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Chairman, Family Business Coalition

Chair Shaheen, Ranking Member Ernst, and Members of the U.S. Committee on Small Business & Entrepreneurship: thank you for the opportunity to address the important topic of small business succession here today. I currently serve as Chairman of the Family Business Coalition (FBC). Our mission is to protect family owned and operated businesses across the country. Today I will discuss the importance of family businesses to local communities, outline current policy proposals that affect the ability of family businesses to pass to the next generation of ownership, and conclude by recommending Congress adopt policy changes that make family business succession easier. The views in my testimony here do not necessarily reflect the position of our Family Business Coalition member associations.

Family Businesses Create Jobs and Support Communities

Family businesses are the lifeblood of the American economy, providing good paying jobs and enriching the lives of those in their communities. When a family business closes its doors, it is not only their employees who suffer; it is the little league baseball team that the local family business sponsors, it is the new wing of the children's hospital being built with the support of local businesses that now has to be put on hold, it is the soul of main street that withers away when family businesses are sold off to multinational corporations or forced to close their doors for good.

The family businesses that we work with consider their employees to be family themselves. When times get tough, both owners and employees tighten their belts to keep the business running. When times are prosperous, the employees of family businesses are the first to benefit. At FBC, we have worked with family businesses of all shapes and sizes including pass-throughs like s-corporations, privately held c-corporations, and companies that are organized as ESOPs. As has been widely reported, the pandemic accelerated a discouraging trend of increased small business closures and consolidation. The time is now for Congress to make meaningful policy changes to prevent the closure and transfer of control of America's family-owned businesses into the c-suites of multinational corporations.

Family businesses and farms face a number of challenges when operating their businesses and planning for the next generation including dealing with federal, state, and local taxes. Compliance with taxes and regulations requires diverted time away from managing the day-to-day operations of a business. Most family business owners specialize in running their businesses, not in legal paperwork. For many of these family businesses, succession planning requires hiring expensive accountants, lawyers, and estate planning attorneys. Even business owners that plan effectively must remain on their toes because of constantly changing tax laws and regulations. All this diverted time, money, and energy could be better directed towards growing their family businesses, upgrading equipment, hiring more workers, and supporting their communities.

Figure 1 in my testimony, which lists common estate planning techniques and their associated fees, illustrates just how expensive this succession planning can be. As an example, consider that according to Figure 1, fees can range between $5,000-$15,000 to set up a simple trust. More sophisticated estate planning for larger family businesses can cost hundreds of thousands of dollars. It is easy to see how family farms or local mom and pop shops can be quickly overwhelmed by both the cost and time required to plan for the next generation. Publicly traded corporations, on the other hand, have constant access to outside experts, auditors, and dedicated accounting firms to assist with every aspect of their compliance. In addition, among other advantages, these mega corporations also enjoy much easier access to large pools of capital to finance their operations.

As it stands now, to pass on a family business or farm under current tax laws is an uphill battle and serious reforms are needed to make this transition less painful. Members of this committee on both sides of the isle deserve credit for having authored and supported legislation which could help make passing on a business easier. These proposals include making the estate tax less burdensome for family businesses and farms, and making the transition to become an ESOP easier. FBC supports these efforts while we oppose misguided proposals that would make transitioning to the next generation more difficult for family businesses like repealing step-up in basis and imposing a new tax on unrealized capital gains.

Addressing ESOP Transition Challenges

For most family businesses and farms, converting to an ESOP, unfortunately, simply is not within the realm of possibility. For many larger businesses that have the resources to undergo the transition, the Employee Stock Ownership Program model (ESOP), can be an attractive option for both owners and employees. The transition to becoming an ESOP, however, can be complex and costly. The larger companies we have worked with that made the full transition from pass-through businesses to ESOPs are generally pleased with the end result but the process to covert can be arduous. One larger business that we work with ran into a number of complications and costs along the way, including undergoing a feasibility study, agreeing on a valuation with the trustee, and setting up processes to comply with the Department of Labor. The entire process took over 18 months. It took nearly two full days just to complete the mountains of paperwork at closing. The last column and row of Figure 1 shows that the cost to transition to an ESOP can range between $50,000-$100,000 for a medium sized business.

While ESOP businesses deserve further attention, FBC is principally focused on the fact that most family businesses are currently organized as pass-through businesses. The main concerns we hear from the perspective of pass-through businesses include the lack of predictability in tax law, the steep compliance costs associated with succession planning, and the costs of taxes and regulations that must be accounted for when building a family business.

Tax Permanence and Small Business Succession

The 2017 Tax Cuts and Jobs Act (TCJA) made important improvements to the tax code for small businesses, including lowering marginal tax rates that small businesses pay across the board, creating a new tax deduction for qualifying small business income, and doubling the unified estate, gift, and GST exemptions. The Family Business Coalition supports making these changes permanent to provide predictability for family-owned businesses that have been forced to grapple with an ever-changing tax code over the past 25 years. Constant changes in the tax code affect planning and compliance for family business owners whose most valuable resource is their time. Being buried in paperwork prevents them from doing what they do best: creating jobs and serving the communities they are a part of.

Congress is quickly approaching another moment of crisis as most individual side tax relief will expire at the end of 2025. Expiring tax relief affects the standard deduction, all marginal tax rates, the Section 199A small business tax deduction, the child tax credit, the estate, gift, and generation skipping trust exemptions, and more. Another last-minute game of chicken between the parties approaching this deadline is the last thing that small businesses need.

Transfer Taxes Complicate Family Business Succession

When planning to pass their businesses to the next generation, family business owners and farmers must consider death taxes on both the national and state level. The federal estate tax, commonly referred to as the “death tax”, presents a potential succession challenge for family businesses, especially for “inventory or land rich but cash poor” businesses that tend to operate on low margins like family farms. When a family does not have the cash on hand to pay the estate tax, they may be forced to fire workers, sell off parts of the business, or in the worst cases close the doors of their family business permanently.

Larger family businesses that compete with publicly traded corporations may be forced to pay a 40% death tax at the turn of each generation, but publicly traded corporations effectively self-perpetuate without the added costs of estate taxes or succession planning. This incongruence in the tax law allows mega-corporations to swoop in upon the death of a family businesses owner or farmer and buy up these businesses at fire-sale prices. This trend must be reversed if we hope to prevent Main Street from being bought by Wall Street.

As family business owners and farmers planning for succession will tell you, annual expenses related to estate planning and compliance must be accounted for in addition to taxes imposed at death. According to the non-partisan Tax Foundation, compliance costs related to estate and gift taxes totaled $18.9 billion in 2023. In 2021, the last year that IRS Statistics of Income (SOI) data is available, collections from estate taxes totaled only $18.4 billion, less than one half of one percent of federal revenue. These numbers show that the estate tax costs more to comply with than the government collects annually in estate tax revenue. Economists from both sides of the isle have written about the inefficiency of raising revenue through taxes at death.

Complicating the compliance picture for family businesses even more, there are currently 12 states that impose their own estate taxes and 6 states that impose inheritance taxes. Maryland is the only state to impose both. These transfer taxes range in scope and severity with some states like Washington state levying a 20% additional state estate tax. Iowa recently joined the majority of states who no longer levy additional death taxes, with their state estate tax on a phasing out by 2025. Regarding state transfer taxes, the Tax Foundation concludes: “Estate and inheritance taxes are burdensome. They disincentivize investment and can drive high-net-worth individuals out of state. The handful of states that still impose them should consider gradually eliminating them or at least conforming to federal exemption levels.” Figure 2, using data from the Tax Foundation and state statues lists the states that currently impose additional death taxes. These multiple layers of transfer taxes complicate the succession picture even more for family businesses. Figure 3 shows federal estate tax returns by state over a twenty-year period from 1995-2015. In Iowa, as an example, nearly $2.4 billion was taken from taxpayers in federal estate taxes over that period.

Given the massive compliance costs associated with estate and gift taxes, the estate tax’s negative impact on job growth and the economy, and the tiny amount of revenue that the tax collects, the Family Business Coalition stands in strong support of Senator Thune and Senator Ernst’s efforts to eliminate the tax. Our Family Business Coalition’s letter of support for the Death Tax Repeal Act included over 155 signatories from industries across the economy including groups like the Associated Builders and Contractors, Wine and Spirits Wholesalers, National Association of Electrical Distributors, and more. Representatives Randy Feenstra (IA-4) and Sanford Bishop (GA-2) recently introduced a bipartisan House companion bill along with 162 original cosponsors. Ranking Member Ernst deserves credit for continuing to build consensus on this important issue and move legislation forward in the Senate.

Proposals Making Succession More Difficult

FBC has opposed a number of tax proposals that would make succession more difficult for family businesses, including eliminating step-up in basis and creating a new tax on unrealized capital gains.

Eliminating step-up in basis would force the current generation to pay capital gains taxes on the entire appreciation of a family business, even if that appreciation occurred during the lifetime of the previous owner. Multigenerational farms, ranches, and small businesses that started with little to no basis and have grown through generations of hard work and sweat equity have the most to lose from this proposed change. A 2020 study by Texas A&M University showed that 98% of family farms would see a new tax liability of nearly $730,000 if the step-up in basis rules were to be eliminated.

Imposing a new tax on unrealized gains, annually or at death would compound the difficulty of passing on a family business or farm to the next generation. Taxing unrealized or phantom gains creates a similar problem that the estate tax does for family businesses. Families who lack the cash on hand to pay an annual tax assessed on the value of their estate may be forced to liquidate parts of their family business to come up with the cash to pay the tax. Tracking and appraising assets annually would create an administrative nightmare for family businesses and federal agencies alike.

Changing the rules for how family businesses calculate their value for tax purposes and retroactively changing the rules for trusts has the potential to make void thousands of businesses long-standing succession plans. Retroactive changes along these lines would pull the rug out from under thousands of businesses, forcing them to undergo the expensive process of estate planning all over again. Eliminating step-up in basis, imposing new taxes on unrealized capital gains, and removing the tools family businesses use the plan for succession will only further tilt the table in favor of large multinational corporations and lead to further consolidation.

Conclusion

If Congress hopes to improve the chances for family business succession and resist consolidation of power into the c-suites of large multinational corporations, a comprehensive approach to the problem must be undertaken. This approach should include better education on the need for estate planning and meaningful, permanent tax relief for small businesses. FBC looks forward to continuing to work with both parties in Congress and our 157 partner associations to help America’s family businesses and farms pass to the generation of ownership. Thank you for calling this important hearing and I look forward to the discussion here today.

Figure 1: Frequently Used Estate Planning Techniques for Family Businesses and Associated Fees

Estate Planning Technique	Description	Range of Fees
Basic estate planning documents	Wills, powers of attorney, and living trusts	$5,000-$50,000
Basic trusts	Basic trusts established to transfer assets to children and spouses	$5,000-$15,000
Retirement-benefit planning	Estate planning related to tax-deferred retirement plans, such as 401(k) accounts	$5,000-$50,000
Irrevocable life insurance trusts	Creation of ILITs to separate life insurance policies from taxable estates	$10,000-$25,000
Limited Liability companies (LLCs) and Limited Partnerships	Established to transfer ownership interests in a family business to subsequent generations while reducing the estate's interest in the business	$25,000-$250,000
Planning for the disposition of a closely held business	Advanced planning techniques, such as stock redemption plans and Employee Stock Ownership Plans used to transfer a business to family members or employees	$50,000-$1,000,000
Charitable trusts	Estate planning related to the deduction for gifts to charity, providing income to heirs for a limited time	$25,000-$100,000
Source: Planning techniques and cost estimates prepared by Michelle Gallagher CPA/ABV/CFF of the firm Gallagher, Flintoff & Klein, PLC, Lansing, MI, for the Family Business Coalition, January 2024		

Figure 2

2023 State Estate Taxes and State Inheritance Taxes

State	Estate Tax Exemption	Estate Tax Rates	Inheritance tax Rates
Connecticut	$12,920,000	12%	
Hawaii	$5,490,000	10.0% - 20.0%	
Illinois	$4,000,000	0.8% - 16.0%	
Iowa			0-6%
Kentucky			0-16%
Maine	$6,410,000	8.0% - 12.0%	
Maryland	$5,000,000	0.8% - 16.0%	0-10%
Massachusetts	$2,000,000	0.8% - 16.0%	
Minnesota	$3,000,000	13.0% - 16.0%	
Nebraska			0-15%
New Jersey			0-16%
New York	$6,580,000	3.06% - 16.0%	
Oregon	$1,000,000	10.0%-16.0%	
Pennsylvania			0-15%
Rhode Island	$1,733,264	0.8% - 16.0%	
Vermont	$5,000,000	16%	
Washington	$2,193,000	10.0% - 20.0%	
District of Columbia	$4,528,800	11.2% - 16.0%	

Source: Tax Foundation, State statues

Figure 3

Total estate taxes paid 1995-2015 by state							
State of residence	Total number of filers	Total filers paying the estate tax	Total paid in estate taxes (thousands)	State of residence	Total number of filers	Total filers paying the estate tax	Total paid in estate taxes (thousands)
Total	1,162,676	541,903	$383,106,423	Missouri	21,858	10,882	$7,000,785
Alabama	11,565	5,291	$3,656,219	Montana	4,299	1,970	$705,992
Alaska	1,227	326	$148,470	Nebraska	8,880	3,994	$2,045,313
Arizona	18,315	7,794	$5,820,142	Nevada	6,616	3,067	$4,041,732
Arkansas	7,196	3,178	$2,547,114	New Hampshire	5,193	2,301	$1,795,378
California	192,164	90,503	$70,238,719	New Jersey	45,219	21,536	$11,694,879
Colorado	15,154	6,758	$4,239,786	New Mexico	5,151	2,203	$1,320,825
Connecticut	22,494	10,013	$8,162,107	New York	88,185	42,235	$37,287,465
Delaware	3,752	2,007	$1,533,058	North Carolina	26,718	11,705	$6,734,453
D.C.	4,036	2,244	$2,386,728	North Dakota	2,881	952	$261,957
Florida	106,590	51,010	$46,869,770	Ohio	40,261	18,836	$11,831,274
Georgia	22,172	9,340	$7,250,128	Oklahoma	10,985	5,843	$3,052,398
Hawaii	5,368	2,444	$1,505,781	Oregon	13,294	5,536	$2,887,931
Idaho	3,283	1,526	$842,675	Pennsylvania	45,742	22,102	$13,644,112
Illinois	57,989	28,696	$16,810,344	Rhode Island	4,430	2,013	$1,151,051
Indiana	19,670	9,069	$4,431,758	South Carolina	13,905	5,309	$3,221,067
Iowa	16,721	6,693	$2,458,030	South Dakota	3,269	1,380	$644,666
Kansas	11,433	4,922	$2,635,664	Tennessee	16,251	7,046	$4,192,674
Kentucky	10,272	4,903	$3,198,758	Texas	58,499	27,053	$21,340,498
Louisiana	10,195	4,966	$3,488,921	Utah	4,417	1,687	$1,381,559
Maine	4,939	2,581	$1,556,747	Vermont	2,626	1,339	$828,739
Maryland	22,921	10,848	$6,613,373	Virginia	29,166	14,394	$8,868,751
Massachusetts	33,232	15,461	$9,155,030	Washington	24,128	10,975	$5,994,360
Michigan	30,258	13,957	$9,193,261	West Virginia	4,355	2,154	$958,547
Minnesota	17,056	7,088	$4,183,103	Wisconsin	17,141	8,077	$4,957,970
Mississippi	5,827	2,642	$1,505,933	Wyoming	2,194	879	$1,062,722

Source: SOI Tax Stats - Estate Tax Statistics Filing Year by State (Table 2)