Comments from the Family Business Coalition on Comprehensive Tax Reform

April 15, 2013

The Family Business Coalition is a diverse collection of organizations and industry groups united for the common purpose of protecting America's family businesses across the country. Our members represent family businesses from many different industries including suppliers, wholesalers, manufacturers, car dealers, distributors, farmers, ranchers and many other industries with heavy family business ownership. The Family Business Coalition works to implement tax policies that promote private business expansion and job growth.

Family Businesses

Family businesses are owned and often run by one or more members of the same family. Family businesses vary in size and tax classification, but most of the 33.6 million business returns filed with the IRS, including sole proprietors (22.7 m.), S corporations (4.1 m.), partnerships (3.2 m. including 2.0 m. Limited Liability Corporations), and farms (1.9 m.), are classified as family businesses (IRS, 2009). Most family businesses file as "pass-through entities," meaning they flow through their business income, deductions, and credits onto their federal form 1040 income tax return.

Family businesses make up 90 percent of all businesses, contribute nearly $6 trillion to gross domestic product, and employ 62 percent of the US workforce (Astrachan, 2003). These statistics show that family businesses are truly the backbone of the American economy. The Family Business Coalition believes that tax reform should promote growth in the most productive, job-creating sector of the economy.

Family businesses can greatly benefit from a comprehensive tax reform package which:

1. Eliminates federal estate and gift taxes

2. Reduces marginal income tax rates

1. Eliminate federal estate and gift taxes

Family businesses, farms, and ranches are hit disproportionally hard by the federal estate tax. Family business owners tend to be “asset rich and cash poor” which often leaves them with large estate tax liabilities but no cash on hand to pay the tax.

In Northwest Iowa, for example, the average value of quality farmland is $11,404 per acre and the average farm size is 333 acres. Once crops, machinery and homestead are included, an individual farmer can easily reach an estate valued over $5.25 million, the current estate tax exemption, with virtually no cash left over to pay the tax (Iowa State University, 2012). Across the Corn Belt, cropland prices increased an average of 20 percent from 2011 to 2012, according to the USDA (USDA-NASS, 2012), but 92 percent of all farms see less than $250,000 in annual sales to keep their farms operating (USDA-ERS, 2008).

Like family farms, many family businesses must keep inventories valued in the millions to services customers. This inventory often accounts for a vast majority of the family’s assets. When the owner of the business dies, the family may be forced into selling equipment or liquidating the entire business in order to raise the cash for the estate tax. Selling the business to pay the estate tax bill could mean selling at a deep discount to find potential buyers.

Estate planning requires a large investment in time and money to mitigate the cost of the estate tax. A study by Alicia Munnell, former member of President Clinton's Council of Economic Advisors, found that the compliance costs for the estate tax are greater than $26 billion, nearly 50% higher than current annual estate tax revenues (Munnell, 1988). A large part of the compliance costs are the premiums paid for life insurance to pay the estate tax. The life insurance industry collects over $12 billion annually in premiums for life insurance (Forsythe, 2005), if the estate tax is repealed, much of that $12 billion can be refocused on investment in family businesses.

The Benefits of Full Repeal

Repeal of the estate tax would not only benefit individual business owners and their families, it would improve the economy and increase federal revenues. Dr. Douglas Holtz-Eakin, former director of the Congressional Budget Office, found that if the federal estate tax were repealed, instead of left at its current 40 percent rate, nearly one million jobs could be created (Holtz-Eakin, 2010).

The Joint Economic Committee found that the estate tax has lowered capital stock in the economy by $1.1 trillion since its inception (JEC, 2012). Capital stock is the fuel to new job growth in the economy. If the estate tax is repealed, more capital stock will become available to help entrepreneurs grow new businesses, increase wages, and hire more employees.

Economist Steven Entin found that repeal of the estate tax would increase the country's gross domestic product by 2.25 percent, increase labor income by 2.34 percent and capital stock by 6.1 percent (Entin, 2009). Entin found that this increase in gross domestic product resulting from estate tax repeal would actually increase federal revenues by $89 billion.

2. Reduce marginal income tax rates

Most family businesses file through the individual income tax code; in 2009 33.6 million businesses filed taxes on personal income tax returns (IRS, 2009). These pass through entities pay approximately 44 percent of all business income taxes, while only accounting for 35 percent of business receipts (Carroll and Prante, 2011).

Lowering the marginal tax rates for individuals and businesses will lead to an increase in employment. A recent study by Ernst & Young found that an entrepreneur's increase in after tax funds of 10 percent would increase the likelihood of hiring by 12 percent and increase the average wage by 3.7 percent (Carroll and Prante, 2012). Additionally, business receipts from an increase in after tax funds would increase business receipts by 8.4 percent, further helping to increase consumption. An increase in wages and workers will better stimulate the economy than any increase in government spending.

We strongly recommend that you reform the tax code to help family businesses create more jobs and pass unharmed to the next generation of business owners. We look forward to working with you to create a pro-growth tax code which protects family businesses.

Sources

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