Committee:

Thank you for this opportunity to share testimony on the effect of the Federal Estate Tax, also known as the death tax. There is no other tax which more unfairly discriminates against responsible wealth creation and the honorable intentions of family members to help provide for the next generation.

My brother was a successful business owner and actor. He also was a dedicated family man who believed in setting an example of hard work, frugality, and love for his family. In this spirit, he avoided spending his money on wasteful material pursuits, and instead, willed a great deal of his wealth to his sisters and nieces and nephews. I believe that his efforts represent what is noble and honorable. According to the death tax, his intentions were selfish and needed to be punished.

When my brother died, I was forced to hire an expensive accountant in order to pay the death tax by the 9-month anniversary of his death. Initially it looked as though I would need to take out a loan. Instead, my family elected to sell his home, and use the sale to pay for the death tax return. It bothers me that any of my brother's wealth should need to be sold. He worked hard in life, and his house was something he took pride in and hoped to pass on to his family at death.

The death tax is wrong. It punishes hard-workers simply for being successful, and for not consuming their wealth in their lifetime. My brother believed in the inherent right to "life, liberty, and the pursuit of happiness," which for him meant to liberty to pass on his success to his children. It is time to restore the full meaning of this promise by abolishing the death tax once and for all.

Respectfully submitted:

Loretta Kartch

Peter Nelson
Vice-President and Principal Owner
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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law
November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Senate Finance Committee: I am honored to present testimony on the Federal Estate Tax, better known as the "death tax." My story is about a company resilient enough to be founded in the middle of the depression, but which could be destroyed by the death tax.

Marc Nelson Oil Products is a strong family-owned business with an Achilles heel: neither the business nor its owners have considerable cash reserves. This otherwise innocuous fact makes the business acutely vulnerable to the death tax. Without cash or other liquid assets, it will be a real hardship to pay the death tax's heavy confiscatory rate of 55 percent. Our business, which specializes in the distribution of oil products, is worth $6-7 million, well above the exemption amount. My family has successfully grown the company for over 70 years, since its founding by my grandfather in 1935. We also have operated a 240 acre Christmas tree farm for the same period, worth roughly the same amount and with almost as much in liquid assets.

Contrary to public opinion, businesses such as Marc Nelson Oil Products and our farm are not awash in cash profits which can be plundered for such events as the death tax. Our capital is very limited and is regularly reinvested in the business. When the death tax comes due, I will very likely be forced to sell some of my assets in order to provide the cash needed for paying it. In doing so, I will substantially weaken my company's growth potential and possibly hamper its long-term sustainability.

In order to prevent the worst effects of the death tax, I have spent excessive amounts of money and time with my lawyer and CPA to implement the latest estate planning techniques. This has resulted in a gross misallocation of productive resources. When I should be building my business and investing in new growth opportunities, I have instead spent hours and a small fortune to try and make the company sustainable when my father

dies. Without the death tax, I have no doubt that Marc Nelson Oil Products would be considerably more profitable and create more jobs.

Even with my efforts, it is very possible that I will be forced to sell assets in order to pay the death tax. If this happens, it will not only hurt me, the business owner, but also the 30 employees and their families who depend on Marc Nelson Oil Products for a steady income. These employees should not be punished for their decision to work for a family-owned company.

What I find most aggravating about the death tax is that it only punishes those who reinvest their income and grow their business, while those who squander their earnings on consumption are exempted from the tax. Like most Americans, I have devoted my life to productive endeavors. However, the tax which supposedly only falls on the "idle rich" now threatens my very livelihood, due to the fact that I invested my wealth in my company. If Congress really cares about addressing the needs of hard-working family-business owners in America, repealing the death tax should be the first priority.

Respectfully submitted,

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Vice-President and COO
Marc Nelson Oil Products

Victor Mavar

Former Vice-President

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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee. I am pleased to offer my views to the committee on the matter of the Federal Estate Tax, more aptly termed the "death tax," and the impact it had on one family-owned business in Biloxi, Mississippi.

I am one of the former owners and Vice President of Mavar Shrimp & Oyster Co., Inc., a family owned seafood processing and pet food manufacturing business in Biloxi, Mississippi. The history of Mavar Shrimp & Oyster Co., Inc. is a classic story of American entrepreneurialism. In 1898, my father, John Mavar immigrated from what is now Croatia to Biloxi, Mississippi. He worked as a fisherman while my mother was employed as a seafood worker. Both were hard-working and frugal individuals. They saved as much as possible, and in approximately 1920 my father purchased his first fishing boat. Owning and operating his own commercial fishing vessel was very successful. Over time he was able to accumulate enough capital to start a small fresh seafood operation in 1926, buying from other boat owners and selling at both retail and wholesale. The business was a success and as each of his four sons finished their education they came to work in the family business.

In the late 1950's, always looking for new business opportunities, we developed a way to make use of small, noncommercial fish, which were typically thrown overboard by shrimp fishermen. It turned out that these fish could be processed and used to manufacture cat food. We realized the opportunity to make use of what was previously a wasted product and dynamically expand the business. Through such wise business investments and the hard work of my family, all of whom were employed in the business, Mavar Shrimp and Oyster Co., Inc. became one of the largest and strongest businesses in the community. In the last few years of our ownership, we were grossing approximately $50 million in annual sales, and in peak season employed approximately 300 people. Our employees were paid the second highest starting wage in the city – only civilians on the local military base were offered a higher starting wage.

Given the company's considerable success, we never had any intention of selling the business. That is, until we became aware of our death tax liability, and the reality that we would be unable to pay the tax without selling most or all of the assets. In fact, we were forewarned that it was very possible that my family would be forced to sell perhaps at an unfavorably low price if one or more of the owners were suddenly killed or died. Because we wanted to save our children from the difficulty of dealing with this problem, we elected to sell in 1988 to the H.J. Heinz Company when they made an offer to buy our business.

When Heinz took over, we hoped that they would keep the business running in Biloxi for the long-term future. Unfortunately, within five years, they chose to relocate the manufacturing operations to Pennsylvania and Kansas. Obviously, most of our employees, who had lived in Biloxi for all of their lives, were not able to simply relocate with the new owners. While a handful did move, the majority simply lost their jobs and had to start new careers. Today, I regularly meet folks on the streets of Biloxi, who tell me that they used to work in our business, and state that they wished it had never been sold.

Ironically, even with the sale of our business, I am still concerned about being able to pay for the death tax. I've spent a fortune on attorneys, accountants, life-insurance and tax avoidance measures, such as early gifting to my children and charitable endeavors. More importantly, I've avoided making any investments in other new businesses, which may not turn a profit for several years. I have chosen to do this despite my interest in supporting the rebuilding of Biloxi, which was ravaged by Hurricane Katrina in 2005. In fact, I have received requests for investments in several local businesses, including a housing development that would help lower and middle income families who lost their housing due to the hurricane. However, I have been forced to turn them all down, lest I burden my children with the same death tax that we sold the business to avoid. As I see it, the death tax has encouraged a "wealth-redistribution," not from the rich to the poor, but from the local community to the national corporations.

Today, one of my sons has his own seafood processing business. He is one of approximately five such operations that remain in Biloxi. He has shown considerable success, and he will likely do very well. I am proud of him, but I would rather that he would be able to pursue success without concerns about the same death tax that led to the sale of our business. For the sake of my son and other entrepreneurs in places like Biloxi, Mississippi, I ask that the committee support legislation to repeal the death tax.

Gary McCall

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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

My name is Gary McCall. I am an Iowa farmer. I am 64 years old. My wife, Karen and our son John, 38, and his family, own and operate a family farm near Ute, Iowa. Ute is a small rural community of approximately 380 people located in West Central Iowa...between Omaha and Sioux City.

Our farm operation consists of slightly over 2,100 acres of Iowa farmland. We produce corn, soybeans, and finish approximately 4-500 fat cattle per year.

We have been a farming family in Iowa for over 5 generations. During this period our family survived....

--the "great depression of the 30s"...

--droughts, torrential downpours and floods...

--transitions to new "methodology" in farming. Gone is the attitude of "all tillage" which left no residue and plows which turned the soil "black". Today's practices of "no tillage" or "minimum tillage" leave most of the previous year's crop residue on the surface and benefits our soil, water and conservation efforts...

--extreme cyclical price swings for our farms production:

- embargos dropped our grain inventories value by 50% in less than a week...
- 8-10 cents a pound for our hog production in '98 closing out our farms hog operation permanently

- losses of $150 a head on fat cattle due to "mad cow" scares

Please understand, I am not writing this testimony to "whine and complain" about any of above. We accept the challenge of dealing with Mother Nature and cyclical markets. But I would like to point out there is something far more fearful looming in our farm's future, something our farm family may not be able to withstand. It is a law, which would re-institute the "Death Tax" as it was prior to 2001.

In my view, the re-implementation of the Death Tax (as previously written) will have a tremendous negative impact on our family farm operation and has the potential to create future encumbrances on our farm and family for generations.

Why? Whenever current inventories of grain, livestock, cash, and all other liquid assets/investments are not enough to pay federal estate taxes due upon the death of the farms major land holder, often all, or a portion of, the deceased's land base is sold to pay this indebtedness.

With land and commodity prices at near record levels, one might ask, "Why is this a problem?...Sell land!... Pay the taxes!".

Please understand this is not an option for many of today's multi generational farms, including ours. Today's farmers may appear to be ASSET RICH because of high land and current commodity prices, but they can be CASH FLOW POOR as well. Along with record land values and farm income we also have record farm expenses, including record purchase costs for machinery and other inputs needed to operate our farm.

When a sale of land takes place generating cash in order to pay estate taxes, even if it's only a portion of farmer's land holdings, it erodes a farm's future production capabilities. This "restriction" in cash flows has a tremendous impact on the "economic engine" that drives our farm and other small businesses in rural America. How? Because past cash flows available for farm inputs are now being paid to federal government for estate taxes, resulting in fewer machinery purchases, less livestock fed, and decreased purchases of inputs from small businesses selling fuel, fertilizer, and other farm needs. As you can see, such restrictions of a farm's cash flows have a multiplier effect which impacts other small businesses dependent upon farmer's purchases for their livelihood.

So what do we do? Each year we continue to do our best to develop our farm's operational plan and try to allow for unforeseen events...i.e.—weather, market disruptions, and NEW governmental tax laws and policies.

However, we remain tremendously concerned about what happens to our 5-generation farm after our death, especially when our children attempt to pay off our <u>estate taxes due</u> and still maintain <u>cash flows needed to continue to operate our farm.</u> If cash flows are not adequate to pay estate taxes and settle the estate, land may need to be sold, investments in new equipment, operational growth, and farm inputs purchased may need

to be curtailed or restricted. If our family does manage to develop a plan to generate "cash" to continue the farm operation and pay off the Death Tax over time... one thing will be certain, our children will then have a NEW PARTNER in their farming operation. UNCLE SAM! This time he will be taking cash OUT of the operation, for taxes due, instead of providing a base of support as in past USDA farm programs.

So...What can Congress do to help family farms like ours during this Death Tax debate? Here are a few suggestions I believe will help the transition of our farm to our 5th and hopefully one day, the 6th generation in our family....

1- Naturally, my **first choice** would be to **continue 2010 provisions...No Federal Estate Tax!**

2- **Retain stepped up basis after 2010** ---Please consider keeping the existing provisions which allow for a "stepped up basis" for family farm land. If inflation or double digit land value increases continue...this will be extremely important for the preservation of our family farm from generation to generation...especially in the event a future non farming heir wants to "claim" their share of a family estate in the form of cash. This usually leads to a "forced sale" of existing farm land by the farming child in order to buy out shares of non farming child.
    a. Suggestion—Could congress implement provisions which would allow a stepped up basis to be triggered by something other than receiving it only at death? Implement a provision which would allow a "long time" farming family to sell land to their farming children...PRIOR to the parents death...at a time the children truly need this asset and they are still young enough to effectively utilize the farm. Why is this important? People live longer. They now live into their 90s. If a landowner in a family lives to be in 90's or approaches 100...do his children, now most likely in their 60's and 70s, really want to "farm" at this age? Their need for the farm land was years before... when they were in their 30s, and 40s, ...even early 50s. Yet today...many multi generational families' patriarchs still hold property until their death ... Why?...because the fear of tax consequences of selling the land which has increased in value 10 times over their purchase price many years ago! So nothing is done while they live! What a waste and loss of economic opportunities for younger farmers in 30's to early 50's! What a loss of collateral for an energetic young farmer/couple (including my son, John, age 38!). Holding land to obtain a better basis position and therefore less tax on the estate stifles opportunities for younger farmers/small businesses and rural communities through out America.

3- I would urge congress to **expand estate tax exemptions** to **7-10 million per person...AND ...index this to inflation.**

4- **Gift tax should be eliminated.** If not possible... exemptions should be **triple** what they are now.

In conclusion, I leave you with this request. Please... YOU... can make a difference. YOU... can help us pass our legacy and our farm on to our 5th and 6th generation.

Please do your "due diligence". Do your homework on the Death Tax. When you do, I feel you will come to the same conclusion as I. The Death Tax is very counter productive, anti-growth, and anti-family. Its reimplementation in its pre-2001 form will have a tremendous negative impact on our family and farm. Please ...I ask you to stand opposed to the reimplementation of the "Death Tax".

Thank you for your time and consideration in this matter.

Lowell Miles

CEO and Founder

Miles Fiberglass and Composites, Incorporated

8855 SE Otty Road

Portland, OR 97086

Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee, I am pleased to present testimony to you concerning the matter of the federal estate tax, also known as the "death tax." I am the founder and CEO of Miles Fiberglass and Composites, Incorporated, a family owned and operated business based in Portland, Oregon. I want to tell you about the work of my company and the contributions it has made to the community. This is one of the many family-owned businesses in America that faces considerable loss, if not financial ruin, due to the federal death tax.

I started Miles Fiberglass and Composites over forty years ago to build products for air-conditioning units and canoes. Today we have expanded and now we handle a diverse production line for such equipment as recreational-vehicles, light and heavy-rail commuter trains, large commercial planters, reinforced replacement panels for military vehicles, and even custom product designs. We do all this through proven high-quality standards, an innovative approach to the industry, our in-house research and development team, and of course, our 100 hard-working and highly-skilled employees, many of whom have served us for 20-25 years.

Besides being a source of economic growth and employment in the state of Oregon, Miles Fiberglass and Composites has always been committed to contributing to our community. I personally have served on multiple charitable organizations including the Clackamas Community College Foundation, Clackamas County Historical Society, and the Portland Public Schools Education Committee. Several years ago my wife and I received national recognition for our charitable work with the local community colleges. Like most family-owned businesses, Miles Fiberglass and Composites has great appreciation for the community and a direct interest in making it stronger.

Unfortunately, the death tax presents a very real obstacle to our long-term involvement in the Portland community. The death tax assesses my penalty based on the size of my assets. Many in Congress assume that the death tax only penalizes the "super-rich" who have plentiful liquid assets. This simply is not the truth. I will be assessed a death tax, and it will not be easy to pay. My "estate" is primarily wrapped up in the business and the hard, illiquid assets that the business owns. Obviously, selling these assets is not an option. That means that in order to pay the death tax, I am forced to make use of complicated and onerous accounting measures, including taking out an unnecessarily large life-insurance policy, and bequeathing considerable stock to my children. Measures such as these waste the productive time and capital of small business-owners such as myself. I would much rather focus my available resources on building the business and making it stronger, rather than preparing for the inevitable federal receipt that my children will face when I die.

Congress needs to act quickly to permanently repeal the death tax. I have every intention of living a long life and I do not want my death to be a burden to my children and family. They are eager to take on new challenges and do even greater things with the business. It is my dream that the company would continue to be an innovative leader in the plastics industry and an important part of the community 100 years in the future. If the death tax is permanently repealed, I have every confidence that this will be the case. I respectfully hope that the Committee will see the wisdom in endorsing legislation to permanently repeal the federal estate tax.

Walter Muralt

President/Family Member (son)

Muralt's Travel Plaza

8800 Truck Stop Road
Missoula, Montana, 59808

Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and Members of the Senate Finance Committee: It is an honor to present testimony on the Federal Estate Tax, better known as the "death tax." I want to tell you about the estimated $600 thousand (non-tax deductible) that my family and I have spent to prepare for the death tax – money that we may very well have spent in vain.

My mom and dad started Muralt's Travel Plaza when it was just a bankrupt, four-lane truck stop. On a shoe string budget, my father and mother turned a dying business into a booming (successful) operation. Over the course of the last thirty years, they expanded the truck stop, added a restaurant, hotel and even a casino. We now employ over 90 people and offer generous compensation. Most employees have healthcare, the option of a 401k, and participation in our profit-sharing program. We also are very active participants in our community through a foundation we started. This foundation makes annual contributions to a nearby foster home and the local chapter of the National At-Risk Kids program, Flagship Missoula.

I care about this company, the jobs it provides, and the difference we make in the community, and for that reason I am doing everything possible to prepare for the death tax. I have taken out life-insurance which has cost us $600 thousand over the course of the last eight years. I have also spent hundreds and hundreds of business hours with our in-house CPA, attorney and other experts and advisers to find legal ways to shield our company from this "extra" tax. I'd like to think that with all this effort, my business will be safe when my parent's die. Unfortunately, it seems that this is a unrealistically optimistic scenario.

My parents divorced several years ago and each took part of the business's assets. They both want to ensure that the business continues on after they have died. My father and I have been able to configure his assets in such a way as to likely guarantee sustainability when he dies. My mother, on the other hand, has not been able to make significant preparation for the death tax. She owns the land surrounding and under the buildings which the business rests upon. Obviously, the business cannot operate without this land. However, her estate is in excess of the death tax exemption amount, and therefore will certainly be a liability. Paying her portion of the death tax will require selling the very land which the business rests upon. This means that all my effort to prepare my father's estate will have been in vain, unless my mother achieves immortality or Congress finally repeals this "extra" tax that penalizes families who have worked hard to create successful organizations.

I consider it a travesty that I should have to spend a single dime in preparation for either of my parents' death – much less that our considerable time and effort should be in vain. Though some members of Congress ignore this fact, the death tax is effectively forcing me to play an expensive shell game with lawyers and insurance companies - simply for the privilege of maintaining our businesses. In a nation which prides itself on individual accomplishment, entrepreneurial spirit and private ownership rights, this is a disgrace. Tax policy should provide revenue to government in the least disruptive manner possible – not through the upending of family-owned businesses like Muralt's Travel Plaza.

My story is not unique. Throughout Montana, a state in which most businesses are family-owned, the death tax is methodically forcing the sale of family-owned businesses with each generation's death. These businesses are almost always sold to larger, national corporations, who do not maintain a corporate office in the Big Sky state. This results in a net drain on capital – and thereby state and local tax revenue – throughout the state. Most importantly, it discourages entrepreneurialism by ripping capital away from those who have diligently accumulated it through their small business.

Senators, I ask that you immediately introduce legislation to end the scourge of the death tax. Businesses in Montana and throughout the nation are depending on you. I thank you for your open ear and attitude. The original purpose of the death tax expired a long time ago, and now, so should this unfair tax.

Gary Houlahan

CEO and Owner, Mutual Materials

605 - 119th NE

Bellevue, WA 98005

Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee:

As a fourth generation private business owner, it is an honor to speak before you today concerning the matter of the federal estate tax, also known as the "death tax." I am the CEO and owner of Mutual Materials, one of the few remaining privately-held masonry companies in the state of Washington. Mutual Materials was founded by my great-grandfather, Daniel Houlahan, in 1900. Daniel, an experienced brick-layer, came to Washington to help rebuild Seattle after the great fire of 1889. While there, he started his own nearby brick plant, Builders Brick Company, the predecessor to Mutual Materials. Builders Brick Company supplied the majority of the bricks used to rebuild Seattle.

Daniel's goal was to build a strong business which would provide long-term employment and income for his family. Over the next 100 years, Mutual Materials did just that. We survived the Great Depression, the brick industry downturn in the 1950's, the "Boeing Bust" of the early 1970's and the recession of 2001. Today, with annual net revenue of $150 million, and 150 employees on payroll, Mutual Materials is the largest brick and block company in the state of Washington. If all continues as planned, my son will soon become the 5th generation owner of Mutual Materials.

Strangely, the greatest threat to my company's survivability might just be its success, which has substantially increased our liability under the death tax. The death tax has already led to the demise of most of the private brick companies in the state of Washington. Many of these companies were bought out by foreign-held corporations who then siphoned their wealth out of the U.S. A host of foreign corporations have made clear their interest in purchasing Mutual Materials. Six years ago, they almost got their chance.

In 2001 my mother passed away, triggering the death tax. I was committed to working honestly with the Internal Revenue Service and did not waste time in preparing the necessary materials. Despite my diligent efforts and good intentions, I was quickly accused of using an incorrect accounting mechanism and thrown into a three-year legal battle. The focal point of this legal battle was the valuation of my company's worth. The IRS determines tax liability according to a complex valuation formula, which is based on a number of very subjective criteria. The IRS rejected the two private valuations I requested, and demanded a third valuation with their own auditor. This valuation was based on Mutual Material's gross sales, which is a very strange way to calculate a company's worth. Few business owners are prepared for the headache of determining their business's value in terms that only a Washington bureaucrat could dream up.

Over the course of three years, I was forced to spend over $400,000 in legal fees and valuations, and countless days in discussion, negotiation, and courtroom presentations, before finally achieving resolution. At no point was our business's survival guaranteed. If the IRS's valuation had been accepted in court, I would have been required to pay $8 million in taxes, plus a $3 million "penalty" for not going along with the IRS in the first place. Ultimately, a reasonable judge threw out the IRS's valuation scheme, and with it their $11 million bill. My final settlement was *only* $800,000.

It bothered me to spend so much time and money to fight the death tax. However, from the perspective of a 4th generation business owner, it was worth it if I could still hold on to the company at the end of the day. To do this, I knew I would have to fight the IRS's convoluted valuation methodology and its demand of $8 million. There is no way I could pay this much tax without selling my business.

Mutual Materials – like most other small, family owned operations – does not have significant cash reserves lying around. Even paying $800,000 is not easy, though we have found a way to pay the tax. In order to increase cash on hand, we doubled the size of our dividend payments. While most of the family is enjoying increased benefits from their holdings in the company, my brother and I are using the extra cash to make annual payments to the IRS. Obviously, we'd rather keep the dividend payments at their normal level, and keep the money in the business.

For the time being, we are managing to make the payments and keep the business running. However, the death tax has certain inevitability, meaning my son will one day

have to deal with it. If Mutual Materials continues to grow, then our liability under the death tax will substantially increase. Moreover, I am well aware that the IRS may try to bill us according to some strange valuation formula again, and that next time we may not have a reasonable judge to depend on. Obviously, I am doing everything possible to prepare for this reality so that the company will be preserved. However, my experience of six years ago tells me that my efforts may very well not be enough. My brother's response to our troubles, only half serious, is to "die in 2010."

The lesson I've taken away from the death tax is that it is great for lawyers and those who make money off of non-productive effort. It is destructive and inefficient for hard-working business owners such as myself. Those who have worked hard their entire lives to build a strong business should not have to worry that their children will face this nightmare when they die. For the sake of family-owned businesses such as Mutual Materials, I respectfully request the members of the Senate Finance Committee to support legislation to permanently repeal this tax.

"Federal Estate Tax: Uncertainty in Planning Under the Current Law"
November 14, 2007

Statement of the National Automobile Dealers Association
8400 Westpark Drive, McLean VA 22302

The National Automobile Dealers Association (NADA) appreciates the opportunity to provide comments to the committee regarding the existing death tax and the need for permanent reform. NADA represents 21,000 franchised new car dealer members, who provide long term economic opportunity to more than 1 million Americans and their families. Over 90% of NADA's members are small family-owned and community-based businesses and half of our members are second or third-generation. The current uncertainty of the death tax is unfair and penalizes small family-owned businesses.

Most assets of automobile dealers are not liquid. A dealer's capital is invested in the land under the dealership, buildings, housing showrooms, vehicle repair equipment, and other facilities. The death tax today drains dealerships of working capital because of legal, accounting, and insurance costs, which dealers need to finance new and used car inventory. Upon a dealer's death, the current excessive rates can cripple or kill a family-owned business, since the survivors are left with few options but to sell the business or incur substantial debt to pay the tax.

We urge Congress to focus on the following points in any death tax policy:

- Without further action, the death tax will reappear in 2011 after repeal in 2010 with a top rate of 55% and a $1 million exemption – levels last seen in 2001.

- The death tax, much like the alternative minimum tax was supposed to be limited to the very wealthy. Unfortunately, it has become an onerous burden on people who are trying to maintain small businesses.

- Every year without a permanent fix, small business auto dealers across America are forced to take resources away from their businesses and their employees to try and plan for this unpredictable situation. Even the most sophisticated death tax planning and the purchase of life insurance cannot sufficiently mitigate the effects of this uncertainty.

- By permanently fixing the death tax today, small businesses can focus their resources on what they do best; growing their businesses, hiring employees, and contributing to their communities.

The automobile industry has been confronted during the past few years with a rapidly changing environment, and this trend is likely to continue during the next several years. Unless Congress brings certainty and fairness to the death tax, the challenges facing automotive retailing could increase dramatically. We thank the committee for their leadership on this crucial issue, commend you for holding this hearing, and urge you to move forward with a policy for permanent relief before 2010.

FOR IMMEDIATE RELEASE
November 13, 2007

Contact: Bailey Wood
NADA Legislative Affairs
(202) 547-5500
(202) 557-1674 (mobile)

DEATH TAX UNCERTAINTY PUTS DEALERSHIPS AT RISK
1.2 Million Jobs Dependent on Domestic Auto Retailing

WASHINGTON— Thousands of family-owned franchised automobile dealerships throughout the country are facing uncertain times due to the unresolved issues surrounding a permanent fix for the death or estate tax. Dealerships, which employ more than a million people nationally, are having to set aside resources that they would otherwise use to grow their businesses, contribute to their communities, and hire employees, in order to deal with the unresolved issues surrounding this unfair tax.

In written testimony submitted to the Senate Finance Committee, the National Automobile Dealers Association (NADA) called on Senators to find a permanent fix for the sun-setting death tax-repeal, which expires at the end of 2010.

"Over 90 percent of NADA's members are small family-owned, community-based businesses and half of our members are second or third-generation dealers," said David Regan, Vice President of Legislative Affairs for NADA. "The uncertainty surrounding the estate tax is having a direct impact on dealers, their future, and their employees."

Regan added that dealers are left with few options but to sell the business or incur substantial debt to pay the tax because of the great deal of resources dealers have tied up in property, showrooms, repair facilities, parts, and inventory.

The National Automobile Dealers Association, founded in 1917 and based in McLean, Va., represents approximately 20,000 new car and truck dealers holding nearly 43,000 separate franchises, domestic and international. For information visit: www.NADA.org.

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NATIONAL CATTLEMEN'S BEEF ASSOCIATION
1301 Pennsylvania Ave., NW, Suite #300 • Washington, DC 20004 • 202-347-0228 • Fax 202-638-0607

November 14, 2007

The Honorable Max Baucus
Chairman
U.S. Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Baucus:

The National Cattlemen's Beef Association (NCBA) appreciates this opportunity to present our thoughts with regards to the Committee's hearing entitled "Federal Estate Tax: Uncertainty in Planning Under the Current Law." Producer-directed and consumer-focused, NCBA is the largest and oldest organization representing America's cattle industry, and it is dedicated to preserving the beef industry's heritage and future profitability through leadership in education, marketing and public policy.

The entrepreneurial spirit is no where more evident than in rural America, and cattle producers are an important contributor to the economic diversity of small towns and communities throughout the United States. For so many beef producers, farming and ranching is more than a job, it is a way of life. In fact, nearly half of the over 250,000 cattlemen and women represented through NCBA and its 46 state affiliates operate businesses that have been in their families for over 50 years; and over 15 percent maintain enterprises that have been in their families for over 100 years! These figures illustrate the fervent desire amongst our industry to maintain viable farming and ranching businesses that can be kept in the family from one generation to the next. However, the Death Tax continues to significantly burden families with costly planning, and in some cases, with the forced liquidation of land, farm equipment and other assets in order to pay off onerous tax liabilities.

The Death Tax does not operate as a tax on the wealthy elite in America. To the contrary, it can often serve as a death warrant to small- and medium-sized family businesses. Wealthy individuals can afford to pay a team of highly specialized accountants and estate planners to help them navigate the tax code and evade estate tax liability; but, for small businesses that isn't the case. Farmers' and ranchers' financial worth rests on the value of their land and equipment, and as such they do not have the luxury of funneling assets into foundations and other mechanisms meant to shield wealth from federal tax liability. Given this, it is not surprising that nearly 90 percent of cattlemen report a fear of the Death Tax has altered the way they invest in their business.

It is important to recognize that beef producers largely operate in an asset-rich, cash-poor situation. As urban areas continue to expand, spilling out into our nation's rangelands and rural

communities, the value of agricultural property has steadily increased. At the same time, economies of scale have driven those families that are wholly dependent upon farming and ranching income to expand the scope of their operation. The combination of these factors leads to a precarious situation for families as they prepare for the death of a loved one. Family businesses and the communities in which they reside would benefit most from the reinvestment of profits back into the ranching operation and local economy. Unfortunately, though, these funds must instead be directed to planning for the Death Tax. When our families fail to expend time and resources on estate planning, they are forced to break-up and sell-off portions of the operation in order to pay off Uncle Sam.

Cattle producers understand and appreciate the role of taxes in maintaining and improving our nation; however, they also believe that the most effective tax code is a fair one. For this reason, NCBA members fundamentally disagree with the taxing of assets that have already been taxed – sometimes two and three times over. In the eyes of American farmers and ranchers, death should not be a taxable event, and they fervently support full and permanent repeal of the Death Tax. Consistent with this belief NCBA, along with its family and small business partners, supported as a step forward Congressional action to pass legislation that would repeal the Death Tax through a phase in of exemptions leading to total repeal in 2010. However, Congress has not taken the necessary steps to follow up on this policy, and the current uncertainty is untenable.

Congress must take steps to address the challenges currently facing families as they struggle to plan for the Death Tax. Every day spent without legislative action to repeal the Death Tax is another day in which farmers or ranchers are left wondering whether their family will be saddled with the burden of a $1 million dollar exemption and a 55 percent top rate (currently 2011 law), or if they will be 'lucky' enough to pass during a period of full repeal (currently 2010 law). This conundrum only serves to exacerbate the costs and difficulty associated with estate planning. U.S. cattle producers need your help. They need Congressional action to bring about certainty and Death Tax relief.

NCBA appreciates the Senate Finance Committee holding a hearing on the "Federal Estate Tax: Uncertainty in Planning Under the Current Law." There are many other important issues before the Congress, but this hearing is recognition of the fact that one of the biggest problems facing farmers, ranchers and small businesses is the current burden and uncertainty associated with the Death Tax. Swift and meaningful estate tax reform is of the highest priority for U.S. cattlemen and women, and I applaud your stated goal of working toward a legislative markup by early next year. NCBA is eager to work with you in the coming months to bring about a legislative solution, and I look forward to a continuing dialogue on this issue.

Sincerely,

John Queen
President, National Cattlemen's Beef Association
North Carolina Cattle Producer

National Electrical Contractors Association (NECA) Statement for the Record

Senate Committee on Finance Hearing:
Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007, at 10:00 a.m., in 215 Dirksen Senate Office Building

National Electrical Contractors Association (NECA)
Contact: Nicole M. Blossé, Director, Legislative Action
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Bethesda, MD 20814
301-215-4537
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Statement of the National Electrical Contractors Association
Before the Senate Committee on Finance
November 14, 2007
In Regard to Repeal and Reinstitution of the Estate Tax

Mr. Chairman, Members of the Committee:

The National Electrical Contractors Association is concerned about the instability in estate planning that would occur if the estate tax is phased out entirely in 2010 and then in January of 2011 is reinstituted as it existed in 2001. NECA remains strongly in favor of complete repeal of this unproductive tax. At the very least, substantial and permanent reductions in the tax rate and a significant increase in the amount of an estate exempted from taxation need to be enacted as soon as possible to help clarify the issue for estate planning purposes. Transfer of small and medium-sized closely held or family-owned businesses are particularly harmed by this tax and the uncertainty surrounding it

The National Electrical Contractors Association is the nationally recognized voice of the electrical construction industry, comprised of over 80,000 electrical contracting firms, employing over 750,000 electrical workers and producing an annual volume of over $125 billion in electrical construction. NECA includes 120 U.S. chapters in addition to several affiliated international chapters around the world. NECA is dedicated to enhancing the industry through continuing education, labor relations, government affairs, codes and standards development, marketing and promotional activities.

NECA would like to thank you for holding a hearing to focus on the estate tax. Construction companies are frequently family owned and will be hit particularly hard by the death tax burden. Federal estate tax rates have increased significantly since their implementation in the early 1900's. They are so high now that families must often sell their small construction companies in order to pay the death tax. NECA supports permanent repeal of the estate tax. In the absence of permanent repeal, NECA supports modification of the estate tax for the highest exemption and lowest tax rate possible.

The estate tax is an unfair tax that punishes growing family businesses. Estate taxes are essentially a "ransom" that families must pay the government for the "privilege" of keeping their business in their family. More than seventy percent of family businesses do not survive the second generation, and eighty-seven percent fail to make the third generation. Studies indicate that the average family business spends nearly $20,000 in legal fees, $12,000 for accounting, and an additional $11,200 for other advisors in preparing for death taxes. To avoid horrendous estate taxes and to ensure that an heir can continue on the family business, small owners often invest in expensive life insurance policies rather than in the business. The result is that the business often falters. These actions impact not only the business owners, but deny opportunity and growth to both the employees and the community.

While the rate reduction during the years 2002-2009 are helpful to some families and the one year full repeal will also work in their favor, the problems will return in the year

2011. This uncertainty requires business owners to continue with estate-planning strategies that are costly and time consuming.

Family businesses need immediate, permanent relief from this tax. We thank you for your continued support to help America's small businesses, and we look forward to working with you in the future on this issue.

Thank you for allowing us the opportunity to present our views.

Robert White	Nicole M. Blossé	Jeff J. Kohmstedt
NECA Executive Director	NECA Director	NECA Director
Government Affairs	Legislative Action	Constituent Action
301-215-4522	301-215-4537	301-215-4544
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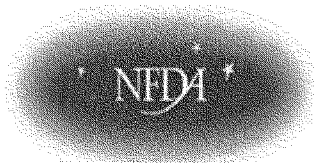


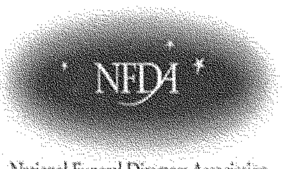
STATEMENT
OF THE
NATIONAL FUNERAL DIRECTORS ASSOCIATION

ON THE
PROBLEMS FACING FAMILY-OWNED FUNERAL HOMES IN COMPLYING WITH THE ESTATE TAX

BEFORE THE
COMMITTEE ON FINANCE

UNITED STATE SENATE

NOVEMBER 14, 2007



Mr. Chairman, Members of the Committee, thank you for the opportunity to present the views of the National Funeral Directors Association (NFDA) on the problems faced by family-owned funeral homes in complying with the federal estate tax. I am John H. Fitch, Jr., Senior Vice-President for Advocacy.

The National Funeral Directors Association represents more than 13,000 funeral homes and over 21,000 licensed funeral directors and embalmers in all 50 states. The average NFDA member is an independently owned and operated business with fewer than 10 employees and has been in the same family for over three generations. NFDA is the leading funeral service organization in the United States, providing a national voice for the profession.

The NFDA has a great interest in estate tax and it ranks as one of the top issues our members state as a major roadblock in growing their business, keeping their funeral home open, or in their family.

While the current law goes a long way towards eliminating the burden of estate taxes generally, it only temporarily eases the burden of small business, such as funeral homes, which seek to transfer the business from one generation or family member to another at death. In order to recognize and preserve the heritage and strength of this foundation of the American economic system, it is absolutely critical that the federal tax laws not penalize or otherwise prevent the tax-free transfer of family business ownership at death to other family members. Moreover, the thousands of dollars many funeral home owners spend annually in so-called estate planning to avoid the estate taxes or in the purchase of insurance policies to cover their potential estate tax liability could be better spent on business operations, salaries and other worker benefits and community outreach programs.

To give you a snap shot of the typical NFDA member, I offer the following from a recent survey:

1. The average funeral home has been in the family for three generations and is valued at over $2.5 million.
2. It employs from 5-15 full-time employees and an equal number of part-time employees.
3. It has created between 1 and 15 new jobs over the past five years and expects to create an equal amount over the next five years.

4. It has spent from $2,000 to over $300,000 over the past five years on estate tax related planning and paid an average of $900,000 in estate tax.
5. If the principal owner would die, the average funeral home have to either borrow the money to pay the estate tax or sell all or part of the business to pay the tax. In addition, it would have to delay, curtail or abandon any plan to grow or expand their business.

As you can see, the federal and state estate tax is a considerable financial burden to small, family-owned funeral homes as well as a significant inhibitor to future growth and expansion and even the existence and ownership of the funeral home.

In responding to the survey, many of our members added some rather compelling comments. Here are several:

1. When my grandfather died in 1983 with no provision in place for estate planning my father had to sell enough of our assets to come up with the nearly $1,000,000 to pay the estate taxes. Because we had to put so many resources toward the estate taxes then, our business growth was severely hampered for over ten years. In order to avoid a similar situation when my father dies, we have had to devote tremendous time, energy and resources that could and should be focused on expanding the business and creating jobs.

2. Due to the federal estate tax, I will have to borrow funds to pay my mother and sister for their stock at the same time borrow to pay the estate tax.

3. We sold to the then Loewen Group, a publically traded funeral service corporation, over 7 years ago. Prior to that time we spent thousands of dollars with our estate planning and key man plans. In fact, when we did sell the most costly part of our attorney fees and CPA costs were to protect this transfer of ownership from a huge tax hit to us personally.

4. We have felt the urgency to purchase insurance to cover estate taxes. At present we spend over $5,000.00 per month, we have seen extreme consequences to families because of the estate tax.

5. My grandfather died 12/03/2000; this left a huge impact on the family funeral business. Fortunately I was able to qualify for an IRS 6166 or 6160 for "Family Owned Business", that was 35% or more of my grandfather's estate. I was able to defer the estate tax and will be able to pay the tax over 10-15 years. Without this I may have been forced to abandon the funeral business. The funeral home property was worth more than the business. Had I not had some relief regarding paying the estate tax over time I may have been forced to abandon the business and re-develop the property for retail commercial use. At this time I am able to continue the family funeral business but should something happen to me my daughter will not be financially able to support the business and pay estate taxes on my estate. I will be the last of my family to own and operate a family owned funeral business.

6. We are currently studying how we can replace the principle owner/CEO and one other top level management member by insurance funded protection to insure stock buy-out, estate tax cost and operating monies for replacement personnel as well as monies to insure cash flow during the recovery.

7. Our business has been in the family for four generations. Each year it gets harder and harder to stay in business with the taxes and government requirements. When a death occurs and the death tax implied it can be enough to force the business to sell to pay the taxes.

8. Being in the funeral profession allows us to witness the drawbacks that many families endure because of this double tax. Many of our families we serve that have a family business don't have proper planning to get their business through this most difficult time. Some simply do not realize that Uncle Sam can tax the assets of monies that have already been taxed. Most families are so involved in their family business that it does not occur to them that the government penalizes a family business.

In our estate plan our attorney explained that our son would need to sell the business to pay the taxes he and his sister would be obligated to pay upon our death.

As you can readily see, estate tax is not an intellectual or theoretical exercise for our members. It is real and has serious and significant business as well as personal consequences.

It is with that in mind that the National Funeral Directors Association on behalf of the thousands of family-owned funeral homes in America urge the Congress to enact sooner rather than later significant permanent reduction in the federal estate tax.

Funeral homes are among the quintessential community-rooted, family-owned business. They are the last of a slowly fading breed of entrepreneur whose survival is only made more difficult by the onerous estate taxes. In order to recognize and preserve the heritage and strength of this foundation of the American economic system, it is absolutely critical that the federal tax laws not penalize or otherwise prevent the tax-free transfer of family business ownership at death to other family members or otherwise inhibit the growth of their business.

Mr. Chairman and members of the Finance Committee, thank you for the opportunity to present the views of the National Funeral Directors Association on this critical issue. I hope it is helpful in crafting legislation that will alleviate this unnecessary and costly burden for our members.

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RE: Senate Finance Committee Hearing, "Federal Estate Tax: Uncertainty in Planning Under the Current Law" scheduled for November 14, 2007

Statement of the National Newspaper Association

Established in 1885, the National Newspaper Association ("NNA") is the national voice of community newspapers. NNA represents owners, publishers, and editors of America's community newspapers and with over 2,500 members, is currently the largest newspaper association in the United States. NNA's membership generally comprises family owned and operated newspapers, predominantly weeklies with circulations under 5,000 or dailies with circulations under 10,000.

The community newspaper is not just another small business. To the community, it is a lifeline of knowledge. Even in the Internet age, substitutes for the community newspaper have not yet developed to any appreciable degree.

The community newspaper touches its customers directly through content and personal connections. As a result, people become dependent on their local paper for community news that could not be obtained elsewhere.

To the editors and publishers, the community newspaper is family. The newspaper consumes the family on a financial, emotional and philosophical level. The editors and publishers of community newspapers devote their lives to the paper; that is the only way for the newspaper to stay alive.

John Denny Montgomery, III is a second generation publisher of *The Purcell Register* in Purcell, Oklahoma. Below, he explains in detail what the newspaper means to his community, his family and to him personally:

> *The Purcell Register* was founded in 1887. It is the oldest weekly newspaper in Oklahoma. The newspaper has subscribers from urban areas, as well as suburban areas. It is the primary local news source for Purcell and its surrounding communities. The paper serves a vital role in the everyday lives of people in that area because it is the only outlet that brings news and public records in which the citizens are specifically interested.

> *The Purcell Register* has been in my family for the past 18 years. Every member of my immediate family has worked at the newspaper, including my wife, who now contributes as well. I have been working at *The Register* for all 18 of the years it's been owned by our family, starting with small jobs like taking out the trash and progressing to assistant editor. My family became involved in the newspaper industry when my father, John D. Montgomery, Jr. purchased his first newspaper in 1977. Our family has been ingrained in the industry ever since.
>
> To sum up our investment with respect to time and money: it's all we've got. We put our heart and soul into the newspaper and its operation.
>
> Considering the fact that I have been planning my entire life around being the publisher of *The Purcell Register*, from earning my degree in journalism to moving back to Purcell to start my family, if we lost the paper it would be devastating.

Without the burdens of the estate tax, the family-owned newspaper industry constantly faces the battle of being bought out by large newspaper conglomerates. However, with the pressures of life insurance, estate planning and the uncertainty of rates for the estate tax, the risk of being forced to sell increases exponentially. Large corporations can and have profited from "fire sales" to the detriment of the newspaper community.

Mark Rhoades, the President of Enterprise Publishing Company in Blair, Nebraska is a fifth generation publisher who has been in the family newspaper business for almost 30 years. Below, he explains the effects of the estate tax on his family-owned business and other small businesses in his community:

> But now I'm dealing with the future of my children and their part in the business. My oldest son has already joined the firm, and I have a younger son who is a senior in college who I hope will join us in a few years. If something would happen to me at this point, and there is no estate tax relief, my family would lose what we've worked to grow for over 100 years. The business is large enough now that it would not be affordable for an individual to buy, and it would end up being purchased by a large corporation.
>
> This same scenario would be common for many family businesses and farms in our area. The estate tax would cripple the ability of family businesses to continue to grow and remain family owned. The large corporations would continue to consume these businesses or many of them would cease to exist because of the estate tax burden.

The effects of the estate tax on both the family-owned newspaper and the entire community newspaper industry have been dramatic. The newspaper industry as a whole continues to face technology advances which present significant challenges to the traditions of the newspaper.

The community newspaper has not seen a dramatic drop in subscribers as the larger daily newspapers however it is uncertain for how long this trend will continue. Where the direction and the future of the newspaper industry will go is unclear. And the added challenge the estate tax creates, for both planning and financial reasons, is an additional uncertainty in the lives of small businesses.

The effect of the estate tax on community newspapers is burdensome. If Congress fails to make legislative changes, in 2011 the effects of a 55% rate may be impossible for community newspapers to overcome. Coupled with estate taxes at the state level and costs for life insurance and estate planning, it would likely devastate the community newspaper industry.

The Purcell Register saw, first hand, the negative effects of the estate tax. The previous owners of *The Register* were forced to sell the newspaper after it had been in their family for over 65 years. The family could not bear the costs of yet another tax and were forced to sell.

NNA urges Congress to carefully consider and enact meaningful legislation that would help small businesses, such as the community newspaper, continue to thrive in an already difficult environment.

Permanently repealing or reducing the tax would allow family businesses to reinvest that money into the company, and help boost a sagging economy. Small businesses make up the fastest growing portion of our economy, but many are crippled by a tax that makes up only about 1% of federal revenue.

Help us keep the heritage and tradition of the community newspaper alive and in the hands of the family.

Respectfully submitted,

Sara A. DeForge, Esq.
NNA, Government Relations Manager

Testimony for the Record

November 14, 2007

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CEO and Owner
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U.S. Senate
Finance Committee
Washington, DC, 20510

Federal Estate Tax: Uncertainty in Planning Under the Current Law

Chairman Baucus, Ranking Member Grassley and members of the Committee, as the son of a rags-to-riches businessman, I am pleased to offer written testimony on the effect of the death tax. I want to tell you about my father, a man who worked hard his entire life, only to have half the fruits of his labor seized by the death tax. My father is a "real-world" example of the death tax's purported social engineering.

Luther Cain knew something about the American dream. He was the grandson of slaves, had no college education, and no source of capital. Even so, he was determined to make a better life for his family and future generations. He wanted to offer his children the possibility of financial prosperity, and was determined to use his mind and sweat equity to make this dream a reality.

In the early 1940's he left his father's small farm in TN with no worldly possessions except for the clothes on his back. He realized that his father's farm would not provide the prosperity that he desired. Over time, he worked three jobs as a barber, a janitor and a chauffeur at one time to improve his family's lot. Needless to say, my father understood the meaning of hardwork.

Luther Cain died in 1982 with a net worth of $982 thousand, very close to his goal of $1 million. Had he lived beyond his young 56 years, I have no doubt that he would have well exceeded this goal. With his money he was able to purchase a home, put myself and my brother through college, and give us our start in life. It also provided for my mom in her later years, when she suffered from multiple sclerosis. Most importantly, my father's achievement gave me a vision of what hard-work, frugality, and discipline can offer to a person living in America. I've taken my father's life-lessons to heart and used it to turn

around a dying restaurant chain, lead a national trade association, and start my own company.

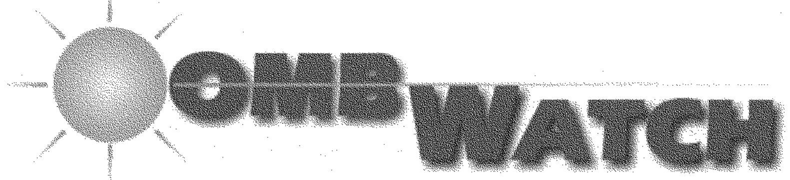
By the time of my mother's death in 2005, my father's assets had grown modestly leaving his family with a death tax liability of $1.3 million. My father would have been proud to have known that his hard earnings had been well-managed and used to propel his family to ever greater heights. Somehow, I do not think he would be nearly as pleased to learn that nearly half of it never made it into the hands of his grandchildren.

Yet my father is only one example of thousands. Most Americans who have earned over a million dollars in their life time have done it through hard work and rigorous discipline. It is easy for members of congress to talk about wealth disparity and to gloat about their grand schemes to ensure "fairness." It is another matter when they confront the individuals whose "wealth disparity" they are actually seizing. Somehow, I get the impression that my father's story – and the thousands like it – does not fit their expected redistributionist model.

My father's story is nothing new to most Americans, and neither is my father's vision of the American dream. Most folks understand that one of our core American freedoms is our right to property. A right to property necessarily means a right to use your mind and sweat equity to create, purchase, own, and trade wealth. In order to have any meaning, it must also mean that it is immoral to confiscate someone's property simply because of their success in creating it. Yet the death tax commits this very immoral act, by punishing hard-working and successful individuals for pursuing the American dream.

Finally, some politicians crow that the federal government could not properly function without the death tax's paltry $24 million in annual revenue. Notwithstanding the many studies which cast doubt on this figure, I find it repugnant that government revenue should be placed on a higher pedestal than the sacred right to one's property. America does not exist to fund the insatiable appetite of government. If a tax cannot be morally justified, government should learn to do with less revenue. Government is not entitled to a minimum level of revenue. My father is entitled to the rewards of his life's work.

Members of the Senate Finance Committee, I recognize that you have heard from many respected individuals such as the billionaire Warren Buffett. While Mr. Buffett is certainly a savvy investor, he should not be considered the litmus test for the moral value of the death tax. My father, and the thousands of Americans who have achieved or are seeking a better life through hard work – they are the real litmus test for the death tax. And by holding the death tax up to this test, it has failed miserably. I encourage the members of the committee to quickly take up and approve legislation to permanently repeal the unfair and immoral death tax.



OMB Watch Statement for Senate Finance Committee Hearing on the Uncertainty of Planning under Estate Tax Law

November 13, 2007

OMB Watch is a nonpartisan watchdog organization that has been advocating for the past 25 years for federal fiscal policies that are fair, responsible, and meet our nation's needs and priorities. We thank the Senate Finance Committee for holding this hearing on uncertainties encountered in planning for the estate tax under current law and for the opportunity to submit our views on the issues.

The federal estate tax has long been and remains an important source of revenue for the federal government. It is also among the fairest and most progressive of the taxes in the code, paid by a small fraction of one percent of the wealthiest estates in the country. The estate tax also provides a significant incentive for charitable giving in this country, as 100 percent of charitable bequests are exempt from the tax. Recent studies have shown nearly $10 billion in charitable giving would be lost annually should the tax be repealed. Finally, and perhaps most importantly, it represents a bulwark against the kind of concentrations of wealth among a small number of the very richest families in our country and the formation of oligarchies that would threaten the nation's deeply held commitment to social and economic mobility and equality of opportunity.

The current schedule of rates and exemptions under estate tax law includes an anomaly that was created when the Bush tax cuts of 2001 were passed into law. The law slowly phased in gradual decreases in the estate tax rate and gradual increases in the deduction through 2009 – and then suddenly eliminated the tax entirely in 2010. In 2011, estate tax law reverts to pre-2001 levels.

We will no doubt hear today about some of the frustrations relating to planning around this anomalous schedule. We share taxpayers' and tax preparer's dismay about this schedule, which may have reflected a cynical effort at the time this reform was adopted to force Congress and the nation into the position of having to consider abandoning the estate tax for good. Yet these small frustrations are fixable, and do not necessitate the abandonment of the estate tax, or drastic reform that would deplete its revenues.

Repeal or drastic reform of the estate tax is unacceptable both from a tax equity perspective and also from a fiscal perspective. Making permanent the repeal of the estate tax after 2010 would add more than $1.1 trillion to the deficit between fiscal years 2012 and 2021, according to the Center on Budget and Policy Priorities.

Celebrating 20 years: Promoting Government Accountability and Citizen Participation - 1983 - 2003

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Such a major disruption in resources would create havoc for federal fiscal planners, putting increased pressure on an already strapped federal budget. Such a large increase in deficits and debt is unacceptable considering less than one percent of all Americans ever pay any estate taxes.

Because of the unusual estate tax law passed in 2001, we believe Congress should take action to enact a steady, consistent estate tax schedule sometime in advance of 2010. This would do two important things: one, it would resolve the planning difficulties faced under current law by parties on all sides; two, it would obviate the need to consider the future of the estate tax at the last minute, before the law reverts back to pre-2001 levels.

OMB Watch favors an estate tax regime without any of the anomalies, gimmicks, and trap doors embedded in the current law. We strongly believe estate tax reform must not exacerbate the national deficit or force otherwise unnecessary and less progressive tax increases – there are certainly ways to structure a reform that is revenue neutral. We also believe it is crucial for any reform to maintain the important incentive for charitable giving present in the estate tax and honor the national commitment to social and economic mobility and equality of opportunity.

While we have strong views on the issue of the estate tax, we also believe there are more immediately serious tax and budget issues this Congress and the succeeding one must come to grips with, starting with the simple enactment of a federal budget for the current fiscal year. Thereafter, addressing the problems caused by a growing Alternative Minimum Tax, expanding both the Child Tax Credit and Earned Income Tax Credit for working families, providing health care for uninsured children, and closing corporate tax loopholes and offshore tax havens would all be more crucial to address than the estate tax, both in terms of the number of citizens who would be impacted under those policies as well as from a revenue perspective.

We hope the Finance Committee and entire Senate will not lose sight of the fact the estate tax impacts a tiny minority of Americans, yet provides a multitude of benefits for our country. While we agree a more permanent reform is required because of the structure of the 2001 law, this action is necessary only sometime before 2010. With that in mind, we want to reiterate that any reasonable estate tax reform must be fiscally responsible, contain incentives for charity, and continue our country's commitment to social and economic mobility and equality of opportunity. It is possible to make small changes to estate tax law that would not significantly impact revenues or eliminate charitable incentives that could alleviate many of the concerns the 2001-law has created – many of the concerns likely to be heard at this hearing. We believe a rush to pass a reform quickly without proper consideration for and adherence to these important factors would be a mistake.

John Bradshaw
CEO and Owner

Portland Transmission
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Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law
November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee, I am honored to present testimony about the Federal Estate Tax, or death tax, and its effect on my business.

In my experience as a business owner, it is practically impossible to adequately prepare for the death tax, even with thousands of dollars in CPA and legal fees. No matter how much time, money and energy is expended, the actual death tax liability is never fully known until death. This means that the surviving family can never be sure whether they have enough capital to pay the tax, or will be forced to take on burdensome loans, unload business assets, or even sell the entire business in order to produce the cash needed.

I believe that it is fundamentally unfair to burden families with such an onerous tax simply because the past generation has attempted to pass on a successful business. The death tax punishes hard-working business-owners who have already paid taxes on their earnings, built the local economy, created jobs, and contributed to the community. I should not have to waste my time and money simply to prevent my business from being sold when I die, and neither should any other business owner. This is not a minor flaw of the death tax – it is inherent to the tax's legal structure. As long as the tax confiscates crucial business assets, businesses such as mine will be placed in limbo every time a generation dies. For this reason, the death tax will continue to cause headaches and grief to family business owners unless it is permanently repealed.

Portland Transmission was started by my father in the early 1930's. After surviving the depression and civilian rationing during the 2nd World War, Portland Transmission became one of the first repair centers to work on automatic transmissions. Outside of our shop, there were no options for the first owners of vehicles with automatic transmissions.

While we continue to do innovative repair work, we have built our current success around our distribution operation. Today, Portland Transmission has become one of the primary distributors of transmission parts in the nation. We occupy a 32,000 square foot warehouse in Portland where we ship parts to repair centers around the world. In 2005 we were the winners of the Massachusetts Mutual "National Family Small Business of the Year" and in 2007 we won the Small Business Administration's "Oregon Small Family Business of the Year" award. If things had gone differently with the IRS in the wake of my father's death - as they nearly did - it is very possible that we would not have won those awards or even have been in business.

When my father died, the IRS demanded an unexpected and unavailable $189,000. As we learned the hard way, you always have more assets on hand than your calculations tell you. My family did not have the cash to pay this tax, nor did we have stocks or other easily liquid assets which we could sell in order to provide the cash. Our liability was almost completely due to the estimated value of the business, meaning payment would have to come out of the business. What most politicians do not seem to understand is that businesses like ours do not have considerable cash reserves on hand. We cannot simply part with nearly two-hundred thousand dollars.

In order to pay the tax, we were forced to take out a large loan and sell - at cost - an entire line of inventory. This is not simply an "inconvenience" for a family-owned business such as Portland Transmission. We cannot afford to take on debts which do not supply us with profitable merchandise or productive employees. As anyone knows who has taken basic economics, resources are scarce and cannot simply be made available because someone needs them. Loans are okay as long as they make the company stronger and lead to higher profits which can be used to pay off the loan. Obviously, the federal government has done nothing to increase our profitability. This means that paying the tax is a drain on our company's revenues - the same revenues we use to pay our employees and maintain our equipment.

Just as we cannot afford to take on unproductive loans, we also cannot afford to sell products for less than the cost of producing them. When we are forced to sell a product at below market value, we lose money. Unlike the Hollywood depiction of the business world, companies do not simply "jack up" prices in order to get higher profits. We ask for the highest price that our clients will pay, and produce our product accordingly. We depend on that expected price to provide a steady stream of income. When we sell below our asking price, we lose the money which we depend on to pay our employees. We cannot simply raid a mythical "slush fund" to make cash flow and keep our company in the black.

Despite these losses, we have managed to withstand the first generation of death tax liability. Whether we will be able to continue to keep the company running after my death is another matter entirely. Because we think of our 21 employees above all else, we will do

everything to maintain their jobs. After all, we depend on their hard-work for our current success. Letting go of even one employee would be a real loss to our company.

Our "options" for obtaining liquidity to pay the death tax include the sale of company land (currently held as collateral for productive loans), the sale of inventory and other assets, and possibly even the sale of my home. None of these are preferable options, which is why we continue to spend hours in discussion with our CPA and lawyer. Keep in mind that this is time that should be spent in productive activity to maintain and grow our business. While it is true that all taxes encourage some degree of economically unproductive activity, the confiscatory nature of the death tax is the worst. Because it threatens the very sustainability of a company, families like mine will spend hours agonizing over strategies to keep their business from becoming a liability. The alternative – losing the business – is to be avoided at all costs.

My story is very simple: the death tax is destructive to family-owned businesses. I see no reason to maintain a tax which provides Washington with a pitiful $24 billion, while putting otherwise strong companies through considerable financial duress. As my testimony is filed, families across America will spend the holiday season reviewing their assets and painstakingly shielding the family business from the death tax. This wasteful and anti-social activity should be reason enough for Congress to abolish the death tax immediately.

Members of the Committee, there is no way to ever have certainty with the death tax – except that it will certainly threaten businesses across America as long as it exists. Please take the time in this session to pass legislation to abolish this tax once and for all.

The 60 Plus Association

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Top agenda items: Kill the Death Tax. Protect Social Security.

James L. Martin
President

Rep. Roger Zion (R-IN, 1967-75)
Honorary Chairman

Pat Boone
National Spokesman

Attention: **STATEMENT FOR THE RECORD**
Federal Estate Tax hearing of 11-14-07

To: **Senate Committee on Finance**
Editorial and Document Section
Rm. SD-203
Dirksen Senate Office Bldg.
Washington, DC 20510-6200b

Fr: **James L. Martin**
President
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The 60 Plus Association is a 15-year-old nonpartisan organization working for death tax repeal, saving Social Security, affordable prescription drugs, lowering energy costs and other issues featuring a less government, less taxes approach. 60 Plus calls on support from nearly 4.5 million citizen activists. 60 Plus publishes a magazine, SENIOR VOICE, and a Scorecard, bestowing awards on lawmakers of both parties who vote "pro-senior." 60 Plus has been called "an increasingly influential senior citizen's group."

As the person who has preached the name DEATH TAX for estate tax for more than 15 years, I want it known that in a city where con jobs are finessed on a daily basis, perhaps the biggest con job of all is the one that repealing the death tax is a tax cut for the rich. That's what Mr. Buffett would have us believe after his Senate Finance Committee testimony of November, 14, 2007. Well, that is hogwash, pure and simple! He and his kind --- I like to refer to them as the uber-wealthy --- try to put a face on the so-called "rich" by invoking the name of Paris Hilton, in other words, that death tax repeal would be a tax break for poor Paris.

Sorry. Can't let anyone who would wish to continue this onerous tax get away with that falsehood. Ever heard of the Hilton Foundation? Paris' parents and grandparents have avoided the death tax for generations via their Foundation. So, too, the Gates Foundation, Turner Foundation, Heinz, Rockefeller, Kennedy, Scaife, Winfrey and yes, the Buffett Foundation, as well as countless others. As a matter of fact, during the November 14, 2007 hearings, I found it surreal to listen to Senator Jay Rockefeller (Rockefeller Foundation) asking Warren Buffett (Buffett Foundation) about the wisdom of people ponying up the death (estate) tax.

It's time to dismount from the "tax cut for the rich" horse because that nag is dead --- or it's certainly on its last bag of oats!

There's a chain of minority owned newspapers --- from California to New York --- that have fought for survival because of this confiscatory tax. Most famous is the Chicago Defender. Another, the Cleveland Call in Ohio, was saved by boxing promoter Don King, who said the paper is part of his heritage.

Whether called the Death Tax, Grim Reaper's Tax, Exit or Departure Tax, Feet First Tax, Tombstone Tax, or The Stiffest Tax of All --- I've got a casket full of these gruesome names --- it's pretty ridiculous that on the death of a loved one, the first claimant in line is not a blood relative but good old Uncle Sam, with greedy outstretched palm.

To quote USC Prof. Edward McCaffery who describes himself as an "unrequited liberal" and who initially favored keeping the death tax but now endorses repeal, he said rather eloquently, "to most people, death seems like the wrong time to tax."

For 15 years, the 60 Plus Association has lived by the slogan 'Dying is not a taxable event.' And I, Jim Martin, proudly say that I have been credited with popularizing the term 'death tax' for the estate tax by the likes of Grover Norquist on the right...and... Bill Gates, Sr. on the left (in his recent book, 'Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes'). Gates spent considerable ink on me and my popularizing the moniker 'death tax' claiming that proponents of death tax abolition knew they'd gained an upper hand when news networks like CNN began routinely calling it the death tax rather than the estate tax. Even Playboy magazine, of all publications, contacted me to balance Gates, Sr.'s assertion that the death tax not be repealed; Playboy may not be my cup of tea but we at 60 Plus will leave no stone unturned in our efforts to answer those who would prefer to keep alive the 'death tax.'

So over the past 15 years, we've helped move repeal from one goal line to the other. While three votes short in the Senate (57-43 for repeal), over in the House we had an overwhelming 110 vote majority in 2005 with 40-some Democrats and more importantly, eight members of the CBC, the Congressional Black Caucus, that voted for repeal because they know this tax hurts minority businesses the most. They have not bought into the con job that repeal is a tax cut for the rich.

To the argument that the tax revenues are needed, I have a question for the naysayer's: Why is it that more than a dozen countries around the world have abolished their estate tax? What do politicians in those countries know that politicians in America don't know?

The answer is simple; economic studies prove that instead of a loss in tax revenues, abolishing the death tax means businesses grow, leading to expansion of the tax base.

It's time Washington did the right thing and KILL THE DEATH TAX! Ostensibly killed three times in the past, perhaps it's time like Mr. Dracula, we drive a wooden stake through its heart!

I'll conclude in this manner: If Mr. Buffett and his wealthiest-beyond-all-imagination friends want to keep the death tax penalty, OK, but let's do this: in their honor, let's change the name to the "Voluntary Tax"...and that way, they may pay the levy. Just please, don't tell the rest of American society how to be taxed.

Thank you.

Statement of: James L. Martin
President
60 Plus Association

1600 Wilson Blvd., #960
Arlington, VA 22209

p.s. Accompanying this testimony is a copy of an article from the May 21, 2001 edition of The American Prospect magazine that featured a story on Jim Martin and his "renaming the estate tax to try to kill it."

THE AMERICAN PROSPECT MAY 21, 2001

Meet Mr. Death

BY JOSHUA GREEN

"Somebody once told me, 'Jim, we ought to call you Mr. Death,'" Jim Martin tells me proudly. "I'll have you know, I don't mind that appellation." These days, Mr. Death has reason to crow. Martin credits himself with coining the term "death tax" in 1993 as a usefully derisive nickname for the estate tax. As the founder and president of the 60 Plus Association—sort of a conservative AARP devoted to repealing the estate tax—Martin is one of the leading advocates for the tax's abolition. His crusade is enjoying considerable success. In April, for the second year in a row, the House of Representatives voted to repeal the tax, with Republicans again frustrating Democratic leaders by drawing substantial cross-party support. And in January, Martin got something he'd wanted for eight years: a man in the Oval Office willing to eliminate the estate tax. Several years ago, even the most optimistic conservatives would have been hard pressed to imagine such a triumph. But thanks in large part to Jim Martin, the estate tax—which most people had never even heard of 10 years ago—may be on the verge of repeal.

In theory, very few people should oppose the estate tax. Only the wealthiest 2 percent of Americans are subject to the tax, which applies to money transferred to heirs at rates ranging from 37 percent to 55 percent. For individuals the tax kicks in only on estates valued at $675,000 or higher; for married couples that figure doubles. Numerous loopholes (such as trust funds, charitable foundations, and gifts to relatives) permit most people, even the wealthiest, to avoid it entirely. And provisions already exist to protect farmers and small-business owners, the groups conservatives claim—in an attempt to lend estate-tax abolition a populist appeal—will be most hurt by the tax. (The writer of a recent *New York Times* article couldn't locate a single case of a farmer who'd lost his business to the estate tax.) What's more, repealing the estate tax would mean $662 billion in lost revenue for the federal government over the next decade—a $662-billion tax cut for the wealthiest people in the country.

Yet while few citizens will ever be subject to the estate tax, polls show that nearly 80 percent of Americans support repealing it (at least they do when it's presented as a "death tax"). Repeal has gained strong support in Congress as well. When the original sponsor in the House—Republican Christopher Cox of California—first introduced a bill in 1993 to eliminate the tax, he didn't have a single co-sponsor. This year repeal drew 274 votes, including 58 Democrats. Arizona Senator Jon Kyl introduced a Senate version in 1995 that attracted a single co-sponsor; last year repeal drew 30 votes. When repeal passed the House last year, Democrats were stunned. "We didn't see this coming," admits one Democratic Senate aide. "This seemed like a radical idea three years ago when [Republicans] were out of power," laments another. "But—boom!—here they are."

What's happened, as Jim Martin eagerly points out (and many Democrats sheepishly concede), is that liberals have lost the battle over popular perception. Conservatives have managed to control not only the tax's image but the very language used to describe it. In the offices of 60 Plus, calling the death tax by its proper name—the Federal Estate and Gift Tax and Generation-Skipping Transfer Tax—merits a one-dollar fine. "It's all a matter of marketing," says Martin. Adds Edward McCaffrey, a professor at the University of Southern California who opposes the tax, "They've got good rhetoric, a good issue, and good timing—to most people, death seems like the wrong time to tax."

Though "death tax" is Martin's best-known coinage for the estate tax, he has countless others. During the course of our conversation, he manages to invoke "the grave-robber's tax," "the Grim Reaper's tax," "the exit tax," "the departure tax," "the success tax," "the pine-box tax," "the heavenly repatriation tax," and—taste is no barrier in the fight for repeal—"the stiffest tax of all." To spread the gospel of death, Martin travels the country drumming up grass-roots interest and trolling for ideas. Earlier this year, at the Conservative Political Action Conference in Arlington, Virginia, he sponsored a slogan-writing contest to generate catchy new phrases. "Steve Forbes's 'no taxation without respiration' is a tough act to follow," he warned passersby. But that didn't dissuade the contest's 40-plus participants. The winner ("the last-grasp tax") took home a $100 prize. But many of the other entries have since found their way, through Martin, into newspapers and television.

A few years ago, Martin gained an important ally in GOP pollster Frank Luntz, whose polling revealed that "death tax" sparked voter resentment in a way that "inheritance tax" and "estate tax" couldn't match. After all, who wouldn't be opposed to a "tax on death"? Luntz shared his findings with Republicans and included the phrase in the GOP's Contract with America. Luntz went so far as to recommend in a memo to GOP lawmakers that they stage press conferences "at your local mortuary" to dramatize the issue. "I believe this backdrop will clearly resonate with your constituents," he wrote. "Death is something the American people understand." Apparently, he's right. Spurred by Luntz, Republicans have employed the term "death tax" so aggressively that it has entered the popular lexicon. Nonpartisan venues like newspapers and magazines have begun to use it in a neutral context—a coup for abolitionists like Martin.

Jim Martin renamed the estate tax to try to kill it.

At first blush, Martin seems an unlikely crusader against a tax geared toward the wealthy. A former Marine and newspaperman who founded 60 Plus in retirement, he has never had great sums of money to bankroll his campaign. Instead, he's relied on salesmanship. Martin's great skill is his ability to make the issue resonate with voters who wouldn't possibly be affected by it. He does this by framing the debate in moral instead of financial terms. Presenting the tax as one on death—and not as one on wealth—obscures its true nature. Everyone dies; not everyone is wealthy. Martin says one of his most effective lines is: "Should Uncle Sam, rather than a blood relative,

over

be the first in line when you die?" Not surprisingly, most folks answer no. As characterized by conservatives like Martin and Luntz, "the death tax" has nothing to do with rich people.

Martin's picture of the estate tax is a clever distortion. And for the most part, Democrats have been helpless to refute it. The closest they've come was last year, when Bill Clinton vetoed the tax's repeal, calling it "a windfall for the wealthy." ("Makes a nice alliteration," Martin admits.) But with Clinton out of office, his party seems adrift.

Democrats are frustrated that they've been unable to sway public perception. Research shows that once voters understand the implications of the estate tax and who pays it, they tend to support the Democratic position. Liberal Democrats have tried to capitalize on this fact and make preservation of the tax more attractive by tying the revenue it generates directly to social programs. For instance, Minnesota Senator Paul Wellstone and Massachusetts Representative Barney Frank have introduced legislation in the Senate and the House, respectively, that uses estate tax revenue to pay for a prescription drug benefit. But so far, these alternatives have failed to gain political traction. The Democrats lack the vocabulary to communicate their message.

Even so, the tax may be rescued by circumstance. Martin worries that if Democrats can forestall repeal, he may lose in the long run. The exemption is slated to rise to $1 million in 2006, and it doesn't take a genius to see the potential Democratic weapon: "the millionaire's tax." Martin says gravely, "My theory has always been that once it gets to a million, we're dead in the water."

But he brightens when I ask him what he has planned in the meantime. Martin hesitates for a moment, as though reluctant to divulge a trade secret, but his enthusiasm soon gets the better of him. "You see, women pay a higher proportion [of the estate tax] because they live longer than men. So who ends up paying the tax? Widows and orphans! That's what we're going to call it next—the 'widow's tax.' It's like robbing a dead man!"

Martin's own symbol of estate tax excess couldn't be further from the image of the rich, white gentry to whom the tax primarily applies. He shares with me the plight of Chester Thigpen, an elderly black tree farmer from Mississippi who, Martin claims, will be unable to pass along his property to his heirs because of the dreaded death tax. "'Old Man' Thigpen is the grandson of slaves," says Martin, who once brought Thigpen to Washington to testify before the House Ways and Means Committee. "On paper, his tree farm is worth two, two-and-a-half million dollars, probably. But he doesn't have two nickels to rub together. When he passes, [the government] will have to chop down his trees to collect, which will ruin the economy. His kids will be forced to sell it. And for all we know, that farm will be a high-rise apartment complex a year from now."

A quick search of newspaper archives confirms my suspicion that Martin has dined out on the Chester Thigpen story many times before. It's not hard to understand why. In fact, Thigpen seems tailored to Martin's campaign. I ask why he hasn't incorporated Thigpen further into his marketing strategy. After all, a Chester Thigpen bill would surely spur more curiosity than the Estate Tax Elimination Act currently before Congress, wouldn't it?

There is a long pause while Martin ponders the question.

"The Chester Thigpen bill, huh?" Martin says, warming to the idea. "We'd make *The New York Times* and *The Washington Post* spend a paragraph each time they wrote about it, explaining that he is an African American, the grandson of slaves, who's being affected."

There is another pause.

"I probably ought to send Congress a letter and ask 'em to do it right now," he says. "Hang on for a minute, while I write this down." ◆

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Top agenda items: Kill the Death Tax. Protect Social Security.

James L. Martin
President

Rep. Roger Zion (R-IN, 1967-75)
Honorary Chairman

Pat Boone
National Spokesman

Attention: **STATEMENT FOR THE RECORD**
Federal Estate Tax hearing of 11-14-07

To: **Senate Committee on Finance**
Editorial and Document Section
Rm. SD-203
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Fr: **James L. Martin**
President
60 Plus Association
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The 60 Plus Association is a 15-year-old nonpartisan organization working for death tax repeal, saving Social Security, affordable prescription drugs, lowering energy costs and other issues featuring a less government, less taxes approach. 60 Plus calls on support from nearly 4.5 million citizen activists. 60 Plus publishes a magazine, SENIOR VOICE, and a Scorecard, bestowing awards on lawmakers of both parties who vote "pro-senior." 60 Plus has been called "an increasingly influential senior citizen's group."

As the person who has preached the name DEATH TAX for estate tax for more than 15 years, I want it known that in a city where con jobs are finessed on a daily basis, perhaps the biggest con job of all is the one that repealing the death tax is a tax cut for the rich. That's what Mr. Buffett would have us believe after his Senate Finance Committee testimony of November, 14, 2007. Well, that is hogwash, pure and simple! He and his kind --- I like to refer to them as the uber-wealthy --- try to put a face on the so-called "rich" by invoking the name of Paris Hilton, in other words, that death tax repeal would be a tax break for poor Paris.

Sorry. Can't let anyone who would wish to continue this onerous tax get away with that falsehood. Ever heard of the Hilton Foundation? Paris' parents and grandparents have avoided the death tax for generations via their Foundation. So, too, the Gates Foundation, Turner Foundation, Heinz, Rockefeller, Kennedy, Scaife, Winfrey and yes, the Buffett Foundation, as well as countless others. As a matter of fact, during the November 14, 2007 hearings, I found it surreal to listen to Senator Jay Rockefeller (Rockefeller Foundation) asking Warren Buffett (Buffett Foundation) about the wisdom of people ponying up the death (estate) tax.

It's time to dismount from the "tax cut for the rich" horse because that nag is dead --- or it's certainly on its last bag of oats!

There's a chain of minority owned newspapers --- from California to New York --- that have fought for survival because of this confiscatory tax. Most famous is the Chicago Defender. Another, the Cleveland Call in Ohio, was saved by boxing promoter Don King, who said the paper is part of his heritage.

Whether called the Death Tax, Grim Reaper's Tax, Exit or Departure Tax, Feet First Tax, Tombstone Tax, or The Stiffest Tax of All --- I've got a casket full of these gruesome names --- it's pretty ridiculous that on the death of a loved one, the first claimant in line is not a blood relative but good old Uncle Sam, with greedy outstretched palm.

To quote USC Prof. Edward McCaffery who describes himself as an "unrequited liberal" and who initially favored keeping the death tax but now endorses repeal, he said rather eloquently, "to most people, death seems like the wrong time to tax."

For 15 years, the 60 Plus Association has lived by the slogan 'Dying is not a taxable event.' And I, Jim Martin, proudly say that I have been credited with popularizing the term 'death tax' for the estate tax by the likes of Grover Norquist on the right...and... Bill Gates, Sr. on the left (in his recent book, 'Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes'). Gates spent considerable ink on me and my popularizing the moniker 'death tax' claiming that proponents of death tax abolition knew they'd gained an upper hand when news networks like CNN began routinely calling it the death tax rather than the estate tax. Even Playboy magazine, of all publications, contacted me to balance Gates, Sr.'s assertion that the death tax not be repealed; Playboy may not be my cup of tea but we at 60 Plus will leave no stone unturned in our efforts to answer those who would prefer to keep alive the 'death tax.'

So over the past 15 years, we've helped move repeal from one goal line to the other. While three votes short in the Senate (57-43 for repeal), over in the House we had an overwhelming 110 vote majority in 2005 with 40-some Democrats and more importantly, eight members of the CBC, the Congressional Black Caucus, that voted for repeal because they know this tax hurts minority businesses the most. They have not bought into the con job that repeal is a tax cut for the rich.

To the argument that the tax revenues are needed, I have a question for the naysayer's: Why is it that more than a dozen countries around the world have abolished their estate tax? What do politicians in those countries know that politicians in America don't know?

The answer is simple; economic studies prove that instead of a loss in tax revenues, abolishing the death tax means businesses grow, leading to expansion of the tax base.

It's time Washington did the right thing and KILL THE DEATH TAX! Ostensibly killed three times in the past, perhaps it's time like Mr. Dracula, we drive a wooden stake through its heart!

I'll conclude in this manner: If Mr. Buffett and his wealthiest-beyond-all-imagination friends want to keep the death tax penalty, OK, but let's do this: in their honor, let's change the name to the "Voluntary Tax"...and that way, they may pay the levy. Just please, don't tell the rest of American society how to be taxed.

Thank you.

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November 12, 2007

The Honorable Max Baucus
Chairman, Senate Committee on Finance
U.S. Senate
219 Senate Dirksen Office Bldg.
Washington DC, 20510
Fax: 202-228-0554

The Honorable Charles Grassley
Ranking Member, Senate Committee on Finance
U.S. Senate
135 Senate Hart Office Bldg.
Washington, D.C. 20510
Fax: 202-224-6020

Re: Senate Finance Committee Hearing on the Estate Tax

Dear Chairman Baucus and Ranking Member Grassley:

I am writing concerning the planned hearing on November 14 to examine the estate tax and offer this letter as written testimony for this hearing.

Like many others in the American manufacturing industry, I have a medium size company, which employs 650 workers. The company, Star Cutter Company, has seven locations based in Michigan. We have been operating for 80 years, and it is my hope, when the time comes, that my family will continue on with the business.

Like the industry as a whole, we have struggled over the years to adapt to new needs and with new technologies amid changing market forces. But we have adapted and, hopefully, will be able to continue so. My concern, however, is that my business, which is the heart of my "estate," will no longer be able to exist should it be subject to so punishing a tax as the estate tax. If not eliminated, that tax will take literally half, give or take, of all the worth of my business – and the years of toil and labor reflected in it – and hand it over to the federal government. There will be little chance that it will be able to remain whole after that.

In light of the November 14 hearing, I am writing to urge you to either completely eliminate this tax altogether or at least set it at a level, and with a high-enough exemption, that will keep our American companies alive.

I know the original intent of the estate tax was to prevent massive wealth from building up among a small number of families. But that intent has long been outwitted by an ever-

complicated U.S. tax code that has served to shelter accumulated wealth, not disperse it. Very wealthy individuals now have any number of options for shielding their "estates" from this federal tax, including corporate structures and foundations. As a result, a tax originally aimed at the super rich is hitting small American businesses on the chin – and ensuring that families that don't have the resources to shelter their "wealth" with the help of clever attorneys are the ones who suffer terribly under this tax.

My company has attempted to shelter its assets with the assistance of legal counsel, but this effort is constantly changing and creating added expense that further threatens the company and its competitiveness in the global market. This punishing tax has many far-reaching effects that continue to threaten the future of Star Cutter Company.

Thank you in advance for holding the November 14 hearing – and, hopefully, for considering ways to either make this tax fair, or make it go away.

Sincerely,

Bradley Lawton
President
Star Cutter Company

Steve Swanson
Owner and CEO
The Swanson Group

Post Office Box 250
Glendale, OR 97442

Statement for the Record

U.S. Senate Finance Committee

Federal Estate Tax: Uncertainty in Planning Under the Current Law

November 14, 2007

Chairman Baucus, Ranking Member Grassley, and members of the Committee: It gives me great pleasure to share with you my support for permanent repeal of the Federal Estate Tax, or "death tax," as it is better known.

My business, the Swanson Group, Inc. has already been placed on the chopping block once due to the death tax. In the next few paragraphs, I want to make clear why facing the death tax a second time could lead to my company's demise.

The Swanson Group is a 2nd generation family-owned success story. Over the course of the last 25 years, we have grown from 70 employees to over 1,100. We run multiple operations which include timber harvesting, manufacturing high-quality construction products, and most recently, utility helicopter chartering. The company's success has been fueled by a series of highly successful buyouts of previously underperforming companies. This strategy has required constant reinvesting of the company's assets and heavy debt leveraging. A key fact about my company is its lack of significant cash or other liquid assets.

While this lack of cash has not stopped the Swanson Group from profitably expanding the business, it has made it very difficult for my family to pay the death tax owed for my father's estate. Because my father anticipated the trouble that we would have paying his tax liability, he aggressively transferred most of his stock to his children before he died. While this avoided the brunt of the death tax, it cost the company millions of dollars in gift taxes. Far from being a small inconvenience, this loss has hamstrung our ability to reinvest and profitably expand in the years following my father's death.

The most frustrating fact of this whole ordeal is that it is not a one-time problem. Just as I and my siblings will one day die, so too will my family be forced to deal with the death tax

yet again. This time, they will not have the option of bequeathing shares, due to the fact that there are now nine owners rather than just one. This would make the gift tax prohibitively large. So instead of bequeathing stock, we are spending a fortune on life-insurance policies. Unfortunately, even this very expensive strategy is not guaranteed to work.

When my life-insurance policy comes up for renewal in a few years, it is very likely that my premiums will become too expensive to justify the cost. Without life-insurance, my family will be forced to sell off assets when I die in order to pay the tax. Selling off profitable assets is always the last thing a business owner wants to do, particularly when those assets include the jobs of loyal and hard-working employees. Whether the assets are machinery, storage space, or people, their loss always severely hampers a business's ability to grow and often puts it at a competitive disadvantage. The loss of productive assets also lowers a company's overall contribution to the local economy, and the tax revenues which it provides to state and local governments.

I am a hard-working and responsible business owner. I have built my life around making the family company stronger. I do not believe that I should be punished for leaving a viable business to my children when I die. In fact, I find the death tax repugnant to the core American virtue of entrepreneurialism. No other tax more directly targets those who have preserved and increased wealth, jobs and prosperity than the death tax.

I have no intentions of dying in 2010, the year that the death tax is temporarily repealed. In fact, I hope to live a much longer life, and see the family business pass on to my children. If Congress does the right thing and permanently kills the tax, I have every confidence that this will happen.

Members of the Senate Finance Committee, please do your part to introduce and approve legislation to permanently repeal the death tax.

Thank you for your time.

Respectfully,

Steve Swanson

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United for a Fair Economy Statement for Senate Finance Committee Hearing on the Uncertainty of Planning under Estate Tax Law, Nov. 13, 2008

United for a Fair Economy (UFE) is an independent, nonpartisan organization that has been raising awareness about economic inequality since 1995. UFE has worked since 1999 to prevent repeal of the estate tax. Members of UFE's Responsible Wealth project have let lawmakers know that thousands of wealthy people who expect to pay the estate tax are happy to do so, because they think keeping the tax is important to our country's future. In addition, UFE is a member of Americans for a Fair Estate Tax, a coalition of dozens of national nonprofit organizations working to retain a responsible estate tax.

UFE's report, "Spending Millions To Save Billions; The Campaign of the Super Wealthy to Kill the Estate Tax," documented that the push for repeal of the estate tax is not a grassroots movement. Instead, the repeal effort comes from a coalition of anti-tax groups, business trade associations, newspaper owners, and lobbying firms, allied with some of America's wealthiest families, including the Mars and Walton clans. The report details how 18 super wealthy families spent millions on estate tax repeal efforts in order to save $72 billion. (See http://www.faireconomy.org/press/2006/pc_and_ufe_expose_campaign.html .)

As the Senate Finance Committee considers changes to the estate tax, United for a Fair Economy requests that two key principles be followed. Any changes to the estate tax should be revenue neutral, compared with estate tax law starting in 2011-2020. Using any other approach would mean increasing taxes – or deficits -- for taxpayers who are not millionaires. A second important principle would be to re-introduce progressivity in the estate tax rate.

Estate tax law in 2011 contains a $1 million exemption and a top tax rate of 55%. A revenue-neutral approach to estate tax changes means that if legislation proposes to raise the exemption, the top tax rate will need to increase. One possible revenue-neutral configuration might be to combine the 2008 exemption of $2 million per spouse, with a progressive tax rate ranging from 40% on estates under $5 million to 65% on the largest estates over $20 million.

Changes to the Estate Tax Are Costly
The estate tax brings in significant revenue. Repealing the estate tax would slash federal revenues that are needed to fund programs like college loans and small business loans that build opportunity for everyone to get ahead. Full repeal would reduce revenues *more than $1.1 trillion* during the first full ten years (2012 to 2021), according to the Center on Budget and Policy Priorities. In the context of prolonged large budget deficits, abolishing the estate tax is fiscally irresponsible,

according to Senator George Voinovich (R-OH) and other moderates in both parties who abhor the prospect of red ink for decades to come.

Proposals to sharply cut the estate tax are almost as expensive as repealing the tax. For example, Senator Kyl's recent proposal exempts the first $10 million of a married couple's estate from the tax ($5 million for an individual) and taxes the first $25 million over the exemption level at the current capital gains rate, and the amount over the $25 million threshold at 30%. The Congressional Budget Office's 2007 Budget Options (pp. 313-314) says that complete estate tax repeal and retention of the modified carryover basis would reduce revenue by $60 billion in 2012. Sen. Kyl's proposal would reduce revenue by $46 billion in 2012, or 76% as much as repealing the estate tax entirely. Like permanent repeal, this proposal is irresponsible in both its fiscal impact and its policy direction.

Even proposals to "freeze" the estate tax at the 2009 exemption and tax rate would reduce revenue by $30 billion in 2012, or 50% as much as repealing the estate tax entirely, according to the CBO Budget Options. Like the Kyl proposal, this proposal would also have the effect of reducing taxes on people who were fortunate enough to inherit large wealth and increasing taxes on middle-class people who have worked for everything they own. That runs counter to the core American value of fairness.

The Estate Tax is the Most Progressive Tax and Fairest Tax

There is now general agreement that growing economic inequality is harmful to our country. As the nation's most progressive tax, and the only tax on wealth, the estate tax plays an important role in maintaining the progressivity of the overall federal tax system and in reducing economic inequality. It helps to ensure the distribution of wealth by merit, rather than by privileges of birth. In this sense, it is our fairest tax. In addition, it enhances economic growth and competitiveness by encouraging the wider dispersion of wealth, rather than its accumulation in fewer and fewer hands.

This progressivity is illustrated by the small portion of people who pay the estate tax. In 2004, with 112,107, 000 households, there were 1,120,000 households with a net worth of more than $5 million. Households with $5 million in net worth are in the top 1% of all households in wealth. When one considers that in 2007, two spouses together can pass on $4 million tax free, with no other planning efforts, it's easy to see how the estate tax is only paid by about 1% of all who die. (Data from Edward Wolff, "Recent Trends in Household Wealth in the US"; June 2007; based on 2004 Survey of Consumer Finances.)

Estate Tax Does Not Threaten Small Farms And Businesses

Contrary to popular thought, the estate tax does not threaten small farms and businesses. According to the Congressional Budget Office, very few small businesses or family farms pay the estate tax - about 123 farms each year at the current $2 million exemption; all but a handful had enough liquid assets to pay the tax. In addition, to lower any estate tax owed, farmers can currently value farmland at between 45% and 75% of its fair market price. Small businesses and farmers can also pay back estate taxes over 14 years. (See http://www.cbo.gov/ftpdocs/65xx/doc6512/07-06-EstateTax.pdf .)

Similarly, according to the Tax Policy Center, in 2004, with an exemption of $1.5 million per spouse, of almost 19,000 taxable estates, only about 440 were primarily made up of farm and business assets. Again, most had enough liquid assets to pay the tax. (This is why opponents of the estate tax still have not been able to find a farm sold to pay the estate tax, especially since the exemptions were increased in 2001.) Some legislators have proposed keeping the estate tax with an unlimited exemption for qualified family-owned farms and/or businesses (QFOBI). However, as the Tax Policy Center noted, an unlimited QFOBI exemption would be very costly, and would give the wealthy huge incentives to buy farms and businesses, thus bidding up prices and actually hurting family farms and businesses. In addition, an unlimited QFOBI exemption would exempt some of the largest businesses in the world, such as Mars and Cargill. (Leonard Burman, William Gale, and Jeffrey Rohaly, "Options to Reform the Estate Tax," Tax Policy Center, March 2005.)

According to a 2004 small business survey by the National Federation Independent Businesses, "death taxes" ranked 36th as an issue of concern to business owners- lower than "controlling my own time". The survey was of 20,000 NFIB members. (See http://www.nfib.com/object/IO_16191.html .)

Tom Buis, President of the quarter-million-member National Farmers Union, recently stated, "Family farmers and ranchers are insulted by those who use farmers as the reason for eliminating estate taxes, when the real beneficiaries are the nation's multimillionaires."

The Estate Tax Encourages Charitable Giving
Repealing or drastically reducing the estate tax would reduce charitable giving as well, by eliminating a powerful tax incentive to make charitable donations. A study by the Congressional Budget Office shows that if there had been no estate tax in 2000, U.S. charities would have lost $13 to $25 billion in donations *that year alone*. Such losses could seriously weaken the enormous variety of important organizations supported by bequests and foundations, from soup kitchens to universities.

For all these reasons, United for a Fair Economy and its project Responsible Wealth advocate changing the estate tax by:

- Maintaining the exemption at $2 million for individuals and $4 million for couples
- Indexing the exemption for inflation
- Keeping the step-up in basis
- Simplifying provisions to ease the transfer of the few family-owned businesses and farms subject to the tax, and retaining the existing ability of businesses and farms to pay any tax over 14 years. One possibility would be to re-instate a higher exemption for qualifying estates with farm or business assets, for example, doubling the existing exemption. Although we support higher exemption levels for small businesses and farms because of their illiquidity, we do not believe they all should be exempted from estate tax responsibility.
- Creating an automatic exemption for married couples that is double that for single people

- Ending loopholes for non-farm estates, such as valuation discounts for multiple owners, and special trust arrangements

- Reinstating the credit for state estate and inheritance taxes, so states do not create a mismatching patchwork of state laws, but can simply piggyback on a reformed federal law

- Returning to a progressive rate structure, lowering the rate on estates smaller than $5 million to 40%, with incremental steps to a top rate of 65% on estates over $20 million.

The responsible estate tax changes we propose would:

- Maintain the revenue expected to be generated by the estate tax from 2011-2020

- Continue to encourage charitable giving

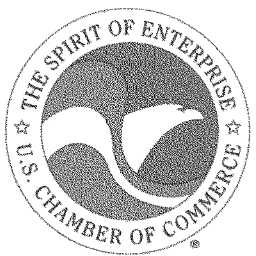
- Simplify estate tax provisions regarding married couples, businesses, and farms

- Reduce compliance and administration costs by simplifying the tax code and reducing loopholes

- Make the estate tax more progressive and thus fairer

- Enhance economic growth and competitiveness by encouraging the wider dispersion of wealth, rather than its accumulation in fewer and fewer hands.

In conclusion, we urge you to support fiscal discipline and tax fairness by voting against both permanent repeal of the estate tax and proposals to change the estate tax that are not revenue-neutral.



Statement of the U.S. Chamber of Commerce

ON: FEDERAL ESTATE TAX: UNCERTAINTY IN PLANNING UNDER THE CURRENT LAW

TO: THE SENATE COMMITTEE ON FINANCE

DATE: NOVEMBER 14, 2007

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region.

More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business – manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 105 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

STATEMENT
on
FEDERAL ESTATE TAX: UNCERTAINTY IN PLANNING UNDER THE CURRENT LAW
for submission to the
SENATE COMMITTEE ON FINANCE
on behalf of the
U.S. CHAMBER OF COMMERCE
by
Martin A. Regalia, Ph.D.
Vice President and Chief Economist

November 14, 2007

The U.S. Chamber of Commerce appreciates this opportunity to express its views on the federal estate and gift tax and to indicate its full support for repeal of the tax. The U.S. Chamber is the world's largest business federation, representing more than three million businesses and organizations of every size, sector and region. This breadth of membership places the Chamber in a unique position to speak for the business community.

UNCERTAINTY AND COMPLEXITY OF AN UNFAIR, INEFFICIENT SYSTEM OF ESTATE AND GIFT TAXATION

When the government in a free society uses its power to tax, it has an obligation to do so in the least intrusive manner. Taxes imposed should meet the basic criteria of simplicity, efficiency, neutrality and fairness. The federal estate and gift tax fails to meet any of these requirements.

The estate tax is anything but simple to understand or comply with. It is a multi-layered taxing mechanism so complex and convoluted that it has given rise to a cottage industry of estate tax planners, accountants and lawyers. While this may be acceptable to those professionals who make their living from the federal estate and gift tax system, it is not acceptable to the thousands of individuals who are forced to pay billions of dollars each year in estate taxes, planning fees, and compliance costs.

Even the simplest of estates require a certain amount of estate tax planning in order to avoid the pitfalls of this complicated tax system. Estate tax planning often includes the creation of one or more trusts, adding even more expense for taxpayers. The estate tax system also contains generation-skipping provisions designed to tax transfers from grandparents to their grandchildren. While there was formerly a "qualified family-owned business interest" deduction that could reduce estate taxes for some businesses in the past, the provision was repealed for decedents dying after 2003.

Taxes are efficient when they waste few resources in the collection process, impose no unnecessary compliance costs on taxpayers and make a high percentage of the proceeds available for public goods. The estate and gift tax, however, is inefficient. The estate tax has very high collection and compliance costs, even though its revenues only account for approximately 1.2 percent of total federal receipts. Individuals and businesses that do not owe estate tax still spend millions of dollars on estate planning and tax return preparation. For example, for 2004 decedents, 19,294 estates were subject to the estate tax; however, almost 42,239 estates had to go through the expense of filing federal estate tax returns.

The other characteristics of an acceptable tax are its neutrality and fairness. While measuring these aspects requires a certain amount of subjectivity, the estate tax can not be considered either neutral or fair to individuals or businesses. The highly-progressive nature of this tax severely penalizes those who have saved more, risked more, and worked harder than others.

The Economic Growth and Tax Relief Reconciliation Act of 2001 did provide much needed relief from the estate and gift tax. However, the phase-in of its provisions and the controversy surrounding their ultimate fate under an impending "sunset" at the end of 2010 have injected additional complexity, uncertainty, and speculation into business and estate planning decisions.

CONCLUSION

The case for complete repeal of the federal estate and gift tax is compelling – the tax penalizes savings, impairs capital formation, results in direct, substantial harm to family-owned businesses and farms, reduces job creation, is complex, costly and inefficient to comply with (and collect), and does not produce substantial federal revenue.

The estate and gift tax depletes the estates of taxpayers who have saved their entire lives, often forcing successful family businesses to liquidate or take on burdensome debt to pay the tax. Taxpayers should be motivated to make financial decisions for business and investment reasons, and not be punished for individual initiative, hard work, and capital accumulation.

Lasting, certain relief from these confusing, complex, and confiscatory taxes is needed for all estates, regardless of size, financial structure or composition of assets. The Chamber, therefore, believes that the federal estate and gift tax should be completely repealed.

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