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THE ESTATE TAX AND THE ALTERNATIVE MINIMUM TAX - INEQUITY FOR AMERICA'S SMALL BUSINESSES

HEARING

BEFORE THE

SUBCOMMITTEE ON TAX, FINANCE AND EXPORTS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

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THURSDAY, APRIL 14, 2005

HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON TAX, FINANCE, AND EXPORTS
COMMITTEE ON SMALL BUSINESS
Washington, D.C.

The Subcommittee met, pursuant to call, at 2:09 p.m. in Room 311, Cannon House Office Building, Hon. Jeb Bradley presiding.

Present: Representatives Bradley, Millender-McDonald, Chabot, McCotter, Keller, Poe, Fortenberry, Fitzpatrick, Lipinski, Faleomavaega, Kelly, Bean, Davis, Case, Michaud

Mr. BRADLEY. Good afternoon, everyone. Congresswoman Millender-McDonald will be here shortly, but I will call this hearing of the Subcommittee on Tax, Finance, and Exports to order and begin with a statement of my own.

I would like to begin by thanking all of you for participating in this hearing this afternoon, especially those of you who have traveled from significant distances to be here to talk about the alternative minimum tax and the estate tax, two taxes in our tax code that I think are among the most unfair.

I look forward to working with all of you, as well as my colleague from California, Congresswoman Millender-McDonald, as we address the many issues facing small businesses in our country.

The estate tax affects all Americans, especially small business owners, and I used to be one, the small business owners who have consistently identified permanent repeal of the estate tax as one of their most pressing concerns.

Working together with President Bush, Congress, in 2001, enacted bipartisan legislation that provides immediate relief, through tax reduction and an expanded exemption, with complete repeal occurring in 2010. Unfortunately, as we all know, the provisions of that bill, in 2001, required Congress to pass additional legislation to make the repeal and the elimination permanent. Thankfully, the House, once again, did that just yesterday afternoon by a vote of 272 to 162, and I might note, a very bipartisan vote. It is now up to our colleagues on the other side of the Capitol to pass similar legislation so that we can finally get to a Committee of conference and, hopefully, put a bill on the president's desk for his signature soon.

Simply put, the estate tax threatens the livelihoods of many families that run small businesses across our country. Small businesses have much of their assets tied up in equipment, in inventory, and other critical assets that are necessary to run a company. They do not have the available liquid capital to pay the estate tax many times, and so are forced to sell either the entire business or integral parts of the businesses in order to cover the tax liabilities of the estate tax. In my point of view, this is not acceptable, it hurts our economy, and that is why we must continue to fight for a permanent repeal of the death tax.

Similarly, the alternative minimum tax is an incredibly complex provision—I am going to pay it tomorrow—in the tax code that requires taxpayers to calculate their taxes twice and then pay the larger amount. Initially, a method to ensure that the wealthiest Americans paid their fair share because of the combined effects of inflation and individual rate cuts, the AMT has reached into the checking and savings accounts of the middle class. The alternative minimum tax unfairly penalizes businesses that invest heavily in capital assets by significantly increasing the cost of capital and discourages investment in productivity-enhancing assets by negating many of the capital-formation incentives provided under the regular tax system.

What we face with the alternative minimum tax is a sleeping giant that is starting to wake up and gobble the hard-earned funds of millions of American taxpayers, in particular, middle-income taxpayers. Today, it is 3 million taxpayers, but in a few short years, if we do not pass legislation to keep the exemptions from returning to previous levels, it will be 11 million taxpayers. And if we do not have a longer-term solution for the AMT by the end of the decade, it could be as many as 30 million taxpayers. One in three Americans potentially will fall under this tax that was originally designed to catch 150 of the most wealthy Americans that did not, at that time, pay their fair share of taxes.

So what we have today, with the AMT, is a situation where middle-income Americans will be paying more than the wealthier Americans because they lose their personal exemptions, they lose their exemptions for state and local taxes, and they lose the exemptions for itemized deductions. Most of the benefits of the tax cuts in 2001 and 2003 will no longer exist for these taxpayers and for anybody that has had to go through the AMT. The compliance costs of having to fill out taxes twice in a dual universe—the normal way and then the AMT way—is much higher.

So I am really looking forward to hear testimony today, but before I get to our panel, I would like to recognize my colleague from California, Congresswoman Millender-McDonald, because I know that you have an opening statement. Thank you, and I am sorry to have start before you got here.

Ms. MILLENDER-MCDONALD. That is all right. I had another one, so I just to just rush over from Rayburn over here.

Mr. Chairman, thank you so much for convening this hearing to discuss a very important issue for small business owners, and that is the U.S. Tax Code. As tomorrow's tax return deadline approaches, this topic is surely fresh in the minds of many small

firms, which we are very much aware of, the engines that drive our economy. How many face a barrage of challenges on their road to success, from inequities in federal contracting to burdensome federal regulations and lack of access to affordable health care? It has become increasingly clear that our nation's small businesses deserve a break.

We are holding today's hearing because small businesses continue to be hit by inequities in the tax code. Over the past five years, a series of tax cuts, with a total cost of over $2 trillion, have been enacted, but the inequities for small businesses still persist. The reality is that over half of small firms only received an average $500 under these cuts despite an enormous cost. Many of the tax cuts in these bills, including the dividend tax cut, provided virtually no benefits to small businesses or entrepreneurs.

While many of the tax reforms were instituted as a way to improve the economy, the job record through 2004 was considerably weak, and the GDP growth rate has hovered over 3 percent since last year. Part of the reason we have not seen job growth is the lack of the tax relief aimed at stimulating the small business sector, the proven job creators.

The two issues before us today are ones that significantly impact small businesses. When considering reform, we must take into account the needs of entrepreneurs and focus on solutions that will stimulate the small business sector. While there is no doubt that the alternative minimum tax and the estate tax reform will provide necessary relief for small businesses, it is clear that we face some tough choices.

With regard to the estate tax, there are clear solutions to this issue that have bipartisan support, and we need to act sooner rather than later. No one supports an estate tax that forces the sale of a family-owned business.

Based on the panelists today, I think we can all agree many American business owners dream of one day passing their business on to another family member. The way the current law is structured, however, it has made estate planning nearly impossible. By reforming the estate tax to meet the needs of small firms, we can ensure that family-owned farms and businesses will be passed on from generation to generation, and I think we owe it to small businesses to work together for a permanent solution.

We will talk about AMT. The mere mention of it brings fear to those who have even had to pay or even calculate it. It is clear that Congress's failure to provide for adequate AMT relief has meant that thousands of small business owners are subject to this tax. The failure to address these issues has contributed to the growing complexity of the tax code. Small should businesses should not be spending thousands of dollars on tax preparation. Small firms simply do not have the resources or capital to comply, and it is wasted money that business owners could allocate elsewhere.

According to an Office of Advocacy report, for small businesses with less than 20 employees, the cost of tax compliance is nearly double that of their larger counterparts.

So today's hearing is an opportunity to assess the real impact of the current tax code on our nation's small businesses. When we examine our tax priorities, the needs of small businesses must be at

the forefront. We are operating in an era of budget deficits, so in terms of tax relief, it comes down to priorities.

I look forward, Mr. Chairman, to today's testimony and hope that we can identify solutions that will provide targeted tax relief to small business owners. It is critical that we examine how our economic policies affect the small business sector and that we develop a tax code that awards our risk takers. Thank you, Mr. Chairman

Mr. BRADLEY. Thank you very much.

I would like to recognize the first witness this afternoon, Mr. Jeff Vukelic, who is the executive vice president of Try-It Distributing from Lancaster, New York, and is here today representing the National Beer Wholesalers Association. Mr. Vukelic, Thank you.

STATEMENT OF JEFF VUKELIC, TRY-IT DISTRIBUTING

Mr. VUKELIC. Thank you, Mr. Chairman.

My name is Jeff Vukelic, and I am executive vice president of Try-It Distributing, where we serve the Buffalo/Niagara Falls market as a distributor of Anheuser-Busch, Heineken, and Labatt beers.

Try-It Distributing was started as a soft drink bottling company by my grandfather, Stephen Vukelic, in 1928. My grandparents were Croatian immigrants. They never dreamed their company would grow into an operation with a fleet of over 110 delivery vehicles and more than 200 employees.

My parents, brothers, and I are fully involved and committed corporate citizens. We serve on civic and not-for-profit boards who respond to needs of charitable organizations, who contribute to programs for at-risk youth and work closely with law enforcement to advocate responsible consumption. Elected officials on every level rely on us to be well-informed and concerned supporters of individuals and ideas that ensure good government.

The Vukelic family is typical of other family-owned businesses in our association. Our home communities look to us as consistent leaders and dependable doers.

As chair of the National Beer Wholesalers Association, I appreciate the opportunity to share some thoughts with you today on behalf of the 1,850 members of our organization.

The beer-wholesaling industry directly employs more than 92,000 Americans nationwide, and the beer industry at large indirectly supports more than 890,000 workers, accounting for more than $30 billion in tax revenues across the country. Many wholesaling companies have been family owned and operated since the repeal of prohibition in 1933.

Regulation is a fact of life for beer wholesalers. We are regulated every day by a virtual alphabet soup of federal agencies, including TTB, FCC, DOT, NHTSA, EPA, OSHA, and the IRS, just to name a few. And because of the 21st Amendment, my company is strictly regulated by the New York State Liquor Control Authority.

I am here to talk about an issue that is absolutely critical to every privately held and family-owned business in America: the permanent repeal of the death tax. Now is the time for Congress to take final action to permanently repeal the federal death tax.

Over the last few years, and again yesterday evening, the House of Representatives has made great strides in helping America's small businesses by voting to permanently repeal the death tax. We continue to wait on the Senate to take action.

Small business owners need certainty when planning for their succession and the long-term viability of their businesses. As long as Congress fails to act, business owners will be forced to divert economic resources from investments that grow businesses, create jobs, and boost the economy. Instead, they will use those funds to pay for estate planners, lawyers, and accountants to navigate them through the uncertainties of the current tax structure and utilizing state funding vehicles.

Permanent repeal would free up that time, money, and energy. This would allow business owners to focus on growing their businesses, creating more jobs, and working to stimulate economic growth as a whole. We want to help keep the American economy strong and viable for our future and the future of our children.

Although full repeal will occur in 2010, the death tax burden will return in full force in 2011 due to the sunset language that was included in the Economic Growth and Tax Relief Reconciliation Act of 2001.

According to a recent survey, 85 percent of those polled want the death tax permanently abolished or significantly reduced. The American people oppose, on principle, the concept of anyone being taxed on the death of their parents. Unfortunately, if permanent repeal is not passed, many small business owners and farmers will continue to pay the ultimate price created by the sunsetting of the death tax repeal: loss of family businesses.

As the father of two young children, I am very concerned about their future and the future of my company if the death tax returns as currently scheduled. H.R. 8, the Death Tax Repeal Permanency Act of 2005, was introduced by Representatives Kenny Hulshof [MO-9] and Bud Cramer [AL-5] and passed the House with strong, bipartisan support yesterday. I would like to thank those members of this Committee that supported that legislation.

S. 420, the Death Tax Fairness Act, has been introduced by Senators John Kyl [AZ] and Bill Nelson [FL]. This bill also seeks full and final repeal of the death tax.

I urge Congress to act quickly and not turn its back on America's small business owners. Please encourage the Senate to schedule a vote on permanent repeal now. Congress must make death tax repeal permanency a priority by sending President Bush legislation for his signature.

As I close my remarks, I am thinking about the talents, sacrifices, and hard work that my grandfather and my father invested in making Try-It Distributing a success. Stephen Vukelic, a young newcomer from Croatia, achieved the American Dream. Please do not allow such bright dreams to become nightmares for the third and fourth generations of families who are working hard every day to sustain solid American businesses.

Mr. Chairman, thank you for the opportunity to share with you our organization's position on these important small business issues.

[Mr. Vukelic's statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much, sir.

Our second panelist is Mr. Thomas Pitrone, who is the principal of the Integrity Group of Willoughby, Ohio, and a member of the National Small Business Association. Welcome.

STATEMENT OF THOMAS PITRONE, THE INTEGRITY GROUP

Mr. PITRONE. Good afternoon, Chairman Bradley and Ranking Member—

Ms. MILLENDER-MCDONALD. —Millender-McDonald.

Mr. PITRONE. —Millender-McDonald.

Ms. MILLENDER-MCDONALD. Thank you so much, sir.

Mr. PITRONE. Thank you. I appreciate the opportunity to testify on the negative impact of the estate tax on small businesses. I am an estate tax practitioner. My primary focus, my practice, has worked with older folks on their money-management issues, but I also consult with small businesses on continuity and estate tax issues.

My firm was started with my dad, Frank Pitrone, who was a CLU, in 1983, and I have been in advocacy for small business since about 1988, through my association with COSE, the Council of Smaller Enterprises in Greater Cleveland, and then I was a delegate to the White House Conference on Small Business, and I am sitting on the board of the National Small Business Association now.

The estate tax is a tax on capital, as far as small businesses are concerned. For the majority of small business owners, their major asset is their business. I know scores of business owners who are worth more than $5 million, but they could not cash a check for more than 10 because they do not have any liquidity. It is hard to get cash out of a company.

They have worked hard all of their lives, as we just heard. They are frugal, they amass wealth, and they take care of their families. They live around the demands of their business. It does not make any difference if it is a farm or a store or a distributorship, insurance agency, when the business is in trouble, everybody in the family reacts. They understand that the business is important to the business owner, to the breadwinner, and it pays the bills.

It is not a new phenomenon. The issues of small business are older than our country. The founders, by our standards, were all small businessmen. They were tradesmen, lawyers, farmers, and they saw the importance of small business preservation as one of the issues that drove the Revolution. In the 1760's, George Washington saw the separation from England as important to the survival of small business, just business in general because there was nothing but small businesses then. So it is not too much to say that part of the reason for the Revolution was the existence of business in the United States, the colonies then.

Well, as I said, I have been involved in advocacy for 17 years, and I hear representatives talking about how important small busi-

ness is and how they believe in small business. I have just got to say, you need to do more than believe in it because, as the Ranking Member mentioned, it is the engine that drives the country, and the freedom to start a business is one of the most important freedoms, and you see it blossom wherever there is liberty. If you go to New York, Kiev, Nairobi, you see people with a box and a few things to sell. They are small business people; they are making it on their own.

So, in our country, a business owner works for 30, 40 years, pays his taxes, volunteers, does all of the things that we know they do, and then one day I come in and talk to him and tell him about what he is going to have to do to avoid the estate tax, or the government is going to take half of his business when he dies. And often, they do not believe me.

I can think of an instance where I went to see a fellow who owned a truck terminal, and I told him that he was going to have to pay half, or the government was going to take his business, and he said, I never heard of this; it cannot be true. And I said, No, no, it is true. And he said, Well, my business is not worth anything. So I looked out the window, and he has got a truck terminal and all of these tractors and probably 25 trailers, and he said, I have written them down; they have no book value. I said, Well, the IRS does not care about that. They go by what a willing buyer would pay a willing seller. And he said, If you get a willing buyer, get him in here.

So we began to talk about what he had to do, and he, frankly, did not believe me. He began to rant and rave, say bad things about the government, and finally ended up kicking me out.

And the truth is, what we have to do to avoid the estate tax is ridiculous. I tell people that they have to do obviously transparently stupid things to avoid the estate tax. They have to have a defective trust. They have to send their children crummy letters, and I feel like a witch doctor. It is like voodoo, but that is what they need to do avoid the estate tax. They often cannot believe me. They also have to buy a lot of life insurance and pay attorneys a lot of money to draft the documents that they need.

A small business owner already has a buy/sell agreement. He has got insurance for liquidity. He understands that. It makes sense to him, but when you tell him that the government is going to take half of his business when he dies, the value of his business, and he has to come up with the cash within nine months, you cannot blame him for feeling persecuted.

So the proponents of the death tax are dismissive about our issues. Small business is secondary to them. They say, "Can't we just fix it? Raise the limits."

There are two provisions that I just want to talk about real briefly. One is Section 6166, which allows a company to finance for 14 years. I have only known one company that did that. They told me it was hell. The IRS is not really financing as much as they become your partner. The other is the family-owned business exclusion, which is so complicated, nobody uses it, and the reason is the exclusions and the inflation have reduced the benefit of it, at any rate.

I will sum up just by saying that small business will not be safe until we have totally eliminated the death tax, and I want to thank you for the opportunity to make my statement, and I look forward to questions.

[Mr. Pitrone's statement may be found in the appendix.]

Ms. MILLENDER-MCDONALD. Mr. Chairman, before we proceed to the other one, I have just been told that we have a vote within a half hour, is it?—about a half hour, and then I will have to leave, so can you please ask the witnesses to be very brief and summarize as opposed to extending their remarks?

Mr. BRADLEY. Well, you have just done that, so I will repeat it, and I will let you ask your questions first when we are completed with all of the witnesses.

Our third participant this afternoon is Ms. Paula Calimafde and is representing Paley Rothman from Bethesda, Maryland, and the Small Business Council of America.

STATEMENT OF PAULA CALIMAFDE, PALEY ROTHMAN

Ms. CALIMAFDE. It is a pleasure to be here, and I commend all of you for holding these hearings on very difficult topics.

I am Paula Calimafde. I am the chair of the Small Business Council of America. It is a national, nonprofit organization which represents small businesses only on federal tax, health care, and employee benefit matters. I am also a tax attorney, and I work with small business owners every day, and, unfortunately, from time to time, I have to deal with probate, which is what happens when someone passes away. I was fortunate enough to be a commissioner at the White House Conference in 1986, and I was a presidential delegate to the White House Conference in 1995.

I have a very important message, and it is very strange for me to be sitting here, surrounded by these people who I know have spent a lot of time and effort to come here and who obviously believe in what they are saying, but my message is very different. I believe, and I guess it is even stronger, I know that repeal of estate taxes in 2010 and beyond actually hurts small business owners, and the reason why it hurts them is a technical reason, and I think that is why most small business owners do not understand the issue. It is because, in 2010, small business owners are going to lose a part of their step-up in basis, and the way the estate tax rules work today, when a person passes away, the heirs get the property from that decedent at fair market value. That is their basis.

In the 2010 rule and beyond, $1.3 million of the assets goes decedent's heirs with a step-up, and the rest get the carry-over basis from the decedent. What that means is whatever the decedent's basis was, they have to use that, and, believe me, it is not easy to figure out what a carry-over basis is. I believe, in 1976, Congress tried to repeal the step-up in basis. It got extended to 1980. It never got put into place. The reason why is a number of attorneys and accountants kept coming to Congress and saying, There is no way we can figure out the basis for someone who died who acquired

property 50 years ago. And under the rules, if you cannot prove the basis, the basis in the property is zero.

So the Small Business Council of America believes strongly that repeal is not the answer. What the answer is, is an increase in exemption level, and I will go over some numbers quickly, but you will see that that exemption level should be $3.5 million next year, not 2009, because when you see how many small businesses are trapped by the $1.5 million exemption level to the $3.5 million level, it is more than, like, 84,000 small businesses are getting caught between that $1 million and the $3.5 million exemption level.

We think the step-up in basis needs to be preserved, and we also believe that the gift and estate tax system should be reunified.

Let me explain to you a simple example so you will understand what I am talking about. As soon as a small business owner who owns exactly $3.5 million of assets—he is single, and he passes away. He passes away in 2011. Congress has repealed the estate tax. Of the $3.5 million, $1.3 million gets a step up in basis. The other $2.2 million of assets that this man has owned and worked hard for is now a carry-over basis.

Imagine this man is 85 years' old. Who is going to figure out what the basis in these assets were? Who knows? But let us assume, for argument's sake, that the basis in the assets is a million. That leaves the heirs of that small business owner with $1.2 million of income tax. Compare that to the estate tax law staying in place in 2009. There would be a $3.5 million exemption, a complete step-up in basis. The man dies, his family inherits those assets, and they have $3.5 million of step-up. If they were to set up the next day, zero taxable income and zero gain.

Now, I hate to be so technical. I hate to be talking about step-up and carry-over. I know Bill knows what I am talking about, and a few others do, but it is because of this that repeal, even though it is being touted something beneficial to small business owners, it is not. This is a very, very sad state of affairs, and, in fact, the small business owners are the straw men today for carrying repeal, and it is the very, very, very, very rich who will benefit from repeal, not the small business owners.

I have got a chart which, if you take a look at it, explains very clearly who is a winner and who is a loser, but basically the small business owners who have more than $1.3 million in assets and less than $3.5 million, which happens to be a huge percentage of small business owners, will do worse with repeal.

So that is my message, and as far as AMT, AMT, just like estate taxes, was never intended to hurt the owners of small businesses who work for a living. It just got that way, and we would much rather see an exemption high enough to get estate tax away from small businesses and repeal AMT. Use those dollars to repeal AMT, which is really hurting small business owners. Thank you.

[Ms. Calimafde's statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much.

Our fourth panelist is Ms. Jenell Ross, who is a dealer and operator and vice president of Bob Ross Buick GMC Hummer in

Centerville, Ohio, and is representing the American International Automobile Dealers Association. Thank you.

STATEMENT OF JENELL ROSS, BOB ROSS BUICK GMC HUMMER

Ms. ROSS. Good afternoon. My name is Jenell Ross. I am here today as a representative of the American International Automobile Dealers Association. I want to thank the Committee for allowing my testimony today.

The death tax is an issue that is near and dear to my heart because of my family's firsthand experience with it. I am the dealer principal of Ross Motor Cars in Centerville, Ohio, representing Buick, GMC Hummer, and Mercedes Benz franchises. Thirty-one years ago, my father, Bob Ross, took the chance of a lifetime and started Ross Motor Cars.

Our family-owned dealership had been in business for 23 years when he passed away unexpectedly. My father was a very talented and capable businessman. Like a lot of small business owners, he knew about the death tax, but he passed away long before any of us expected him to, and because of that, the dealership's estate planning was years behind where it should have been. When he died, the responsibility of keeping the business running and the workers employed fell on my mother, brother, and me. Although we were familiar with many of the dealership operations, I can tell you that none of us was fully prepared to take on the overwhelming responsibility of managing the day-to-day operations of the business. It was, in many ways, on-the-job training.

Perhaps you can imagine, amidst all of the emotions surrounding this personal family tragedy, the incredible shock we felt in receiving a federal tax bill for more than half the value of our business. That shock was compounded by the fact that nearly 90 percent of our dealership's net worth was tied up in land, building, equipment, inventory, and parts—assets that could not be easily liquidated without seriously damaging our ability to function. And that was true not just in our case, but it is true for most dealerships today.

Dealerships are heavily leveraged, and in today's competitive environment, dealers have no choice but to maintain large inventories of new vehicles. At the same time, we are under enormous pressure from manufacturers to maintain our properties and buildings at increasingly higher and higher levels.

My experience with the death tax has made this issue a very personal one, and we are not alone. Every year, tens of thousands of families are forced to endure what we have endured. But it is important to remember that the death tax imposes a huge cost, even on automobile dealers who are fully prepared for it. In fact, 70 percent of dealers view the tax as the greatest barrier to expanding business opportunities because death tax planning drains resources away from growing the business and creating more jobs.

It is not uncommon for dealers to divert upwards of $10,000 per month in estate planning. That has certainly been the case for our family business. Ever since we received the federal death tax bill years ago, my mother has been in weekly contact with a team of

lawyers and insurance agents to make sure our death tax payment plan remains viable and our dealership remains solvent. We are currently embarked on a 10-year payment plan to pay off the death tax. In the meantime, our business is being held for collateral. Our dealership and our employees are managing very well today, but there is no question, the experience took a tremendous toll on my family.

Our ordeal with the death tax has been eye opening. It has motivated us to do what we can to help bring a permanent end to his oppressive and burdensome tax. Not a day has gone by over the past eight years in which we have not been haunted by what could have been, not only to our business but to the 145 employees of Ross Motor Cars whose families depend on us.

The majority of today's 21,000 automobile dealerships are true family businesses, run, managed, and expanded by family members across several generations. We employ over 1 million Americans. When small businesses do not have to commit tens of thousands of dollars to death tax planning, that money is typically reinvested into the business, and as we expand, so do our payrolls.

The argument that death tax repeal would be too costly to the federal coffers is just flat-out wrong. As you may be aware, Dr. Wilbur Steger, who advised six U.S. presidents, conducted a study on the death tax recently. He calculated what the repercussions of death tax repeal would be on the economy and concluded that repeal of the tax would actually result in a slight increase in revenue to the federal government, $1.7 billion over 10 years.

The arguments for permanent repeal of the death tax are many, but perhaps the most important reason for why this tax should be permanently repealed is that this tax, more so than any other, is viewed by the public at large to be fundamentally unfair. Last year, AIADA conducted a national survey to gauge public sentiment on this issue, and what we found was truly remarkable. Voters across political, ideological, and demographic lines considered it unfair for the government to tax individual earnings twice, both when they are earned and again at the time of the earner's death. Nowhere among the major voter groups did we find less than 70 percent saying it was unfair. If for no other reason, the death tax ought to be permanently repealed because it is a tax that is fundamentally unfair.

I want to applaud this Committee for recognizing this reality early on, and I want to applaud this Committee and this entire chamber not only for the work you did in 2001 to repeal the death tax but also for your bipartisan cooperation on this issue yesterday.

In today's competitive auto-retail business environment, auto dealers need predictability in the tax code in order to hire additional employees, buy new equipment, and expand business opportunities. This chamber's vote yesterday will help bring badly needed predictability to the tax code.

In closing, I want to urge the Senate to follow this chamber's bipartisan action on this issue and vote to permanently repeal the federal estate tax. This issue is not about politics; it is about fairness. Thank you.

[Ms. Ross' statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much, Ms. Ross.

Our next panelist is Paul Zittel. He is from Eden, New York, and represents the American Farm Bureau Federation.

STATEMENT OF PAUL ZITTEL, AMOS ZITTEL AND SONS, INC.

Mr. ZITTEL. Thank you and good afternoon. My name is Paul Zittel. I, along with my brother and two sons and two nephews, own and operate Amos Zittel and Sons, Inc., in Eden, New York. I am also the elected vice president of New York Farm Bureau. Farm Bureau thanks the Subcommittee for holding this hearing to spotlight the need for permanent death tax repeal and to end the alternative minimum tax.

Farm Bureau supports the permanent repeal of death taxes. This is for a good reason: Farm and ranch estates face heavier, potentially more disruptive, death tax burdens than other estates. Roughly twice the number of farmer states paid federal death tax in the late 1990's compared to other estates. Moreover, the average death tax is also larger than the tax paid by most other estates.

My brother and I are the fourth generation of Zittels to farm. We grow fruits and vegetables on 180 acres of land and flowers under plastic in two and a half acres of greenhouses. We sell a portion of our products through our own family retail market.

Our family farm corporation employs 60 people, 22 of them year round. My two sons and two nephews plan to continue the family farming business. My family and I have spent thousands of dollars and countless hours structuring our business to try to reduce or eliminate the impact of death taxes when my brother and I die. We pay thousands of dollars per year in life insurance so that there will be cash for Uncle Sam if the tax is due. The financial drain on our business is significant, and still no one can tell us for sure that our escape plan will successfully protect the future of my children's livelihood.

Last year was a particularly difficult year for us due to crop damage caused by three hurricanes that ravaged the East Coast. Even so, we could not risk foregoing our insurance payments. This meant that we had to freeze our wages for our employees and reduce the wages for ourselves. In addition, we had to borrow money for operating expenses and were not able to afford the scheduled improvements to our buildings and equipment. We do not know yet when we will be able to recover.

The impact of death taxes with rates as high as 47 percent can be so severe that their imposition can destroy farm businesses. Farm operations are capital-intensive businesses whose assets are not easily converted into cash. In order to generate the funds that are needed to pay death taxes, heirs often have to sell parts of their business, and this can ruin the economic viability of the business. Faced with the realization that their family farm may not survive death taxes, children may choose to leave the farms.

An increase in the death tax exemption is not the answer. Only a complete elimination of the death tax can erase the impact of the death tax and the estate-planning burden caused by changing exemptions.

Before I conclude, I would like to mention the alternative minimum tax. AMT relief is important to farmers since they pay the tax more often compared to other taxpayers. According to the USDA Economic Research Service, slightly more farmers are subject to AMT, with just under 2 percent of farmers currently paying a tax. Farm Bureau supports the extension of the increased AMT exemption and the total elimination of the alternative minimum tax.

Farm Bureau commends the Committee on Small Business for holding this hearing to highlight the need for permanent death tax repeal. Farmers, however, will not be able to rest in peace until Congress finishes the job of eliminating the death taxes. Farm Bureau calls on both the House and the Senate to pass legislation to end death taxes once and for all. Thank you.

[Mr. Zittel's statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much, Mr. Zittel.

Our final panelist is Mr. Bill Beach, who is the director of the Center for Data Analysis at the Heritage Foundation here in Washington, D.C. Thank you, sir.

STATEMENT OF WILLIAM BEACH, CENTER FOR DATA ANALYSIS, THE HERITAGE FOUNDATION

Mr. BEACH. Thank you, Mr. Chairman, Congresswoman. In the interest of your time, I am going to lay before you the case for repealing the estate tax presented by my colleagues. Clearly, you can see it is a tax on virtue, a virtuous life. It undermines the economy. It slows the economy. It is, in many respects, a tax that undermines the income tax. It has every earmark of the kinds of bad taxes that you, from time to time, review and yesterday repealed, and I congratulate you for that.

Let me focus, instead, on the alternative minimum tax because, as the chairman said, this is also an important tax for small business, and I will just take a few minutes to review a few facts about the AMT.

In a conversation I once had with former Senator Bob Packwood, I asked him, Senator, tell me how many people, taxpayers, did you originally intend, or did Congress intend, to cover with the AMT? And he said that it could not have been more than 150,—I believe you used the number, 155—and it was 150 very high-income taxpayers, at that.

We are a very far cry from 150 taxpayers today. If we do nothing to rein in the AMT or to repeal it, the tax is expected to be paid by nearly 40 million taxpayers in just five years from now. If that forecast holds, the population of AMT taxpayers would have grown by 16 times since 2003, or 16 times over a seven-year period.

The personal AMT directly affects individuals who file their business taxes through the 1040, and it does so in a number of ways. First, the AMT filers generally pay higher tax rates than regular income tax filers. The AMT tax rates are 26 percent and 28 percent. Higher tax rates mean that one's own labor income and capital costs are higher, thus either driving down overall operating margin or increasing prices, and we believe that there is a tangible,

measurable, and significant effect on economic performance because of the increasing coverage of the AMT.

Second, the AMT tax brackets are not indexed for inflation, unlike the regular tax brackets. That means the AMT filers annually face an increase in their taxes just from the effects of inflation.

And, thirdly, small businesses located in high-tax states are much more likely to incur AMT liabilities than in low-tax states. According to Len Burman and David Weiner, the state and local tax deduction permitted on the 1040, Individual Income Tax Form, accounts for 51 percent of all tax liabilities under the AMT. In other words, 51 percent of those people who are thrown into the AMT are thrown in because you are permitted to deduct state and local taxes. Indeed, taxpayers in high-tax states are 5 percentage points more likely to be on the AMT than those in low-tax states.

Mr. Chairman, on page 9 of my testimony, copies of which are available at the table in the back, we have all original data just for this hearing. I asked my colleagues back at the Center for Data Analysis to go through their data bases and to determine the number of AMT taxpayers who have a small business in their tax form, and they found, for 2005, 1.9 million taxpayers are also small business operators and filing their taxes through the 1040.

As you know, the current law has an increased exemption amount which expires at the end of this year, and so how much more AMT filers will there be in the small business community? That number will jump from 1.9 million to 6.4 million in just one year alone. If Congress does nothing to extend the current exemption levels between now and the end of the year, we will have a threefold increase in small businesses covered by the AMT.

So, in conclusion, like my colleagues who made a very good case for the permanent repeal of the estate tax or for repealing the estate tax in such a way as to fix the basis problems that Paula was talking about, I would make the case, or, at least, start the case, that we should repeal the AMT for purposes of fairness in the tax code, to get back to the original intention, at least, and also for economic efficiency.

You cannot have that big of an increase in small business people who are covered by the AMT and expect the economy to continue to produce the kinds of good jobs and strong growth that it has been producing in the last two years. Thank you.

[Mr. Beach's statement may be found in the appendix.]

Mr. BRADLEY. Thank you very much, Mr. Beach.

Congresswoman McDonald, because you said you have to attend another hearing,—

Ms. MILLENDER-MCDONALD. Thank you so much, Mr. Chairman. It seems like if it is not one end of the spectrum, it is another, but thank you all so much for your testimony.

Mr. Pitrone, I think it is, you stated that if we are interested in small businesses, then we should understand, and I am paraphrasing you, the anguish that small businesses have in terms of the estate tax and AMT, and, I mean, we certainly do sympathize with you, and we are certainly for small businesses, so I want to make that position first. But I do want to go back to what Ms.

Calimafde said about the step-up in basis and that being a disposition or an imposition for small businesses as opposed to the exemption level.

How do you disagree with what she is saying, when she has so eloquently spoken to that and, I am sure, has the data to support that, Mr. Pitrone? Is it Pitrone?

Mr. PITRONE. Yes. Pitrone is correct. Thank you.

You are asking me why I would support the elimination of the death tax?

Ms. MILLENDER-MCDONALD. What I am saying is that Ms. Calimafde said that, of the years that she has had the experience of working with taxes, that she does not think the step-up in basis and the estate tax should be repealed, that the step-up in basis should be reserved, and she would much rather see exemption levels being dealt with. Do you not agree with what she is saying, or if you disagree, why is that?

Mr. PITRONE. Okay. I do not know that I disagree. I have to be frank. Before I sat down next to her and started talking to her before the panel began, I had not given it a whole lot of thought. I had done some research on the topic that she is discussing. I think that a lot of what she is saying is valid and the small business community has focused primarily on the elimination, and, as you know, especially from the testimony yesterday and the debate, the American people do not like the idea of having to pay a tax just because someone died, whereas the capital gains tax, which is what she is talking about, does not occur because someone died; it occurs because somebody sold something.

Frankly, I am not crazy about any taxes, but I am really not prepared to give you an answer, although—

Ms. MILLENDER-MCDONALD. That is all right. I do understand that, and I am sorry that I put you in that imposition, but what about the gentleman next to you? Is it Vukelic?

Mr. VUKELIC. Vukelic, yes.

Ms. MILLENDER-MCDONALD. Yes, Vukelic. What are your thoughts on what Ms. Calimafde said?

Mr. VUKELIC. In just listening to her, like Mr. Pitrone, I heard her talk about it for the first time, and that, to me, sounds like more of a compromise. Maybe she was talking more of a compromise. I do not know. For me, I am for a permanent repeal.

Ms. MILLENDER-MCDONALD. I see. If we had permanent repeal of that, as I look at the budgetary cost of that, it would be in the neighborhood of $290 billion that the budget will be hit, and as we move into years of this repeal and interest payments on the debt, we are talking about nearly a $1 trillion budget hit. We are already at $450 billion as a deficit. What do you gentlemen propose that we do, as members of Congress who have to balance your budget?

Where do we get that money when we have been hit like that with a repeal of those taxes?

Mr. PITRONE. Well, you know, the numbers that you are discussing have been in the Washington Post. Over the week, they have run a series of articles. I think the numbers come from the Urban Tax Foundation.

Ms. MILLENDER-MCDONALD. It does not say that, sir, but I do know that our own deficit does raise the issue because—

Mr. PITRONE. I understand. I understand.

Ms. MILLENDER-MCDONALD. Yes.

Mr. PITRONE. Well, first of all, what exactly the numbers are going to be is highly speculative. For instance, I hear someone talking about if we repeal the estate tax, and Bill Gates, Warren Buffett, and Larry Ellison happen to be on a plane the next day, and it crashed, the government would have lost several billion dollars.

Ms. MILLENDER-MCDONALD. Let me just say this. I am saying, what do we do, as members of Congress, to backfill this money, irrespective of whether it is whatever or whatever?

Mr. PITRONE. It works out to 2 percent a year. It is 2 percent a year. The trillion-dollar number over the next 15 years is 2 percent of the annual budget a year.

Ms. MILLENDER-MCDONALD. We are still talking about a deficit.

Mr. PITRONE. I understand, but—

Ms. MILLENDER-MCDONALD. So where do we get the money if we should happen to repeal all of these on a permanent basis, and that is only one tax?

Mr. PITRONE. You can make the case that economic growth, as a result of eliminating the estate tax and not forcing small businesses to spend huge amounts of money on planning and insurance that they otherwise would not need, would raise growth to the point—it is only 2 percent.

Ms. MILLENDER-MCDONALD. That is certainly not a valid assessment of that, Mr. Pitrone.

Ms. Calimafde, what do you think, as we grapple with this? And you have said, and I certainly appreciate your assessment of this, what can one do when we are faced with this large deficit, and we are talking about a repeal permanently on these taxes?

Ms. CALIMAFDE. Well, I have thought about this a lot, and years ago I was for repeal, and I was for it because, at the time, it seemed that too many people who worked hard all of their lives

were losing businesses and farms, and then the more I looked at it,—

Ms. MILLENDER-MCDONALD. And we all regret that.

Ms. CALIMAFDE. Right.

Ms. MILLENDER-MCDONALD. That is right.

Ms. CALIMAFDE. But the more you look at the numbers, they are not nearly what they seem to be, and the more I looked at the repeal bill, and I realized it was really hurting small businesses, we, as a group, had to just change our position. And I do think that, for instance, if NSBA looks at this issue carefully, they are going to realize more of their members get hurt by repeal than if they keep it at the $3.5 million exemption, and I would hope that that amount would increase.

I do think there are some numbers out from the Center of Budget and Public Policy Priorities, I believe, is the group, that say that if you increase the exemption, even, like, to the $10 million level, which is $10 million per person, and if you have got a married couple, that means $20 million of assets that is going to the estate tax free, if you keep the estate tax rate at a 45-percent level, which, by the way, the effective rate is usually around 18 percent, even though it says 45 percent, because of deductions and charitable contributions, I think you retain quite a bit of the revenue from the estate tax.

Saying that in another way, what that means is there are some very, very high-income taxpayers out there,—they are the ones who are generating that percentage of the revenue—and then you have this huge group of small businesses, between 1 million to 3.5 million, that are also putting a lot of revenue into the estate tax. So that is why I am saying, if we get them out of the system, we still have revenue for the folks who are very, very high-income taxpayers. That would be my approach.

Ms. MILLENDER-MCDONALD. And would you agree that even with the repeal of the estate tax, that there will continue to be some complexities associated with the system that provides for the stepped-up-basis regime?

Ms. CALIMAFDE. From a probate viewpoint, it is going to be terrible because the repeal part sounds good, and actually, Mr. Pitrone mentioned, well, it will be a capital gains tax. It is not always a capital gains tax; it can also be a regular income tax on assets that small business could be hit with. But if you cannot prove your basis, your basis is zero, so, to me, it is totally unworkable, and I would say you either have to go with the exemption at a higher amount so that small business is really taken out, or if you are going to go with a repeal, somehow you have got to step up the basis to a minimum of 3.5 a person so, at least, they are as good as they were in 2009. And, frankly, as I said, years ago they tried to—not "they," Congress—tried to appeal the step-up in basis—

Ms. MILLENDER-MCDONALD. We are "they."

Ms. CALIMAFDE. I know. I did not want to make you feel badly.

Ms. MILLENDER-MCDONALD. We feel badly all the time.

Ms. CALIMAFDE. No. You all are doing a very good job. But the step-up in basis, the reason why it never got repealed is that it was unworkable. So here we are going to 2010 with a bill that, I think, is really unworkable.

Ms. MILLENDER-MCDONALD. I thank you so much.

Mr. Chairman, just one for Mr. Beach.

Mr. Beach, you might have some legitimacy to some of your points on AMT because while it was initially for those that were wealthy, it has kind of impacted a lower level of persons who are making $50,000.

Mr. BEACH. You are absolutely right about that.

Ms. MILLENDER-MCDONALD. And so it is a possibility we need to look at a balanced approach here, and I would love to maybe sit with you about some balance to this as opposed to just terminating it altogether so, at least, we come halfway with what you have said with the AMT.

Mr. BEACH. Well, if I may just comment on that, if you will permit me, I think the balanced approach has a name, and it is called "tax reform." The AMT was put in place as a plug in the tax system, and, at the time, it was an appropriate plug. Many people were upset about those 155 people. It was in the Newsweek magazine, as you may know from looking at the clippings of that time period. But now it reaches every income level except the bottom 10 percent of the income distribution, and the more the Congress does will well-intended, social policies, the more difficult it becomes.

So I am very happy to hear you say that you are interested in that, and I would be delighted to sit down with you at any time.

Ms. MILLENDER-MCDONALD. I would love to do that.

Mr. Chairman, I appreciate your allowing me to go first and to raise the questions. And I would like to perhaps look at a study, request a study to be done, on this to ensure that we are, at least, getting information that is recent to look at the stepped-up basis, along with the estate tax repealed permanently, because we do want to do the right thing for small businesses,—you are the engine that drives the country—but we also want to make sure that that deficit does not continue to grow so exponentially that we are just off the chart and trying to, at least, take care of the people's business. So I thank you so much.

Mr. BRADLEY. Thank you very much, Congresswoman Millender-McDonald, and perhaps our respective staffs can talk about that information issue.

I would like to get back to one of the points that my colleague raised and Mr. Pitrone answered in terms of the ability of the repeal of the estate tax to make it easier for small businesses to survive and not have the financial impact that a static look at where revenue loss would be, and that was estimated to be nearly $300 billion would be, and if you had some further information or perhaps, Heritage,—I see nodding—that you might have some further information that would diminish that tax loss by virtue of the tax repeal. And we know that, for instance, as the capital gains tax has been less, that it actually increased revenues because people were not holding onto investments that would have been more productive elsewhere, and perhaps this is a similar situation, so if you would like to comment on that.

Mr. BEACH. If I could be permitted to do so, there is a body of economic literature—it exists in the academic literature and the public policy literature—that, I think, correctly analyzes the estate tax from a tax standpoint. It is a tax on capital. It increases the cost of capital. It increases the cost of capital to all borrowers of that capital, and, as a consequence, when you reduce the tax wedge or the tax on the capital that reduces the price of capital, when you reduce the price of capital, you make it more available for investment.

And so we do see, in the modeling on this, an increase in economic activity, an increase in employment in the neighborhood of about 250,000 jobs per year, an increase in national output, and also, as a consequence of all of that sort of thing, an increase in the revenue reflows back to the federal government. Just as an exercise, if you had about a $25 billion static reduction in the estate tax revenue in one year, in the first year, and all of the economics that I have just described to you come true, about a third of that would come back to you in additional revenues in that second year, and that grows over the course of time.

The estate tax repeal never totally pays for itself, but it is not the complete static losses that have been described here today. In fact, if we can address the basis issues that Paula has, quite correctly, raised, and we can get to a situation where we have, one, repeal; and, two, we are taxing the voluntary transfer of assets outside the family business or a family situation, either under cap gains or income taxes, then the work that others have done on this indicates that the reflows are substantial because now what you are doing is you are augmenting the natural reflows coming from repeal of the estate tax with additional cap gains revenues and income tax revenues.

I have not seen a simulation yet, over a 10-year period, in which all of the revenues come back, but they are getting very close to coming back. So if we can reduce the question to how do we do the basis, I think there are many different answers to that. Again, it is voluntary. We do not hear a basis question, carry-over, or step-up until there is a voluntary transfer outside of this family business. We could exempt very old property or have a fair-market-value test for very old property.

Back in the seventies, we had some real questions about basis because we were dealing with a lot of property that predated any

tax law at all, back in the 1910's and into the 1890's. Now, most property in use has come into use or has transferred into somebody's hands since modern taxation policies have been put in place at this date in federal level, so record keeping is much better than it was, even 30 years ago.

And I think there is a good discussion which can be had either in the House, probably in the Senate, and, hopefully, and compromise on this whole basis question. We should not let that stand in the way of what is the right move here, and that is a complete and permanent repeal of estate taxes.

Mr. BRADLEY. Thank you very much.

I would like to ask one quick question about the alternative minimum tax. I have been a co-sponsor of Mr. English's bill to permanently repeal AMT, but, as you know, given the budget circumstances that we have, it is just very unlikely that that is going to happen.

Yesterday, I introduced legislation that will extend will extend the expiring provisions that up the income limits, and it makes indexing for inflation permanent. Is this, in your view, ladies and gentlemen, a reasonable solution, at least for this year, as we try to address, I think, what you spoke about in terms of tax reform?

Mr. BEACH. Well, if I could just start very quickly, yes, that is the necessary step that Congress must take. The exemption levels need to be extended so that the President's Advisory Panel on Tax Reform, the president himself, his staff, and the relevant members of the Committees here, tax-writing Committees in the Congress, can do the work of changing the entire tax system to something that is simpler, fairer, and more pro-growth.

You would complicate the matters extremely by letting key provisions, AMT being one, to expire and thus to produce a different baseline from which all of the tax reform measures would be taken. So I strongly recommend that as a good move, and I can hear members on both sides saying, yes, that is something that they could support.

Mr. BRADLEY. Anyone else on that?

Ms. CALIMAFDE. I think it is a great first step because, you know, AMT, when you really look at it, it is a second-alternative system sitting on top of the regular system, and what it does in the small business arena is the owners are not able to take advantage of deductions, so it is a really unfair tax.

Mr. BRADLEY. And when one looks at the AMT, and this is my last question on AMT, the cost of compliance is just something that seems excessive. Have there been any studies that have been done that you are aware of that would indicate what the cost of alternative compliance is?

Mr. BEACH. Remember, Mr. Chairman, that the alternative minimum tax exists at the individual level and at the corporate level; there is a corporate AMT. Most of the tax analysts—Leonard E.

Burman is the most, I guess you might say, accomplished of those here in town—have argued that the compliance of the AMT is almost as great as the compliance cost with the estate tax because of the record keeping required, the accountants and lawyers required to advise, the kinds of penalties associated with miscalculation, late-filing fees, on and on and on.

So I would guess, conservatively speaking, that it is probably close to 30 cents on the dollar. We have generally kind of settled on 31 cents on the dollar as the compliance cost for all federal estate taxes, and that is gift, generation skipping, and the estate tax. If AMT is close, I would say 25 to 30 cents is not a bad estimate.

Mr. BRADLEY. Mr. Beach, if you could leave us with that study, or get it to us, that you talked about in your first question, that would be great.

Mr. BEACH. It is a footnote in my testimony, sir.

Mr. BRADLEY. Okay. Thank you.

Lastly, and we are in the middle of the vote on the bankruptcy bill, and I do not want to miss that vote, and I know it was not so much the subject of today's hearings, but perhaps you would like to touch on some of the provisions in the 2001 and, in particular, the 2003 tax cuts and their impact on small businesses. Were they positive? Were they negative? What is your view on some of those expensing provisions, the drop in the income tax rates, and how they impact small business?

Mr. BEACH. Let me just reference a couple of things. We have written on this on several occasions, the Heritage Foundation has. Starting with 2001, the best thing in that legislation was the reduction in the rates, sir, and those rate reductions have accounted for a significant proportion of the growth since 2001 in the economy. The combination of the rate reduction in 2001 with the very pro-growth elements of the 2003 bill, i.e., dividend rate reduction, the way you handle cap gains, but particularly the accelerated depreciation provisions; the provisions that stimulated investment, by themselves, account for three-fourths of the employment gain since that time, probably as much as half of the overall output gain.

We had a very severe contraction in our stock markets, we had a major contraction in world trade flows and capital flows following September 11th, and we had what is almost an unprecedented blow to the confidence that investors have in corporate America—all three of those things combined together, as the president has said many, many times, and yet we had one of the shallowest recessions in U.S. history. And now we have had nearly 3 million jobs growth since the 2003 act. I think that those are the provisions that affect everybody, but they really help small businesses.

Mr. BRADLEY. I am very sorry. I have one more question, and perhaps each of you would like to touch on this. There has been an awful lot of discussion about a compromise in the Senate on the estate tax. What is a realistic compromise that achieves the goals that, I think, all of you have expressed on the estate tax and how

it impacts small businesses and the economy? What would be a reasonable compromise, or perhaps there is not one?

Mr. VUKELIC. A reasonable compromise? I believe the exemption rate would have to be more than what they proposed yesterday in the Pomeroy Amendment. I believe it had to be at least $10 million, and the rate would be a capital gains rate. That is what we would be for.

Ms. CALIMAFDE. I would like to add to that that step-up basis should be preserved, and the gift and estate tax system should be reunified, and I particularly think if the rates are going down, there is a way that Congress could target that to small business interests only, so if somebody went above the exemption level, and it is because of a family-held business or a closely held business, those interests could be taxed at, say, a 15-percent rate.

Once again, our view is protecting small business here, so that is why I think a compromise is very doable.

Mr. PITRONE. Yes. I would go with the $10 million per individual, $20 million for husband and wife.

Mr. BRADLEY. At a cap gains rate?

Mr. PITRONE. At a cap gains rate.

Ms. ROSS. Considering the personal experience that my family and I have had, we are in the mindset of a permanent repeal of the death tax due to what we are still having to pay and how that compromises us extending and expanding our operations as well as creating jobs.

Mr. BRADLEY. I would agree with you. Unfortunately, in order to get something through, there may have to be a compromise.

Mr. ZITTEL. I am sure there probably will have to be a compromise, but agriculture's view has been repeal of the death tax, and I think that is where we would stand, but certainly when we are talking the $10 million per person, it would go a long ways in meeting the needs of agriculture.

Mr. BEACH. I honestly do not think you need to compromise, but if you do, then make it a temporary measure. We are in favor of a unified capital tax—put everything at the same rate, under the same definition of taxing capital, throw everything into the pie—because we think, once we are there, we can then talk about double taxation much more reasonably, and we can move for fundamental tax reform.

The estate tax is likely on its last legs because the American people do not view it as an economic or fiscal issue; they view it as a moral issue, and they think it is the wrong thing to do, to talk to the tax collector at death. So if there is a compromise, it must necessarily be a temporary one because I do not think that the voters are going to say, "Ah, you fixed it at last."

Mr. BRADLEY. I would like to thank all of you who have come this afternoon. It has been very informative. We appreciate it very much, and please stay in touch with us on these critical issues.

[Whereupon, at 3:17 p.m., the Subcommittee was adjourned.]

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FOR IMMEDIATE RELEASE
April 14, 2005

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NBWA Board Chair Testifies on the Importance of Permanent Death Tax Repeal

ALEXANDRIA, Va. – The chairman of the Board of Directors for the National Beer Wholesalers Association (NBWA), Jeff Vukelic, will testify today before the House of Representative's Committee on Small Business Subcommittee on Tax, Finance and Exports regarding permanent repeal of the death tax.

H.R. 8, the "Death Tax Repeal Permanency Act of 2005," sponsored by Representatives Kenny Hulshof (MO-9) and Robert E. "Bud" Cramer (AL-5) passed the House yesterday with broad, bipartisan support. Nonetheless, this hearing is extremely important for establishing a record to encourage the Senate to schedule a vote on companion legislation sponsored by Senators Jon Kyl (AZ) and Bill Nelson (FL).

Vukelic will testify on behalf of nearly 2,000 independent beer distributors servicing every state and congressional district across the country. These small business owners are actively lobbying senators to follow the House's lead and bring death tax repeal permanency legislation to President Bush for his signature.

Many beer wholesaling companies have been family-owned and -operated since the repeal of Prohibition in 1933. The beer industry provides billions in tax revenue and hundreds of thousands of jobs to hardworking Americans. Aside from stripping these small business owners of their livelihood, the death tax can also cost them their heritage and way of life.

The following is Vukelic's prepared testimony:

"Thank you, Mr. Chairman.

My name is Jeff Vukelic and I am the Executive Vice President of Try-It Distributing where we serve the Buffalo/Niagara Falls market as the distributor of Anheuser-Busch, Heineken and Labatt USA beers.

Try-It Distributing was started as a soft drink bottling company by my grandfather, Stephen Vukelic, in 1928. My grandparents were Croatian immigrants. They never

dreamed their company would grow into an operation with a fleet of over 110 delivery vehicles and more than 200 employees.

My parents, brothers and I are fully involved and committed corporate citizens. We serve on civic and not-for-profit boards. We respond to the needs of charitable organizations. We contribute to programs for at-risk youth. We work closely with law enforcement to advocate for responsible consumption.

Elected officials on every level rely on us to be well informed and concerned supporters of the individuals and ideas that ensure good government.

The Vukelic family is typical of the other family-owned businesses in our association. Our home communities look to us as consistent leaders and dependable do-ers.

As Chair of the National Beer Wholesalers Association (NBWA), I appreciate the opportunity to share some thoughts with you today on behalf of the 1,850 members of our organization.

The beer wholesaling industry directly employs more than 92,000 Americans nationwide and the beer industry at large indirectly supports more than 890,000 workers, accounting for more than $30 billion in tax revenues across the country. Many wholesaling companies have been family-owned and operated since the repeal of Prohibition in 1933.

Regulation is a fact of life for beer wholesalers. We are regulated every day by a virtual alphabet soup of federal agencies including the TTB, FCC, DOT, NHTSA, EPA, OSHA, and the IRS just to name a few. And because of the 21st Amendment, my company is strictly regulated by the New York State Liquor Control Authority.

I am here to talk about an issue that is absolutely critical to every privately held and family owned business in America-the permanent repeal of the death tax.

Now is the time for Congress to take final action to permanently repeal the federal death tax. Over the last few years, and again yesterday evening, the House of Representatives has made great strides in helping America's small businesses by voting to permanently repeal the death tax. We continue to wait on the Senate to take action.

Small business owners need certainty when planning for their succession and the long-term viability of their businesses. As long as Congress fails to act, business owners will be forced to divert economic resources from investments that grow businesses, create jobs, and boost the economy. Instead, they will use those funds to pay for estate planners, lawyers and accountants to navigate them through the uncertainties of the current tax structure and utilize estate planning vehicles.

Permanent repeal would free up that time, money and energy. This would allow business owners to focus on growing their businesses, creating more jobs and working to stimulate economic growth as a whole. We want to help keep the American economy strong and viable for our future and the future of our children.

Although full repeal will occur in 2010, the death tax burden will return in full force in 2011 due to the sunset language that was included in the Economic Growth and Tax Relief Reconciliation Act of 2001.

According to a recent survey, 85% of those polled want the death tax permanently abolished or significantly reduced. The American people oppose on principle the concept of anyone being taxed on the death of their parents.

Unfortunately, if permanent repeal is not passed, many small business owners and farmers will continue to pay the ultimate price created by the sun setting of death tax repeal — loss of the family business. As the father of two young children, I am very concerned about their future and the future of my company if the death tax returns as currently scheduled.

H.R. 8, the "Death Tax Repeal Permanency Act of 2005," was introduced by Representatives Kenny Hulshof (MO-9) and Bud Cramer (AL-5) and passed the House with strong, bipartisan support yesterday. I would like to thank those members of this Committee that supported this legislation.

S. 420, the "Death Tax Fairness Act," has been introduced by Senators Jon Kyl (AZ) and Bill Nelson (FL). This bill also seeks full and final repeal of the death tax.

I urge Congress to act quickly and not turn its back on America's small business owners. Please encourage the Senate to schedule a vote on permanent repeal now. Congress must make death tax repeal permanency a priority by sending President Bush legislation for his signature.

As I close my remarks, I am thinking about the talents, sacrifices, and hard work that my grandfather and my father invested in making Try-it Distributing a success. Stephen Vukelic, a young newcomer from Croatia, achieved the American dream.

Please don't allow such bright dreams to become nightmares for the third and fourth generations of families who are working hard every day to sustain solid American businesses.

Mr. Chairman, thank you for the opportunity to share with you our organization's position on these important small business issues."

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Founded in 1938, the National Beer Wholesalers Association advocates before government and the public on behalf of nearly 2,000 licensed independent beer wholesalers with operations servicing every congressional district and state across the country. Beer wholesalers are committed to ensuring that the products they provide are consumed legally, moderately and responsibly.

For more information about beer wholesalers, please visit http://www.nbwa.org.

Testimony of Thomas Pitrone,

The Integrity Group

On Behalf of
The National Small Business Association

House Small Business Committee
Subcommittee on Tax, Finance and Exports
"The Estate Tax and the Alternative Minimum Tax – Inequity for America's Small Businesses"

April 14, 2005

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Good afternoon Chairman Bradley and members of the committee. I appreciate this opportunity to testify on the negative impacts of the estate tax on small family businesses. My name is Thomas Pitrone and I am a Principle at the Integrity Group. The Integrity Group financial service practice was started with my father, Frank P. Pitrone, CLU, in 1983. The practice works with seniors to provide retirement planning. I also consult with small businesses on estate planning and continuity issues. I have been actively involved in small business advocacy since 1988 when I joined the Council of Smaller Enterprises (COSE). That involvement led me to serve as a delegate to the 1996 White House Conference on Small Business. I currently sit on the board of the National Small Business Association.

The estate tax, as far as small business is concerned, is a tax on capital. For the majority of small business owners, their major asset is their business. I know scores of business owners whose net worth is over $5,000,000 but can't pass a check for more than $10,000 personally. It's because all the value is in the business. It can be very difficult to get personal liquidity out of a business.

They have worked hard and lived frugally in order to amass the capital investment we call a business. They view the business as part of the family. The family lives around the demands of the business all the time. It doesn't matter if it's a farm, a construction company, an insurance agency or a store. When the business is in trouble, everyone in the family reacts. They understand that the business is part of the breadwinner's life. They understand the business pays the bills.

This is not a new phenomenon. It's older than our nation. The Founders were all small businessmen, by our standards. They were farmers, printers, lawyers and self-employed tradesmen. In the 1760s, Washington began to realize that separation from England was vital for business in the Colonies to thrive. In fact, it wouldn't be an overstatement to say that the survival of independent small business was one of the chief motives for the Revolution and the development of our government.

I have been involved in advocacy for 17 years. I've heard representatives from both parties say, "I believe in small business." That's nice. But they'd better do more than believe in it. Our country exists for small business and depends on it. The freedom to start your own business is one of the most precious freedoms and one of the first to blossom where there's liberty. When you go into New York or Kiev, you see people on almost every corner with a box and a few items to sell. They are self-employed; making it on their own.

So, a business owner works for 35 or 40 years. Reinvests his profits. Pays his taxes. Volunteers and contributes. He complies with all the regulations. He plays by the rules. Then I call on him, one day. I tell him that the government will take half the value he's built when he dies. He often doesn't believe me.

One fellow I spoke with, a trucking company owner, told me it couldn't be true. He said his company wasn't worth that much. I looked out the window of his office at his

terminal and tractors. He probably had 25 trailers in his yard. He said they had no book value, they had all been written down. I said the IRS doesn't care about book value. They go by the price a willing buyer would pay a willing seller. The fellow told me if I knew a willing buyer to bring him in, quick. He started to rant and say unpleasant things about the government. He said there had to be a way he could avoid having the government take his business from his family. As I began to explain to him what he had to do, he was astonished. He told me it was ridiculous and kicked me out of his office.

The truth is it is ridiculous. The things we make people do to reduce, eliminate and fund estate taxes are absurd. I have to tell folks they need irrevocable defective grantor trusts. Then they have to send Crummy letters to their kids. It's voodoo. I feel like a witch doctor. First, I convince them that they have a problem they never heard of and can't believe in, then I tell them that they have to do certain transparently meaningless acts to make the problem go away. Of course, they also have to pay lawyers a lot of money and buy life insurance.

A small business owner already has a buy-sell agreement with his partner. He has insurance to provide liquidity when he dies to keep the business and the family afloat. Those things make sense. He can see the need. Now, he's got to have enough cash to buy 50% of his company back from the government with nine months of his death?! Can you blame him for feeling persecuted?

The proponents of the death tax are dismissive of the concerns of small business. They say elimination isn't necessary. "We can fix all that by raising the exemptions and credits." They say. "Why isn't that good enough?"

I'll be candid about why it's not good enough. We don't trust Congress.

While most in Congress voice concern for the impact of the death tax on small business, the fixes offered thus far to mitigate the estate tax's impact on family businesses shows a lack of real world understanding.

Look at the two major estate tax provisions you've made for small business so far; the Family-Owned Business Exclusion and IRC Section 6166. Both of these provisions are supposed to help small business reduce the impact of the tax.

The Family-Owned Business Exclusion allows a family to exclude part of the value of the business from their estate for tax purposes. However, it's so complicated that few can plan to use it. The only way it gets used is if after the death of the owner, the executor of the estate happens to notice that the estate fits the requirements. Even then, they may not take advantage of it because use of the exclusion is conditioned on the estate continuing to qualify for ten years. Failure to continue to qualify forces the estate to pay the avoided tax. Beside that, the exclusion isn't indexed so its benefit is almost eliminated by inflation and the increase in the Unified Credit.

Section 6166 allows an estate to pay its estate tax bill over time, 14 years, financed by the

IRS. I only know of one case where this was used. I talked to the son of a fellow whose accountant convinced him not to plan and buy insurance. When he died, the estate had to use Section 6166. The company stayed in the family and the son was running it. He told me it was living Hell.

He said it isn't so much that the IRS finances you, as they become your senior partner. They can look at the books anytime. They can tell you you're paying yourself too much. They can tell you that, if your children go to community college, you can pay the loan off quicker. They can tell you that you can't do an expansion or an improvement. This arrangement used to be called serfdom.

The folks that tell small business to trust them to "fix" the estate tax are the same ones who came up with the Family-Owned Business Exclusion and Section 6166. We'd rather not trust our futures to their tender mercies. Family businesses will not be safe until the death tax is eliminated.

For that reason, the National Small Business Association fully supports the efforts of Representative Kenny Hulshof and Representative Bud Cramer to fully and permanently repeal the estate tax by passing H.R. 8, "The Death Tax Repeal Permanency Act of 2005." The House vote on H.R. 8 has been designated a *Key Vote* for NSBA and our membership will be paying close attention to the vote's outcome.

I once again thank the committee for the opportunity to testify and look forward to any questions.

Small Business Council of America

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Congressional Testimony

How Repeal of the Federal Estate Taxes will Harm Small Businesses and how Repeal of AMT is Necessary

Testimony Before
The Subcommittee on Tax, Finance and Exports of the
Committee on Small Business of the
House of Representatives

Testimony of Paula A. Calimafde. Esq.
Chair of the Small Business Council of America

April 14, 2005

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SBCA

The Small Business Council of America (SBCA) is a national nonprofit organization which represents the interests of privately-held and family-owned businesses on federal tax, health care and employee benefit matters. The SBCA, through its members, represents well over 20,000 enterprises in retail, manufacturing and service industries, virtually all of which provide health insurance and retirement plans for their employees. The SBCA is fortunate to have the leading small business advisors in the country on its Advisory Boards.

Small businesses need certainty in the estate tax area. In order to immediately exempt small businesses from the federal estate tax, the estate tax exemption should be increased to the $3.5 million dollar level this year – not in 2009. The SBCA is in favor of reforming the existing estate tax system and is not in favor of the repeal of the estate tax law in 2010 and beyond, because repeal hurts so many small business owners. We believe the following reforms are needed:

- Increase the estate tax exemption amount *immediately* to $3.5 million and then increase it gradually over a number of years until it reaches *at least* $5 million and thereafter have it increase by COLA
- Preserve the step-up in basis at death for simplicity and fairness
- Reunify the estate and gift tax exemptions, increasing the gift tax exemption to immediately equal the estate tax exemption, for simplicity and flexibility
- Exempt retirement plan assets from the estate tax in an amount up to an additional $1 million if assets are going to a surviving spouse and up to an additional $500,000 if the assets are going to other heirs
- Reduce the top estate tax rates, particularly if an interest in a closely held or small business is subject to the tax.

By implementing these steps, small business owners who have worked a lifetime to build their companies will be virtually exempt from the estate tax system which is the professed goal of Congress. **Additionally, by implementing these proposals, many small business owners will find themselves in a better tax position than they would if the proposed repeal were to take place as scheduled in 2010.** This is because total repeal would be accompanied with a loss of the step-up in basis and a continuing $1 million cap of the gift tax exemption. Further, exempting a certain portion of retirement plan assets from the estate tax would promote retirement plan savings at a time when it is essential for Congress to incentivize such savings in order to assist our country in dealing with the future health care and retirement income burdens which will be imposed on the country by the baby boomer generation.

The estate tax historically was imposed only on the very, very rich of this country as a way to avoid the problems that occur when a very small elite of the country is able to amass great wealth and pass this wealth down to the next generation; it was never intended to reduce the estates of working Americans who had built up a family business or a small business based on their own hard work.

Unfortunately, many small businesses will actually end up paying more taxes under the proposed repeal in 2010 and beyond than they would with the increased exemption proposed to be in effect in 2009. This is because a majority of small businesses actually do better under our current system of estate tax with the increased exemption ($3.5 million or more) than they would under repeal because of the loss of the step-up in basis.

To understand the repeal proposal and our pro-small business proposal, there are a few basic concepts to our estate tax system that need to be explained.

Step-Up in Basis

First, today any assets that a person receives from another person's estate receive a "step-up" in basis - this means that the person receiving them gets them with a tax basis increased to fair market value as of date of death. Thus, when the person decides to sell the property, he would be taxed on the difference between the sales price and the date of death fair market value (this gain would be subject to either income tax or capital gains tax depending upon the asset).

A step-up in basis is contrasted to a "carry-over" basis where the heirs receive the assets with the same basis that the deceased owner had. For example, assume a father bought an investment property for $20,000 and did not improve it in any way and that 35 years later at his death, the property is valued at $750,000. If the son received the property with a "carry-over" basis, his basis in the property would be $20,000. If the son then sold the property for $750,000, he would have $730,000 of gain which would be subject to capital gains taxes. If instead the son received the property with a stepped-up basis, his basis in the property would be $750,000 and there would be no gain subject to tax when he sold the property for $750,000.

Under current law, upon the full repeal of the estate tax in 2010, the current rule providing for a fair market value basis in property acquired from a decedent (i.e., the step-up in basis) is repealed. In lieu of this rule, the recipient of property acquired from a decedent will have basis in such property equal to the lesser of the decedent's adjusted basis in the property or the property's fair market value at the time of the decedent's death. However, recipients of property from a decedent will be entitled to an aggregate basis increase of $1.3 million (adjusted for inflation after 2010). In addition, the decedent's surviving spouse will be entitled to an additional aggregate basis increase of $3 million (adjusted for inflation after 2010). Accordingly, if a decedent is survived by the decedent's spouse and the value of the decedent's estate is $4.3 million, the full amount of the estate will pass to the spouse free of any estate tax and the surviving spouse will have a stepped-up basis for the entire estate. If there is no surviving spouse, then only $1.3 million of assets will receive the step-up in basis.

"Exemption Level" (formerly the "Unified Credit")

Second, any assets that a person owns up to the estate tax exemption level - $1.5 million this year, can be given away at death, free of estate taxes. This is referred to as the estate tax exemption or exclusion amount and it is scheduled to increase over the next several years until it reaches $3.5 million in the year 2009. This means with basic estate planning in the year 2009, a couple could leave $7 million to their heirs without the imposition of estate tax and with a step-up in basis on the entire $7 million of assets. Assuming a couple had assets in excess of $7 million in 2009, the excess would be subject to the maximum estate tax rate of 45%. [1] (This assumes that the couple had already sheltered $3.5 million at the earlier death of the first spouse).

In the 2001 Act, Congress was concerned that once the estate tax was repealed, taxpayers would refocus their efforts on shifting assets to lower income tax bracket taxpayers (such as their children or grandchildren). Accordingly, Congress capped the gift tax exemption (which had for a long time been "unified" [or in lockstep] with the estate tax exemption) at $1 million. Thus, although a person can pass up to $1.5 million estate tax free (scheduled to increase to $3.5 million in 2009), only $1 million can be passed during lifetime. Many estate planners have found that this artificial cap on giving has caused the senior generation owners of small businesses to resist passing ownership to junior generation members. As a result, it can be more difficult to retain and motivate junior generation family members, as the amount of ownership that can be passed to them during their lifetime is limited.

Example – Why Making Repeal Permanent in 2010 Would Be a Tax Increase on Many Small Businesses

Assume there is a small business owner who has $3.5 million of assets and no surviving spouse. He (or rather his heirs) are much better off under the 2009 law rather than total repeal of the estate tax because of the loss in the step up in basis. This is how this works:

Under total repeal: $1.3 million of the assets receive a step-up in basis to the fair market value of those assets at date of death. The remaining $2.2

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[1] The maximum marginal rate is currently 47%, with decreases scheduled in 2006 (to 46%) and in 2007 through 2009 (to 45%). However, after application of the exemption and numerous available deductions, the IRS found that the average effective tax rate on taxable estates was only 18.8% in 2003. In addition, the Urban Institute Brookings Institution Tax Policy Center estimates that if the exemption were set at $3.5 million and the top rate at 45%, taxable estates would face an average effective rate of only 17.4%. (Source - April 12, 2005 Center on Budget's paper: HOUSE TO VOTE ON PERMANENT REPEAL OF ESTATE TAX: Estate Tax Reform, Rather Than Repeal, Could Preserve Much Needed Revenues And Help Restore Social Security Solvency. Report available on-line at http://www.cbpp.org/4-12-05tax.htm.).

million of assets will have the basis that the decedent had in those assets. (As an aside, imagine if the decedent were an 85 year old man who acquired many of these assets more than 40 years ago... how anyone is even going to be able to figure out the carry over basis of those assets is beyond us. The burden is on the heirs to prove any basis, and many will fail to have enough records, resulting in a zero basis. The step-up in basis was repealed back in 1976 and was then reinstated in 1980, though the carry-over rules never became applicable during that period, because Congress learned from attorneys and accountants who handled the probate process that it was almost impossible to determine the carry-over basis for many assets.)

Now when the heirs of this decedent sell this $2.2 million of assets, they will be subject to income tax on the difference between the then fair market value of the assets and any basis they can prove the decedent had in those assets. For example, let's assume that the heirs are able to prove that the carry-over basis in the assets is $1 million - then the heirs will be taxed on $1.2 million (assuming the fair market value of the assets was still $2.2 million).

Under an immediate $3.5 million exemption:

All $3.5 million of assets receive a step-up in basis to the $3.5 million level (this is the fair market value of his assets as of his passing). Now when the heirs sell any of these assets (assuming the fair market value of the assets was still $3.5 million), there would be *no* income tax and *no* estate tax.

Basically, a single person with assets greater than $1.3 million up to $3.5 million is better off under the estate law as it stands in 2009 and does much worse under total repeal of the estate tax. Similarly, a decedent who is married with assets greater than $4.3 million up to $7 million does better under the law as it would stand in 2009 than he would under total repeal. This covers a significant amount of taxpayers based on the data that illustrates how many taxpayers drop off of the estate tax rolls as the exemption amount increases. Based on data set forth in a March 16, 2005, issue paper from the Center on Budget and Policy Priorities[2]:

- If the estate tax exemption were $1 million in 2011, then 53,800 estates would be subject to the estate tax (this represents about 2% of the 2.6 million people expected to die in that year). Of the 53,800 estates that would be taxable, nearly

[2] This paper is entitled, "Estate Tax Reform Could Raise Much-Needed Revenue: Some Reform Options with Low Tax Rates Raise Very Little Revenue" by Joel Friedman and Ruth Carlitz.

half (46%) would have assets of less than $2 million and nearly three-fourths would be valued at less than $3.5 million.

- If the exemption level in 2011 were $2 million instead of $1 million, then the number of taxable estates would shrink to 21,000. This is a reduction of 61% in the number of estates that would face the estate tax.

- **If the exemption amount in 2011 were $3.5 million instead of $2 million, then the number of taxable estates would drop to 8,500** (84% of the estates would be exempt compared to the number that would have been subject to estate tax if the exemption amount were $1 million in 2011). **This amount represents about 0.3% of all the people who are expected to die in 2011.**

These numbers clearly show how many small business owners would be worse off under total repeal than if the law were frozen at 2009 (with the $3.5 million exemption and the step-up in basis).

The reason why most small businesses owners (particularly where they have assets which under repeal will have a carry over basis versus a stepped up basis if the $3.5 million exemption were in effect) do not understand that they are worse off under repeal, is that they do not understand the impact of the carry over basis and the ultimate imposition of income tax on those assets.

If Congress really wants to protect small business owners, it should do so by increasing the exemption amount immediately up to $3.5 million and then increasing the exemption amount over the next several years, retaining the step-up in basis, reunifying the gift and estate tax exemptions and reducing the tax rate on any small business or family business interests held in an estate that was in excess of the then exemption amount.[3]

Promote Retirement Savings

The SBCA also believes that giving an exemption for up to $1 million in retirement plan assets that are left to a surviving spouse and up to $500,000 for retirement plan assets that are left

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[3] If Congress determined that there were still small businesses or family owned businesses that needed protection from the estate tax then it could create a true small business exemption. Such an exemption would not bear any resemblance to the Qualified Family Owned Business Interest (QFOBI) exemption that came into law a few years back. This rule was not only complicated, but suffered from the most severe planning defect - a business owner would not be able to know if he qualified for the exemption until death occurred. Rather Congress could create a very simple exemption - for example, *any* business interests owned by a decedent in an active family or small business that was passed on to a family member would be exempt from the estate tax, or alternatively estate tax rates could be reduced (for example, to 15%) on those small business or family owned business interests.

to others would go a long way towards promoting retirement plan savings by small business owners and others. This estate tax exemption on retirement plan assets is also important because these assets are subject to estate tax and income tax when distributed to the deceased plan participant's beneficiary. Currently, the incentive for contributing money to a retirement plan (and thereby locking it up until retirement) are being diminished by the lower tax rates on capital gains and dividends that do not apply to funds coming out of a retirement plan. If the administration's LSA proposal were to be enacted, this would be a further disincentive to contributing to a qualified retirement vehicle which forces the savings to be maintained in the vehicle until retirement since one can save in the LSA vehicle tax free with the ability to access the funds at any time.

Repeal AMT

AMT is basically a second tax system that sits on top of our regular system and in effect the taxpayer has to end up paying the higher tax generated by each of the systems. Viewing this from a bare bones approach, it means that many of the deductions allowed by the regular tax system are rendered meaningless by the AMT. This particularly harms small business owners. This is another tax that was never designed to hit the working American but instead was designed to apply to a very few, very rich taxpayers who one way or another seemed to be able to dodge their tax bill every year under the regular tax code - they did it legitimately, but it did not sit right with Congress that the very richest taxpayers often paid the smallest amount of tax. Today, the AMT affects more and more Americans and it is time that it be rolled back entirely. A repeal of AMT will simplify our tax system and will make it more fair for the American worker and small business owner.

Fiscal Responsibility

Data cited by the Center on Budget and Policy Priorities notes that:

- The Joint Committee on Taxation estimates that extending repeal beyond 2010 would reduce revenues by $290 billion through 2015, including $72 billion in 2015 alone.

- But the Joint Tax Committee's estimate essentially captures only the cost of four additional years of estate tax repeal. The revenues losses associated with 10 more years of repeal — for the period from fiscal year 2012 through fiscal year 2021 — are much higher, about $745 billion.

- When the associated $225 billion in higher interest payments on the debt are taken into account, the total cost of repealing the estate tax for a decade would be nearly $1 trillion.[4]

At the end of the day, the proponents of repeal have won over the small business community with flashy slogans - "Kill the Death Tax" or "Is it fair that you have to pay taxes when you die?" (Of course, most of the owners did not realize that the estate tax never would

[4] See the Center on Budget's April 12, 2005 paper cited above.

have applied to them in the first place because the estate tax exemption is higher than their total assets.) **Nor has anyone explained to them that a great number of small business owners will be worse off if repeal is enacted and only an extraordinarily few will be better off.**

Small business are being used to make repeal "respectable" - it is far easier to talk about how outrageous it is for a farmer to lose his farm to pay estate taxes than to talk about how unfair it is that a billionaire will have to pay a portion of his assets to the government and/or charities. Proponents of repeal tout the benefits of estate tax repeal to the small business owner when, in fact, repeal will actually harm most small business owners because of the loss in the step-up in basis. The SBCA believes that it would be far better to use the dollars that would be "saved" by the 2009 estate tax law being enacted with our changes instead of estate tax repeal[5] on a total repeal of AMT which really does hurt small businesses. By enactment of our estate tax proposals, small businesses will be removed from the reach of the estate tax. Proponents of repeal have used small business as the straw man to push for estate tax repeal when, in fact, many small business owners and their families will be harmed by estate tax repeal. Repeal will only help the extraordinarily rich.

Ms. Calimafde is the current Chair, past President and a member of the Board of Directors of the Small Business Council of America, Inc., the only national non-profit organization which has represented the interests of privately owned businesses exclusively in the Federal tax, retirement, health care and employee benefits areas for the past twenty-five years. She received her B.A. from Swarthmore College and her J.D. from Catholic University.

She is a partner in the Bethesda, Maryland law firm, Paley Rothman, where she chairs the firm's Retirement Plans Practice Area and the Employee Benefits Practice Area. Ms. Calimafde has nearly 30 years of experience advising small businesses and closely held businesses in tax areas and estate planning. For nearly 30 years, she has been a legislative advocate for small and closely held businesses in the Federal tax, health care and employee benefits arena.

In 1986, Ms. Calimafde was elected at the Maryland State Conference to serve as a delegate to the White House Conference on Small Business. She was subsequently appointed by the White House Conference to serve as one of eleven National Commissioners of the 1986 White House Conference on Small Business. As such, she chaired the Payroll Costs Session at the National Conference, which covered qualified retirement plans, employee benefits and social security, among other issues. In 1995, Ms. Calimafde was

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[5] The March 16, 2005, Center on Budget's paper referred to above states that if the exemption were set at $3.5 million and the top tax rate were 45% (i.e., this is the 2009 law), the total estate tax revenue raised would be $17 billion in 2011 according to the Tax Policy Center. Even at the $3.5 million exemption level, which would exempt 84 % of taxable estates from estate tax in 2011, 44% of the revenue that would be lost under total repeal would still be preserved. These numbers reflect the fact that some of the taxable estates remaining would have enormous wealth which would generate significant estate taxes.

appointed by the White House to serve as a Presidential Delegate at the 1995 White House Conference on Small Business.

She is also a member of the Board of Directors of the Small Business Legislative Council (1992-), Past Chair (1988-1990) and Vice Chair (1986-1988) of the Closely Held Committee of the ABA Tax Section, Advisory Board of the Journal of S Corporation Taxation, 1989-1994, Employee Benefits Council, Chamber of Commerce of the United States, 1986-1994, 1996-, and Small Business Council of the U. S. Chamber, 1995-1998 and the Washington, D.C. Estate Planning Council, 1994-.

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STATEMENT of

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American International Automobile Dealers
before the
Subcommittee on Tax, Finance and Exports of the Committee on Small Business
April 14, 2005

Good morning.

My name is Jenell Ross. I am here today as a representative of the American International Automobile Dealers Association. I want to thank the committee for allowing me to submit testimony on the federal estate tax. It's an issue that is near and dear to my heart because of my family's first-hand experience with it.

I am the dealer principal of Ross Motor Cars in Centerville, Ohio. We are a family-owned dealership carrying Buick, GMC, Hummer and Mercedes-Benz.

As a small-business owner and auto retailer, I can say with certainty that the death tax absolutely impacts family-run businesses. My family has experienced it first-hand, and because of our experience with it, we view it the most intrusive and burdensome tax ever levied by the federal government.

Thirty-one years ago, my father, Bob Ross, took the chance of a lifetime and started Ross Motors Cars. Our family-owned dealership had been in business for 23 years when my father passed away unexpectedly. My father was an incredibly talented and capable businessman. Like a lot of small business owners, he knew about the death tax, but he passed away long before any of us expected him to. And because of that, the dealership's estate planning was years behind where it should have been.

When he died, the responsibility of keeping the business running and the workers employed fell on my mother, brother and me. Although we were familiar with many of the dealership operations – particularly my brother, Rob, and I – I can tell you that none of us was fully prepared to take on the overwhelming responsibility of managing the day-to-day operations of the business. It was in many ways, on-the-job training in a very literal sense.

Perhaps you can imagine – amidst all of this – the incredible shock we felt in receiving a federal tax bill in the amount of hundreds of thousands of dollars, more than half the value of our business. The shear amount of that massive bill was almost overwhelming in and of itself, but it was compounded by the fact that almost 90 percent of our dealership's net worth was tied up in assets such as land, building, equipment, inventory and parts – none of which could have been easily liquidated without seriously damaging our ability to function.

And that was true not just in our case, but it's true for most dealerships today. Dealerships are heavily leveraged. Automobile consumers have huge demands when it comes to purchasing a new vehicle. In today's competitive environment, dealers have no choice by to maintain large inventories of new vehicles. At the same time, we're are under enormous pressure from manufacturers to maintain our properties and buildings at increasingly higher and higher levels.

All of this creates the perfect estate tax storm and has the potential to devastate a successful family-owned dealership.

My experience with the death tax has made this issue a very personal one. Particularly because when the death tax bill arrived, none of us – neither I, nor my mother and brother – were prepared for it. When a family loses a loved one, it takes an incredibly high emotional toll. That was certainly the case for us. Being hit by the death tax during this very trying time made our personal family tragedy almost overwhelming.

And we are not alone. Every year, tens of thousands of families are forced to endure what we endured. No family should ever have to experience that.

But the death tax imposes a huge cost even on automobile dealers who are fully prepared for it. In fact, among our industry, about 70 percent of dealership principals view this tax as the single-biggest federal government-imposed barrier to expanding business opportunities.

Consider what Jeff Davis, another Ohio auto dealer had to say recently, "I can tell you without reservation that if my businesses were forced to pay a 55 percent tax on our total net worth, we could not survive. In all likelihood, my 11- and 12-year old children would lose the family business."

The death tax forces dealerships to allocate precious resources to pay for specialized accountants and estate lawyers. It's not at all uncommon in our industry for dealers to divert upwards of $10,000 per month on estate planning. The effect death tax planning has on dealers is to drain limited focus and resources away from growing the business and subsequently creating more jobs.

That has certainly been the case for our family-owned business. Ever since we received the federal death tax bill eight years ago, my mother has been in weekly contact with a team of lawyers and insurance agents to make sure our death tax payment plant remains viable and our dealership remains solvent. We are currently embarked on a 10-year payment plan to pay off the death tax. In the meantime, our business is being held for collateral.

Our dealership and our employees are managing today, but there is no question that the experience took a tremendous toll on my family.

Our experience has been an eye-opening one, and it has motivated us to do what we can to help bring a permanent end to this oppressive and burdensome tax. Not a day has gone by over the past eight years in which we haven't been haunted by what could have been – not only to our business, but to the 145 employees of Ross Motor Cars whose families depend on us.

The majority of today's 21,000 automobile dealerships are true family businesses – run, managed and expanded by family members across several generations. The ability of a family working

together to create a business and employ their neighbors is an essential part of the American economy and American dream.

I want to applaud this committee for the work it did in 2001 to repeal the estate tax, but I want to urge this committee to make permanent the death tax phaseout. In today's competitive auto retail business environment, auto dealers need predictability in the tax code in order to hire additional employees, buy new equipment, and expand business opportunities.

In fact, one of the arguments of getting rid of this unfair tax, that it would be too "expensive" to the federal government is just flat out wrong. As you may be aware, Dr. Wilbur Steger, an expert on the Death Tax, and an advisor to Presidents Kennedy, Johnson, Reagan, Bush, Clinton, and President George W. Bush conducted a study on the Death Tax recently and what would happen to the economy were it to be eliminated. Dr. Steger's findings, called the CONSAD study, concludes that repeal of the Federal Estate Tax, along with a reasonable adjustment in the way capital gains taxes are applied to estates, would actually result in a slight increase in revenue to the federal government--- $1.7 billion over ten years--while relieving the unfair and often fatal burden of the Federal Estate Tax on families and small businesses and, at the same time, stimulating enormous new economic activity.

Mr. Chairman, if it pleases the committee I would like to submit a copy of the CONSAD study with my testimony.

The arguments for permanent repeal of the death tax are many, but perhaps the most important reason for why this tax should be permanently repealed, is because this tax – more than any other – is viewed by the public at large to be fundamentally unfair and un-American.

Last year, AIADA conducted a national survey to gauge public sentiment on this issue, and what we found was truly remarkable.

Voters across party, ideological and demographic lines consider it to be unfair that the government taxes the earnings of individuals, and again taxes the estate at the time of the earner's death. Nowhere among the major voter groups do we see less than 70 percent of the voters saying it is unfair.

The poll found that voters support permanent repeal by a 3:1 margin. Likely voters who believe the estate tax, or death tax, should be permanently abolished outnumber proponents of the tax by a margin of more than three-to-one. According to the poll, 61.6 percent of respondents support permanent repeal; 18.7 percent oppose permanent repeal.

Voters believe the death tax is fundamentally unfair. When asked whether it is fair or unfair to tax earnings while being earned and again after the earner dies, 84 percent of all voters consider it to be unfair. Voters view the death tax as a double tax and another example of government overreaching. Belief that the death tax is unfair is at 92 percent among self-described "conservative" voters and 73 percent among self-described "liberals."

Most Republicans, Democrats and Independents favor permanent repeal. According to the survey, 73.2 percent of Republicans support permanent repeal, as well as 50.3 percent and 61.3 percent of Democrats and Independents, respectively.

Support for permanent repeal transcends ideological lines. According to the survey, self-described conservative Republicans (77.7 percent) and moderate Republicans (69.6 percent)

overwhelmingly support permanent repeal. Among liberal Republicans, support for permanent repeal is at 59.5 percent. Even self-described conservative Democrats and moderate Democrats support permanent repeal, 60.9 percent and 51.4 percent, respectively. Only among self-described liberal Democrats is support for permanent repeal below 50 percent (44.5 percent).

Income is irrelevant to voter sentiment that the death tax is unfair. According to the poll's findings, among voters earning less than $40,000 per year, 84 percent feel the death tax is unfair; 12 percent feel it is fair. Among voters earning over $100,000, 82 percent view it as unfair, while 11 percent view it as fair.

Most minorities support permanent repeal. According to the survey, 56.4 percent of African Americans support permanent repeal of the tax, and 51.4 percent of Hispanics believe the tax should be taken off the books forever. Among Caucasian voters, 63.5 percent favor permanent repeal.

The majority of both men and women favor permanent repeal. The survey found that among men, 62.9 percent favor permanent repeal of the tax; among women, 60.0 support permanent repeal.

Most Americans, regardless of age, support permanent repeal. According to the survey, 67.3 percent of likely voters age 41-65 support permanent repeal; among likely voters age 56-65, support for permanent repeal is at 63.6 percent. Likely voters over the age of 65 support permanent repeal at a rate of 61.9 percent. Among 26-40 year-olds, support for permanent repeal is at 53.2 percent. Only among likely voters age 18-25 is support below 50 percent (48.2 percent).

What this survey accomplishes is to deal a serious blow to the prevailing argument being employed by death tax proponents: that the tax is fair. Voters recognize double taxation when they see it, and they don't like it – regardless of whether they are personally affected by it.

If for no other reason, the death tax ought to be permanently repealed because it's a tax that is fundamentally un-American and fundamentally unfair.

Thank you.

About AIADA:
Founded in 1970, AIADA represents the 11,000 American automobile dealerships that sell and service international nameplate brands including Acura, Aston Martin, Audi, Bentley, BMW, Ferrari, Honda, Hyundai, Infiniti, Isuzu, Jaguar, Kia, Land Rover, Lexus, Maserati, Maybach, Mazda, Mercedes, MINI, Mitsubishi, Nissan, Porsche, Rolls Royce, Saab, Scion, Subaru, Suzuki, Toyota, Volkswagen and Volvo. These retailers have a positive economic impact both nationally and in the local communities they serve, providing nearly 500,000 American jobs. Visit AIADA online at www.aiada.org.

Mission:

AIADA's mission is to protect the economic viability and represent the political interests of America's 10,000 international nameplate automobile dealerships by educating lawmakers, policy makers and the public at large about the positive impact our members have on their local, regional and national economy. America's international nameplate automobile dealers are a driving force in the economic recovery: we provide hundreds of thousands of well-paying jobs, inject millions of dollars each year into local economies through taxes and charitable contributions, and, perhaps most importantly, as a result of our products and services, millions of American consumers have their transportation needs met each day.

About the American International Auto Dealers:

Headquartered in Alexandria, VA, the American International Automobile Dealers Association (AIADA) is the only national lobbying force in the United States dedicated exclusively to representing the economic and political interests of America's 10,000 international nameplate dealerships. AIADA member dealers sell and service the following international nameplate brands: Acura, Aston Martin, Audi, Bentley, BMW, Ferrari, Honda, Hyundai, Infiniti, Isuzu, Jaguar, Kia, Land Rover, Lexus, Maserati, Mazda, Mercedes, MINI, Mitsubishi, Nissan, Porsche, Rolls Royce, Saab, Scion, Subaru, Suzuki, Toyota, Volkswagen and Volvo.

AIADA was founded in 1970 to increase awareness among the government and the public of the international nameplate automobile industry's value to the U.S. economy. International nameplate dealers – found in all fifty states and every congressional district – facilitate 500,000 American jobs and inject hundreds of millions of dollars into the nationally economy. Locally, AIADA member dealers contribute thousands of hours and tens of millions of dollars to various charities and deserving causes.

As a lobbying force on Capitol Hill, AIADA focuses on federal issues impacting America's international nameplate automobile dealers. These issues include: quotas, tariffs and other restrictions policy initiatives that limit the availability of international nameplate automobiles; tax measures that have a direct impact on the ability of international nameplate dealerships to grow and create jobs; fuel economy policies that constrict consumer choice; global warming and clear air legislation; and other policy developments that may affect the economic viability of the international nameplate automobile dealer. The association frequently testifies before Congress and government agencies and publishes policy studies on these issues.

At the grassroots level – just as it does in Washington – AIADA strives to educate elected officials and the public about the benefits of an open market economy and the positive impact of the international automobile industry on the U.S. economy, employment and consumers. The association also works to forge meaningful and mutually beneficial relationships between local auto dealers and their respective federal representatives.

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Statement of the American Farm Bureau Federation

TO THE
HOUSE SMALL BUSINESS COMMITTEE
SUBCOMMITTEE ON TAX, FINANCE AND EXPORTS
REGARDING
ESTATE TAX AND ALTERNATIVE MINIMUM TAX

April 14, 2005

Presented by,
Paul Zittel
Vice President, New York Farm Bureau, Inc.

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Vice President, New York Farm Bureau, Inc.

My name is Paul Zittel. I, along with my brother and two sons and two nephews, own and operate Amos Zittel and Sons Inc. in Eden, New York. We grow fruits and vegetables on 180 acres of land and flowers under plastic in 2.5 acres of greenhouses. Our family farm corporation employs 60 people, 22 of them year round.

I am also the elected vice president of the New York Farm Bureau and speak today on behalf of the American Farm Bureau Federation. Farm Bureau thanks the House Small Business Committee, Subcommittee on Tax, Finance and Exports for holding this hearing to spotlight the need for permanent death tax repeal and the need to end the Alternative Minimum Tax (AMT).

Permanent Repeal of Death Taxes

Farm Bureau supports the permanent repeal of death taxes. This is for good reason. Farm and ranch estates face heavier, potentially more disruptive death tax burdens than other estates. Roughly twice the number of farm estates paid federal death taxes in the late 1990's compared to other estates. Moreover, the average farm death tax is also larger than the tax paid by most other estates.

Families own 99 percent of our nation's farms and ranches and unless death taxes are repealed, many of these family farms are at risk. The impact of death taxes, with rates as high as 47 percent, can be so severe that its imposition can destroy farm businesses. When this happens farms and ranches can be lost, surviving family members can be displaced, employees can lose their jobs and rural communities can lose their economic base.

Excessive tax rates are not the only reason that death taxes are so damaging to farm and ranch operations. Farm operations are capital intensive businesses whose assets are not easily converted into cash. In order to generate the funds that are needed to pay death taxes, heirs often have to sell parts of the business. When this occurs, the economic viability of the business can be destroyed.

Death taxes can also affect the longevity of farm and ranch businesses. Children must decide whether they intend to continue the family business. When faced with the realization that their

family farm may not survive death taxes, many choose to leave the farm. Without children interested in the business, it is common for farmers to sell. Where there are alternative uses for farmland, land is often developed for other uses and open space is lost.

An increase in the estate tax exemption is not the answer. Only repeal can erase the burden and uncertainties of estate tax planning. Because it is often difficult to predict the future net worth of a farm or ranch operation, many farmers and ranchers feel compelled to spend money for estate planning and life insurance. This expense is a drain on ongoing farm operations, and for some, the cost prohibits estate tax planning. Even with the best of plans, no attorney or accountant can guarantee that the plans farmers pay for will save their farms.

No Farm Bureau statement on death taxes would be complete without mention of the importance of the stepped-up basis. Stepped-up basis has been an integral part of the tax code for the past 80 years. Under current law, the basis of inherited property is stepped-up to current market value for the new owner, which has the effect of adjusting the value of the property for inflation. If the property were sold, the new owner would pay capital gains taxes on the amount the property increased in value while he owned it.

Farmers and ranchers hold farmland for an average of 30 years. Over that period of time, land increases in value five to six times. Land accounts for 79 percent of the assets owned by farmers and ranchers. Elimination of the stepped-up basis would impose a new, potentially huge capital gains tax on farmers and ranchers. This new tax would impede the sale of land making it more difficult for children to take over farms while their parents are still alive, for farmers to acquire land for expansion purposes and for surviving farm heirs to buy out their non-farming siblings.

Alternative Minimum Tax (AMT)

The Alternative Minimum Tax now functions as a separate tax system parallel to the regular individual income tax system. Taxpayers above certain levels must calculate their liability using both the income tax and the AMT and pay whichever liability is higher.

Under the 2003 tax act, the AMT exemption amount increased by $9,000 to $58,000 for married taxpayers and by $4,500 to $40,250 for single taxpayers for 2003 and 2004. In 2005, the exemption amounts will revert back to the amounts provided under prior law.

This AMT relief is important to farmers since they pay the tax more often compared with other taxpayers. According to USDA's Economic Research Service, slightly more farmers are subject to the AMT with just under two percent of farmers currently paying the tax. Under the AMT relief, most farmers would fully benefit from the tax cuts.

The AMT clearly adds to the complexity of tax filings. Many farmers and ranchers who include tax management in their business planning find they may owe AMT after irreversible business decisions have been made. Farm Bureau supports an end to AMT and harmonizing depreciation schedules if for some reason it is retained.

Conclusion

In conclusion, Farm Bureau commends the Committee on Small Business for continuing to highlight the need for permanent death tax repeal. But farmers will not be able to rest in peace until Congress finishes the job of eliminating death taxes. Farm Bureau calls on the both the House and Senate to pass legislation to end death taxes once and for all.

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Congressional Testimony

How Federal Death Taxes and the Alternative Minimum Tax Challenge America's Small Businesses

Testimony Before

The Subcommittee on Tax, Finance and Exports of the

Committee on Small Business of the

House of Representatives

Testimony of William W. Beach
Director of the Center for Data Analysis
The Heritage Foundation

April 14, 2005

Testimony of William W. Beach

My name is William W. Beach, and I am delighted to present the following arguments in support of estate tax repeal and repeal of the Alternative Minimum Tax (AMT) to the Subcommittee on Tax, Finance and Exports of the House Committee on Small Business. I am the John M. Olin Senior Fellow in Economics and Director of the Center for Data analysis at the Heritage Foundation, a Washington based public policy research organization. The following remarks constitute my own opinions, and nothing in this testimony should be construed as representing the views of The Heritage Foundation or support by the Foundation for any legislation pending before the Congress.

It hardly exaggerates the importance of small businesses to U.S. economic performance to state that economic activity would be substantially less without a deep and healthy layer of small businesses. We have only to look at other economically developed countries that tax and regulate their smaller sized businesses more heavily to know what ill health in that sector leads to. Relative to the United States, they have higher unemployment rates, lower levels of investment, and slower rates of per capita economic growth.

While the U.S. provides a friendlier economic environment today for small businesses, it has not always been so. High individual income tax rates after World War II discouraged small, non-corporate business and encouraged the growth of ever larger business organizations. Regulations governing the application of new technologies, particularly in telecommunications, computing, and transportation reduced efficiencies in these sectors that could have been provided by small businesses competing in freer markets.

Thanks to the tax reforms that began in 1981 and continue to this day and the steady deregulation of key aspects of the U.S. economy, those bad old days are fading from memory. However, there is nothing inevitable about the process of liberalization of economic life. Continued progress requires the relentless attention and pressure of economic liberals in the Congress and the larger policy community to further expand economic liberties by reducing the burdens of taxation and regulation.

The Congress again is challenged to support the growth of small businesses by addressing two enormously damaging components of current U.S. tax policy: federal death taxes and the Alternative Minimum Tax. Death taxes (estate, gift, and generation skipping taxes) cut deeply at the central, core values of American economic life. Indeed, as I shall argue shortly, they are taxes on economic virtue and deserve immediate repeal if for no other reason than the immoral policing activity they sanction. The AMT compliments the devastation wreaked by death taxes. At a time when average tax rates are falling for many Americans, an increasing number of taxpayers find themselves thrown onto the AMT rolls, where tax burden is rising. The growth in the number of AMT taxpayers means that their capital and labor are more heavily taxed, which in turn increases the costs of labor and capital to small businesses.

It is time that the Congress repeal both of these taxes.

Repeal Death Taxes

The Economic Growth and Tax Relief Reconciliation Act of 2001 increased the amount that taxpayers can exempt from estate and gift taxes and slowly reduced the rate over the period 2002 through 2009. Then, the Act repealed death taxes for one year, 2010, before restoring them at their 2003 levels in 2011.

Congress created this bizarre fiscal hiatus in order to enact all of the tax policy changes given the amount of money it had set aside through its budget resolution for tax relief. Compounding this difficult task was a last-minute estimate by the staff of the Joint Committee on Taxation (JCT) of how much federal revenue would decrease if Congress permanently repealed all federal death taxes. By using static rather than dynamic scoring and by making assumptions about how federal income and gift tax payments would interact, the JCT significantly increased the "cost" of repeal, thus forcing congressional tax writers to create this on-again, off-again tax policy.

When President Bush signs legislation eliminating this peculiar hiatus and making death tax repeal permanent, taxpayers will likely do two things:

1. Cease economically wasteful federal estate tax planning,
2. Focus more on running their businesses and personal affairs knowing for certain that they do not have to look over their shoulder for the death tax collector.

Good tax policy is known for its certainty, if for no other characteristic. Without predictability, tax policy can create confusion and have a lethal effect on economic activity.

Permanent repeal would eliminate a number of death tax threats posed to economic activity. The death tax hinders economic activity in the following ways:

1. Discourages savings and investment;
2. Undermines job creation and wage growth;
3. Prevents economy from achieving investment potential;
4. Contradicts central promise of American life: wealth creation.

Discourages savings and investment. For those Americans who think that their estates may one day pay federal death taxes, the tax sends a signal that it's better to consume today than invest and make more money in the future. Instead of putting their money in the hands of entrepreneurs or investing more in their own economic endeavors, the unmistakable message of federal estate taxes is to consume it now, not pay it later.

Undermines job creation and wage growth. Not only does this message have a corrosive effect on the virtue of savings and prudent investment, but also it directly

undermines job creation and wage growth; and these latter effects make death tax repeal everyone's concern. Heritage Foundation economists estimate that the federal estate tax alone is responsible for the loss of between 170,000 and 250,000 potential jobs each year. This additional employment never appears in the U.S. economy because the investments that would have resulted in higher employment are not made.

Prevents economy from achieving investment potential. Further, the effect of the estate tax on preventing the economy from achieving its investment potential holds down wage growth. Workers are more productive when they have new tools, machines, and factories; and increased productivity boosts wages and salaries. It is through productivity growth that enhancements to economic and social well-being are and the virtues of our form of economic organization are most abundantly seen.

Contradicts central promise of American life: wealth creation. Indeed, the support for permanent repeal of federal death taxes stems generally from the appreciation of this last feature of our economy. Most Americans oppose death taxes because they seem so un-American. The death tax appears to many people as a clear contradiction to a central promise of American life: that if you work hard, save, and live prudently, you will be assured the enjoyment of your economically virtuous life. There are few other places on the planet where this promise is made (let alone kept), and it along with companion promises of political and religious freedom has attracted millions of immigrants to the United States.

Death taxes eat away at this promise. Some Americans, like farmers, ranchers, homeowners, face the threat of death taxes because they have improved the land upon which their other assets sit or because factors beyond their control, like the population growth of cities, drive up the price of their property. Many Americans save in their businesses in order to pass an asset along to their children; and, for millions of African-Americans and others for whom the economy is not always benign, the threat of seeing their life savings absorbed in a single tax bill is reason enough to demand permanent repeal.

Still others are just starting out or, like many women, returning to the labor force after raising families or taking care of other obligations. There before them is an economy that welcomes their enterprise and creativity, that promises a living in exchange for meeting the needs of people in their community. Small businesses offer a way around the corporate glass ceiling, and the language barriers that immigrants face in larger organizations are seldom-insurmountable obstacles in a business you own yourself.

What About Small Business Carve Out Legislation?[1]

Narrowly aimed family business estate tax relief has been attempted in the past--it has failed miserably every time. The most recent Code section aimed at family business

[1] The following section on small business carve outs draws heavily on a forthcoming essay by William Beach, Harold Apolinsky, and Craig Stephens, "Narrowly Aimed Family Business Carve Out Legislation Fails to Save Businesses from the Estate Tax." (*Tax Notes,* April, 18, 2005).

estate tax relief was recently repealed IRC Section 2057. Section 2057, before its demise on January 1, 2004, was commonly known among estate planning attorneys as the single most complicated estate tax Code section ever drafted. The legislation contained page after page of definitions and tests that had to be interpreted, applied, and deciphered in order to determine whether a taxpayer even qualified for potential relief. In addition, the Code section relied upon numerous cross-references and definitions throughout the Code. Many law firms refused to consider applying Section 2057 because of the potential malpractice of applying it incorrectly.

On January 7, 2003, with Section 2057's repeal imminent, S.34, the so-called "*Estate Tax Repeal Acceleration for Family-Owned Businesses and Farms Act*" was introduced. It quickly became known as the Section 2057 replacement, and quickly became as unpopular as Section 2057. The bill died before ever being brought to a vote.

In its simplest form, Senate Bill 34 was designed to give an executor the option of deducting the full value of what would be known as the "carryover business interest" ("COBI") from the taxable estate. The COBI would then take a carryover basis (a basis equal to the decedent's basis), or the COBI would take a basis equal to the property's fair market value, whichever was less.

The simplicity stopped at that point. The threshold determination of whether a family business interest qualified as a COBI interest depended upon how many families owned an interest in the business, and the percentage interest owned by each particular family. If multiple generations are involved in a family business, which is often the case, and certain family members want to diversify and sell their interest, it becomes questionable whether the business will meet the required definition of "family business."

The proposed legislation then listed certain business interests that were expressly excluded:

- Business interests attributable to cash or marketable securities, or both, in any amount in excess of the "reasonably anticipated business" needs of such entity;
- Business interests in any entity that is readily tradable on an established securities market or secondary market at any time (whether currently or in the past); and
- that portion of a business interest in an entity transferred by gift within 3 years before the date of the decedent's death.

Senate Bill 34 also required a fact-specific inquiry into the family's business activities during the 8 to 10 year period preceding the decedent's death. The bill required "material participation" in the business by certain family members or a "qualified heir," but failed to provide guidance on what constituted "material participation."

The shortcomings of S.34 were evident almost immediately through its repeated cross-references to other Code sections. The numerous cross references to Section 2032A were reminiscent of flawed Section 2057. Including the cross-referenced pages, the 9 pages of proposed legislation easily turned into 20 pages of statutory games, which would have provided little if any relief. As such, the bill died.

As fresh and progressive as this economic picture appears, at the end of a life of economic struggle still stands the nightmare of the American dream. Without swift and decisive action by Congress, the death tax withers over the next decade but does not die. The uncertainty in tax planning will grow, the economy will consistently under perform, and the hypocrisy of the economic promise of American life will reverberate louder than ever. Now is the time to bring this sorry chapter in U.S. tax policy to a close.

The estate tax relief stemming from family business carve out legislation is uncertain at best. However, the enormous legal fees, accounting fees, and appraisal fees that such proposed legislation would generate are most definite. Legislation like S.34 and former Section 2057 would undoubtedly incorporate and cross reference other complex Code sections--2032A, 6166, and 267. Use of such proposed legislation would be dependent upon a lawyer's interpretation of the statute and quantitative calculations run by accountants. It would be impossible to attempt to even qualify for relief under such proposed legislation without professional assistance. It would generate thousands upon thousands of dollars in professional advisory fees, which would likely result in a finding that a decedent's business does not qualify for tax relief. Why generate the need for professional advisory fees when a permanent repeal of the estate tax effective January 1, 2005, would provide more realistic and practical relief.

Family business carve out legislation creates and invites more tax related litigation. As with S.34, such legislation would find business-owned liquid assets inherently offensive. In S.34, the definition of COBI excluded cash or marketable securities to the extent that the cash or marketable securities exceeded the "reasonably anticipated business needs" of the family business, as determined by the Service (if such a determination is even possible). Despite a justified business reason for owning significant liquid assets, relief would not be available for the portion of the business that the Service determined to be excess liquid assets. Proceeds from a corporate division or divestiture, or capital needed for improvements or future investments (i.e., capital for purchasing equipment or real estate) would be considered suspect, and if the Service determines it is "too much," tax relief would be thwarted. Why are liquid assets inherently offensive to the drafters of family business carve out legislation?

It is expected that many family businesses would not satisfy the "material participation" requirements of S.34 type legislation through the use of a "qualified heir." A qualified heir has been defined as a non-family member who has managed the business for 10 years preceding the decedent's death. Because many families have transitioned management of the family business and have employed a series of "outsiders" to run the business, those businesses would likely fail the requirement that one person had to have been in charge for 10 years. A ten-year tenure, such as the one required under S.34, is unusually long for an outsider. In addition, there is no definition of what constitutes "material participation" by a "qualified heir." Even if such definition were provided, it would be highly complex and require professional advice for interpretation.

Such a ten-year period required for outside management would also strangle traditional business decisions. For example, an inefficient executive manager would find

comfort in knowing that his lack-luster performance is protected by family business carve out legislation because his ten-year tenure is required by the legislation in order for the family to pass the business to the next generation. Over inflated compensation packages would become the norm in order to prevent a manager from leaving just prior to the ten-year tenure period, which would make relief unavailable. An outsider's desire to perform poorly or leave a position should not create multi-million dollar estate tax consequences for the family business owner's family.

Businesses that contemplate becoming public businesses, either permanently or temporarily, would be forced to change their long-range business plans. Legislation such as S.34 prevented the use of public funds as a means of raising capital or expanding the business, even temporarily. The definition of COBI excluded businesses that had ever been "readily tradable on an established securities market or secondary market." The proposed legislation would certainly stifle economic business growth and development, along with the additional jobs that come with such growth.

Simply stated, legislation such as S.34 and former Section 2057 discriminates against family businesses that do not fit complicated statutory molds. Those statutory business molds fail to address the practicalities of operating a business. A business's Capital needs, employee and management issues, and stock percentage ownership decisions, cannot be confined to an inflexible and complicated set of arbitrary rules in order to save the business from liquidation to pay estate taxes. If such legislation is passed, family businesses will fail to qualify for relief, liquidations will inevitably occur, jobs will be lost and economic development will suffer. Below are two case studies.

Repeal the Alternative Minimum Tax

In a private conversation I once had with former Senator Bob Packwood about the AMT, I asked him how many taxpayers he and his House colleagues intended the AMT to affect. While the Senator could not recall that any one number dominated the tax writing deliberations of the Senate Finance Committee, he believed it could not have been more than 150 very high-income taxpayers.

We are a very far cry from 150 taxpayers today. If we do nothing to rein in the AMT or repeal it, that tax is expected to be paid by nearly 40 million taxpayers in just five years from now. If that forecast holds, the population of AMT taxpayers would have grown by 16 times since 2003.

This growth is particularly troubling because of the emphasis it gives to how badly the designers of the AMT built it. Congress originally intended this tax to make certain that taxpayers who could afford clever lawyers and accountants would not escape taxation entirely through innovative uses of tax shelters, credits, exemptions, and deductions. By 2010, however, the AMT will reach down to taxpayers even in the lowest 20 percent of the income distribution.

Congress's well-intentioned changes to tax law are to blame for this expansion. When Congress turned the income tax into its principal tool for social and economic

engineering, it created a host of opportunities for taxpayers to reduce their tax liabilities by taking lawful advantage of exemptions, credits, deductions, and "shelters." However, when Congress began to reduce tax rates in the late 1990s, they also created circumstances where taxpayers would trigger an AMT liability by taking advantage of these tax preferences. Indeed, the 2001 tax cuts alone likely will account for doubling in the number of AMT taxpayers by 2010.

The personal AMT directly affects individuals who file their business taxes through the 1040 income tax form in a number of ways.

- First, AMT filers pay generally higher tax rates than regular tax filers: the AMT rates are 26 and 28 percent. Higher tax rates mean that one's own labor and capital costs are higher, thus either driving down overall operating margin or increasing prices.
- Second, the AMT tax brackets are not indexed for inflation, unlike the regular tax brackets. That means that AMT filers annually face an increase in their taxes just from the effects of inflation.
- Third, small businesses located in high-tax states are much more likely to incur AMT liabilities than those in low-tax states. According to Leonard Burman and David Weiner,[2] the state and local tax deduction permitted on the 1040 accounts for 51 percent of all AMT tax liabilities. Indeed, taxpayers in high-tax states are "five percentage points more likely to be on the AMT than those in low-tax states."[3]

Congress recently increased income levels below which taxpayers are not subject to the AMT. Currently those levels are $58,000 for married taxpayers and $40,250 for singles. That increase has produced some relief. However, the exemption levels are scheduled to fall in 2006 to $45,000 for couples and $33,750 for singles.

The Center for Data Analysis estimates that this single movement downward in exemption levels will have a significant effect on the number of small businesses subject to AMT taxation. Table 1 below shows the estimated number of small businesses who file their business taxes through the individual income tax system and who also have AMT liabilities.

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[2] Leonard E. Burman and David Weiner, "Suppose They Took the AM Out of the AMT?" (2004): www.taxpolicycenter.org

[3] Leonard E. Burman, Testimony before the President's Advisory Panel on Federal Tax Reform, March 3, 2005.

Table1
Number of Business Owners Affected by Individual AMT

2005	(Millions of Taxpayers)	Percent
AGI Under $100,000	0.1	5%
AGI Between $100,001 and $200,000	0.6	33%
AGI Over $200,001	1.2	62%
Total - 2005 - ALL	1.9	100%
2006		
AGI Under $100,000	1.7	27%
AGI Between $100,001 and $200,000	2.9	45%
AGI Over $200,001	1.8	29%
Total - 2006 - ALL	6.4	100%

Businesses defined as those taxpayers with schedule C, E or F income (positive or negative) with individual AMT liability.

If Congress does nothing to extend the current exemption levels between now and the end of the year, our analysis shows that small business AMT taxpayers will increase by over 3 times in number, from 1.9 million to 6.4 million.

Conclusion

It is hard enough running an independent, small business. Capital is hard to raise and retain, employees come and go, and the customers are continuously fickle and demanding. It is almost cruel to complicate the everyday difficulties of small business life with onerous taxes. Yet, Congress routinely does just that when it turns away from pleas to repeal death and AMT taxes.

If our country owes a large measure of its current prosperity to the virtuous, industrious, and innovative owners of small and medium businesses, it becomes Congress's duty to do whatever it can to create and advance economic liberty. The current Congress can make a significant step toward a better economic environment for businesses of every size by repealing federal death taxes and the AMT now and for good.