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IMPACT OF FEDERAL ESTATE AND GIFT TAXES ON SMALL BUSINESSMEN AND FARMERS

JOINT HEARING

BEFORE THE

SELECT COMMITTEE ON SMALL BUSINESS

AND THE

JOINT ECONOMIC COMMITTEE

UNITED STATES SENATE

NINETY-FOURTH CONGRESS

FIRST SESSION

ON

THE IMPACT OF FEDERAL ESTATE AND GIFT TAXES ON SMALL BUSINESSMEN AND FARMERS

MINNEAPOLIS, MINN.—AUGUST 26, 1975

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IMPACT OF FEDERAL ESTATE AND GIFT TAXES ON SMALL BUSINESSMEN AND FARMERS

TUESDAY, AUGUST 26, 1975

U.S. SENATE,
SELECT COMMITTEE ON SMALL BUSINESS
AND THE JOINT ECONOMIC COMMITTEE,
Minneapolis, Minn.

The committees met, pursuant to notice, at 9 a.m., at the Government Center, Minneapolis, Minn., Senators Walter F. Mondale (acting chairman of the Select Committee on Small Business), and Hubert H. Humphrey (chairman of the Joint Economic Committee).

Present: Senators Mondale and Humphrey.

Also present: Herbert L. Spira, tax counsel, Select Committee on Small Business; Larry Yuspeh, economist, Joint Economic Committee; and James Verdier, legislative assistant, Office of Senator Mondale.

STATEMENT OF HON. WALTER F. MONDALE, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator MONDALE (presiding). The committee will come to order. My colleague, Senator Humphrey, will be with us shortly.

This begins a series of hearings to be conducted by the Senate Select Committee on Small Business, of which I'm a member. And in this case jointly with the Joint Economic Committee chaired by my colleague, Senator Humphrey.

We are very pleased to be here this morning in these modest circumstances, I hope you'll bear with us. We're honored to have Mr. John Derus, and I think chairman of the county board, Mr. Tom Teisen with us, and we're glad to hear from you this morning.

Very pleased to have you, sir.

Mr. TEISEN. Thank you, sir. We're delighted to have you here. You draw a better crowd, Senator, than we ordinarily do, but we hope the surroundings are compatible with your needs, and thank you again.

Senator MONDALE. Thank you again, Mr. Commissioner and Commissioner Derus, and we're very pleased to be afforded these quarters.

Our hearings this morning will look at some of the problems small businessmen and farmers have with the Federal estate and gift tax laws, and at some possible legislative solutions to those problems.

The Federal estate and gift tax laws have remained essentially unchanged for more than 30 years, yet during that time there have been fundamental changes throughout our economy.

The $5 billion in revenue raised each year through Federal estate and gift taxes represents less than 2 percent of total Federal revenues. Yet the impact of these taxes has been growing.

In 1961, estate taxes had to be paid in less than 3 percent of adult deaths. By 1972, that number had risen to over 6.5 percent.

Much of this is due to the steady increase in the dollar value of estates. The average value of farm assets, for example, has increased from around $50,000 in 1960 to $170,000 in 1974. With the estate tax exemption remaining $60,000, this increase in farm asset values has subjected more and more farms to estate taxes, even though much of that increase is merely a paper increase—it's not an increase in real value.

Too often, it becomes necessary to sell off part or all of a family farm or business in order to pay the estate taxes.

This hurts everyone. It hurts the family that loses its farm or business. It hurts the community that loses the support and concern that local ownership brings. And it hurts our national economy, as concentration increasingly pushes out competition.

There was recently a study by an economist in Wisconsin of the small businesses in local communities which had sold ownership to absentee, out of town owners, which disclosed that the second principal reason given for the sale was estate taxes and also concluded that the effect on the community had been very adverse. Employment in these businesses had dropped, the use of local services, lawyers, banking services, and other community services upon which the community depends was reduced and the net effect of absentee ownership of locally owned small business had been deleterius in almost every case.

And, so, for all of these reasons it seems to me this is a matter crying out for serious study.

The healthy competition our economy needs to continue strong, noninflationary growth is undermined when family farms are taken over by huge corporate farming operations, and when independent and innovative small businesses are taken over by large outside corporations.

Our estate and gift tax laws are intended in part to prevent excessive concentrations of wealth. Yet in their application to small businesses and family farms, they may inadvertently be encouraging it.

It is long past time to take a fresh look at our Federal estate and gift tax laws. The House Ways and Means Committee plans to start work on legislation to reform these laws later this year, and the Senate Finance Committee—on which I serve—will take up this legislation after the House has acted.

Some of the witnesses today are farmers and small businessmen who have had to face these problems in very practical ways. Others are professionals who have handled estates for small businessmen and farmers for many years and have had extensive experience with the types of problems that arise and the possible solutions.

Another witness has taught and written about State and Federal gift taxes, from our own Minnesota Law School, and we're pleased they have been able to join us today and we look forward to hearing them today.

[The prepared statement of Senator Nelson follows:]

Statement of Hon. Gaylord Nelson, a U.S. Senator From the State of Wisconsin

We are pleased that the Senate Small Business Committee is able to convene this hearing in Minnesota to hear the views of smaller businessmen, farmers, and others concerned with the private enterprise system in a location close to their homes.

Senator Walter Mondale of the Committee has been designated Acting Chairman for this hearing. It is also most gratifying to be joined in this session by the Joint Economic Committee of Congress, under the chairmanship of the junior Senator from Minnesota, who has long been an acknowledged leader in the cause of economic justice for independent business.

Since six Small Business Committee members also serve on the Senate Finance Committee (the tax-writing body in the Senate), it has found itself in a fortunate position to tackle small business problems in the tax field.

In February of this year, our Committee held three days of hearings on the emergency tax reduction proposals. We were successful in gaining acceptance of rate reductions totaling $7,000 for the corporation earning $50,000, and a further benefit of $5,000 for any business purchasing used machinery of $100,000 in value. On July 21, together with both Minnesota Senators and 10 others in the Senate, I introduced a bill (S. 2149) to extend these small business provisions indefinitely.

In June, our Committee conducted three days of public hearings to launch an indepth study of the business tax structure so that sound small business recommendations could be developed for inclusion in whatever tax reform legislation is developed in Congress in 1975 and 1976. Also a part of this study is the Subcommittee on Financial Markets of the Senate Finance Committee, under the chairmanship of Senator Bentsen of Texas. As a result, there are now nine Senators who are members of the Finance Committee engaged in this project, which is a hopeful sign.

The Small Business Committee is also investigating the ability of the family farm to survive. Hearings were also held on this subject this summer.

Today's hearings are in furtherance of these important inquiries, and also in accordance with the Committee's policy of holding field hearings throughout the country to hear directly from those most knowledgeable and concerned about small business and its economic environment.

The present structure of estate and gifts taxes has been in effect since 1942, and it has remained unrevised and largely unexamined by Congress for over 30 years. Rapid inflation is making the fixed dollar limitations, such as the $60,000 federal estate tax exemption, increasingly restrictive. For example, according to Agriculture Department figures from 1972: 1 million U.S. farms have assets of over $200,000, 600,000 U.S. farms have assets of over $250,000, and 240,000 U.S. Farms have assets of over $350,000.

We in Congress need to learn the extent to which these and other tax provisions discourage the continuation of farm and other family businesses.

The testimony we receive at this hearing will thus be a valuable contribution to responsible recommendations in behalf of small businessmen and farmers in the estate and gift tax area which we in Congress who are interested in independent business hope to propose and advance toward enactment into law.

Senator Mondale. We will hear from our witnesses in two panels. The first panel will be a farmers and businessmen panel, Mr. Lewis Woehler; Gerhard Ross, a farmer from Fisher; Mr. Woehler is a farmer from Sibley County; Mr. Tim Velde, a farmer from Granite Falls, Minn.; and accompanying them is Mr. Cy Carpenter, president of the Minnesota Farmers Union.

Lloyd Cherne of Cherne Industries of Edina, Minn., and Mr. Jared How, publisher of the Mankato Free Press of Mankato.

I think we will hear from the witnesses in that order.

Mr. Woehler?

STATEMENT OF LOUIS WOEHLER, FARM OWNER AND OPERATOR, SIBLEY COUNTY, MINN.

Mr. WOEHLER. I, Louis Woehler, farm in Sibley County, Minn., south of Arlington, own and rent, operating 650 acres of land. My family includes my wife, one son, and three daughters.

I am very concerned about the proposed new legislation on estate taxes because of the rapid rise of farm value and prices.

The farming outlook has changed so completely in the last 4 years that everything agriculturally has at least doubled and the land value has tripled in many instances (appendixes A, B, and C). In 1942 when the present law was passed, a small farm in our county was 80 acres, a medium farm was 160 acres and 320 acres was considered a large farm. At the present time 169 acres is small, 320 acres is medium and some of the larger farms are 1,000 acres or more. From 1942 to 1957, my father was able to start each of three sons farming on 200 acres along with machinery and livestock and with very little gift tax paid.

Four years ago I set up a simple will which just stated the way in which I would like to have things done in the event of my death, but made no real provision for them to be carried out. One of my main problems was not taking the estate tax laws into consideration. In time, this bothered me and when it became apparent that my son wanted to come back into farming after college, I knew more had to be done. I was put in contact with a man that specialized in estate planning and worked with him in getting my total estate plan completed. About 9 months and approximately $150,000 worth of insurance later we came up with an estate plan we feel will do all the things we want. My main objective is to be able to keep the family farm in operation without having to sell anything at a loss to pay the cost of dying. We did have an advantage over most father-son partnerships in that my son is a stepson and had a considerable amount left him by his father's estate.

I do have accompanying material that shows the estimated capital needed to operate a small and medium farm in Sibley County in 1975 plus the estimated minimum personal capital needed to start farming (appendixes A and B). This information was documented by Mr. Ron Molstad, PCA manager in Gaylord, Minn., and Mr. Britt Nelson, president of Citizens State Bank of Gaylord, Minn. Both stated that no way would anyone ever again be able to start farming in Sibley County without considerable help from a benevolent source.

There is also a table showing the impact of inflation on a farm estate (appendix C). Land value in Sibley County in 1942 was $100 an acre and presently in 1975 it is $1,000 an acre. This gives us an inflation rate of 7.23 percent per year (appendix E). This figure projected against the estimated cost of a 160-acre farm, plus equipment and livestock, which has been estimated at $260,000, gives us a total of over $4,000,000 by the year 2015 (appendix D).

It is for these reasons I feel that the $60,000 estate tax exemption should be raised to at least $300,000. If one takes the $60,000 exemption which was established in 1942 and projects it by the inflation rate of the land value of 7.23 percent, one comes up with a figure of well over $600,000 in 1975 (appendix F). It is also my thinking that the personal exemption should be put on a sliding scale to keep up with the inflation. I do not believe that spreading the estate taxes over 10 years would be of much help. In many cases it could work against the farmer because he would feel he had only the taxes to work for and might give up after a few years. Reducing or postponing estate taxes, at a low interest rate, might help keep the family farm in operation.

At the present time there is no difference in Sibley County between the land used for farming and that used for commercial purposes. This would have no effect on my own operation but I can readily see this to be a factor in some areas.

The proposed capital gain after death would all but extinguish the family farm. I have taken a few of my neighbors' farms that have been owned for 20 or more years and can come up with no more than a $200–$300 cost basis per acre. This results in a capital gain of $700–$800 per acre. Thus, on a 320-acre farm we would come up with an approximate addition of $64,000. This would result in land being sold to settle an estate (appendixes G and H). It would open the door for corporate farming, resulting in loss of production and jobs.

If it is the intent of the Government to remove the means of production from the people, then without changes in the tax laws, that is exacly what will happen.

I wish to thank the committee for this opportunity to testify at this hearing and hope that the statement I have given and other factual material submitted has been of a helpful nature.

[The attachments to the prepared statement of Mr. Woehler follow:]

Appendixes A - H

Prepared By

John B. Kelly, Business and Estate Analyst

Used As Reference for a Statement By

Louis Woehler, Farm Owner and Operator

Before The

SENATE COMMITTEE ON SMALL BUSINESS

and the

JOINT ECONOMIC COMMITTEE

Minneapolis, Minnesota

August 26, 1975

Appendix A

Capital Needed to Operate a Small and Medium Size Farm - 1975, Sibley County, MN.

I. Small: (160 acres)

A.	160 acres @ $1,000/acre	$ 160,000
B.	Machinery	50,000
C.	Breeding Stock	5,000
D.	Equipment - for livestock	5,000
E.	Additional buildings for livestock	15,000
F.	Feed credit 1st year	10,000
G.	Investment in crop	15,000
		$ 260,000 *

II. Meidum Farm (320 acres)

A.	320 acres @ $1,000/acre	$ 320,000
B.	Machinery	75,000
C.	Breeding Stock	7,500
D.	Equipment - for livestock	7,500
E.	Additional Buildings for livestock	22,500
F.	Feed credit for 1st year	15,000
G.	Investment in crop	30,000
		$ 477,000 *

*Above estimates varified with Mr. Ronald Malstad, Manager - Production Credit Association, Gaylord, MN; and Mr. Britt Nelson, President - Citizens State Bank, Gaylord, MN

Appendix B

Estimate of Minimum Personal Captial Needed to Start a Small (160 acre) Farm 1975

I. Small Farm (160 acres) - Least amount of personal capital possible.

A.	Land (160 acres) minimum down through a private party	$ 15,000*
B.	Machinery Financed through implement dealer	25,000
C.	Breeding Stock - PCA balance	2,500
D.	Equipment for livestock - PCA balance	2,500
E.	Additional building - balance PCA	7,500
F.	Feed credit - balance PCA	5,000
G.	Investment in crop - balance PCA	7,500
		$ 65,000

* $15, 000 Down would not qualifty for a Federal Land Bank Mortgage; therefore, the above estimate is very conservative. Without a private contract for deed, the above estimate would have to be raised by at least $25, 000, bringing the total personal capital needed to over $90, 000.

Appendix C

Estate and Inheritance Tax Estimates - Small Farm (160 acres)
Absolute Minimum Taxes Possible

		1971	1975	% Inflation/ Year
1.	Estate	$130,000	$260,000	18.92%
2.	Estimate - Funeral Administration and Probate costs	- 10,626	- 17,750	
3.	Adjusted Gross Estate	119,374	242,250	
4.	Personal Exemption	- 60,000	- 60,000	
5.	Net Taxable Estate	59,374	182,250	
6.	Net Federal Estate Taxes	9,189	43,161	47.22%
7.	Inheritance before State Taxes	110,185	199,089	
8.	MN. Taxable Inheritance (1 adult heir)	104,185	193,089	
9.	MN. State Inheritance Taxes	5,093	11,316	22.09%
10.	Net Inheritance (1 adult heir)	105,092	187,773	
11.	Total Cost of Dying	24,908	72,227	30.49%
12.	% of Estate Destroyed	19.16%	27.78%	

Assumptions:

A. No marital deduction - because we're concerned with wealth passing from one generation to another - we assume that the last to die had title to the entire estate.

B. Farm completely paid for by the effort of last generation.

C. Does not consider taxes paid on 1st to die or that to raise the capitol to settle the estate may require selling the farm at some loss of value.

Appendix D

Effect of Non-Inflating Personal Exemption and Inflating Tax Tables on Future Estate Taxes on A Small 160 Acre Farm*

		1975	1995	2015
1.	Estate (7.23% inflation rate)	$260,000	1,050,266	4,242,537
2.	Estimate - Funeral, Administration and Probate Costs	- 17,750	- 58,376	- 190,978
3.	Adjusted Gross Estate	242,250	991,890	4,051,559
4.	Personal Exemption	- 60,000	- 60,000	- 60,000
5.	Net Taxable Estate	182,250	931,890	3,991,559
6.	Net Federal Estate Taxes	43,161	267,753	1,547,458
7.	Inheritance Before State Taxes	199,089	724,137	2,504,101
8.	MN. Taxable Inheritance (1 adult heir)	193,089	718,137	2,498,101
9.	MN. State Inheritance Taxes	11,316	56,552	231,790
10.	Net Inheritance	187,773	667,585	2,272,311
11.	Total Cost of Dying	72,227	382,681	1,970,226
12.	% of Estate Destroyed	27.78%	36.44%	46.44%

Assumption:

A. No marital deduction - because we're concerned with wealth passing from one generation to another - we assume that the last to die had title to the entire estate.

B. Farm completely paid for by the effort of last generation.

C. Does not consider taxes paid on 1st to die or that to raise the capital to settle the estate may require selling the farm at some loss of value.

Appendix E

Measurement of Inflation Over 33 Years And An Estimate of the Personal Estate Tax Exemption Necessary to Have Kept Pace with Inflation

I. Land Inflation

   A. Cost of 1 acre in 1942 - $100
   B. Cost of 1 acre in 1975 - $1,000*
   C. Compound Inflation Rate/Year over 33 years - 7.23%

II. Consumer Price Index Inflation

   A. 1940 Consumer Price Index - 2.381
   B. May 1975 Consumer Price Index - .628
   C. Compound Inflation Rate/Year over 35 years - 5.19%

III. Personal Estate Tax Inflation

   A. Personal Estate Tax Exemption 1942 - $60,000
   B. Personal Estate Tax Exemption 1975 - $60,000
   C. Compound Inflation Rate/Year over 33 years - 0%

IV. Estate Tax exemption necessary to have kept pace with inflation over the last 33 years.

   A. If 7.23% is used - $600,000
   B. If 5.19% is used - $318,000

* Land is actually selling, as farm land, for slightly more but this is a conservative estimate of average value in Sibley County.

Appendix F

Effect of 9% Interest on Deferred Payment of Estate Taxes.

At 4% Interest:

$1,000 of Taxes = 10 installments of $123.29
= $1,232.90 with interest

AT 9% Interest:

$1,000 of Taxes = 10 installments of $155.82
= $1,558.20 with interest

Appendix G

Effect of Non-Inflating Personal Exemption and Inflating Tax Tables on Future Estate Taxes on a Medium Size Farm (320 acres)

		1975	2015
1.	Estate	$477,500	7,791,581
2.	Estimate - Funeral, Administrative and Probate Costs	- 26,850	297,449
3.	Adjusted Gross Estate	450,650	7,494,132
4.	Personal Exemption	- 60,000	- 60,000
5.	Net Taxable Estate	390,650	7,434,132
6.	Federal Estate Tax	102,287	3,450,714
7.	Inheritance before State Taxes	348,363	4,043,418
8.	MN. Table Inheritance (1 adult heir)	342,363	4,037,418
9.	MN. Inheritance Tax	23,249	385,722
10.	Net Inheritance	325,114	3,657,696
11.	Total Cost of Dying	152,386	4,133,885
12.	% of Estate Destroyed	31.91%	53.06%

Assumptions:

A. No marital deduction - because we're concerned with wealth passing from one generation to another - we assume that the last to die had title to the entire estate.

B. Farm completely paid for by the effort of last generation.

C. Does not consider taxes paid on 1st to die or that to raise the capitol to settle the estate may require selling the farm at some loss of value.

Appendix H

Additional Effect of Capital Gains on a Medium Size Farm - Now and 40 Years From Now - on a Medium Size Farm (320 acres)

		1975	2015
1.	Estate	$477,500	7,791,581
2.	Present Cost of Dying	152,386	4,133,885
3.	Capital Gains Tax (on just the land - $200 basis 1975, $1,000 value 0 $1,000 basis 2015, $16,317 value)	64,000	1,225,396
4.	New Cost of Dying	216,386	5,359,281
5.	New % of Estate Destroyed by adding capital gains tax to an estate.*	45.31%	68.78%

* By requiring greater than 33% of an estate be paid at death, bank financing has been absolutely precluded. By requiring greater than 50% of an estate be paid at death, Production Credit Association financing has been absolutely precluded. In other words, <u>NO</u> medium size farm operation will survive by the year 2015.

Senator MONDALE. Thank you, Mr. Woehler, and we will place in the record this very useful statement which you have attached to your statement. It's very, very helpful.

Since our hearings began, my colleague, Senator Humphrey has arrived. I notice he doesn't have his engineer's clothes on today. After stealing all those pictures from me yesterday.

STATEMENT OF HON. HUBERT H. HUMPHREY, A U.S. SENATOR FROM THE STATE OF MINNESOTA

Senator HUMPHREY. Well, I had my bib overalls on yesterday.

I have a short statement, Senator Mondale, which I will not burden the witnesses with reading. It relates to some of the questions which were raised by Mr. Woehler and also some of the items which you outlined in your opening statement.

I also want to make available for the record, for whatever purpose it may serve, an analysis of estate and gift tax laws, particularly as they relate to the problems of the small businessman and the farmer. This analysis has been prepared for me by Mr. Larry Yuspeh of the staff of the Joint Economic Committee who is with me today.

Senator MONDALE. Let's place that in the record.

Senator HUMPHREY. So I'll place that along with materials I have here.

[The information referred to follows:]

STATEMENT OF HON. HUBERT H. HUMPHREY, A U.S. SENATOR FROM THE STATE OF MINNESOTA

In the past two years, a combination of severe recession and inflation has retarded economic growth and dulled business performance. Small business has had an especially hard time operating within an economy that threatens even its large competitors.

Farms have fared little better. Farm incomes have been high, but so have costs. And the outlook is for costs to grow faster than income.

The Administration tells us that the worst of the recession is over though. Our economy has started its comeback. But just as we hear some good economic news, bad economic news follows.

Yes, our economy may have bottomed out a few months ago, but unemployment remains at unacceptably high levels. Last month it fell to 8.4%, a fall that is too slow and not far enough. At this rate, unemployment will be above 7% through the end of 1976.

And just when it appears that a blistering inflation rate has been halted, double digit inflation pops up again. Last month's figures indicate a return to an annual inflation rate of 10%.

So we find ourselves in an economic state that is not significantly better than it was two years ago—when the Nixon Administration started its battle against inflation and when the Ford Administration recognized that some action was needed to pull us out of the deepest recession since World War II. Two years of Administration economic policies, and we still face 8.4% unemployment and 10% inflation.

I firmly believe that we cannot hope to improve our general economic well-being—and the well-being of small business and farming in particular—unless we can pull our economy out of the recession doldrums and return it to a path of solid economic growth. The 1975 *Annual Report* of the Joint Economic Committee, which I chair, proposed an aggressive and comprehensive program to get the Nation back on the growth path. Its elements included an income and business tax cut, which you have already received, a jobs program, which the President vetoed, and a solid housing subsidy program, which the President rejected. The Congress has tried to implement programs to help our economy recover at a rapid pace, but Presidential vetoes have stood in the way.

Our economic program which has troubled me particularly, and which I believe has a major impact on our high inflation rates, is the widespread decrease of competition in industries where few firms operate. Last year the Joint Economic Committee investigated pricing activities in the steel industry. At this time, the staff of the Joint Economic Committee is in the final stages of a major investigation of food chain pricing activities. I expect that this major study will shed considerable light on whether food prices are higher in concentrated markets and on which particular food chain business practices cause us to pay higher food prices.

One way to avert the ill effects of this widespread concentration in particular industries is to foster and maintain a strong independent business and farming sector in our economy. Several problems stand in the way of this goal. Small entrepreneurs complain about the heavy hand of Federal regulations on their enterprises. Also, capital formation for the small businessman and farmer is so difficult that it threatens the survival of many. I will look for ways to ease this capital formation burden—through my work on the Senate Agriculture Committee and as chairman of Small Business Administration Oversight hearings that the Senate Small Business Committee will hold jointly with the Joint Economic Committee next month.

Today, though, we are dealing with another problem that threatens the survival of the small business and farm—the possible liquidation of the small enterprise to pay estate taxes upon the death of the owner. I am anxious to hear what my fellow Minnesotans have to say about the way Federal estate and gift tax laws treat small business men and farmers in America.

I want to know whether you think the $60,000 standard estate tax exemption should be increased to account for inflation valuation changes since 1942, the year the figure was established by law. Do you think similar action should be taken to increase the life time gift tax exemption of $30,000 and the per person annual exemption of $3,000? Should Congress enact legislation that defers estate taxes on family farms and small businesses as long as the enterprise is directly operated by the family of the decedent?

When I return to Washington, I will inject your ideas into the Congressional debate on tax reform. Through our efforts here today, hopefully we will come up with an equitable way to prevent the forcible liquidation of a small enterprise to pay Federal estate taxes. Small business men and farmers have enough business problems when they are alive, let's see if we can ease the burden of one problem that plagues their survivors after they die.

Joint Economic Committee Staff Analysis

GENERAL INFORMATION ON ESTATE LAWS AND GIFT TAX LAWS

(1) Definitions

The Federal Government imposes an estate tax, which is a tax on the privilege of transferring property. The tax is calculated as a percentage of the gross estate—stocks, bonds, real estate, mortgages, businesses, and any other property that technically belonged to the decedent—and the estate itself is responsible for paying the taxes owed.

States impose inheritance taxes, which is a tax on the privilege of receiving property. The recipient of the inherited property is responsible for paying this tax.

To prevent the tax free transferral of property before death, gift taxes are imposed. There is a Federal gift tax, but only 13 of the 49 states with inheritance taxes also have gift taxes. The donor must pay the gift tax.

(2) Tax Rates

Estate tax rates start at 3% of $5,000 rising to 77% of a taxable estate in excess of $10,000,000. Two basic deductions are allowed—(a) a $60,000 basic exemption and (b) the marital exemption, which permits the decedent to pass on 50% of his net taxable estate to his spouse tax free.

Gift tax rates are nominally three quarters of estate tax rates. But they are actually less than that, because property transferred to the government for the purpose of paying the gift tax is excluded from the gift tax base. Also, a donor has an automatic exemption of $30,000 and in addition can pass on tax free $3,000 worth of property per person per year.

(3) Basic Ways to Minimize Estate Tax

There are three major ways to minimize estate tax payments. The first is to dispose as much property as possible through gifts during one's life. As was pointed out in the section on rates, gift tax rates are much less than those for estate tax. Therefore, passing property on in the form of gifts affords significant potential tax savings.

Joseph Pechman, head of Brookings Institution's Economics Division, points out that people rarely use gifts to achieve maximum tax savings. There are a few reasons. One, most people are reluctant to contemplate death. Two, many will not relinquish control of their property during their life. Three, many people are ignorant of the law and are not aware of the tax savings gifts afford.

The second way is through generation skipping by establishing trusts. A trust is administered by a trustee and names a life tenant, who is the trust's beneficiary. The trust can name any number of life tenants, who need not be from the same generation. The trust also names a remainderman, the person to whom the trust's assets are transferred when the trust is terminated.

The estate tax advantage of the trust is simple. Estate or gift taxes are paid only when the trust is formed. No taxes are paid when the trust's property is transferred from one life tenant to the next or to the remainderman. The trust's property is not subject to estate or gift taxes again until the remainderman passes it on.

The problem with trusts is that their assets are managed quite conservatively, which ties up potential venture capital in less risky investments. And since trusts exit for as much as 100 years, trust capital can be lost to higher risk markets for a very long time.

The last way is through creating a foundation. The property used to form a charitable foundation can be transferred free of either estate or gift tax. The income produced by a foundation's property provides the funds for its operation. Members of the decedent's family usually compose the foundation's board of directors, thereby maintaining family control over his property.

There are two problems with the foundation approach to estate tax savings. Foundations have become increasingly difficult to form. And foundations can usually be formed only by the very wealthy, because the wealthy are the only ones who can forego income from a large part of their assets and still have enough remaining to live well.

SPECIFIC ESTATE TAX PROBLEMS OF THE SMALL BUSINESSMAN AND FARMER

(1) Small Business

Estate taxes present an especially bothersome problem to the small businessman, whose estate is composed almost exclusively of his small business. If a small businessman has not planned well, his survivors could find themselves in a situation where the decedent's business must be liquidated to pay the estate's taxes.

In most cases, the $60,000 standard exemption combined with the 50% marital exemption provide sufficient estate tax exemptions to make estate tax payments unnecessary, thereby removing the need to liquidate the small business. In the case where the business is large enough to still require estate tax payments after the exemptions, two routes are open to the survivors. First, if the business has a good financial position, heirs could borrow money on the business to pay the estate taxes on it. Second. estate tax payments can be spread over a ten year period, with 9% interest charged annually on the unpaid balance.

(2) Farms

The estate tax problems surrounding the transfer of the family farm to survivors are pretty much the same as those for small business. If the farmer has not planned well, the executor of his estate might have to sell the farm to pay the estate taxes.

Central to the debate on easing the estate tax burden of the farmer is the land valuation issue. Should farmland be valued for estate tax purposes at its assessed value or at its agricultural use value? Presently, no such choice is open to the decedent's heirs. Estate taxes are paid on the land's assessed value. Even if the family wants to continue operating the farm, it may be forced to sell it to pay estate taxes if its assessed value is well in excess of its use in agricultural production.

PROPOSED REFORMS

Proposed Congressional estate tax reforms to ease the problems of the small businessman and farmer fall into two main areas.

(1) Deductions

Various House bills propose that the standard estate tax exemption and marital deduction be increased. The standard exemption will be increased from $60,000 to $200,000. The marital deduction would be increased from 50% of the estate to 50% plus $100,000.

In general, there is broad support for the deduction increase approach for helping small businessmen and farmers avoid liquidation of their holdings to pay estate taxes. The $60,000 figure was established by law in 1942. At that time, $60,000 was a large sum, but inflation has reduced its value considerably. It would be completely within the 1942 legislation's intent to inflate the exemption level to 1975 dollars. The $200,000 proposed increase is roughly equal to an inflation adjustment of the present exemption. Also, this reform is equitable; it benefits everyone, not just those who own small businesses and farms.

There is little if any reason to increase the marital exemption above 50%. The 50% exemption level is generous; and because it is a percentage deduction, it is not subject to the same deflecting effect of the $60,000 standard exemption.

(2) Land Valuation

Instead of assessing the value of land for estate tax purposes at its fair market value, it would be assessed at its use value. As long as a law could include reasonable tests to establish actual use, assessing land at its use value is probably a good estate tax reform. But such tests are not easily devised.

One use valuation proposal would revoke the use valuation privilege if the land was sold or converted to a non-agricultural use within five years of the decedent's death. At that point, the estate would owe the estate tax in excess of the amount due under the use valuation privilege, plus interest. Another proposal includes no time limit for loss of the privilege. At any point when the land is sold or its use changed, the extra tax is due.

Since the purpose of this subsidy is to help maintain the strength of farming in particular and family farming in general, there is no reason to give the heirs an out after five years. Anyone could hold on to the land and run it as a farm for five years, cash in on the estate tax subsidy, and then sell it for non-agricultural purposes. If the heirs stop farming the land, the estate should pay the estate taxes that would be due if the land were never used for farming.

Both of these reforms would result in a large loss of Federal revenue. Therefore, any move to increase exemption levels or to implement use valuation should be areas of the estate and gift tax laws.

One way to do this would be to increase estate and gift tax rates across the board or maybe just to increase the tax rates on large estates. Another way would be to change the laws on trusts in such a way as to make generation skipping less profitable than it is now. Whatever is done, it is important that any reform that lowers revenues in the estate and gift tax area be offset in other areas that increase it. There is surely room for such increases, since much of the estate tax burden has been shifted away from large estates, which should rightfully bear most of the burden.

Senator MONDALE. I might also say, Mr. Herb Spira, who is the associate general counsel of the Small Business Senate Committee is with us today. And I think this might be an appropriate place to include a study prepared by the Department of Agriculture entitled, "Increasing Impact of Federal Estate and Gift Taxes on the Farm Sector," which very much supports Mr. Woehler's point of view here.

Senator HUMPHREY. That's it, thank you.

Senator MONDALE. Mr. Ross?

STATEMENT OF GERHARD ROSS, FARMER, FISHER, MINN.

Mr. ROSS. My name is Gerhard Ross, I operate a farm of 1,400 acres at Fisher, Minn. Approximately 400 are owned and 1,000 are rented; 1,100 acres are in wheat and 300 in sugar beets. This is the 20th year of operating my own farm, 11th year at its present acreage.

I am 46 years old. Most of the years have been years of good production resulting in increasing net worth. Starting out in 1956 at approximately $4,000 of net worth, it has increased by 1966, for 10 years, to $108,000 which consisted of $190,000 of assets and $82,000 of debt.

In 1971 this increased to $242,000 of assets and $82,000 of debt for a net worth of $174,000. By 1973 net worth declined to $231,000.

Until this time I largely ignored the effects of inflation on value, but in 1973 I started to include in my accounting, the market value figure instead of purchase price.

Largely due to the increase in crop prices and inflation of land and machinery values, my net worth jumped to $480,000 on January 1, 1974, and to $709,000 on January 1, 1975.

This represents $1,046,000 in assets, $147,000 in current and long-term debt, $45,000 income tax liability due in 1975, and a potential income tax liability of $145,000 due in 1976, for a total of $337,000 in debt.

These figures are from net worth and cash flow statements which I supplied to my banker, I've been told they are conservative.

Estate consequences are apparent. Wills have been changed, insurance has been bought, more insurance is contemplated.

On the advice of people I trust, I incorporated. I have a wife, three sons, and three daughters. All my sons indicate an interest in farming. The oldest, age 19, is enrolled in an agronomy class in college. My goal is to train one or all, including my wife, to take over my responsibilities.

The estate tax at this point in time is estimated at $115,000 if I die first and over $280,000 if my wife dies before I do. The net cash outflow will deplete the farm of all operating cash. Even if no selloff were required, it is doubtful that any banker would advance my son, age 19, the necessary capital to operate the farm at its present size.

I think a farmer's training, the business community which makes present-day farms possible, and the natural resources of the farm have made a contribution to the best interests of the Nation. I feel it to be in the interest of the Nation to allow farms like my own and many more like it to continue as intact as possible where children are interested in continuing the farm and training to take it over.

I support raising the exemption from $60,000 to $200,000 or more and particularly what I recommend is providing a period of 10 years or more to pay the estate taxes.

Thank you for your attention to this matter.

Senator MONDALE. The point you make which comes up in your family with several children, all of whom are interesting in farming, I think, raises one of the most crucial questions in American agriculture.

How can the next generation be encouraged to stay on the land if they want to? And this is where the estate tax can, I think, discourage something that we want very much. These figures that you use, the impact of the estate tax on your efforts to pass that farmland on to your children, I think, make an especially good argument.

Senator Humphrey?

Senator HUMPHREY. The $60,000 figure, of course, is a 1942 figure which is completely out of line with current economic conditions, and I gather that's why you feel that the increase to $200,000, which is one of the proposals Senator Mondale mentioned that's in the House

Ways and Means and Senate Finance Committee, makes some good sense. Is that your justification?

Mr. Ross. Yes; I feel its more realistic.

Senator HUMPHREY. When you mention the 10-year period for the extended time payment for estate taxes, you didn't mention the interest rate. The current rate is 9 percent. You can go to a bank and get 9 percent money, that's no special privilege at all or no special consideration. Wouldn't you believe that that rate ought to be substantially lowered?

Mr. Ross. It would be helpful.

Senator HUMPHREY. Well, it seems to me that if there's going to be any kind of concession made over a time period by the Government in terms of the collection, that there ought to be a concession, in fact, because 9 percent money, while it's not readily available is, if you have good collateral, sometimes available.

And it seems to me a reasonable reduction in that rate would be desirable and some of us have proposed 4, 5 percent as a rate.

Mr. Ross. It would be helpful to the young people; yes, it would.

Senator HUMPHREY. It certainly would.

Senator MONDALE. Thank you very much.

Mr. Velde?

STATEMENT OF TIM VELDE, FARMER, GRANITE FALLS, MINN.

Mr. VELDE. In November of 1973 my grandfather died, leaving his estate to his three children. I hope to show how outdated the current tax system is by using my father's share of the estate as an example.

My father inherited 160 acres of land with an appraised value of \$400,000 as of the time of my grandfather's death. This makes a total appraised value on the land of \$64,000.

After all the expenses of administration and the allowable exemption of \$60,000 were taken off the estate, the portion of tax against the land was \$14,054. This amount is \$87.84 an acre.

When the farm was originally purchased in 1941, by my grandfather, it cost \$8,000 or \$50 an acre. Through inflation, the value of the land has increased to eight times the original cost by 1973.

Because of the tax system that did not keep up with the new inflated values, it cost more to inherit the farm than it originally cost to purchase it.

What concerns me now is that land values have again increased and are currently over \$800 an acre in my area.

If inheritance and estate tax law is not reformed and brought into line with new, inflated values on land and machinery, family farms will suffer extreme hardship and the number of farms forced into liquidation because of unrealistic taxes will increase.

Thank you.

Senator MONDALE. Thank you very much, Mr. Velde, for giving us a view of how the tax looks to someone who is going to inherit and pay these taxes. That's very helpful.

Senator HUMPHREY. I have nothing.

Senator MONDALE. Next, Mr. Lloyd Cherne of Cherne Industrial, Inc., Edina, Minn.

Oh, pardon me, excuse me. Cy Carpenter, president of the Minnesota Farmers Union. That was a close call.

STATEMENT OF CY CARPENTER, PRESIDENT, MINNESOTA FARMERS UNION, ST. PAUL, MINN.

Mr. CARPENTER. Thank you, Senator Mondale and Senator Humphrey. We greatly appreciate the opportunity to be here and present testimony. We appreciate your concern for bringing the hearing here where the witnesses you have just heard can speak.

Those that have testified already with reference to agriculture and the farming situation speak more effectively than I can because they are experiencing it firsthand.

There are a couple of other comments I would wish to make and then we will submit a written statement that will give some additonal detail.

I think its necessary to recognize that inflation has hit all of us, but has hit the price of agricultural land even faster and that rise is accelerating, particularly as food becomes a more crucial item and the agriculture land is now all taken up, and that demand and pressure can only accelerate at an even faster rate, outstripping not only the outdated laws, but the comparative position with the rest of the economy.

Now, farmers don't expect a favored position, but they do not want something that will not throttle agriculture, and as indicated here will necessitate liquidating these farms simply to transfer them from one operator to another.

I'd like to quote from a letter we received from a widow living on a farm. She says:

> I'm in the process of probating and find I am only entitled to $60,000 exemption. We bought when land values were low, today in 1975 they are high. This means I am unfairly taxed and it will cost me a lot of money that it ought not to. That exemption today should be double that amount or more.
>
> Another thing that is unfair, my husband and I farmed for 42 years and I worked side by side with him for many years. Haying, milking cows, feeding animals and so on. I have earned a good share of that farm income but can't get any tax credit for it. Our tax laws need to be overhauled and now.

And I think that speaks effectively to the situation. I think an illustration can be made that the total exemption now of $60,000 will buy one substantial farm implement or 50 to 100 acres of land depending on where you buy it. And certainly not both, which indicates that there is no way that a farmer receiving this kind of inheritance can continue a realistic farming operation.

I think it's difficult to set a precise figure at this time because of the variation, and I think some flexibility needs to be included. We believe careful study should be given to assessing one level of tax on inheritance of land with a second level of inheritance held in abeyance for several years, but payable if the land were sold. And this would allow the land to continue as a single family operation where a single member of the family has to pay all other heirs. It necessitates liquidating land in many instances.

We believe a second consideration should be given to assessing a different level of inheritance tax if the recipient has been directly involved when the value of the business was accumulated as opposed to a recipient of inheritance, who was not involved in building this estate.

Under present conditions it would seem that the minimum should be at least a $100,000 and perhaps more.

Now, any of this really is reaction to the result and we think it might well serve if more study was given to the cause and some corrective action before this kind of a situation develops.

The price that is used in assessing this tax is real in that the land can be sold, but on the other hand its hollow because you have to go out of business to really get the value of that land. And with land becoming increasingly scarce we feel there must be a realistic means of transferring it.

Here in Minnesota we're developing a program somewhat duplicating the Saskatchewan land bank program, with an emphasis on ownership rather than lease, and this is necessary because of the changing conditions. The homestead law was to take up the land and now that land is all taken up. And we need something that is just as current today and necessary as the homestead law was at that time.

We believe the State and Federal Government should act as an agent in land transfer, allowing those who desire to sell, the opportunity to predetermine who will be the purchaser as long as he's a qualified young farmer. And we feel the Government, acting as such an agent, could allow the seller to receive compensation over a period of time and at a realistic interest rate.

On the other hand, the young farmer knowing the State or Federal Government was acting as guarantor, could buy this land for a very minimal down payment and with a realistic rate of interest and interest only paid on the amount committed, not on the unpaid balance as we're doing now.

We think that this kind of transfer system would allow the farmers to compete between themselves on land for agriculture production purposes and would eliminate the outside price pressure from speculators and others who will increasingly be coming into this market.

So it would serve two purposes, it would establish a real price value on that land as relates to its profit producing capability and, thus, the assessment of a realistic inheritance tax and would also maintain family farm operations.

[The prepared statement of Mr. Carpenter follows:]

Inheritance and Estate Taxes
In Agriculture

by

Cy Carpenter

August 26, 1975

Joint Hearing

U.S. Senate Committee on

Small Business and the

Joint Economic Committee

Good morning. My name is Cy Carpenter and I am president of Minnesota Farmers Union based here in St. Paul. Minnesota Farmers Union works to help farm families and their rural communities to become more prosperous, efficient and secure.

We commend you, Senator Mondale and Senator Humphrey, and members of your committee for recognizing the need for action in the area of estate and inheritance taxes. We also commend you for bringing your committee hearing to the center of agricultural activity to hear witnesses most directly affected by this issue. We also appreciate the fact that you understand the unique position that agriculture holds.

While inflation has been a real concern to all people in this country, the price of land for agricultural purposes has increased at even a faster rate over the last several years. Thus, the established level of exemption for estate or inheritance taxes is outdated because of inflation alone.

But, for agriculture, it is even a more serious problem needing the kind of attention you are giving it. Other witnesses who are directly involved in farming may speak with more firsthand experience but one or two brief examples site the need for adjustment.

At today's operating prices, a single implement on a family-sized farming operation, when you consider financing charges and need for a small second attachment, might well cost between $30,000 and $45,000. Good, productive agricultural land can sell as high as $1,000 per acre, an average price for our area.

Thus, a $60,000 exemption that currently exists would allow a farmer a single implement with a small attachment or approximately 60 acres of land before he would be subject to tax.

Let me quote from just one letter I received from a widow who shared a farming operation with her husband for 42 years:

"I'm in the process of probating and find I'm only entitled to $60,000 exemption. Land values then were low and today in 1975 are high. This means I'm unfairly taxed and will cost me a lot of money that ought not to be. That exemption today should be double that amount or more. Another thing that is unfair, my husband and I farmed for 42 years and I worked side-by-side with him for many years, haying, milking cows, feeding animals, raising ducks and flocks of chickens and much more. I've earned a good share of the farm income but can't get any credit for it tax-wise. Our tax laws need a good overhauling and now."

With the normal family farm operation averaging somewhere between $150 and $250,000 and many as high as $500,000 in investment and with the average family-farm size approximately 400 acres, it is obvious that the exemption figure must be moved substantially higher so that this tax does not throttle the agricultural industry.

Farmers do not want special exemption or special consideration, but do need a tax pattern that will deal with reality. They need a situation that will not require them to either obligate their operation by debt piled on top of their normal operation debt to meet an inheritance tax. Or even worse, require liquidation of all or part of their property to meet the tax assessed against their inheritance or that of other members of their family who must help to continue a single family-farming operation.

Granted, under the present regulations, the tax can be paid in installments. To do that means keeping the estate open for several years. All that time interest and administration costs have to be paid. Depending on demands of the estate, those administration costs can be extremely high.

At this point, it seems difficult to set a precise figure as the best level of exemption because of the rapidly changing situation. It is also difficult because land values vary by region.

We believe careful study can be given to assessing one level of tax on inheritance of land with a second level of assessment held in abeyance for several years but payable if the land is sold. This would encourage those participating in the inheritance to allow the land to continue as a single family farming operation. The second consideration should be to assess a different level of inheritance tax if the recipient had been directly involved during the time when the value of the business was established or accumulated as opposed to the recipient of the inheritance who was not involved in building the establishment.

Under present conditions, if the inheritance tax is not to seriously jeopardize farming operations, it would seem the level of exemption should be raised to at least $100,000.

However, any and all such direct measures are merely reaction to the problem and do not treat the cause. We would like to suggest that constructive action be started now to treat the cause of the problem.

As cited earlier, the value and, thus, the assessment for estate tax purposes is applied to land that skyrochets in value each year. Much of this increase is the result of outside pressure. It is not related to the profit-producing capability for agriculture. As you know, land is becoming a scarce resource. The price of the land, and thus, the valuation for tax purposes is real in that it can actually be sold for this price. But, it is hollow in that it does not provide a commensurate profit to the operator and can only be realised in value when the farmer goes out of business.

To attack the cause of the problem, we need to restrict the outside pressure on land. This would allow the pricing and resulting value placed on the land to be principally the result of competition between farmers based on profit from a farming unit.

Here in Minnesota, we are developing a land transfer program duplicating somewhat the Saskatchewan Land Bank Program but with greater emphasis on ownership rather than long-term lease. Just as the Homestead Law was abandoned when all the land was taken up, the current method of purchase and transfer of land is truly outdated. You have a different situation today.

We believe the state or federal government should act as an agent in the land transfer allowing those who desire to sell the opportunity to predetermine who the purchaser will be. The predetermined purchaser should be a qualified and preferably young eligible farmer. This would eliminate excessive outside competition that can only increase as the demand for food, and thus, land accelerates.

Acting as such an agent, the government at the state or federal level could pay the seller of the land over a period of time, thus reducing the tax on his life-long accumulation to a realistic level, but with the faith and guarantee of government behind such an arrangement.

On the other hand, it could sell the land to a young farmer for a minimal down payment and with interest only applied to the actual amount of money committed to the seller rather than on the unpaid balance.

With the faith and trust of the government behind such a two-way contract, and the land itself as security, an orderly and continuing transfer of land could be accomodated between farmers without the excessive price pressure from outside competition. Those that did not choose to use such a plan, would be free to continue as they are. But, both the desire to keep the land in hands of the family farmer and the realistic application of spreading the tax burden would be a strong inducement for participation in such a plan.

Additionally, land transferred under such an arrangement would be priced in accordance with its capabilty for producing profit. The result would be establishment of a realistic tax assessment value as it applied to an inheritance or estate tax. While this would not eliminate the need for periodic scrutiny of such an inheritance tax, it would put agriculture much more in line with all inheritances resulting from the sale of accumulated business or capitol and thus, the tax would be equitable.

When we can facilitate cultivation of farmland by future generations, we are guaranteeing the future economic well-being of our agricultural industry, our No. 1 business.

Thank you.

Senator MONDALE. Senator Humphrey?

Senator HUMPHREY. The problem, Mr. Carpenter, in reference to the family farm is that in order to pay these estate taxes that are based upon this rather antiquated State tax system we have which I don't believe has been changed fundamentally since 1942, is that you have to sell off such a large section of—or large part of your property in order to pay the tax that you leave yourself or the recipient with an area that is uneconomic in terms of livelihood, of income and production. Isn't that about what happens?

Mr. CARPENTER. That's correct. As Mr. Ross and other witnesses have pointed out, it's necessary to have about $1/2 to $1 million in committed capital. But there is no way that you can use that in terms of capital flow to meet this tax need without discontinuing your operation.

Senator HUMPHREY. You see, Mr. Carpenter, as I sense it, it is that the whole economics of agriculture in terms of the tax laws is caught up in the immediate post-depression years and the tax laws have not been adjusted to the economic realities of the war years, the period since 1950 up to the current time.

And then when you have the selling of the land or whatever other properties there may be to pay for the estate taxes, you also have the competing forces of what we call the tax shelter boys that can move on in, that are not interested at all in what we call profitable, productive farming, but are interested in having places to invest capital, sometimes actually for purposes of loss for tax purposes. Is that not a fact?

Mr. CARPENTER. That's correct. And to that kind of a buyer, the higher price per acre is desirable.

Senator HUMPHREY. Exactly.

Mr. CARPENTER. But is not based on the profit producing capability of the land.

Senator HUMPHREY. Now, it gets down to the type of assessment that we have on agricultural land, and I think you were referring to it.

The current value, for estate and gift tax purposes, is the assessed valuation of the land rather than the use valuation, is that not the case?

Mr. CARPENTER. Yes.

Senator HUMPHREY. And where you have this kind of competition with people that have excess capital that look upon land because of its intrinsic value as a good investment, even though it may not be used for productivity purposes at all, you get into the situation where the farmer that has to pay an estate tax is actually having his values pushed up all the time which, in turn, creates a tax burden upon him by people and by interests that are not interested in agriculture.

Mr. CARPENTER. That's right.

Senator HUMPHREY. I think this is a very, very fundamental problem that we have and lends itself not only to corporate agriculture, which is a concern in this State and I hope elsewhere, but even more so lends itself to no agriculture. It lends itself to holding actions on land which is used for purposes of speculation or tax shelters.

Mr. CARPENTER. I would only add, Senator, that as bad as the situation is now, it will certainly worsen very rapidly with the additional pressure on land.

Senator HUMPHREY. Because of suburban development, highways, all the many development pressures upon the land area that we have.

Mr. CARPENTER. And the pressure to get into the speculative production or agriculture activities for tax shelters and so on, combined with the fact that the agriculture land is now all committed.

Senator MONDALE. Would it be fair to say, Mr. Carpenter, that just as a career in farming is once again looking more attractive to the young people—after 20 years of trying to encourage sons to follow on in their father's place—because of inflation of land values and the rest, it could well be that the estate tax could rob us of this opportunity to achieve what we've been trying to achieve all these years?

Mr. CARPENTER. Very important. And, in addition, the redistribution of population and of economics out to the rural communities could also be jeopardized.

Senator MONDALE. Thank you very much.

Mr. Lloyd Cherne of Cherne Industrial, Inc.

STATEMENT OF LLOYD G. CHERNE, PRESIDENT, CHERNE INDUSTRIAL, INC., EDINA, MINN.

Mr. CHERNE. Senators, I want to thank both of you for your concern regarding our present burdensome inheritance tax and your desire as evident by the calling of this meeting to correct it.

You know, I was completely flabbergasted by your calling this meeting when I remembered just a few short years ago our neighboring Democratic Senator while contending for the presidency was actually advocating a 100 percent inheritance tax. I honestly felt that an increase in tax thinking for inheritance was just laying dormant somewhere in the Democratic platform and would rear its dumb head again.

Senator HUMPHREY. Now would you clarify as to whom are you speaking? There are two of us here that messed around with that presidency.

Mr. CHERNE. That comes next.

Senator HUMPHREY. Well, if it's me, make it quiet, will you.

Senator MONDALE. Get there as fast as you can.

Mr. CHERNE. Well, now it's evident where the problem actually was, Senator McGovern passed his economic courses with 1,000 percent grade.

I often wonder if the words, "inheritance tax, estate and gift tax" aren't a misnomer and a better definition would be death punishment tax. And where does the punishment fall? It falls on the widow and children that are trying to hang onto a small farm or business.

In addition, it falls on the employees and their families of that small business whose bitter last memories of the place of employment were watching the sheriff conduct his sale of the business assets and the destruction of their jobs.

I can't help but feel even the Government is being punished in an ironic sort of way when these defeated employees are added to the welfare rolls and the food stamp rolls.

I wonder what it does to the children to see their parents beat, their home and farm lost at the death of that small entrepreneur who plowed every penny back into the business to try to make it better and more secure.

However, you might ask why feel sorry for him? According to most opinion polls someone drummed into the heads of us average voters, doesn't every business make 28 cents on every sales dollar? Then surely that entrepreneur could have used those dirty dollars to purchase insurance.

By the way, that reminds me and I wonder, has anyone stopped to think that the act of purchasing insurance to pay that death punishment tax is just another unnecessary tax on the function of a business.

I honestly do feel sorry for you politicians that are trying to do a decent job in the area of business taxation or maybe a better way of saying it is job preservation. And constantly being under the handicap of knowing that your average voter has no conception that business takes in only 4 cents on every sales dollar and business also must invest approximately $35,000 just to put one employee to work.

No; I don't envy your jobs. And while writing this speech I recall that our Congress was recently trying to appropriate about $5 billion to create some jobs.

It would seem to me they would get far more value for their money if they employed it in this area where you are rightfully having concern. Here we have jobs that are already putting out a product, where all the research has been paid for, where the marketing system is already working at no small cost to get this going.

Just to give you some insight as to how much it costs to launch a new product in a company—you won't be able to follow me there, Senator. I did not print out in my text what I just said.

Senator MONDALE. I wasn't trying.

Mr. CHERNE. Let's think back right here in Minnesota about the local stock companies that were started since 1957. Which is the Control Data kickoff year. Each of these companies raised about $300,000 plus and I think if you would check you would find that about 300 of them have folded now. The loss is about $100 million, and fortunately out of these investments came some very strong companies. Just Control Data made all the losses worthwhile. So this gives you an idea of the cost to launch businesses.

And with the inheritance state tax destroying them, it's total foolishness.

My suggestion for improvement has to do with the small local stock companies of which my company is one.

Now you'll be able to follow me, Senator.

I started this business from scratch in my basement about 20 years ago and today it employs about 90 people and has sales of $3½ million per year. We manufacture water-pollution-control equipment and our sales are generated throughout the United States and about 10 foreign countries. My wife and I and my children hold about 75 percent of the stock and most of my net worth is in that stock.

Now my problem with inheritance tax is the arbitrary valuation as to the net worth of my company and then the method having to pay that tax. It is a twofold problem, each solvable by using a different method of payment that is not now employed. The Internal Revenue would still get cash but they would get it from me or any insurance company.

Now the reason I even started working on the inheritance problem was that acquisition-minded companies were pointing out to us little ones that if we died while holding our stock, we'd never be able to pay the inheritance tax. I thought they were crazy, but I owed it to my family anyway to start considering a will, which of course, is something most of us put off until we die and then the State writes one for us.

As we know, it's bad enough even for a Congressman to fill out a timely tax report, much less the rest of us work on a will.

Senator MONDALE. There's been a study showing, I think, that only a third of the farmers prepare a will.

Mr. CHERNE. Why don't you have them raise their hands in here, see how many have a will. That he's real satisfied with. Go ahead——

Senator MONDALE. How many of you have prepared a will that you are satisfied with?

Mr. CHERNE. I think that you would find that there are very few. Well, did I get an education! The big company boys were correct and they had a hot sales point going for them. In fact, once a year we have our national pollution convention, this year it is in Miami in October. There will be at least two or three that will walk by all 400 booths asking us if we want to sell. And they know what they've got going for them. Getting back to the subject. My particular problem—well, it just so happens that water-pollution-control stocks were hot. Mine started from $3 at the original stock offering and flew up high enough for us to get off another stock offering at $9 a share and then it just kept heading for the Moon—eventually reaching the height of its trajectory at $20 per share.

However, when it was going through the $10 per share, I was working on my will and I, of course, had many insurance salesmen point out that the problem is quite solvable—all I had to do was pay them a tax and they would come up with the death punishment tax for the Government. Now, of course, they weren't so nasty as to call their tribute a tax—they dressed it up in the nomenclature of "premium." Well, the question was, how much premium to pay? No problem there, I thought. I would just call on my friendly tax man and we'll get together and figure out how much the business would be worth if our creator thought that my body should be recycled. So I asked my friendly revenue man for his opinion after stating my problem. Well, he said, Mr. Cherne, we can't decide the worth of your business now—we can only do that when you're dead. I told him that would be too late. My insurance man would not sell me any insurance when I am dead. It seems they don't make any money that way. He said that would be like calling your fire insurance salesman to insure your smoldering barn.

Well, as you well know, I couldn't stop with the local Internal Revenue man—I had to get better answers and I was told that the answers I want could only come from the top—namely the Secretary of the Treasury. Apparently, he was the only one who could issue new rulings. As luck would have it, I finally got hold of the Assistant Secretary of the Treasury. I guess he happened to pick up his own phone while 10 of his secretaries were down in the cafeteria giving Matilda her birthday present. [Doesn't every office have a Matilda?] He was a very pleasant chap and he sympathized with my problem—

I'm sure he didn't shed any tears—but he assured me that the Internal Revenue Department would certainly be reasonable with my widow. Then I asked, how come most everybody thinks otherwise? And even most of these Small Business Administration chaps said some not-too-pleasant words about you fellows? They said, "From the evidence presented in court cases, it appears according to those reports that the Internal Revenue Service has tended to use whatever approach to 'fair market value' will result in a high value and tax liability?"

I told him I didn't think those were very pleasant words about you fellows. I went on to say:

And then too, I notice in my reading that you fellows don't regard that the wife contributes anything to a household. If she has insurance policies in her name as owner, you attack those by having her try to reconstruct where she made some money to pay the premiums. If she cannot do this then you slap those policies into the husband's estate and build up his tax liability. However, you fellows never lose out on getting your cake, because I notice that if this same husband should embezzle funds from his bank and take his girlfriend to South America, the wife, who is always the last one to know anyway, finds herself scrubbing floors to pay off the tax on those embezzled funds.

Well, on that issue he informed me that the innocent spouse rule had now been written to avoid those kind of things.

However, we can all rest assured that that innocent-spouse rule came about because of the pressure exerted when the widow had to go to court to fight the unreasonableness of this approach. I also asked, how come the tax liability doesn't die at the bankruptcy door when a person files bankruptcy. It seems that we creditors leave but you Internal Revenue fellows linger outside the door waiting for the victim to walk back out so you can keep bankrupt life. No; I don't think I would be wise in assuming you would be fair to my widow and children.

Basically the conclusion reached by my attorney was—that there was no way at that time that the Internal Revenue would value our stock below $10 per share even though the business had a net worth of $2 per share because we raised $400,000 at $9 per share just the year before. In other words, if I died right then, my widow is in trouble. I, therefore, found myself with the necessity to purchase $1½ million in insurance having a premium of $36,000 per year which was quite a few thousand more than my salary and so it was finally resolved that the company with stockholder approval would purchase this insurance and become the beneficiary of the policy.

Eventually, the company would purchase stock from estate so that my widow could pay the tax. It made me very bitter to pay this insurance money, still makes me bitter, which by the way, is not tax deductible, when I consider that we could be putting two more employees to work each year if we could keep that money in the business. When I mentioned this to one Internal Revenue agent he said, well after all, maybe the insurance company is putting them to work. I then asked him which is better for our country—more people working in an insurance business or more people making antipollution-control equipment? He had no answer.

My solution to this particular problem is for the Government to take the stock of a company and then over the next 9 months sell it. In my particular case, the scenario would have been as follows: Assuming they value my business as my attorney surmised at $10 per share, they would ascribe a $4 million net worth to my 400,000 shares. This would have been a tax of $1½ million. For the $1½ million they would get 150,000 shares. It would have been mandatory that they sell it within the next 9 months just like they demand from us—obtaining their money without our getting involved in loans and, therefore, interest payments.

No matter what our stock was selling for on the over-the-counter market, I dare say that the most they probably would have gotten for 150,000 shares was $1 a share, particularly in view of the fact that the principal was now dead. My estate would now be subject to revaluation and that value would be 1/10 of the original or namely $400,000. The tax on $400,000 would be $100,000 and, therefore, only 100,000 shares need be sold. The Government would stop short of selling the other 50,000 shares and return them to my widow. By use of this method, the company would not have had to purchase any insurance and the money would be better utilized in the business. There would be no unreasonable guessing as to the true value of my estate because that would finally be established in the marketplace. Hence there would never be a need for a court case by my widow, and anytime something can be done to diminish the amount of court cases, it should be done.

Now the acceptance of something other than money is not foreign to the Internal Revenue Service because they are in the business of selling property or assets almost every day from some bankrupt business.

In summary, you should make it mandatory for the Internal Revenue Service to take common stock of a company for payment with a 9-month limitation for selling it. This would even work for the private companies with unlisted shares and I am sure the trust officer of any bank would be more than willing to show the Internal Revenue Service how to accomplish the sale of this minority stock in an unlisted company.

In closing I would like to address the five questions posed in Senator Mondale's release of August 11.

One: Regarding the present $60,000-tax exemption, I certainly concur that this should be raised and the ratio to raise it to—as a minimum—could be whatever the cost-of-living would have been in 1942 when it was established at $60,000 divided into the cost-of-living here in 1975. I think you'd find it would be about $190,000 to $200,000 now.

Regarding the payment of estate taxes being liberalized over a 10 year period, this definitely should be done. In fact, I don't think it should be left up to the Internal Revenue Department to make that determination. I think that that should be done by the estate paying the tax. Second, I can't help but feel the 9 percent interest rate is extremely unreasonable.

Right here in Minnesota the mortgagers were testifying that our housing construction would not pull out of the doldrums unless the 8 percent usury rate was raised. It was not raised. I feel that this should be put back to the 4 percent; nor should the Internal Revenue Department feel that the widow is getting a break—she is being hurt badly by paying a tax that would never have had to be paid if her spouse didn't die. It's bad enough losing the spouse or the breadwinner without also having to pay a tax. I think if we reflect on it, the inheritance tax was only put in to level the rich families. The problem is that it didn't stay up high enough for that level process—it came down to ruin many small family businesses. Going back to No. 1, I would say the real minimum should possibly be at least $500,000 and this, in turn, indexed to inflation.

As for Nos. 3 and 4, regarding the farm, I would presume they would be automatically taken care of if the estate tax exemption was raised to $1/2 million.

As for No. 5, the impact for taxing capital gains at death—I do not feel this should be done. The farms and small businesses just do not have extra money for this type of tax. It has never been programed in and they cannot sell their products for a high enough price to program it in. A farmer has no control over the price of his products. In a small business, the administration costs on every sales dollar runs about 15 percent. On a large business it runs about 5 percent and by a large business, I mean one that's doing $20 million or more per year. This is an extra 10-percent disadvantage that the small business must operate at and try to remain competitive with big business. So when you come along later and slap an inheritance tax on them, well there's just no way for it to go but out of existence.

Gentlemen, I'd like to go further and talk about another tax on estates imposed at death of the entrepreneur—not by the Federal Government—but by a group of citizens, and that tax is legal distortion, its vicious! It can even put a business into bankruptcy. This tax must be stopped. If time permits I'd like to tell you about that. Thank you very much for holding this meeting.

Senator MONDALE. Before you end, could you mention the name of that last tax?

Mr. CHERNE. Yes; its probate—terrible, terrible.

Senator MONDALE. Thank you very much, Mr. Cherne, for a very excellent statement in placing the problem of estate taxes in the context of a small business that's competitive, healthy, thriving but in which its owner must face up to the tough realities of what is going to happen at death.

One point you passed over very quickly was your annual sales conferences at which you said frequently people would stop by and want to buy your business.

And I assume these would be larger corporations which would like to have more and more widely diversified——

Mr. CHERNE. Last year, I'll tell you, it was Dart Industries and they picked up Environmental Research of St. Paul. Another one gone.

Senator MONDALE. So that would it be fair to say that the present application of the estate laws are such that they undermine the competitive system in the sense that they would force small, but effective, prosperous independents like you into the sale of their business to absentee ownership?

Mr. CHERNE. No doubt about it. That point alone is enough——

Senator MONDALE. It seems to me that that is a fundamental point about all these laws. Certainly at the heart of America's economic problems is the need to restore a more vigorous, competitive, independent, locally controlled economic environment. And this law is working in just the opposite way and having exactly the opposite effect of what its original framers intended, which is trying to head off big wealth.

Instead of that, they are leaning toward concentration. Would that be correct?

Mr. CHERNE. Yes; absolutely.

Senator HUMPHREY. Well, what we've heard here this morning is that we have different parts of the Government with their policies working in different directions.

On the one hand, we have Farmers Home Administration Department that says we have to preserve the family farm. Senators say this, people all over America say this, people point out its productivity and the unique genius of the American agricultural system based on the family farm.

Then we have tax laws that literally tear it apart. Indeed, on the death of an owner, the estate taxes, the gift taxes, the inheritance taxes, I should say, really take so much capital that the possibility of holding together a productive unit—and it has to be larger today because of the cost of materials, machinery, et cetera—is diminished. We have a tax system that works counter to the social policy that we have proclaimed; namely, the individually-owned family farm.

Now we come over here to Mr. Cherne and he talks about the situation where the tax laws threaten the viability and the lifeline of an independent enterprise and the larger company, as Senator Mondale has pointed out, comes by, looks at your company to see that you're doing very well, takes a look at you and says how long do you think you are going to live? It's kind of selling an insurance policy the rough way, you know.

Mr. CHERNE. Absolutely.

Senator HUMPHREY. And indicating that if you want to survive, if you'd like to have a little money in the bank and a little income for mom and the kids and yourself, we'll buy up your company.

Mr. CHERNE. Right.

Senator HUMPHREY. And that, of course, promotes the very thing that the Antitrust Division is supposed to be fighting against. Of course, this is a good way to keep jobs in the Government.

But the tax laws, I think, are much more effective in performing their purpose than the Antitrust Division is in performing its responsibilities. I don't think there's any doubt about it at all.

And I think the most important part of your statement is this impact of the merger, the bigness, the growth that continues to accumulate in American enterprise, the concentration which we have seen.

Now, we've seen this, for example, in the grocery business, it's very big. We're just finishing a study in the Joint Economic Committee on pricing in the grocery business which is going to be very revealing as you see competition destroyed.

And we have a study on the steel enterprise showing what happens when you have larger and larger units and fewer and fewer competitors; 43 percent of the business output of the country is by small business. And that's businesses under a million dollars; is that correct? Under a million dollars, 43 percent.

I'm not talking agriculture now, but I mean small business enterprises. And a very large percentage of the total employment of this country is presently in small business. Over half, I've been informed here, over half the total employment. Now, at a time when we're trying to expand employment and we need a diversification of industry and we need also to break out of these huge centers into the smaller areas looking toward what we call rural economic development, a type of policy which penalizes growth and expansion of small business is counterproductive.

Now, this is just one of the tax policies. Senator Mondale is on the Finance Committee; we're having a special set of hearings by the Joint Economic Committee and the Senate Small Business Committee, joint hearings on the whole subject of taxation on what we call the smaller business enterprises in this country. Put the $20 million figure on what you might call large business, and anything from that figure on down are the growth enterprises in this country. At least they ought to be growth enterprises.

Specifically now, because you are a very knowledgeable witness—and I must say I've never had real sympathy for an IRS agent, but you made me have some this morning because you really knew how to handle them.

What part of the estate and gift tax laws would you change, specifically now, just to kind of recap what you said for us, to induce small businessmen not to sell their firms to larger corporations? In other words, not only to hold on, but to grow.

Mr. CHERNE. You have to get that tax exemption up much, much higher.

Senator HUMPHREY. That's No. 1.

Mr. CHERNE. You've got to let us decide on how we pay the tax—money or stock—don't let the Federal Government decide how we must handle it.

Senator HUMPHREY. As to the method of payment?

Mr. CHERNE. Yes. But I think it's awfully important for the Internal Revenue Department to take our stock, and they sell it. Don't make us sell it.

In fact, in 1928 when the stock market was booming, I understood that many widows were scrubbing floors in 1929 and 1930 because their estate had been valued so high and they had hung onto their stock. But they still had to pay that tax that was set back in 1928. There was no mercy for them when they could not sell the stock at the value the Internal Revenue Department ascribed.

Senator HUMPHREY. What does that do when the IRS—say you pay off your tax in stock. The IRS dumps it in the market, the price of that stock goes down, also the price of the stock in your company goes down.

Mr. CHERNE. Oh, sure, it hurts the outside market.

Senator HUMPHREY. What does that do, then, to your collateral, bank loans, and other things that may relate to the remaining part of your business?

Mr. CHERNE. It would be disastrous if I used my stock as collateral. But I think banks recognize that. The banks recognize a small company's stock does not have quite the worth the Internal Revenue wants to put on it.

Senator MONDALE. That's what you are getting at, isn't it? If they think it's worth that much, let them have it.

Mr. CHERNE. Yes; I can cite you case after case—in fact, they lose half their cases in tax court, so you can see they are starting out with an unreasonable value.

Senator HUMPHREY. Well, you wouldn't like to buy a drugstore, would you? I'm not, I don't want to be counter to my general theory of opposing mergers, but I've got a little problem——

Mr. CHERNE. I think you can understand mine then.

Senator HUMPHREY. I sure as the devil do, if you can pardon my French, because we had the same situation in a family business, it was a little private business corporation. And it poses a very serious problem now in liquidation of that business. You really don't know how to do it.

Mr. CHERNE. You know Gene O'Brien quite well, and Gene had the same problem on a lumber mill his dad owned. Same thing happened to him.

Senator HUMPHREY. If I can sell the business, by the time I get through with it there isn't much left for anybody, that the business has accumulated for 72 years.

Mr. CHERNE. He finally did sell it and it was about a half or a quarter what the Internal Revenue had put on it.

Senator HUMPHREY. Looking for a merger. Wouldn't that be—a merger with Humphrey's Drugstore.

Senator MONDALE. This point about how taxes affect the competitive structure, I think there's some hopeful sign that we're beginning to realize that and try to adjust to try to produce more competition rather than less.

Interestingly enough, on the oil depletion allowance, we reduced it for the multinational oil companies, but retained it for the independents. So that they are going to have a competitive advantage which they can well use, to try to get into the business. Similarly, for the first time in many, many years we lowered the small business corporate tax rate by what? Seven thousand dollars per corporation.

Senator HUMPHREY. That's annual savings.

Senator MONDALE. That's right. That's not big money, but it did cost some $1.5 billion and I think that's the first time in many years there's been a tax cut for small business, and that should all be helpful. But we have still not touched the subject we're talking about today. What can we do to change the estate tax laws so they contribute to local business rather than undermining it?

And that brings us to the final witness, Jared How, who some years back started telling me what was happening in Mankato and some of these communities with good business that were facing this estate tax and were sold to large corporations. And he adds to that, special interest in the need for competition in media outlets. We must have not only competition in economics, but also in ideas.

Mr. How?

STATEMENT OF JARED HOW, PRESIDENT, FREE PRESS CO., MANKATO, MINN.

Mr. HOW. I am Jared How, principal owner of the Free Press Co. which publishes daily newspapers at Mankato and Owatonna in Minnesota. When I inherited the majority interest in the company about 19 years ago, the value of the company was modest. The estate taxes payable were tolerable. The specific exemption of $60,000 covered a substantial part of the company's value and the remainder of the value fell into the low and middle end of the graduated rate.

Today, partly as a result of inflation and partly as a result of the great growth of group newspaper operations and very impressive advances in technology, market value of our company, as determined by formulae used by the IRS has increased tremendously. The same situation, of course, faces the owner of any enterprise where availability is in short supply.

The trouble is my business, which, like farming, involves a very valuable asset, does not throw off enough income to pay estate taxes on top of the cost of operating and modernizing the business. The value in the marketplace is far greater than the value to my heirs.

It would be helpful if the present provisions permitting payment of estate taxes over a period of years in installments were liberalized, but these proposals assume that the deferred tax will be based on a value equal to the price a buyer might be willing to pay at the time of the owner's death. The trouble with this is that it makes it very difficult for me to pass ownership of my business on to my family.

If I can't lay up enough cash during my lifetime to pay my estate taxes, what should I do? I am better off to sell out to a large, publicly owned company in a taxfree reorganization. This will give me marketable stock that can be sold to pay my estate taxes. However, this means there is no guarantee of family continuance in the operation of the company.

My responsibility, as a publisher of a privately held newspaper, is to myself. Group management's responsibility is to public stockholders. Their primary responsibility is to maximize profits.

I feel that individual or family ownership of a business or farm is a good thing. From a market-value viewpoint some small businesses and farms may not necessarily be small business anymore, but they are businesses with close personal ties to their communities and are apt to have a continuing interest in and commitment to that community's future.

As family-owned businesses and farms pass into ownership of publicly owned corporations or are consolidated into larger holdings, the concentration of wealth is enhanced.

I am concerned about this increasing concentration, at least some of which is brought about by estate taxes. In my own field I am concerned about the decreasing number of real decisionmakers. I think the managers of today's newspapers are, generally, public spirited, concerned citizens who are doing a good job, but I do feel that the communications industry could do a better job if there were more decisionmakers, more competitors for America's attention. In short, I think there is a public interest to be served in making it possible for people like myself to pass ownership of their businesses on to their families.

What can be done to achieve that goal?

First: The specific exemption must be increased to a level that reflects the enormous increases in the value of business assets brought on by technology, inflation, and lack of availability. I think the present $60,000 exemption should be increased to at least $150,000.

Second: Estate tax rates should be reduced, especially at the upper end of the bracket where they are almost confiscatory. An owner may sell his farm or business during his lifetime at capital gain rates which are less than half of the top inheritance tax rates. The property received in that sale can then be disbursed among a number of family members so as to greatly reduce the estate tax that will be payable on the seller's death. This fact creates an enormous pressure to sell out rather than pass the business on to one's family.

Third: It seems to me that the estate tax on a closely held business ought to be more closely related to what that business has earned historically in the years preceding the owner's death. In other words, my widow should pay a tax based upon the value of the property to her—what it can provide her in dividends, salary, or other forms of compensation rather than the price she can get for the business if she sells it.

If she should sell it at a later time for a higher value, she would pay tax on the difference either in the form of a capital gains tax if the inheritance and capital gains systems were unified, or in the form of a deferred estate tax if they were not.

I recognize that fixing the value at which the property should be initially taxed to the family poses some difficult problems, but I don't think the solution of those problems is beyond the ingenuity of this country's tax experts.

In summary, I believe our tax policies should be aimed at difusing ownership of American business throughout the widest group possible. Our present estate tax system works the other way and tends to concentrate the ownership of our farms and businesses into ever-larger units—concentrations which brings problems arising from lack of competition, problems such as public suspicion of administered prices and other monopolistic practices. I believe in family ownership of small American business. I hope this committee can be instrumental in making changes in the estate tax system that will help us keep the ownership of American business in as many hands as possible.

Senator MONDALE. Thank you, Mr. How, for an excellent statement.

You make reference to the importance of competition in the news industry. What has been the trend over the last 20 years in your industry?

Mr. HOW. The trend toward group ownership has been a very strong trend.

I'd like to say, at this time, that group ownership, from personal experience and observation, doesn't necessarily mean a deterioration of the quality of a newspaper or radio station or television station. And I don't think my concern is as much with deterioration as with potential.

As I tried to say, the group manager's responsibility is to his stockholders. He is hired by them and is working for them. The individual publisher or operator of some other medium has a responsibility, really, to himself. He doesn't—he may somewhere along the line be able to avoid the conflict that develops in the organization manager who is faced with the problem of what is good for the stockholders and what is good for the community.

Senator MONDALE. In other words, it's possible for you, owning your own business, to take a position which you deem to be in the best interest of the community, which may not be in the best interest of the profit structure of your business at the moment?

Mr. How. This is correct.

Senator MONDALE. But if you were working for a totally publicly owned stockholders corporation, you might have to look differently at that problem?

Mr. How. You would certainly have to take into consideration, entering into your decision, your obligation to your public stockholders.

Senator MONDALE. Would you say that this trend toward nonlocally owned news facilities—newspapers and the rest—has been the result, in part, of the present estate tax structure?

Mr. How. I think it has been the result in part, yes. There are other incentives, not the least of which is money.

Senator MONDALE. But it is a matter of significance, in your judgment, in that trend?

Mr. How. I think its fair to say, and partly from my own knowledge, that in about a third of the cases of mergers or sales of groups it is a factor. It is a major factor.

Senator MONDALE. I found that study I referred to earlier, the study by Mr. John Udell, University of Wisconsin, called the Social and Economic Consequences of the Merger Movement in that State. And it showed that those companies acquired by out-of-State corporations experienced a substantial decline in payment and payroll growth.

In addition, the new out-of-State parent corporation frequently required the acquired company to use the legal, financial, and purchasing services of the parent corporation rather than continuing to have this done locally.

The study also found that local United Fund contributions were adversely affected by out-of-State takeovers. The study also included a survey of some 20 acquired companies showing that the two most frequently cited reasons for selling out were, one, to reduce estate tax problems for the previous owners and, two, to acquire financial sources for the company.

Senator Humphrey?

Senator HUMPHREY. Mr. How, you have certainly made a very strong case, particularly in the media field. I think when you add up the fact that smaller enterprise, particularly when there is tight credit and high interest, has less attraction to the money market, or to put it another way, the prime rate goes to the best customers, to the biggest customers. This is a factor which surely has to be taken into consideration. Anyone who runs a small business knows that the margin of difference in interest rates is a high cost item in operating the business, that's No. 1. Not getting in the media field, but even such things as advertising, when you go into large operations your unit costs are sometimes less than they are in smaller operations.

But if you look at the money, at the tax rate itself, which you emphasized in the matter of estate taxes, I think you will find the following: The top estate tax rate for companies above $10 million of taxable estate is 77 percent. The top capital gains rate is 35 percent, a merger is tax free with the exchange of stock.

In other words, if you can take your company and exchange the stock with ITT, A.T. & T., or General Motors, it's absolutely tax free.

So you see that, again, the tax laws themselves accelerate and accentuate the very thing that we say we do not want to have happen. Namely, that the big get bigger and the small get fewer.

I would surely agree with you that in any form of communication, that this has very serious social constraints and dangers. There is a need not only for competition in the marketplace of goods, but in the marketplace of ideas. And I think it's very serious that today, with the exception of small radio stations, it is very difficult to establish major newspapers or a major television outlet unless there is big financing and big backing. And the money is made in the transaction of mergers.

I don't want to become detailed in it, but it can be documented point after point, instance after instance.

I hope that as we look at the matter of taxes, that we'll not just concentrate, of course, on estate taxes and inheritance, because while that is important there are other tax laws that affect independent and small business.

The truth is, the large corporation gets a bigger tax break than the small corporation; if you add it together all the way down the line.

I was speaking this morning with our specialist, who I had come out from Washington, that works with us in the Joint Economic Committee in the small business area. And, in general, in general its more difficult, may I say to Mr. Cherne here and Mr. How and others, for the smaller business—and I don't mean the $5,000, $10,000 one, but an enterprise that has some growth possibilities. Its more difficult, the tax laws are rigged against you. And this is the time to examine them, we are going to examine all the tax laws. The Finance Committee and the House Ways and Means Committee.

Mr. Cherne. Senator Humphrey, may I add one thing about that point? You recall I said for a small company our administration costs are around 15 percent, 15 cents out of every sales dollar. I know Minnesota Mining is 5 cents. And, of course, you just mentioned one item, prime rate. Big companies can have prime rate. For us its more, that's part of our administrative costs.

Therefore, in the area of taxes I think the small companies, you should raise that lower limit up from where it is now.

Senator Humphrey. That is what Senator Mondale was referring to, we made a start in the last tax reduction bill, but it was a hurried start and this is why these hearings are being held here and in Washington, to get a good picture of just what we mean by small business, No. 1, and, second, what kind of tax rates ought we to have at the corporate level. And people should not look upon them as concessions, that's my point.

My point is if there are any concessions and you put it together in one bag, the larger, let's say above the $50 million corporation, you could possibly get a better break. I'm not saying they ought not to have certain breaks, because I think investment today is of critical importance and capital formation has become a matter of urgent necessity and we ought not to just generalize on it.

But to say that you are going to give small business a tax break really is merely to talk about giving them a better chance to catch up.

Mr. Cherne. To be competitive.

Senator Humphrey. Yes; to be competitive. We have the effective rates, Federal taxation on manufacturing corporations by asset size, and it's on page 345 of the Small Business Committee hearing record. And it shows, for example, that for all manufacturing corporations, the effective rate is 41.36 percent.

Under $1 million, 51.25 percent.

From $1 to $5 million, 50.64 percent. I'm pointing out that if you take all manufacturing corporations, which includes the very large giants, the effective Federal tax rate on manufacturing corporations is 41.3 percent. But you take corporations that have asset size of $1 to $5 million, its 50.64 percent, $5 to $10 million, that approaches somewhat the size you were speaking about on the low side there, 50.64 percent—$10 to $25 million, 51.3 percent—$25 to $50 million, 50.70 percent. Now, when you get to $1 billion and over the tax rate is 35 percent.

When you get from $250 million to $1 billion, the effective tax rate is 44 percent. So you are carrying an extra bag of stones on your back just to start. And then you'd take a look at what the interest rates are that you have to pay, the compensatory balances, you take a look at what it is in inventory control and management, which is the key to most businesses, and you begin to find out why people are in trouble.

Senator MONDALE. Mr. How, you and the others have all testified for an increase in that minimum exemption, which would reflect the realities of inflation and the rest. And I think that's unanimously agreed to here.

But there has been no discusion about the rate of tax on assets that are subject to the tax. And I'm wondering whether that table of taxation, which itself was established in 1942, as well as the exemption, doesn't need to be adjusted upwards.

Mr. HOW. Senator, my feeling on that, and I speak only for myself, is that the problem is not so much with rate as with methods of valuation. If your valuations bear some relation to the worth of the enterprise, farm, and business, to its heirs, then the rate is relatively immaterial. And, in fact, the rate may be doing what it was intended to do, which was to stop the accumulation of massive piles of money at the top. The sharp graduation upward isn't of tremendous significance.

If we are talking about farming and small business, if we can get the value into some relationship with worth, with actual worth to heirs.

Senator MONDALE. In other words, it may be worth less to the heirs as a going business than it would be on the market if you were to sell it?

Mr. HOW. I think this is the whole estate problem, is that my corporation may well be worth $1 million or more to my heirs. But it is worth perhaps seven or eight times that to a group operation that—because its not available because its in a good market and there's only one of it and because of, as Mr. Cherne said, the ability to take something bigger and drop your administrative costs 10 percent. So its very attractive to them, its worth much more to them than it is to my wife. It can only provide her so much money.

Senator HUMPHREY. Exactly.

Senator MONDALE. Now, a few years ago I put in a bill to value farms at their value for farming purposes for estate tax purposes where the heirs continued to farm. That bill hasn't passed yet, but I think that's a correlary to what you are talking about.

Mr. HOW. That's exactly right.

Senator MONDALE. Where your heirs continue on a privately owned, local business it should be valued in terms of its value to them.

Mr. How. That's correct.

Senator Mondale. Now if at some later point they sell, then somehow that should be recouped.

Mr. How. It can be recouped. In the first place, they are going to pay capital gains. But you could, as I think Mr. Cherne before I suggested, you could defer——

Senator Humphrey. Wait.

Mr. How. You could defer State taxes until a sale or you could put a limitation on the time that they were deferred for.

Senator Mondale. This is really a problem in agriculture where a farm abuts a growing suburban community. Because its value for a shopping center or for subdivided land, may be 5, 6, 7, or 10 times greater than its value for farming and it almost forces those farmers to sell and produces urban sprawl, which we all agree, I think, is out of hand at this time.

So far all these reasons it's been a bad development.

Senator Humphrey. This is what I was getting at earlier, the two forms of value, of assessed valuation, which is what Senator Mondale is speaking of now in terms of farmland abutting a surburban development or shopping center development and so forth and it gets a big assessed valuation. And the other is use valuation. And use valuation in the instance of an enterprise such as yourself, Mr. How, is would be what use does it have to the family, what does it provide in terms of income, living, compensation, et cetera, for the persons that operate it.

I think the proposal made of a deferred estate tax, once that the use in terms of the original owner and the inheritor—those that inherited from the original owner—once that use is changed then you could move to the other higher tax, to the estate tax.

Mr. How. Well, I certainly wouldn't argue that if my heirs were taxed in such a way, that they could keep the business and subsequently decided to sell at a very increased value over the amount they paid in tax, I wouldn't argue that they shouldn't at that time pay the difference.

Senator Mondale. As a matter of fact, that would be an additional encouragement to keep it locally owned.

Mr. How. That's right.

Senator Humphrey. I notice if the estate tax rate at $1 million, for example, of taxable estate is about 39 percent. The capital gains rate is 35, so that if it was a smaller company, let's say at a taxable estate of $1 million, the gain in playing the tax game would be modest even though the 4 percent is not to be sneezed at, its something worthwhile.

Mr. How. You see, you accentuate that, too, because the lower you tax it the lower you value it in an estate, the lower the base on which you are going to pay capital gains taxes. So you are going to punish yourself.

Senator Mondale. Thank you very much for a most excellent panel.

Our next panel of witnesses consists of Mr. Oelke, attorney in Minneapolis; John Kraft, attorney in Olivia; Mr. Thomas Waterbury, professor of law, University of Minnesota Law School; Norman Winer, chartered life underwriter, Minneapolis; and Richard Thorsen, CPA, Minneapolis.

Please come forward.

[Off the record.]

Senator MONDALE. The committee will come to order. We have Commissioner Richard Hanson with us, although he is leaving just as we introduce him.

This panel has been introduced and we are adding Mr. Jack Carlson, representing the Greater Minneapolis Chamber of Commerce. And we will start with Mr. Oelke of Minneapolis.

STATEMENT OF ROBERT W. OELKE, ATTORNEY, MINNEAPOLIS, MINN.

Mr. OELKE. Thank you, Senator.

Senator HUMPHREY. By the way, may I interrupt? Are you related to an Ed Oelke, by chance?

Mr. OELKE. Yes; he was my father, Senator.

Senator HUMPHREY. Well, I want to say hello. He was my benefactor, I would have starved without him when I went to the university. Thank you very much.

Senator MONDALE. Do you want to say anything more about that?

Senator HUMPHREY. No; he was a great friend of mine.

Mr. OELKE. Senator, I have three recommendations which I have made in my prepared statement. All three of which have a familiar ring by now. First, that the $60,000 specific exemption against the Federal estate tax should be significantly increased; second, that real estate devoted to farming or to the operation of other small businesses should be valued for estate tax purposes with reference to that use and without reference to its value if put to some supposed optimum use; and, third, that the interest on the estate tax in those situations where the tax may be deferred should be assessed at a rate no higher than 4 percent.

I am an attorney who practices in the area of estate planning and probate administration and for that reason I have a prejudice that leads me to believe that many solutions to the problem are nonlegislative.

One: The present Federal estate tax exemption was established at a time when a loaf of bread cost a dime, a fine automobile could be purchased for less than $1,000, and good farmland was available for $100 per acre or less. If a man left his wife and children with an aggregate of $100,000 of assets, he was thought to have secured their financial future. Today bread approaches 50 cents a loaf, a cheap car is $4,000, and it is not unusual for farmland to be traded at $1,000 per acre or more. Whereas an estate of $60,000 generated no estate tax 30 years ago, an estate representing the same purchasing power today would bear the burden of a Federal estate tax well in excess of $20,000. The Congress has seen fit from time to time to increase the Federal income tax exemption. It is long past time for the Congress to acknowledge the eroding effect which inflation has had on the $60,000 estate tax exemption and to increase it at least threefold, with parallel adjustments to the Federal gift tax exemption and exclusion.

Two: We have assumed here, correctly, today that it is our national policy to foster the preservation of family farms and other family businesses, and I believe the Internal Revenue Code should be amended to permit the estate of a farmer or a small businessman the option to value real estate used in connection with the operation of the farm or business at the value thereof when so used, without attempting to speculate what greater value might be attributed to the real estate if put to some different use.

Such legislation would necessarily contain safeguards to assure that if within some reasonable period of time after the death of the farmer or small businessman the real estate is sold or its previous use substantially altered, the estate tax would be recomputed without the benefit of the optional valuation. Continuity in the family unit of the operation of the farm or other small business utilizing real estate would thus be encouraged, and with a minimal effect on national revenue in view of the modest proportion of total receipts which estate taxes represent.

Three: Section 6161 of the Internal Revenue Code permits an estate, with the consent of the Secretary, to defer payment of the estate tax for as long as 10 years where it is determined that payment would result in "undue hardship" to the estate. The regulations cite as examples of undue hardship (a) the necessity to liquidate assets at a sacrifice or in a depressed market, and (b) the necessity to sell a family business to unrelated persons, even though the price may be equal to its fair market value, at a time when the estate representative has a prospect of raising funds from other sources for the payment of the tax. Section 6166 of the Code gives the estate representative the right to pay in as many as 10 annual installaments that portion of the estate tax attributable to the decedent's interest in a closely held business, provided that the interest constitutes a specific percentage of the estate, regardless of whether the estate has sufficient cash to pay the tax in full.

Now, for years these two deferred taxes attracted interest at the rate of 4 percent. Effective this year, the rate was increased to 9 percent and the Secretary has authority to make adjustments to that 9-percent rate from time to time.

Senator MONDALE. Mr. Oelke, I think what was happening with the old 6-percent assessment on unpaid income tax was that a lot of people were just saying, "Well, I can get better than 6 percent so I think I'll just owe this money to the Federal Government."

So, in order to prevent that from happening, to make people pay their taxes, it was raised to 9 percent, which was then the prevailing rate.

But then I think we did not carefully discern the difference between income tax delayed payments and estate taxes.

Would you agree they have different problems and good public policy justifies a reduced rate for the estate tax? It's really a problem of a big bill that has to be paid all in 1 year and, therefore, you want to spread to avoid the bunching problem?

Mr. OELKE. I'm in complete accord with that observation, Senator. The provisions that I have briefly described here are clearly intended to be relief provisions and the potential for their use is there, but my own experience is that these provisions are seldom used. The deferring of the payment of estate tax occurs only rarely.

In my own practice I've only had the occasion to use this provision twice in 24 years, and I think that that is not an untypical experience. And it seems to me that increasing the interest rate by 150 percent works to discourage the use of these sections and to that extent the Congress is withholding the relief which initially was intended to be affected by those provisions.

I feel that no one this side of paradise could have anticipated the inflation that the country has experienced in the last 30 years or so and I feel, also, that while this adds to the tax burden very substantially, the cost of transmitting, let's say, the family farm from father to son is affected by many nontax circumstances.

I have included in my prepared statement a very homely illustration where the father is the sole proprietor of the business and the business will not support more than one family, with the result that three of the children leave the business and engage in other activities while one son stays on to assist his father with the expectation, on everybody's part, that one day he will have the business.

Over the years the business cash in excess of living expenses is put back into the business, purchasing real estate, equipment or otherwise. At father's death, the business has a value of $200,000 and attracts an estate tax of $31,500. That's a very significant number.

But since this is the principal asset in the father's estate, the tax may be paid in 10 annual installments of $3,150 plus whatever interest rate is then prevailing, so that it is something that normally could be handled.

And while this tax and interest is a substantial obligation, a far more disturbing question for the son is how he can possibly scrape together sufficient financing to permit him to pay off his brother and sister the $126,000 plus, which is their three-fourths of the estate, and pay them interest on what he isn't able to pay now.

It is my personal experience that it is that kind of a burden, the burden of buying out the inherited shares of the rest of the family, rather than the burden of the Federal estate tax, which is determinative on the question of whether the family business will be retained or sold.

There are many tools available to the farmer or the small businessman that go under the generic term of "estate planning."

It mould not serve the purpose of this hearing for me to review any of those now, but it is important that at an early time in his business life, the farmer or small businessman should decide what his goals are and take steps to put his plan in order so that the Federal estate tax will be the principal problem to hurdle at intergenerational transmission rather than only an additional problem.

Thank you.

[The prepared statement of Mr. Oelke follows:]

STATEMENT BY

ROBERT W. OELKE, PARTNER
FAEGRE & BENSON
ATTORNEYS AT LAW
MINNEAPOLIS, MINNESOTA

BEFORE THE

SENATE COMMITTEE ON SMALL BUSINESS
and the
JOINT ECONOMIC COMMITTEE

Minneapolis, Minnesota
August 26, 1975

These hearings are being conducted for the purpose of examining the impact of the federal estate tax on the estate of the small businessman, including the agricultural businessman, and what legislative steps might be taken to ameliorate the problems created by the imposition of that tax. It is my opinion that the Congress should act in three specific areas tc help relieve the heavy burden which this tax presently constitutes in many estates:

1. The $60,000 specific exemption against the federal estate tax should be significantly increased;

2. Real estate devoted to farming or to the operation of other small businesses should be valued for estate tax purposes with reference to its value for the purposes used and without reference to its value if put to its optimum use;

3. Interest on estate tax, payment of which has been deferred pursuant to the provisions of Internal Revenue Code §§6161 or 6166, should be assessed at the rate of 4% rather than at some higher rate.

As an attorney whose practice has centered on the fields of estate planning and probate administration for 24 years, it is my further opinion that many of the problems faced in transmitting the small business or farm to members of the next generation have solutions which are non-legislative in nature.

1. The present federal estate tax exemption was established at a time when a loaf of bread cost a dime, a fine automobile could be purchased for less than $1,000, and good farm land was available for $100 per acre or less. If a man left his wife and children with an aggregate of $100,000 of assets, he was thought to have secured their financial future. Today bread approaches 50 cents a loaf, a "cheap" car is $4,000, and it is not unusual for farm land to be traded at $1,000 per acre or more. Whereas an estate of $60,000 generated no estate tax thirty years ago, an estate representing the same purchasing power today would bear the burden of a federal estate tax well in excess of $20,000. The Congress has seen fit from time to time to increase the federal income tax exemption. It is long past time for the Congress to acknowledge the eroding effect which inflation has had on the $60,000 estate tax exemption and to increase it at least three-fold, with parallel adjustments to the federal gift tax exemption and exclusion.

2. Assuming that it is our national policy to foster the preservation of family farms and other family businesses, the Internal Revenue Code should be amended to permit the estate

of a farmer or a small businessman the option to value real estate used in connection with the operation of the farm or business at the value thereof when so used, without attempting to speculate what greater value might be attributed to the real estate if put to some different use. Such legislation would necessarily contain safeguards to assure that if within some reasonable period of time after the death of the farmer or small businessman the real estate is sold or its previous use substantially altered, the estate tax would be recomputed without the benefit of the optional valuation. Continuity in the family unit of the operation of the farm or other small business utilizing real estate would thus be encouraged, and with a minimal effect on national revenue in view of the modest proportion of total receipts which estate taxes represent.

3. Section 6161 of the Internal Revenue Code permits an estate, with the consent of the Secretary, to defer payment of the estate tax for as long as ten years where it is determined that payment would result in "undue hardship" to the estate. The Regulations cite as examples of undue hardship (a) the necessity to liquidate assets at a sacrifice or in a depressed market, and (b) the necessity to sell a family business to unrelated persons, even though the price may be equal to its fair market value, at a time when the estate representative has a prospect of raising funds from other sources for the payment of the tax. Section 6166 of the Code gives the estate representative the right to pay in as many as ten annual installments

that portion of the estate tax attributable to the decedent's interest in a closely held business, provided that the interest constitutes a specific percentage of the estate, regardless of whether the estate has sufficient cash to pay the tax in full. For years interest on payments under either of these Code provisions was assessed at the rate of 4%. Effective July 1, 1975, the rate of interest was increased to 9%, with power in the Secretary to further adjust the interest rate from time to time.

While both of these provisions have great potential use in averting the necessity of an untimely sale of farm or business assets in order to make timely payment of the tax, neither is widely used. In 24 years of probate practice I have on only two occasions taken advantage of the relief afforded by these provisions. Conversations with other attorneys and with the local office of the District Director leads me to believe that my experience is not unique. Since these Code sections are seldom used, it follows that they are seldom abused and there was no need to change the interest rate. To the extent that increasing the interest rate by 150% discourages the use of these sections in the future, Congress is withholding the equitable relief which was initially intended.

* * * *

While it is true that the sagest prophet could not have anticipated the tremendous increase in the impact of the federal estate tax by reason of inflation over the last 30 years, it is also true, in my opinion, that the erosion of capital for non-tax purposes in the typical transmission of the farm or other small business from father to son may and frequently does dwarf the problems of tax payments. Let me pose an example which may not be untypical.

Father is the sole proprietor of the family business (farm or otherwise). The business will not support more than one family, with the result that three of the children leave the business and engage in other pursuits while one son stays on to assist father, with the expectation that some day the business will be his. Over the years business cash in excess of living expenses is used to acquire additional real estate, equipment, machinery and other business assets. At father's death the business has a value of $200,000 and an estate tax of $31,500 is payable.

Since the business was the principal asset in father's estate, the tax may be paid in ten annual installments of $3,150, plus interest on the unpaid balance. While the tax and interest are substantial obligations, a far more disturbing question for the son who remained with father is how he can possibly scrape together sufficient financing to permit him to pay his siblings the $126,000 plus representing their three-fourths share of the estate, again with interest on the unpaid balance payable either to the siblings or to his lender. It is my experience that it is the crushing burden of buying out the inherited shares of family members outside of the business, rather than the burden of the federal estate tax, which is determinative on the question of whether the family business will be retained or sold.

Intelligent estate planning, commenced early in one's business life and periodically reviewed as family and estate dimensions change, can serve to drastically reduce the impact of the federal estate tax. Should the small business owner (or other members of his family) secure insurance on his life to provide liquidity for the payment of taxes at his death? To enable the son to buy out his siblings? Should property be acquired in or transferred to the joint names of the owner and his wife? His children? Should he engage in a program of lifetime giving? Should the business be incorporated to facilitate a gift program? To prevent father's interest in the business from increasing in value? Should father and son enter into a buy-sell agreement with respect to the business? What steps should be taken to insure the owner's widow of security in the event she survives him? Will his estate be eligible for the maximum marital deduction against the federal estate tax? How about an installment sale? A private annuity? How do you best protect the interests of minor children? Of children who are not active in the business? What are the relative advantages and disadvantages of the various alternatives available?

The problem of transmitting a closely held business interest from one generation to the next is not a new one, and if there were a single pat answer it would have been universally adopted long ago. Each family situation must be reviewed on its own facts. Nevertheless, I believe that if the legislative reforms proposed above were adopted, and the estate owner and his family were to prepare for the transition of assets by utilizing a competent estate plan the nation would be assured of the continued vitality and independence of competetive small businesses and farms.

Senator MONDALE. Were you saying, Mr. Oelke, that while in this example that you believe to be typical there is another problem greater than the estate tax problem, nevertheless, the estate tax, as presently structured, contributes to the difficulty of solving it?

Mr. OELKE. Oh, indeed so. Thank you.

Senator HUMPHREY. I just thank you, Mr. Oelke, for your helpful recommendations and also for calling to our attention the matter of the buying out of the shares, which gets to be a very serious problem for anyone that is in the situation of your example.

Let me just quickly say, again for my friend and colleague here, that when I was a student at the university, at the corner of 14th and Fourth Street S.E., there was a drugstore that your father ran. And I was one of those that didn't have enough money to pay my tuition. And I went to see your father time after time looking for a job, and I think he finally gave me one because I was a pest. And, in fact, the truth is I went down in the basement of the store without ever having a job one day and started washing dishes and cleaning up the basement. And your father came down and said, "What in the world are you doing down here? I didn't hire you."

And I said, "No; but you have to, there's just no way out, you've just got to do it."

And he said, "I think its cheaper to hire you than to keep telling you to get out."

And he gave me a job and was one of my best friends. I just wanted to put that down in the public record because it's little things like that that make life meaningful.

Mr. OELKE. Thank you, Senator. Among other observations my father had about you was that you were a malted milk expert in the consumer area.

Senator HUMPHREY. I used to do what we call eat the mistakes. It was one of the ways we survived. There was a chap by the name of Schumacher that came to see me, Fritz, not long ago, and he was a railroad clerk. He didn't know anything about making ice cream sodas and malted milks. But he got a job, and between myself and Fred Schumacher, we made enough mistakes that we survived. We never purchased lunch. I could swallow a whole cheese sandwich while I was chipping his ice.

Senator MONDALE. In about 4 months some tax experts are going to go over this record and will try to figure out the significance of this. And I wish them well.

Next is Mr. John Kraft. I would ask that we try to keep the statements as short as possible, since we are running out of time. We want to hear fully from you, but at this stage in the hearings, we often repeat points that have been made. But proceed as you wish.

STATEMENT OF JOHN H. KRAFT, ATTORNEY, OLIVIA, MINN.

Mr. KRAFT. Thank you, Senator. My name is John Kraft, and I'm from Olivia, Minn., and I practice in a three-man law firm there, and our office is in the general practice of law. But within that framework I do all of the estate planning, probate, and business law matters.

I think that the most significant factor that we are dealing with in the farm estate or small business estate is that we are most often dealing with an estate that deals with only one asset, a farm operating unit or a business. There is generally very little liquidity, together with a large amount of debt.

Because of the lack of liquidity, there are only two methods of obtaining farms to pay estate taxes. One, borrow the necessary funds; or two, sell a portion or all of the assets.

In the situation of the farm economy, we have experienced a continuing decline in the number of farmers and an increase in the average size of the farms.

I believe Government should be concerned with the decline in the number of farmers and make every effort to prevent large estate taxes from causing a further decline.

In my experience, I have never seen an individual go into the farming business without the assistance of his parents, a relative, or a generous benefactor.

Business which deals with agriculture is not concerned with the number of farmers that they deal with. They are concerned with acres, not farmers.

The numbers of farmers they deal with does not determine their profits and losses. The numbers of acres for which they supply or the numbers of acres for which they purchase the product determines their profit and loss.

The business sector of the economy, therefore, really has no incentive to protect the number of farmers. Government all too often does not concern itself with the number of farmers either. We continually read statistics concerning total production, total production per acre, total cost per acre, and so forth. But never do we read about production or cost of production per farmer.

But there is only one person vitally interested in continuing the farm operation as a unit, and that is the farmer.

With this in mind, let's arrange the tax laws in such a way that the farmer's objectives of passing the farm operation to his son or sons can be accomplished.

The first thing that should not be done is taxing the appreciation of capital assets at death. This has been said many times this morning; I won't spend any further time on that. I would suggest that the gift and estate tax be combined into one transfer tax. There should be one tax rate and one exemption applied whether there is a lifetime gift or a transfer upon death.

The farmer and the small businessman find it almost impossible to take advantage of the favorable gift tax rate and the generous exemptions and deductions provided by the gift tax laws. The only ones that can take advantage of the gift tax law break are the wealthy. The farmer and the businessman have only one asset and he can't give that away.

Second, I suggest that the marital deduction concept be eliminated or maybe what we should call a 100-percent marital deduction.

Senator MONDALE. Minnesota has the full deduction?

Mr. KRAFT. No; they don't.

FROM THE FLOOR. $35,000.

Mr. KRAFT. The wife has $30,000 and the surviving husband has $6,000.

Senator MONDALE. OK.

Mr. KRAFT. I think that this transfer between husband and wife should be tax free, whether it be by a gift or at death. Under our present law only half of the estate can transfer to the surviving spouse, tax free.

Now, this is an oversimplification, but for discussion purposes we'll use this.

The other half is taxed whether it goes to the spouse, to the children, to a trust or wherever it goes. If it goes to the spouse it will be taxed again upon her death, so we have a double taxation of that half.

The estate tax technique of using a trust to receive the taxable one-half works conveniently for an estate which can be easily divided. But we are talking about an estate of only one basic asset, which is not easily divisible. It doesn't work so easily, even though we have been forced to use this technique solely because of the estate tax laws.

Furthermore, the farmer and the small businessman cannot afford the professional administrative assistance that such techniques require. They simply cannot understand their operation and to be very frank, they screw it up and they lose whatever benefit that was arranged.

Together with the elimination of the marital deduction concept and establishment of a transfer tax, I suggest that the present individual State and gift tax exemption be replaced by what I will call a family exemption.

Borrow from the gift tax exemption the $30,000 for the wife and the $30,000 for the husband; that is provided for a lifetime exclusion, and borrow from the estate tax law the $60,000 individual estate tax exemption of the husband and the $60,000 estate deduction of the wife, put it together and we have $180,000 deduction, that's a nice start. Perhaps it should be a lot bigger than that.

In my opinion this would solve many problems facing the small businessman and the farmer.

It would allow for the transfer of the entire estate to the surviving spouse without any fancy legal gyrations and without any adverse tax consequences. Transfer to the surviving spouse is one of the objectives almost everyone of my clients has. They are not interested in transferring it directly to the children. They want the use of the property for the joint lives of themselves.

Also, everyone would be given the benefit of the exemption, not just those who can afford to make the lifetime gifts and those who have easily divisible estates. At the same time, it will not hinder those wishing to make lifetime gifts or transfer a portion of his estate to someone other than his surviving spouse upon his death. They still can use this exemption at this time and it does not penalize the individual who desires to transfer all to his surviving spouse.

Senator HUMPHREY. You'd have an option?

Mr. KRAFT. Yes, if he wanted to transfer part to his children he could transfer upon his death. And whatever was used on his death would be subtracted from the $180,000, to be used for the surviving spouse.

An analysis of this proposal reveals that there has been no change in the amount of exemption. But there has been a change in the availability of the exemption for use by the farmer and the small businessman.

As I explained before, the rich individual can take advantage of the gift tax exemption and deductions and the farmers and small businessmen cannot.

One concluding comment in regard to the so-called family farm inheritance tax proposal which, as I understand it, provides a specific proposal or a specific exemption just for the farm operator.

I guess that I don't—I do disagree with this concept of providing special exemption for only one individual sector of the economy. This is not equitable and I do not believe that the farmers are asking for this special treatment. I think the increase in the exemption is necessary for both the small businessman and the farmer.

Thank you.

[The prepared statement of Mr. Kraft follows:]

STATMENT BY

John H. Kraft, attorney with the law firm of
Willette, Kraft & Walser, Olivia, Minnesota

BEFORE THE

SENATE COMMITTEE ON SMALL BUSINESS
and the
JOINT ECONOMIC COMMITTEE

Minneapolis, Minnesota
August 26, 1975

INTRODUCTION

I practice with a three man law firm at Olivia, Minnesota. Our practice consists of a general practice dealing with farmers and small agricultural related businesses in West Central Minnesota. Within our general office practice, I handle the estate planning, probate, tax and business law matters.

I will direct my analysis and opinions concerning the Federal Estate and Gift Tax Laws as they relate to the farmer even though most of my comments will apply to the small businessman also.

UNIQUE ASPECTS OF THE FARM ESTATE

There are three basic economic factors involved with the farming business that in the combination, make the farming business unique. First, the capital investment of the farmer is very high as compared to the cost of the labor input. Secondly, the income to asset value ratio of the farmer is extremely low. The statistics of the IRS indicate that this ratio is only about 3% nationally for farm and ranch net income. Thirdly, the inflation of land values has been unbelievable. I would estimate that land values of Renville County, Minnesota, have increased by 100% in the last three or four years.

FINANCIAL FACTORS OF THE FARM ESTATE

In addition to the economic factors, several financial factors of the farm business must be noted. The typical farmer has substantial short, intermediate, and long term debt. The inflated land costs have greatly increased the necessity for long term borrowing by any farmer who finds it necessary to expand the number of acres operated. The short term borrowing increased even more because of the high cost of yearly operating expenses. This increased debt load of the farmer has amplified the lack of liquidity problem facing most farm estates. Only about 5% of the wealth of the farmer is not tied up in production assets according to the USDA. I would be the first to admit that farm land is a liquid asset from the point of view of obtaining immediate cash if the necessity arises, but this, of course, means the dissolution of a farm operating unit. The typical farmer reinvests in the operation any liquidity that he may obtain.

SIGNIFICANCE OF ECONOMIC AND FINANCIAL FACTORS

What is the significance of these economic and financial factors? Most importantly, it means that if a farm unit is forced to dissolve because of the necessity of paying taxes, it is gone forever. The land and assets will be acquired to expand an existing operation. In my experience in growing up on a farm in Southwestern Minnesota and in practicing law at Olivia for nine years, I cannot recall of a specific instance when an individual went into the farming business without the assistance of his parents, a relative, or a retiring charitable individual. Business, both big and small, and government do not have any incentive to deal with the farmer as a person, but deal in terms of acres, production per acre, cost of production per acre, etc. Businesses supplying farm production inputs and purchasing the production of the farmer do not care whether they sell to one or twenty persons because their financial condition is determined by the number of acres they can supply or the number of acres of production they can purchase. Government speaks in terms of total production, production per area, production cost per acre, etc. Nowhere is there ever any mention of production per farmer. I understand this philosophy of business because they are in business to make the best profit --and rightfully so. Manufacturers, distributors, wholesalers, and business in general, are interested in getting as many salesmen, retail outlets, and as much exposure of their product as possible. Therefore, they encourage and assist such businesses in their establishment thru guaranteed salaries, financing arrangements, education, advertising, etc. However, government should be sensitive to the retention of the number of farmers. At the very least, it should not force the farmer to dissolve his farming unit to pay estate taxes. As I indicated, the only individual with any real incentive or interest of continuing a specific farm unit is the owner of that farm unit. Consistently, I hear the objective of the farmer in planning his estate, "I want to keep the farm together for my son, but I want to treat all my kids equally". I have most often suggested that the farmer accomplish these objectives by providing the farmer-to-be-son with an option to buy the farm land upon the death of the parents at the then market value. This creates the following economic fact. The parents have worked many years to put together the farm operation and it is usually just becoming an efficient operation because the income has been plowed back into the operation and the debt load has finally become manageable. Now, in order to compensate the non-farming children, the farmer-to-be-son must borrow to the limit, if indeed he can. This then immediately lessens the efficiency of the farming unit and the cycle starts all over again. Of course, as you add estate taxes to the transfer, which taxes are ever increasing under present law, the number of farm units dissolving will correspondingly increase.

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Let's make every attempt to prevent a decrease in the number of farmers. We have already lost too many without forcing a further loss by high estate tax.

I will address myself to some of the proposed estate and gift tax changes as well as indicate some changes that I think would encourage the continuance of existing farm units and would, in most instances, apply equally to small business. These are primary objectives of most everyone.

TAXING THE APPRECIATION OF CAPITAL ASSETS AT DEATH

If our objective is to eliminate the family farm, a tax on the appreciation of capital assets at death is the one that would do it. Inflationary values of farm land have created the estate tax problems for farmers, not the accumulation of wealth caused by monopolistic supply and demand conditions as is the case in some industries. Land is an asset required by all farmers. Add such a tax to the already high estate tax, and the results need no comment.

I am aware of the abuses and the problems of granting a new basis for capital assets upon death. I do not believe that the criticisims of this "loop hole" have been directed to the situation where the assets owned by a businessman or farmer have increased in value and are an integral and necessary asset of production in his operation. I believe it is directed, and maybe should be, at the investment situation. Any such drastic change in the tax law should provide an exemption for assets owned, used, and necessary in the business operation. Not only would this exemption be a necessity to the farmer, but also, to a lesser extent, the typical small businessman.

UNIFICATION OF ESTATE AND GIFT TAXES

In my opinion, unification of estate and gift tax into a single transfer tax has merit. By definition, the small businessman and the farmer are unable to take full advantage of the gift tax exemptions and the lesser gift tax rates. First, they usually cannot afford to make a gift without giving up their financial independence. Secondly, even if they felt they could afford it, they are not able to do so because their wealth is concentrated in a single integral asset. It may not be impossible to do so, but it is usually not practicable. If they decide to make a gift, it is necessary to use an artifical business form to protect the operating unit, such as a corporation, a trust or a partnership. The persons who can take full advantage of the gift tax benefits are the very wealthy individuals who have diversified investments. The gift of one asset does not affect the assets retained.

I would like to point out here that the typical farmer and small businessman is skeptical about becoming involved with the use of a trust, a corporation, or a limited partnership. They consider such creatures to be unnecessary and complicated methods of doing business. They do not have the experience, interest, or funds available to go through these gyrations. The time, effort, and methods of planning a small estate for tax purposes are the same as for a 10 million dollar estate - at least that is what I have been told. Therefore, I would urge that the tax structure be organized in such a way so as to minimize the necessity of using these so called "sophisticated estate plans" for the sole purpose of saving taxes. The farmer and the small businessman are more interested in working in their business rather than tax planning. Why should they be penalized for allocating their resources to production?

PROVIDE A FAMILY EXEMPTION AND ELIMINATE MARITAL DEDUCTION

In my opinion, the starting point for eliminating the penalty of farmers and small businessmen would be to eliminate the marital deduction concept and provide a family exemption realistic in light of our present inflationary values. The tax should be a transfer tax with no distinction between intervivos transfers and testamentary transfers. Rather than having individual exemptions of $60,000 for estate tax purpose and the $30,000 lifetime exclusion for gift tax purposes, there would be a $180,000 "family exemption". Preferably this exemption would be even more. There may have to be an adjustment of this exemption for the person who never married. There would be no tax on transfers between husband and wife. I believe such a method of tax is more equitable and would not appreciably affect the collection of funds by the government, which is always of someone's concern.

First, I believe this to be more equitable because the wealthy have been able to take advantage of both the gift tax exemption and the estate tax exemption. This amounts to $90,000 for the husband and $90,000 for the wife. Therefore, we are not increasing the availability of the exemption, but simply making it practicable for the farmer and small businessman to make use of it.

Secondly, the tax free transfer of property between husband and wife will more closely conform to the econom ic and financial factors of the farmer, as well as the typical small businessman. Basically, estate planning under our present structure consists of providing a method of distribution to the children of the family without a tax on the same property both on the death of the wife and on the death of the husband. If all the estate is transferred to the surviving spouse under present law, that portion above the exemption and not qualifying for the marital deduction will be taxed twice by the time it ends up in the hands of the children. There are three basic methods in use for eliminating the double taxation on this portion of the estate; the use of a marital deduction trust, a life estate, or a transfer of the assets to children upon the death of the first one. None of these methods are satisfactory, although used, for the typical farmer or small businessman. They divide an integral operating unit making it cumbersome to operate efficiently. It is not the same as dividing cash, stocks or bonds. The family exemption would allow for the operating unit to be transferred to the surviving spouse without tax. The tax would, however, be paid upon the transfer to the children or beneficiaries upon the death of the last one. This provides [illegible] deferral of tax, but this seems to be a small price to pay for allowing the continued simple and orderly operation of a business or farm unit. If it were not for existing tax laws, most individuals would prefer that their surviving spouse have the benefit and control of the property for his or her lifetime with full freedom of management. This would eliminate the necessity of using techniques presently required which is an exercise the individual does not understand. These techniques are very complicated and many times are not properly administered by the individual.

I think that the idea of a single transfer tax coupled with a "family exemption", as opposed to the present individual exemption, is worth pursuing. I am sure that such a change will affect many provisions of the tax law, but a system which allows the natural objectives of the taxpayer to be accomplished without adverse tax consequence should be fully explored.

JOINT TENANCY

Under present law, the first joint tenant to die is presumed to be the owner of all joint tenancy property. A recent case has made the presumption a little easier to overcome in the farmer - - farm wife situation. Joint tenancy is a very common form of ownership of real estate among farmers. They are becoming more and more aware of the tax problem of joint tenancy ownership, but this presumption is and will cause many estates undue heavy expense, if not unnecessary taxes. The typical farm family has worked together in the farm business and it is through their equal efforts that the entire assets accumulated. This is maybe unique to the farm business and should be specifically provided for in the Code. The taxpayer should [illegible] have [illegible] of overcoming the presumption. In the farm situation, there should at least be no presumption against equal contribution and, in fact, the estate should have the presumption of equal contribution by the surviving joint tenant. The free transfer of property between husband and wife as proposed would eliminate this entire problem of taxation of joint tenancy.

INSTALLMENT PAYMENT OF TAX

The Code provision allowing for the installment payment of tax is a necessary option that must be retained. The advantage of this method of payment was all but eliminated when the rate of interest was increased from 4%. Under the present law, the only estate provided any advantage is the estate that is so lacking liquidity that it is unable to borrow any funds to pay the tax. The interest rate charged by the government is substantially the same rate that the estate would have to pay if it borrowed the funds to pay all the tax when due. I would suggest that the interest rate be fixed at 4%.

PROPOSED FAMILY FARM INHERITANCE ACT

I am opposed to the system advocated by the "Family Farm Inheritance Act" or to any proposal which applies only to farmers. Farming is "small business" and any Federal Estate Tax Relief should apply to everyone. I do not think farmers are asking for special treatment but only the opportunity to take full advantage of exemptions and deductions provided by the tax law without unduly complicating the operation and management of the farm unit.

Senator MONDALE. Thank you very much, Mr. Kraft, for a very fine statement.

Is Paul Willette your partner?

Mr. KRAFT. Yes; he is.

Senator HUMPHREY. I just want to thank you. I think you've given us some new thinking here, particularly in this combination and the options that are there—the lifetime gift tax exemption plus the estate tax exemption totaling up to $180,000.

Mr. KRAFT. Hopefully more than that.

Senator HUMPHREY. But that's a basic minimum.

Mr. KRAFT. We are doing absolutely nothing by leaving it at $180,000.

Senator HUMPHREY. The point is, many people can't take advantage of the law that is presently on the books.

Mr. KRAFT. That's right. I'm sure this would take considerable study and people like Professor Waterbury, to get all the loopholes worked out.

Professor WATERBURY. I haven't got many of them out so far.

Senator MONDALE. Thank you very much, Mr. Kraft, for a very fine statement.

Professor Thomas Waterbury, professor at the University of Minnesota Law School.

STATEMENT OF THOMAS L. WATERBURY, PROFESSOR OF LAW, UNIVERSITY OF MINNESOTA LAW SCHOOL

Professor WATERBURY. Thank you, Senator. In response to your invitation to be terse, let me run quickly through the five specific questions which you raised in your release of August 11 announcing the hearing. And then let me offer the one thing that I thought I might suggest as an alternative approach to one of the problems that has been discussed here.

Senator MONDALE. Professor Waterbury, we will include your full statement as though read, and do the same with the other witnesses, so you can summarize as you deem fit.

Professor WATERBURY. Very good. I am less enthusiastic about the exemption increase than anyone else who has spoken.

I suppose the basic reason why is that I view the question from a somewhat different perspective.

I start with the question, where does a fellow who has to accumulate an estate out of income after payment of ordinary income taxes, get an estate to plan? That is true of the vast bulk of the people in the country.

The only way they do it is by saving out of personal service income, whether they are self-employed persons rendering personal services as professionals or employees.

It is true that they can have pensions provided for retirement, but that is not a source of an estate to transfer to succeeding generations of the family. Or a prominent source of it.

The estate tax exemption is one thing if you are talking about an exemption for assets left after payment of an ordinary income tax. It's another thing if you are talking about assets left that have never been subjected to an income tax.

It is because I would like to have the people who accumulate estates out of income after tax and the people, who engage in businesses which require the accumulation of capital to run the same estate planning race, if you please, that I suggest that realization of the gains tax at death is important.

Put it this way. Take the cases that have been discussed this morning. The fact that the present market value of land is let's assume a thousand dollars an acre, whereas in the depression it was hopefully worth a hundred, as Mr. Oelke suggests, is an illustration of asset value that has never been subjected to an income tax.

So my case for the proposition that the exemptions should be viewed somewhat conservatively is tied into the proposition that the opportunity to transmit some wealth to one's heirs ought not be confined to people who are engaged in heavily capitalized enterprises.

Anyway, to wind up quickly on this realization at death business, the late President Kennedy's original proposal to realize gains at death contained a simultaneous proposal to reduce the gains tax rates.

What the Senate ended up, sticking—I think I'm correct that it was the Senate—into the Reform Act of 1969 was a raise, to raise the maximum capital gains tax rate.

Senator HUMPHREY. That's correct.

Professor WATERBURY. Now, my proposition is this. You don't have to tax capital gains at a particularly high rate incident to a realization at death. It would be all right with me if the overall capital gains rate was 12 percent or thereabouts, which was suggested in President Kennedy's message, as I recall it.

But the proposition is that you do not permit people of the country to run anything like a competitive race in accumulating some property for their families, assuming that's a general motivation of parents, unless everybody starts from a more or less comparable point. And I think there's enough of a break involved in the preferential rate on capital gains, without forgiving the tax altogether, at the time that a person dies. Or to wind up on this point, I might put the point this way.

Suppose that you had been in the Congress, Senator, in 1913 when the income tax law came in and you were listening to the arguments in favor of its adoption.

I dare say that you would not have heard any proponent of it say—since past accumulations of capital were not to be included in income under the 1913 tax—"Look here, we've got all the people with large accumulations of wealth that we want in this country now. What we need is a bunch of people to pay taxes. And, so, we're going to have an income tax and everyone who earns a salary or a professional fee from now on can pay and the capital will belong to the people who accumulated it during the period prior to 1913, and their heirs."

No one would have said that. Now we are down the road a ways. The question is, and it's a hard question, how do you permit capital accumulation for the purpose of helping a fellow who wants to get into a business?

I simply say you don't have to forgive the gains tax to solve that problem.

Senator HUMPHREY. I see your point.

Professor WATERBURY. Now, once you get the realization at death into the law, I think that there are some significant differences between taxing liquid assets and taxing assets that are hard to value and hard to sell, which justify the availability of some relief provisions.

When the Kennedy bill came out in the first place on realization at death, it included some. Section 6166, the 10-year installment payment provision which has been repeatedly referred to this morning was proposed there to be made available to pay a gains tax.

And I agree with Mr. Oelke and others who have spoken, it doesn't make sense to defer the tax and charge the commercial rate of interest. It ought to go back to something that makes the break a break, or forget it. And as far as exemption is concerned, I agree with Mr. Kraft that it would make sense to add the gift tax lifetime exemption to the estate tax exemption and say: "Take it when you want it, only I'd leave it at 90 until we get through deciding what else we're going to do to the estate tax law."

I'd like to see, as I indicated on the first page of the statement, a lot lower scale of rates, certainly at the top. I start thinking about 50 percent instead of 77 and going down. And I guess I'd say just one more thing about the exemption, although I am hopping around. What I meant by saying initially that I'd like to sort of decide what the exemption would be at the end, is this kind of thought. The exemption ought to be a different amount, depending on the height of the first rate. If the first dollar that is taxable is taxed at 20 percent or at 2 percent, those two situations create a case for a different kind of basic exemption.

Senator MONDALE. I'm glad you brought that up because I am convinced we have to look not only at the exemption, but also at the rate.

Professor WATERBURY. There's no doubt about it. I haven't much more.

I didn't indicate much enthusiasm for valuing farm land for estate tax purposes at its value as farm land, rather than its value for other commercial purposes. And I guess I don't have much enthusiasm for that.

The average interval between impositions of death taxes is a generation, and let's call that 30 years. If you permit a person who has land that is worth $500 an acre for agriculture and is worth $2,000 per acre for development to pay estate taxes on a valuation of $500, he can hang onto it for the next 30 years during which everything else develops and have a crack at the high dollar. Everyone wants to sell last. It's not so obvious to me that that's a good idea.

It's not so obvious either that its a good idea in terms of Mr. Oelke's problem of the shares of the kids—my dad happened to have two, one boy, one girl. If I tried to tell my sister that I should take the farm at farm land value as my share and that she could have the liquid assets at market value, I'd have a little trouble with her. She's not that stupid a girl.

Senator HUMPHREY. Try it on other relatives, that's even worse.

Professor WATERBURY. Should estate taxes be reduced or postponed if family farms are kept in the family? I don't know. I think a lot of family interests in the inheritance of property, but you've got to be cautious about what, with the greatest respect for that family interest, you might call an idiosyncratic attachment to an asset. I suppose my classic illustration of the kind of thing that makes me skeptical about this might be two quick ones.

Suppose you start legislating on the premise that you want to let people hang onto assets to which they are particularly attached. You say, well, farmers are particularly attached to farms so we'll let them hang onto them in 1975. And now about 1985, before the committee descends $50,000 worth of lawyers and $50,000 worth of accountants to argue the case for the idiosyncratic guy who is just inseparable from this stock certificate. And the stock certificate happens to be for 1 million shares of IBM. Or what about the fellow who's a very large farmer? I once visited a farm in Montana. It was a very nice farm, 36 square miles. A township. I'll bet you that fellow was pretty attached to that place.

I'd say one more thing, so as to sort of prove at the end that I'm not merely here to be a devil's advocate and quarrelsome with the objectives of the hearing.

I did think of one legislative possibility that I didn't have time to work up anything on. I know of one historic piece of State legislation that bears some analogy to it, an old New York statute.

As to farms or any other businesses that have a very heavy land or taxable property component, you might consider the possibility of a variant on the Federal credit for State death taxes.

The farmer has to pay real property taxes which can be a material annual cost on his land. If you go to the gentleman who was sitting where Mr. Thorsen is now, who was a publisher from Mankato, on the last panel, its my impression that the publishing industry is a heavily capitalized one also.

You might consider, for the farmer and other heavily capitalized businesses, whether you wanted to enact a provision that would permit the crediting of real property taxes paid in respect of a particular asset against the estate tax liability with respect to it. The argument for the credit would be that this is a kind of asset that exposed more heavily than most business assets to an alternate capital levy, the State property tax.

Such a credit could pay a lot of Federal estate taxes for the estate of a farmer who was farming in an area in which real property tax rates were high.

Thank you.

Senator MONDALE. Thank you very much, Professor Waterbury.

Senator HUMPHREY. Thank you.

[The prepared statement of Professor Waterbury follows:]

STATEMENT BY

Thomas L. Waterbury, Professor
of Law, University of Minnesota
Law School, and Of Counsel
Johnson, Thompson, Klaverkamp &
James, a Professional Association,
Minneapolis, Minnesota

BEFORE THE

SENATE COMMITTEE ON SMALL BUSINESS

and the

JOINT ECONOMIC COMMITTEE

Minneapolis, Minnesota

August 26, 1975

RE: "THE IMPACT OF FEDERAL ESTATE AND
GIFT TAXES ON SMALL BUSINESSMEN, FARMERS"

I am most pleased to have received the Committee's invitation to submit testimony at this Hearing. This statement is a discussion of the five specific questions which were mentioned in Senator Mondale's Release of August 11th, announcing the Hearing, as of interest to the Committee. The order in which these questions are discussed was chosen, in part, because some of the questions are broader than the rest. These broader ones are discussed first. Also one of the more specific ones is a new question to me. So all I know about it is what I have been able to find out (or think up) in the last couple of weeks. I have saved this one for the last -- in order to postpone it as long as possible.

1.

Should the present $60,000.00 estate tax exemption (unchanged since 1942) be increased?

The question whether the exemption should be increased is, in effect, the question, how large an estate should be allowed to pass estate tax free to the usual beneficiaries of an estate? Evidently, this is not an easy question. I would urge the Committee to reserve this question for decision after it has been decided whether to make other changes in the estate tax (and income tax) law that would substantially alter the burden of the tax upon the usual beneficiaries of most estates. (I would like to see a couple of prominent "loopholes" closed, several relief provisions enacted, and a lower and less steeply progressive estate tax rate schedule substituted for the present one.) If, however, the exemption question is to be faced first, I think I would vote for an "integration" of the federal estate and gift tax exemptions (so that the estate tax exemption would be $90,000.00 if the decedent had never used any of his lifetime exemption of $30,000.00 under the federal gift tax law and remain $60,000.00 if he had used all of it[1]), and no other change. My reasons are as follows.

It is obvious that the $60,000.00 exemption is "worth" much less today than in 1942 in terms of the purchasing power of that sum. In these terms, more than a three-fold increase in the exemption would be necessary to "restore" the 1942 exemption level. And information supplied by Senator Mondale's staff notes that "It has been suggested that the exemption be increased to $200,000" to achieve this.

On the other hand, of course, such an increase in the exemption would sharply reduce revenues. (Senator Mondale's staff information notes the estimate that this revenue loss would be "about $2.5 billion", or "about 45%" of estate and gift tax revenues.)

Such an exemption increase would also eliminate the immediate concern of the vast majority of potential estate taxpayers with the tax. Treasury data indicate that over 77% of estate tax returns filed in 1966 reported "economic estates" (gross estate, with minor adjustments, less indebtedness) of less than $200,000.00.(2) Thus the percentage of United States decedents whose estates were required to file a return would return to the 1922-50 level of one to two percent(3) from the much higher level of recent years -- 1971 estate tax returns represented 7.76% of United States deaths in 1970.(4)

Moreover, the suggestion that the 1942 exemption level be restored by such an increase ignores the one major substantive change in the federal estate tax law that has occurred since 1942 -- the introduction in 1948 of the federal estate tax marital deduction. In 1942, the Congress undertook to <u>prevent</u> estate-splitting between husbands and wives in community property states by taxing the <u>entire</u> community estate at the death of the spouse whose earnings had acquired it (commonly, the husband).(5) Thus, in 1942, the attempt was to tax an estate in excess of $60,000.00 passing to a surviving widow. Since the introduction of the marital deduction in

1948, the Congress has fostered estate-splitting in all states. An estate of $120,000.00 can pass estate tax free to the widow (the usual survivor) in a non-community property state if one-half of the "adjusted gross estate" (gross estate less indebtedness and administration expenses) "passes" to her (i.e., if she receives sufficiently substantial beneficial ownership of this one-half). In the community property states, the estate-splitting achieved by the community property system (whereunder one-half of the community property is the property of the surviving spouse) has been recognized for federal estate tax purposes since 1948.

As a practical matter, in most cases, a surviving spouse will be the life beneficiary of at least the income, if not the principal, of an estate of no more than $200,000.00, because the first spouse to die will regard provision for the surviving spouse as his first obligation and will regard an estate no larger than this as required for her support.(6) And, under the present federal estate tax law, an estate of $200,000.00 "passing" to a surviving spouse so as to benefit from the maximum marital deduction will only attract a federal estate tax of $4,800.00. (The Minnesota inheritance tax would be higher -- about $6,100.00, so the total death tax bill locally on such an estate would be about $11,000.00.)

Thus the primary beneficiaries of an increase in the exemption to $200,000.00 would be the usual beneficiaries of an estate at the death of the surviving spouse -- middle aged adult children, since the surviving spouse is likely to die at or after attaining 70 years of age.[7] The federal estate tax on such an estate is now $31,500.00. So the typical effect of the suggested exemption increase would be so save these middle-aged beneficiaries -- who have typically been financially independent of their parents for many years anyway -- $31,500.00.

I would like to see these typical beneficiaries saved their $31,500.00 since, I am committed to the view, that this typical "family interest in the inheritance of property" is entitled to substantial recognition under the federal tax law[8]. But I cannot justify further major concessions to this interest under the federal estate tax law, for the scant ten percent of families that have enough property to encounter the federal estate tax law, under the present exemption, until a major "loophole" in the federal income tax law is closed. This brings me to the next question.

2.

What impact would proposals to
tax capital gains at death have
on farms and small businesses?

I think that the answer to this question is that, if a comprehensive proposal to realize unrealized capital gains at death under the income tax were adopted, the result of its adoption might well be to increase the tax burdens incident to the deaths of some farmers and small businessmen enough to make some relief provisions highly appropriate. Another of the Committee's questions refers to one relief provision in the present law that might be adaptable for this purpose -- the authorization of deferred payment of estate taxes over a period of up to ten years in certain cases, Internal Revenue Code of 1954, Sections 6161, 6166. The Kennedy Administration's realization at death proposal of 1963 incorporated this provision, as well as another suggestion applicable to incorporated farms and other small businesses[9]. And I have a further suggestion in this regard, designed to deal with cases in which, at the death of the owner of a small business interest, there is no "buy-out" agreement in force to indicate the value of the interest, and its value is truly speculative within a wide range of substantial sums (say, $100,000.00 to $300,000.00)[10].

But, on the other hand, I think that the Committee's other three questions, all of which relate to the desirability of further estate tax concessions to the owners of small businesses in general, or farms in particular, would be hard to argue affirmatively unless such a comprehensive proposal to realize unrealized capital gains at death under the income tax were adopted as part of the same "tax reform package".

My reasons for the belief that a comprehensive realization at death proposal is so important to the case for special concessions to the owners of farms and other small businesses are elaborated in detail in a 1967 article of mine on the subject of gains tax realization at death.[11] Since that article is available (indeed, I discussed realization at death before the Senate Finance Committee in September of 1969, basing my discussion on that article), I can simply summarize these reasons for present purposes.

The first point, put bluntly, is that, insofar as I could discover from study of the economic literature on the subject, the fact that a punative death tax might force the sale of a number of small businesses (including family farms) which the families wanted to keep would pose no particular threat to the national economy, as distinct from the affected families. The reason is, of course, that a forced sale would simply put these enterprises in the hands of some buyer who would then operate them, and there is no particular reason to suppose that he would operate them less efficiently, from an economic standpoint, than the would-be family successors of the decedent. (In terms of farms, a neighboring farmer would buy, or an agricultural corporation would buy, and would presumably raise as much corn or soybeans per acre as the decedent, or his child who wanted to "hang onto the home place".)

Therefore, the strong arguments for permitting families to retain their farms or other businesses (and hence for death tax concessions that would enable them to do so), must be rooted somewhere else. I concluded, after much blundering about, that these strong arguments centered on "the family interest in the inheritance of property"(12). This phrase is simply my term for the familiar fact that parents are seriously interested in the future welfare of their children, and want to leave their wealth to their children when both parents are deceased. So far, so good -- families are our basic social units, the interest within each family in its successive generations gives the family continuity past the life-span of any parent-property-owner, so inheritance of family property is a tradition that the tax law should respect, and so death tax laws should not force the sale of cherished family assets such as farms.

However, as fond as I am of this line of argument, it has its logical limitations. One pertinent limitation is that "the family interest in the inheritance of property" -- or at least of enough of it to invoke the federal estate tax -- is a distinctly minority interest in the United States, affecting only ten percent or fewer of our families.

But the most pertinent limitation for present purposes is that each generation of parents has a universally shared "family interest in current maintenance for dependents" while children are growing up -- and this interest is a higher family priority than leaving some property to the children when they are middle-aged, and commonly self-supporting.

The final link in the logic is that the federal income tax has been imposed, since it became a "mass tax to finance the war" at the advent of World War II, upon modest family incomes. Hence the "family interest in current maintenance for dependents" has been subordinated since that time to the requirements of the federal fisc -- expenditures for family maintenance have been reduced by the need to pay the income tax. (Not to mention social security taxes.)

Accordingly, it is hard to argue for income tax exemptions to foster "family interests in the inheritance of property", and hence hard to argue for forgiveness of the capital gains tax on appreciated assets at the death of the owner to facilitate his transfer of his wealth to his descendants.

This is why I think that it is important to realize gains taxes at death before attempting to argue for estate tax reductions. In a nutshell, the income tax is the "first tax" on individual (and hence family) incomes. Once it is paid, and wealth has been accumulated out of after-tax income, death taxes become "second taxes" -- a burden which the great majority of families don't have to bear. Accordingly, it is much easier to argue for concessions in respect of these "second taxes" for the benefit of the minority of families that *is* burdened by them.

I do not suggest that the income tax rates on capital gains realized at death need be high rates. Indeed, the Kennedy Administration's realization at death proposals of 1963 were coupled with proposals to substantially *reduce* the rates of the capital gains tax -- on *all* capital gains, whenever realized.[13] After all, the *average* income tax rates on modest personal service incomes are not very high.

I merely insist that to argue for income tax exemptions to foster family interests in the inheritance of property, while we need to collect taxes out of incomes that would otherwise be very largely expended for current maintenance of family members in order to "run the country" is to argue for an inversion of family priorities that is much too baldly apparent to escape notice.

3.

> Should the provisions which now permit estate taxes to be paid over a 10 year period -- but only in limited circumstances -- be liberalized?

Assuming satisfaction as to realization at death, I can think of a couple of "liberalizations" that would be worth investigating. One is another look at the rate of interest charged on the deferred tax. It was recently increased by the Congress from a favorable four percent to nine percent. Logically, if the deferral of the tax is a deserved relief provision because collection of it nine months after death would be unduly burdensome, one would think that the Treasury could reasonably settle for less than a full rate of interest on the deferred tax. Otherwise, the "relief provision" may amount to no more than assurance that the estate can borrow from the Treasury at a "going commerical rate" in order to avoid paying a "hold-up" rate to some commercial lender. That is not much of a concession.

Another "liberalization" that I would think worth investigating probably should be considered as a liberalization of the present alternate valuation provision rather than of the deferred payment provisions. The point is that some assets are simply of highly speculative value when the owner dies. In some of these cases, if the estate had the option to elect to defer the estate tax valuation date for several years, some of the uncertainties might be removed and a more reliable valuation secured. Some small business interests surely fall within this category. Perhaps the criteria for qualification should be drawn in terms of the range of uncertainty regarding date of death valuation, as well as in terms of whether the asset of uncertain value was of a sufficient maximum value to threaten a burdensome tax, but for the deferred valuation.

4.

Should farm land be valued for estate tax purposes at its value as farm land rather than its value for other commercial purposes, so long as the heirs continue to farm the land?

This suggestion is a new one to me as an estate tax relief provision, though I have encountered the idea in the context of state ad valorem taxes on real property. It is my impression, though I have not investigated the matter thoroughly enough to be sure of my ground, that this particular relief provision in state property tax laws is a mixed blessing.

The argument for such a relief provision that makes the most sense to me is that the speculative "development value" of farm land can be highly illusory in this specific sense -- the market is to "thin" to make the "going rate" realistically available to all landowners in the area. That is, maybe the land is worth $500.00 per acre for agricultural pruposes, and $1,500.00 per acre as development land in the sense that those buyers for development who show up are willing to pay $1,500.00 per acre, but only enough buyers show up to purchase about five percent of the land in the area in any year at that price and not enough landowners want to sell to drive the price lower. Under these circumstances, a <u>state real property tax</u> valuation of <u>all</u> of the land in the area at $1,500.00 per acre (because that is the "willing buyer- willing seller" price) is in fact <u>much too high</u> because if those conditions obtained as to all of the land, it would change hands at a much lower price. I am not sure that this argument is applicable in the estate tax context because one would suppose that (barring some localized disaster) few of the landowners in any area would die in a given year, so the $1,500.00 market value might be much closer to the price at which the parcel of a deceased farmer <u>could</u> be sold.

The argument against such a relief provision that makes the most sense to me is that it becomes possible for landowners to hold land off the market by using it for "farming", and hence to keep their taxes down while waiting for the "top dollar" that normally goes to the last sellers of attractive land in an area of development. I should think the risks of this would be greater under an estate tax than under a state real property tax because the estate recurs at much less frequent intervals (That is, if you let the land be valued at $500.00 in "Dad's" estate when it's worth $1,500.00 for development, it may not be subject to death taxes again until "Sonny" dies about 30 years later.)

5.

Should estate taxes be reduced or postponed if family farms are kept in the family and continue to be used for farming?

This suggestion is an entirely "new thought" to me. It differs from the preceding one in that it is a frank proposal for an estate tax subsidy to the "family interest" in keeping "dear old Blackacre" in the "Nelson family". Coincidentally, I have enough of an agricultural background and know enough farmers to have encountered the very strong attachment which some of them have to the "home place".

One shred of evidence that the "family farm" is entitled to special consideration is my impression (based on some experience) that the parents and children in a farm family may all accept the idea of keeping the farm going in the hands of one of the children, even if the practical result of this "estate plan" is that the rest of the children get much smaller shares of the parental estate than the fellow who "gets the farm" -- simply because most of the parental estate <u>is</u> the farm.

However, it seems to me that this proposal involves a different kind of subsidy to "the family interest in the inheritance of property" than I have argued for thus far.

My argument is basically an estoppel argument which runs like this: When taxes are imposed that are designedly "progressive" -- i.e., aimed at placing more than proportionate tax burdens on taxpayers with larger incomes and greater wealth than on the average taxpayer, the basic justification for doing so is that it is "fair" to ask those members of the society who are "better off" to contribute something to the cost of government for the benefit of those who are "worse off". And, when pressed on fairness, the advocate of these redistributional taxes tend to emphasize the "common bonds of mutual interest and mutual dependence" which unite us as members of the same society.

My argument responds as follows, well and good, but there are smaller social units in the country whose members are also united by such bonds -- viz: families. If you want to levy re-distributional taxes which emphasize the "brotherhood of men" across the society, you had better be willing to concede that the "brotherhood of brothers" is also relevant for tax purposes.

Now this proposal for estate tax concessions in respect of family farms that are kept in the family goes a step further. It emphasizes the unique bonds that unite farm family members to the "home place" and asks for an estate tax subsidy to this peculiar attachment of the "people to the land".

To be sure, the fact that this proposal goes a step further than my prior ones doesn't mean that there's anything wrong with it. But I am cautious about extention of ideas in legislative areas in which there are many conflicting interests to be reconciled, and there are plenty of philosophic conflicts, and plain, unadorned conflicts of economic interest, to be reconciled in "reforming" the federal estate tax.

Indeed, one could describe the present federal estate tax law as having become the crazy-quilt that it is simply because conflicting ideas have been extended too far in designing different parts of it.

I am mindful, therefore, of the anonymous Greek admonition, Nothing in excess!

I need to think about this proposal some more.

FOOTNOTES

The footnotes below remind me (unhappily) of Benjamin Disraeli's remark, "An author who speaks about his own books is almost as bad as a mother who talks about her own children." The reason for this flagrant self-citation is that this statement was prepared over a weekend following notice that the Committee expected a written statement prior to the Hearing. If the reader will pardon my citation of my own articles and check the citations, he will find many original sources cited therein.

(1) This integration of the exemptions was proposed several years ago by the American Law Institute, American Law Institute, Major Problems in Federal Estate and Gift Taxation and Recommendations in Reference Thereto (1968).

(2) Data are cited in Waterbury, Taxation of Intrafamily Transfers Over Time, 51 Texas Law Review 852, note 31 at 857-58 (1973), (hereinafter cited as, "Waterbury, 51 Texas Law Review").

(3) Id., note 43 at 860.

(4) Id.

(5) These provisions of the 1942 Act are discussed in Lowndes & Kramer, Federal Estate and Gift Taxes, 369 (2nd ed., 1962).

(6) Waterbury, 51 Texas Law Review, 862 at note 51.

(7) Id., notes 50, 52.

(8) My case for this view is stated in Waterbury, A Case For Realizing Gains At Death In Terms Of Family Interests, 52 Minn. Law Review 1, 18-28 (1967) (hereinafter cited as "Waterbury, 52 Minn. Law Review").

(9) Id., 36 and notes 121, 122.

(10) Id., and note 123.

(11) Waterbury, 52 Minn. Law Review, 28-47.

(12) Id., 18-28.

(13) Id., 53-54 and note 171.

Senator MONDALE. Our next witness is Norman Winer, and I'm going to ask you—if it's not too much of an imposition—to limit your statement to 5 minutes.

STATEMENT OF NORMAN H. WINER, CHARTERED LIFE UNDERWRITER, NORTHWESTERN MUTUAL LIFE INSURANCE CO.

Mr. WINER. Senator Mondale, my name is Norman H. Winer. I'm with the Northwestern Mutual Life Insurance Co. and I'm a chartered life underwriter who is involved mostly with dealing with small businesses.

I'm going to digress from the statement, in that some of the prior statements that were made, our industry does not create the problem, but actually solves the problem in that when someone dies there is going to be cash to take care of their needs.

I would like to also say that I agree to some extent with Mr. Oelke, that the problem is how do you pass the property on? At least I find that to be true.

Yesterday I had five men, between the ages of 53 and 69, decide to pay almost $60,000 of premium, reducing their own income to their corporation so that they can use it themselves, so they can find a way to pass on and pay these estate taxes at the same time, their property. There's no other way to resolve it because there's no other way to pay the estate taxes and yet leave their family with some of the property they have.

I was going to involve myself with the income tax as it applies to the estate tax part of what we're talking about, and unfortunately because of the limited time that we have I'm just going to have to run through these things very quickly.

But everything I not only wanted to say, but I am talking about the associates with Northwestern Mutual and my industry, are included in the statement.

Senator MONDALE. The full statement will appear as though read, Mr. Winer.

Mr. WINER. Thank you. The areas that we feel are really the greatest concern, one are the accumulated earnings situation. Although you have liberalized the accumulated earnings to $150,000, a small businessman who is growing and has a continual need for capital is not in a position where he's going to be able to grow with—keeping so little amount of capital on hand. He really needs to accumulate the capital.

And another section that we're concerned about is currently under section 303 of the Internal Revenue Service Code, which is a very fine section of the code. It allows the small businessmen to resolve a great deal of their problems at dying, through the payment of a figure of 35 percent of their gross or 50 percent of their net taxable estate, by using the business to pay these expenses.

And I should think that this would be something that you should consider liberalizing so that these payments can be made out of these corporate assets without endangering these businesses.

The accumulated earnings tax creates a problem, the 303 problem—in the 303 area, in that when you accumulate money to pay these final expenses through a 303 program, the amount of money that you are accumulating is subject to the accumulated earnings taxes and it makes it extremely difficult for these businessmen. Even if they buy life insurance and start a sinking fund or however they decide to handle it, they find themselves only with one provision, that the day or the year they die they are allowed to have that money in the corporation.

Well, how are they supposed to get the money to it to start with.

And another area we're concerned with is in the area of passing life insurance policies around. And that is, how does a person have the right to buy a life insurance policy from another person? The transfer for value laws, as they presently stand now, say that the policies can be passed between partners and partnership, but when you get involved with corporate planning it cannot be passed between stockholders, only from the corporation back to the stockholders. This creates a tremendous burden on people who are older people who want to use their insurance for their children, for cross purchase agreements and so on and they have no way of getting the policy across to them without suffering an income tax problem at death. And that's something that we also feel should be reviewed.

And I guess that's it in 5 minutes.

[The prepared statement of Mr. Winer follows:]

STATEMENT OF

NORMAN H. WINER

CHARTERED LIFE UNDERWRITER

BEFORE THE

SELECT COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

Minneapolis, Minnesota

August 26, 1975

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STATEMENT OF NORMAN H. WINER BEFORE THE SELECT COMMITTEE ON SMALL BUSINESS, UNITED STATES SENATE

Minneapolis, Minnesota

August 26, 1975

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Mr. Chairman, my name is Norman H. Winer. I am a Chartered Life Underwriter associated with The Northwestern Mutual Life Insurance Company and its general agent Jack G. Brown in Minneapolis. As a small businessman who is actively engaged in helping small businesses solve some of the problems which I will be discussing today, I appreciate this opportunity to appear before you.

The Role of The Life Underwriter

Perhaps a word on my own background will be helpful in placing my comments in perspective.

I have spent most of my life in the Minneapolis area. I graduated from the University of Minnesota in 1959 with a degree in accounting. Following several years in accounting and accounting related employment I decided to go into business for myself and became a full time life insurance agent with the Jack Brown agency of The Northwestern Mutual Life Insurance Company in 1964. I completed the requirements to receive the professional designation of Chartered Life Underwriter in 1968.

Northwestern Mutual is a mutual life insurance company located in Milwaukee, Wisconsin and is licensed to do business in the District of Columbia and all states of the United States, except Alaska, through its field force of approximately 3,200 full time agents. Although Northwestern Mutual is a fairly large financial institution, (with assets in excess of $7 billion, it is the seventh largest life insurance company in the United States) the Company represents a classic example of an institution with assets composed of the relatively small savings of many individuals. The Company does not sell group insurance and, therefore, no significant percentage of its business represents premiums from large corporations or pension plans. Essentially, the Company sells individual life insurance policies and, perhaps to an extent greater than any other similar institution, its business is concentrated in the small business and professional fields.

My comments today reflect my own observations as a small businessman advising other small businessmen. In addition, the comments reflect a portion of the collective judgment of my fellow Northwestern Mutual agents.

The subject under discussion today is important. Absent proper planning, the small businessman who has spent a lifetime creating a business is likely to find that his business cannot survive his own death, and that he and his heirs will be forced to sell, merge or liquidate the business under terms that may not adequately reflect the fair market value of the going concern. Even with proper planning, under our present tax structure it is difficult to preserve a small business for future generations.

The role of the Chartered Life Underwriter, as a member of the estate planning team, is to provide for the protection of human life values, and to provide the liquidity necessary to meet the estate taxes, so that the small business can survive from one generation to another. Life insurance, in many instances, is an effective tool to use in guaranteeing that the business will survive. However, there are various tax problems which cause life insurance to be less effective than it could be. I would like to briefly describe some of these problem areas for your consideration.

The four problem areas included in my remarks involve situations where the small business is incorporated, and relate to:

(1) the need to provide a source of funds to enable the business to survive the death of key personnel;

(2) the effect of the accumulated earnings tax on the retention of such funds;

(3) restrictions on the transfer for value rule;

and (4) restrictions on so-called Section 303 redemptions.

SOURCE OF FUNDS

Typically, a small businessman will have most of his personal assets invested in the business. At his death, his estate will consist primarily of an illiquid business interest, and yet the estate taxes must be paid in cash. All too often the business will have to be sold to provide the needed liquidity.

Often, to avoid this kind of forced liquidation sale the businessman will consider entering a pre-death agreement, whereby the business as an entity, or another individual, will be contractually obligated to purchase the business interest from the businessman's estate. The funds from such a sale would then be available to provide the necessary estate liquidity to pay the estate expenses.

In order to carry out this obligation, however, the purchaser must have the necessary cash available at the death of the businessman with which to purchase the business interest. Whether life insurance, a sinking fund or cash reserves are the contemplated source of these funds, it will take current cash today to insure that the necessary funds will be available when they are needed at some point in the future. The problem, however, is that the small business is usually so cash poor that it can't spare the current cash necessary to fund the future problem, despite the fact that, without the source of liquidity, the business may have to be disposed of in order to meet the estate obligations.

Cash flow is a constant concern of small businesses. Cash is needed to pay current expenses, cash is needed to pay income taxes, cash is needed for business expansion and to keep up with competition, and cash is needed again, at death, to pay the estate expenses. If the congressional policy is, and we believe it should be, to help small businesses survive, then we must enable small business to provide for the anticipated expenses at the death of a key employee or a principal shareholder.

In order for small business to flourish and prosper, it needs working capital. Capital for marketing, research, development, hiring, and training. It needs capital for all of the competitive, job creating functions necessary for the progressive development of the business. But, even more than this, capital is needed today for the preservation of the business in the future. Money to pay premiums on life insurance, or money to create a sinking fund, to indemnify the small business against the loss of a key employee, or to enable the business to adequately fund a stock redemption, has to be available today in order to prevent the problems which, in the absence of such planning, will occur in the future. The availability of capital when it is needed is absolutely essential to the preservation of the typical small business.

In order to guarantee that the necessary capital will be available in the future, the corporate tax structure must be changed to enable the small business to improve its present cash position. Unlike big business which can obtain capital in the open market, current earnings are the most important source of working capital for the small business. Capital creation through public stock offerings or via loans at favorable rates from major lending institutions is usually not available to small business. The temporary increase in the corporate surtax exemption, and decrease in the normal corporate tax rates, provided by the Tax Reduction Act of 1975 were certainly welcome steps in the right direction. But, permanent and even more progressive changes in the corporate tax structure of Section 11 of the Internal Revenue Code are necessary.

ACCUMULATION OF CAPITAL

Merely increasing the present cash position of the small business by changing the corporate tax structure, however, is not enough. The small business must be able to retain earnings.

The present tax laws contained in Code Sections 531 through 537 limit the amount of such capital that can be retained to that which can be shown to have been retained for the reasonable current and anticipated needs of the business, with a minimum credit of $150,000. Because small business has to rely upon its internal funds to finance expansion, fund stock redemptions, weather periods of inflation, pay current taxes and meet its contractual obligations, it should be allowed to accumulate higher amounts of capital today to enable it to meet the unexpected periods of tomorrow. While the recent increase in the minimum accumulated earnings tax credit to $150,000 was helpful, it was not adequate. Only with sufficient pools of capital can we insure the continuity of the small business.

Both a change in the corporate tax structure of Code Section 11, and a rise in the minimum accumulated earnings tax credit of Code Section 535(c)(2), would involve only minor revisions of the Code and would help prevent the forced liquidation, merger or acquisition of small businesses by enabling the small businessman to better prepare for the future with a better cash flow today.

An additional area of concern in conjunction with the accumulated earnings tax is that businesses today cannot adequately prepare in advance for redemptions under Section 303 of the Code. The accumulated earnings tax provisions contained in Code Section 537(b)(1) only recognize accumulations in the year of death or any taxable year thereafter as being within the reasonable needs of the business and, therefore, exempt from the penalty tax.

We believe that to aid in the preservation of small businesses everywhere it should be statutorily recognized that accumulations of earnings in years prior to the death of a shareholder in anticipation of a Section 303 redemption are also accumulations for the reasonable needs of the business. Again, such a revision would be easily incorporated into the present statutory provisions of Code Section 537(b)(1) and would tend to encourage more small businesses to plan in advance for the continuity of their operations.

TRANSFER FOR VALUE RULE

The third problem area is a much more subtle one. It involves the way in which life insurance can be used to solve the liquidity needs of the small businessman and help guarantee the continuity of the business.

Quite often we see situations in which a stockholder in a small business would like to use an existing life insurance policy which he owns on his own life to fund a stock purchase agreement between himself and another shareholder. Normally, proceeds of life insurance are received on a tax favored basis. There are, however, situations in which the transfer of life insurance policies will cause a substantial part of the proceeds of such insurance to be taxed as ordinary income.

Under the present law contained in this Code Section 101(a)(2)(B) this unfavorable tax treatment can be avoided if the transfer of the life insurance policy is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer. Unfortunately, the favored exceptions do not include the transfer of policies between shareholders. Thus, in cases like the one just described, the insured could not safely transfer the policy which he owns on his own life to another shareholder in order to enable that shareholder to fund the stock purchase agreement.

To help the small businessman effectively plan for the continuity of his business and provide the necessary liquidity for his estate, we feel that Section 101(a)(2)(B) of the Code should be changed to permit the transfer of life insurance policies between shareholders without causing the proceeds of such insurance to be taxed as ordinary income. As a result of such a change, planning for the ultimate passage of business interests would become easier, and the availability of existing insurance to fund stock purchase agreements would help make them more attractive. By encouraging the use of stock purchase arrangements, we would again be helping preserve the small business for the benefit of all concerned.

SECTION 303 REDEMPTIONS

A Section 303 redemption, I am sure you are aware, is a redemption of stock by a small corporation, specifically designed to help the estate of a small corporate stockholder solve its liquidity problems. In addition to providing this necessary liquidity, Section 303 redemptions serve to protect small businesses from forced liquidation or merger which might otherwise result from the heavy impact of the death taxes.

I have already discussed the adverse effect that the accumulated earnings tax code sections have on the retention of funds in anticipation of a Section 303 redemption. Another major problem affecting the available use of Section 303 is that in order to qualify for a 303 redemption, the value of all of the stock of the redeeming corporation which is includable in the decedent's gross estate must comprise either greater than 35% of the value of the decedent's gross estate, or more than 50% of the value of the decedent's taxable estate.

In order to protect many small businesses from extinction, we feel that these percentage limitations should be lowered. By expanding the availability of Section 303 redemptions to a greater number of small businessmen and capital investors, it would necessarily follow that fewer businesses would be forced to merge or liquidate because of the liquidity necessary in the estate of a corporate shareholder. Again, free enterprise, competition, local jobs, and local economies would reap the benefits of such a change.

CONCLUSION

As indicated, I have confirmed my remarks to four particular areas of concern that relate particularly to life insurance. Life agents, of course, are aware of a number of other, perhaps more basic, liquidity and tax problems facing small businesses. It would seem appropriate, for instance, to reexamine the estate tax exemptions and rates in the light of inflation, and perhaps consideration should be given to the ability of small employers to deal with the complications of current pension legislation. These subjects, however, are beyond the scope of my comments.

I appreciate the opportunity to appear before you today. I would be pleased to expand my remarks or answer any questions which you may have on the general area of my involvement in the estate planning process.

[Mr. Winer subsequently submitted the following:]

WINER MAKES STATEMENT ON SMALL BUSINESS TO SENATE COMMITTEE

Speaking as "a small businessman who helps small businesses solve problems," Norman H. Winer, CLU, of the Jack Brown agency in Minneapolis said in a statement to a Senate committee that several changes should be made in the corporate tax structure to save the small business from extinction.

The hearing of the Senate Select Committee on Small Buiness, chaired by Wisconsin Democrat Gaylord Nelson, was held in Minneapolis August 26 by Minnesota Democratic Senators Hubert Humphrey and Walter Mondale.

In his opening remarks, Winer reminded the committee that without proper planning, the business which the small businessman spent a lifetime creating, might not survive his death. Heirs may be forced to sell, merge or liquidate the business, often at an unfair price, where planning has not been done, Winer said.

"Even with proper planning," he continued, "under our present tax structure it is difficult to preserve a small business for future generations."

Life insurance, by providing the liquidity necessary to pay estate taxes, can be effective in guaranteeing the survival of the business, but "there are various tax problems which cause life insurance to be less effective than it could be."

Winer then went on to define four problem areas and made recommendations to meet these needs:

Working capital.—While working capital is needed today to preserve the business in the future, the small business is "usually so cash poor it can't spare the current cash necessary to fund the future problem," he pointed out.

In order to help the small business survive, Winer said, "the corporate tax structure must be changed to enable the small business to improve its present cash position."

While certain provisions of the Tax Reduction Act of 1975 were steps in the right direction, permanent and more progressive changes are necessary in the corporate tax structure of Section 11 of the Internal Revenue Code, he said.

Accumulation of capital.—The small business also "should be allowed to accumulate higher amounts of capital today to enable it to meet the unexpected periods of tomorrow," Winer asserted.

Changing Code Section 11, and increasing the minimum accumulated earnings tax credit of Code Section 535(c)(2), would help prevent forced liquidation or merger of small businesses by giving the small business a better cash flow today which, Winer said, would encourage the small businessman to plan in advance for the continuity of operations.

Winer also suggested that "It should be statutorily recognized that accumulations of earnings in years prior to the death of a shareholder in anticipation of a Section 303 redemption are also accumulations for the reasonable needs of the business."

Transfer-for-value rule.—While life insurance proceeds are normally received on a tax-favored basis, the transfer of policies between shareholders to fund a stock purchase agreement is one situation where a substantial portion of the proceeds are taxed as ordinary income, Winer told the committee.

Section 101(a)(2)(B) of the Code should be changed so that these proceeds are not taxed, he said. "Planning for the ultimate passage of business interests would become easier, and the availability of existing insurance to fund stock purchase agreements would help make them more attractive." Encouraging the use of stock purchase arrangements in this way would again help preserve the small business, he added.

Section 303 redemptions.—A major problem affecting the use of the Section 303, Winer said, is that in order to qualify for it, the value of all of the stock of the redeeming corporation which is includable in the decedent's gross estate must comprise either greater than 35 percent of the value of the gross estate, or more than 50 percent of the value of the decedent's taxable estate.

"These percentage limitations should be lowered," Winer maintained. "By expanding the availability of Section 303 redemptions to a great number of small businessmen and capital investors, it would necessarily follow that fewer businesses would be forced to merge or liquidate because of the liquidity necessary in the estate of a corporate shareholder."

Free enterprise, competition, local jobs and local economies would benefit from such a change, Winer added.

Senator MONDALE. Thank you very much. Mr. Thorsen?

STATEMENT OF RICHARD D. THORSEN, CERTIFIED PUBLIC ACCOUNTANT, MINNEAPOLIS, MINN.

Mr. THORSEN. Senators, I'll do the same; that is, abstract a few points that I gleaned from talking with fellow CPA's.

I'm a practicing CPA, a small businessman in my own right, 37 people in our firm, 8 partners. I have been practicing since 1949.

I have had a lot of association with people in the field and I'm trying to put together a compendium of ideas from our profession. I'm not speaking officially, but in the record that the Senate will have the various details, and maybe some of them are more detailed because accountants are always accused of being nitpickers, so we have maybe some smaller points.

I do agree with all the items—basically all the items that have been said before so I would be repeating ad nauseam many items that you have heard and heard and heard again.

One thing, however, that occurred to me that was not in my prepared commentary, and that has to do with constant references by all of us to the Internal Revenue Service. I'm a great believer in the self assessment system and I think that all of us in public life or private life really have to be careful in what we say about the tax collector.

You know, we say it is jest and yet I feel that it's many times—many times it's the Congress attempting to solve the kind of problems that we're talking about here today or attempting to solve a problem for maybe some special interest group that creates such a complicated tax structure, whether it be in the estate tax area or whatever area we're talking about in the tax field.

And I think that I would plead for common sense in the writing of the tax laws so that we don't have the Commissioner and his people, all the way up and down the line, being castigated for something that maybe they are doing their very best job they know how to do.

Senator MONDALE. Could you come down next week and talk to my Finance Committee on that point? You ought to watch us put a tax law together.

I think it was Bismarck who said. "He who loves sausages and laws should never watch either being made."

[Laughter.]

I agree with you. When they put those—I can't understand how anyone can understand them.

Mr. THORSEN. I would just like to say, and somebody that's sitting on the other side of the desk, the people in the IRS, that they are working with a pretty complex set of laws and I think they do a rather spectacular job. And I'm not trying to gain any points with the Service in this respect.

But, further, I think deeper than that is this whole matter of respect for our self assessment system. And I think that that wasn't a part of anything you are going to see in the printed remarks that are going to come to the committee. But I really, sincerely feel that our system has to count on this to have continuing respect and also have the respect for the people that are enforcing the laws.

And my observations over the years has been, from 1949 since I started practicing, that honestly I think, by and large, with the exception of a few bad apples in the whole thing, that we're having pretty excellent tax administration.

So I plead with the Congress to keep watching for overly technical things that come out of the accountants' minds, out of attorneys' minds and out of good staff ideas. But sometimes the laws become so complex that when it comes down to enforcing the laws we can barely keep the system working.

The rest of it will be in writing.

[The prepared statement of Mr. Thorsen follows:]

STATEMENT OF

RICHARD D. THORSEN, C.P.A.

BEFORE THE

SELECT COMMITTEE ON SMALL BUSINESS

UNITED STATES SENATE

AND THE

JOINT ECONOMIC COMMITTEE

UNITED STATES SENATE

Minneapolis, Minnesota

August 26, 1975

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STATEMENT OF RICHARD D. THORSEN, C.P.A. BEFORE THE SELECT COMMITTEE ON SMALL BUSINESS, UNITED STATES SENATE

Minneapolis, Minnesota

August 26, 1975

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Mr. Chairman, my name is Richard D. Thorsen. I am a practicing C.P.A. with a medium-sized local CPA firm consisting of a total of 37 people, including 8 partners, of which I am one. As other witnesses before the Committee have described themselves, I,too, am both a small-businessman and an adviser to many small businesses. I have practiced public accounting since 1949; I received my CPA certificate in 1954. Since that time I have been very active in professional activities both nationally and locally. I have served as President of the Minnesota Society of CPA's and as Chairman of the State Board of Accountancy of the State of Minnesota. Presently I am on the Editorial Advisory Board of the Tax Adviser magazine (an AICPA publication) and I am one of 13 members of the 1975 Commissioner of Internal Revenue Donald Alexander's Tax Advisory Group.

Although today I do not speak in an official capacity for any CPA group, in this past week I have been in close communication with members of the tax departments of most of the local and national CPA firms in the Twin Cities to determine the views of various CPA-tax practitioners on the subject of the effect of the Estate Tax on small businesses in the area. I have found that their experiences are very similar to those in my firm relative to the problems facing small-business-people. This week I canvassed my partners to determine how many times in recent years the solution of selling out a small business to gain sufficient liquidity to pay death taxes has either been considered or actually been used. Quickly we counted up 8 times in the past year. Fortunately, through planning, often costly to the client in terms of fees to us, fees to our friends in the legal profession, and premium payments to our friends in the insurance industry, these clients have most generally been able to avoid the thing that all of us representing the small business sector dislike the most - - - a sell-out to a large national company, or worse yet, a forced sale of individual assets at depressed prices. Sometimes, however, the various professionals in the estate planning team get to the client too late to help - - - many times after the principal shareholder is dead or uninsurable. I feel deeply that the strength of our nation is closely allied to the continuance of strong, independent, small businesses. The thought of a further concentration of control of businesses in the hands of a relative-handful of corporate giants is repugnant to me and most of my colleagues.

I recognize that all the problems of the small businessman cannot be solved by tax-reform legislation. I would like to pass on to the Committee some of the specific thoughts that have been expressed to me by my colleagues in the past few days relative to the subject at hand.

First, the level of the estate and gift tax exemptions is pitifully low. If we assume that the $60,000 level of the estate tax exemption in 1954 was correct (and I am not necessarily sure this was so, but) we must take into account (I think) the effect of price level increases just to stay even. I am not a statistician but using consumer price indices it appears to me that just going from 1954 to the present, we have had about a doubling of the index. Perhaps on this basis a $120,000 exemption would be in order. I am sure that your staff advisers have better thoughts on what the level of this exemption should be, based on statistics coming from estate tax returns filed. Nevertheless, I echo the feeling of a large number of my fellow-CPA's when I suggest that the exemption level be raised.

Secondly, an often-cited problem facing the small business person or the tax advisor is the matter of valuation of the interest in the small closely-held enterprise. I recognize the myriad of problems that this proposal has, but many of my colleagues have asked the question - - - is it possible to develop some type of legislated "safe-harbor" rules or guidelines for the valuation of interests in non-publicly-held companies? I do not have an answer as to how to develop these rules or what they should be, but we put the idea forward in hopes that such a scheme be studied by the Committee and its staff.

Thirdly, again in the valuation area, many practitioners have expressed the view that life insurance proceeds should not be included amongst the "other factors" in valuing a non-public company (as is presently required by Treasury Regs. 20-2031-1 (f).) To include them unfairly compounds the very liquidity problems facing the small company that the insurance has been purchased to avoid.

Fourthly, the two provisions added to the code to aid the estates of owners of closely held businesses, Sections 303 and Section 6166 are not as helpful as they might be and as Congress intended them to be. Among other items, valuation problems previously mentioned can cause the availability of these sections to be in doubt. The blanketing in of Section 6166 under the recently adopted 9% interest rate makes this benefit less than ideal, and even a penalty.

Lastly, and my list is by no means complete, the inadequacy of Section 691 (f) in preventing double taxation of items of income in respect of a decedent has frequently been mentioned by CPA's. One solution, to give a greater degree of fairness might be to give a dollar-for-dollar income tax credit rather than a deduction for estate taxes attributable to such income. Other solutions have been offered, but this one should be considered to provide greater fairness for the small businessmen.

I certainly appreciate having the opportunity to appear before you and hope that my remarks have been of some small value. Thank you.

Senator MONDALE. That's well taken. Now, I invite any of the panel and any of the people here today who wish to submit further materials for the record, simply to write me a letter and we will include it in the full printed report, which the staff will use at the time we develop the tax legislation. So that anyone on the panel or anyone in the audience who wishes to do so, we'd be delighted to hear from you.

Mr. Jack Carlson representing the Minneapolis chamber.

STATEMENT OF JACK W. CARLSON, ATTORNEY, MINNEAPOLIS, MINN.

Mr. CARLSON. Thank you very much, Senator. I'm an attorney here in Minneapolis, formerly a certified public accountant both in Chicago and here. And I'm representing, today, the Greater Minneapolis Chamber of Commerce.

The comments you have are comments that have been passed on by our Taxation Task Force and were approved by the board of directors of the chamber.

I guess I should just take this opportunity to again thank Senator Humphrey for being with us for lunch yesterday, and we appreciated his remarks at that meeting.

I'm just going to take a couple of minutes because I know the time is short. I guess I would like to reiterate the comments that my good friend, Dick Thorsen, made with regard to the Service and the operation of the law.

The self-assessment system is so very important to all of us, and as we see countries where they don't have such a system and they have great failures, we have to appreciate our system even though we often times become frustrated with a portion of it.

Quickly, with regard to the estate tax exemption, a great deal has been made with regard to how it affects farmers and small businessmen, and I think that's awfully important, and certainly in our remarks we're indicating that we would hope that would be increased also.

I think we should also look for just the average citizen, the person who doesn't have such a large estate, maybe a modest estate. There's a great sense of pride in him passing on some property that he has earned through his labors, be it as a clerk in a store or a union worker, and although that estate doesn't often get very large, it may include some insurance and may certainly go over that $60,000 level.

And I think the great sense of pride that he can pass on something to his family and to his children makes it important to make that figure higher so that a great part of those dollars aren't eaten up in taxes.

Although the question here has been for the small businessman and farmer, I think we also have to consider that average wage earner.

Senator MONDALE. I think what they are saying is the exemption ought to go up for everybody, but in valuing the estate of small businesses and farms, they ought to be valued at the value of the business and not at some other theoretical value of its market.

Mr. CARLSON. Clearly understand that, and we strongly support that. In fact, just to comment on some of Mr. Cherne's remarks with regard to the valuation of a company.

At about this time on Thursday morning I'm going to be discussing with the Minnesota people the valuation of stock in a small business.

The Federal Government has determined it to be $125 per share and the State is talking about $200 per share, and although we often don't find that kind of disparity, I think it points out some of the kind of problems you have in trying to value a small business.

Then, quickly, I think the most important thing in my mind has to do with regard to some of the discussions with regard to taxation at death with regard to capital gains.

There have really been two proposals that have been made. One is to tax capital gains, the difference between the basis of the property and the fair market value of the property at the time of death.

The other has been to keep the basis the same and have that carry on to subsequent generations.

With regard to the first question, we found how difficult it is just to value the stock or to value the farm for estate tax purposes, but now in addition you have to have an additional—the same valuation with regard to income tax purposes. I think that makes the problem doubly difficult.

And, again, the fact that everyone else has pointed out that we may have to have small farms or small businesses sold or a portion of them sold just to pay the income tax as well as the estate tax, makes the fact that you would tax capital gains at the time of death really a disaster with regard to that small businessman or to that farmer.

I think then, with regard to the other proposal that hasn't been made necessarily here, but its been discussed at other times with regard to keeping the basis the same. As you both know, basis increases to the fair market value at the time of death, but to keep the basis the same so that a person who is inheriting property would have a large capital gain at the time that was sold, I think would also be a bad policy. And the reason, primarily I think, it doesn't have to do with the tax laws specifically, but with regard to the practical aspects of trying to determine the basis of any piece of property.

I know the attorneys and the accountants and others who are helping advise their clients with regard to the possible sale of a particular piece of business property oftentimes have a very difficult time in determining what the basis of that property is so that the gain can be determined for taxation purposes.

The one good thing about having the basis increased to the fair market value at the time of death gives a certain point of finality or certain starting point again for the next generation with regard to determining what that basis might be.

And I guess I've seen too many times a substantial number of dollars spent for legal fees or accountant fees in trying to determine basis when, if you had a better starting point you might reduce some of those costs.

Well, I had other things to say, the time is fleeting and we have passed on our written comments and we appreciate being able to testify here today.

[The prepared statement of Mr. Carlson follows:]

Greater Minneapolis Chamber of Commerce
Taxation Task Force

MEMORANDUM

This special memorandum is in regard to the forthcoming hearings by the Special Senate Committee with Senator Mondale of Minnesota attending on the impact of federal, estate and gift taxes on small businessmen and farmers.

The following are the questions which will be discussed at the Senate Committee hearings scheduled to be held in Minneapolis on Tuesday, August 26, 1975, at 9:30 a.m. to 12:00 noon in Room 2400 (County Commissioner's Board Room), in the Hennepin County Government Center at 300 South 6th Street in Minneapolis.

1. Should the present $60,000.00 estate tax exemption (unchanged since 1942) be increased?

   Answer: We believe that the $60,000.00 estate tax exemption should be increased. That amount has been in effect since 1942 and was meant to relieve the tax impact on smaller estates. Clearly it is inadequate in 1975 and we would suggest that the estate tax exemption be raised to at least $100,000.00 and maybe more properly to $120,000.00. Such an increase is especially important because of the increased number of small estates which have life insurance as one of the assets.

2. Should the provisions which now permit estate taxes to be paid over a 10-year period--but only in limited circumstances--be liberalized?

   Answer: We have generally found little problem with regard to the timely payment of estate taxes and do not necessarily believe that the provisions providing for a 10-year payment period need be liberalized. The one specific area where some liberalization may be necessary involves an estate consisting primarily of farm property where there are no liquid assets to pay the estate taxes.

3. Should estate taxes be reduced or postponed if family farms are kept in the family and continue to be used for farming?

   Answer: Although we do not believe estate taxes should be reduced if family farms are kept in the family and are continued to be used for farming, we do believe that it would be desirable to postpone for a period of time the estate tax on such family farms. The main difficulty, of course, is that if there are no other liquid assets in the estate there would be no available funds to pay the taxes. Neither social or tax policy is well served by forcing the estate of a family farmer to have to sell a portion of the farm merely to pay the estate taxes.

4. Should farm land be valued for estate tax purposes at its value as farm land rather than its value for other commercial purposes, so long as the heirs continue to farm the land?

   Answer: We believe farm land should be valued for estate tax purposes at its value as farm land rather than its value for other commercial purposes so long as the heirs continue to farm the land. The key question would be how to insure that the heirs would continue to farm the land and what would be the consequences if they did not. It would seem that heirs who inherited the farm land could be required to sign a certificate indicating that they were intending to continue to farm the land. In addition there could be some additional tax assessed against the new owners of the farm land if within a certain period of time (for example five years) they changed the use of the land from farming to commercial purposes. This could operate somewhat similar to depreciation recapture on real estate where the increase in valuation and estate taxes would depend on the length of time the property was used for farming.

5. What impact would proposals to tax capital gains at death have on farms and small businesses?

   Answer: We believe it would be a disaster to tax capital gains at death especially for farmers and small businessmen. By having an income tax on the difference between the basis and the value of farms or small businesses at death the law could in many instances destroy the farm or the small business merely because there would be no liquid assets to pay the income tax. There should be strong opposition to any proposal of this nature.

6. Another proposal with regard to income tax at the time of death is to not adjust the basis to the amount included on the federal estate tax return. This would cause an heir who later sold the property to have to pay a greater income tax on the difference between the original basis and the selling price. In effect it would create a situation similar to that of a gift where the donee takes the donor's basis. The difficulty with this type of proposal is the purely practical one of trying to determine the basis of property held for a long period of time. Any attorney or accountant will tell you that often times it is next to impossible to provide the proper basis when property is sold. The time and cost that

goes into such determination could well be as great as the tax involved. By having some specific time when a new basis has to be determined (the new basis at the time of death or alternate valuation date) there is some starting point for later sales of the property.

6a. In all these discussions one of the great problems is the cost of preparing returns or determining information in computing the tax. In making any determination with regard to a change in the law this should be an important factor for consideration.

Harry Fiterman, Chairman
Taxation Task Force
Greater Minneapolis Chamber of Commerce

Dated: August 21, 1975

Jack W. Carlson, Vice Chairman
Subcommittee on Income and
Corporate Taxation

Senator MONDALE. Senator Humphrey?

Senator HUMPHREY. No, I just want to express my thanks to all of the witnesses here today who have had some very productive suggestions and helpful commentary. I appreciate it very much.

Senator MONDALE. I wish to join Senator Humphrey in expressing my appreciation to the panel. I think we've developed a case for a clear need for reforming the estate and gift tax laws and this record, coming as it does from a broad cross section of Minnesotans, will help us make that case in the Congress.

There are some final record insertions that I would like to make. One, a table showing a combination of Federal and State estate taxes which I believe should go into the record.

Next, a statement prepared by Alfred Trahms, T-r-a-h-m-s, a farmer from Janesville, Minn., in cooperation with Land O'Lakes, and Mr. Richard Magnuson, their counsel. And another, a telegram in support of the objectives of this hearing which we've just received from several life underwriters from around the State which strongly urges reform in taxes as they affect small businessmen and farmers. That will also go in the record.

Thank you very, very much for your help.

[Whereupon, the hearing concluded.]

APPENDIXES

APPENDIX I

LAND O LAKES®

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STATEMENT OF ALFRED A TRAHMS
FARMER,
AND DIRECTOR, LAND O'LAKES, INC.
BEFORE THE
SENATE SELECT COMMITTEE ON SMALL BUSINESS
AUGUST 26, 1975

My name is Al Trahms. My son and I operate a diversified farm near Janesville, Minnesota, in the southern part of the state. Our main enterprises are swine and corn, but we also raise soybeans and canning crops and maintain a small dairy herd and a small beef herd.

I am very grateful to you, Senator Mondale, for showing interest in the problem of estate and gift taxes and their effect on a farmer such as me.

I am very concerned about what will happen to my farm in the future. My wife and I, and our eight children, put 35 years of work, investment and care into building an efficient, progressive family farm. This year I turn 65. Soon I will retire, and I hope to pass the farm on to my children and keep it intact. With the present estate and gift tax structure, that may be difficult to do.

In 1942, the $60,000 estate tax exemption represented a lot of money and exceeded the value of most farms. In the 33 years since then, the effects of inflation, plus the need to increase the scale of farming operations have pushed the investment in an efficient family farm to many times the $60,000 estate tax exemption. As a result, farmers have found it increasingly more difficult to transfer the farm business to the next generation.

I think this is an unintended consequence of the estate tax law. America has always valued the independence of its farmers, and independence requires control of the land, labor, and capital involved in farming. An independent farmer is flexible and has the incentive to make the best long run use of our farming resources. With a large estate tax obligation, the ability to transfer to the next generation full control and full independence is lost.

Concern about this problem is widespread among farmers. I am a director of Land O'Lakes, Inc. and our farmer members have resolved that "...legislative bodies, both state and federal, review the effect of inheritance and estate taxes on future ownership of agricultural land, and that appropriate estate and inheritance tax relief laws be enacted to insure that the future ownership of agricultural land will remain with the farm operators."

In summary, I recommend that the estate tax exemption be increased to cover the value of an efficient-sized family farm, and be adjusted periodically so that farmers will be able to transfer their farm business without incurring a large estate tax obligation. Alternatively, special estate tax credits could be made available when the operation of the farm business is kept in the family. If estate tax relief is given, the nation will benefit by maintaining an independent, prosperous, and efficient farming sector.

APPENDIX II

JOHN C. LINDSTROM
DISTRICT 21A
KANDIYOHI COUNTY
415 W. 7TH ST.
WILLMAR, MINNESOTA 56201
TELEPHONE:
WILLMAR: 235-1980
ST. PAUL: 296-4222
ASSISTANT MAJORITY LEADER

COMMITTEES:
APPROPRIATIONS
CRIME PREVENTION AND CORRECTIONS
JUDICIARY
RULES AND LEGISLATIVE ADMINISTRATION

State of Minnesota
HOUSE OF REPRESENTATIVES
MARTIN OLAV SABO, Speaker

August 22, 1975

Senator Walter Mondale
443 Russell Senate Office Building
Washington, D.C. 20510

ATTENTION: Jim Verdier

Dear Senator Mondale,

Attached you will find testimony which I have prepared for the hearing by the Senate Select Committee on Small Business on federal estate and gift taxes to be held in Minneapolis on August 26, 1975.

I will be unable to appear to give oral testimony but request that this written testimony be made part of the committee record.

With best wishes,

John C Lindstrom

John C. Lindstrom
Assistant Majority Leader
MN House of Representatives

Enc.

mjm

Testimony on Federal Estate and Gift Taxes

by

John C. Lindstrom

Assistant Majority Leader

Minnesota House of Representatives

presented to

United States Senate Select

Committee on Small

Business, August 26, 1975

I would like to add my strong support for and advocacy of a change in the federal estate and gift taxes on farmers and small businessmen.

As an attorney practicing in a rural area and doing work in probate and estate matters, I am keenly aware of the need for a change in both state and federal estate and gift tax laws. My experience indicates that the current law has a negative impact on family farms and small business.

Dr. Philip Raup, an agricultural economist at the University of Minnesota, recently concluded that "the estimated value per acre of Minnesota farmland increased 7% from 1971-1972, 20% from mid-1972 to mid-1973, and 42% from July 1973 through June 1974." There is, of course, no way of accurately predicting what the future land values will be. Nevertheless, when we note that the average farm in southern and southwestern Minnesota currently represents an investment in excess of $250,000, it becomes evident that it is extremely difficult for young persons to enter farming and equally difficult to keep farms intact when the current owners die.

Given the current tax structure, it is often impossible for children to keep their parents' farm. The transfer of family farms from parents to children commonly necessitates sale of all or part of the farm.

One of the consequences of this is the increase in the number of corporate farms in the state. The simple economics of the current situation are dictating the increased concentration of farmland in fewer and fewer hands. This is not good for agriculture and it's not good for rural Minnesota. The preservation of family farms is not just important for the farmers themselves, it is equally important for all the communities and small businesses that serve the farmers' needs.

Current tax law places most of the economic incentiveson the side of bigness, concentration and ownership by persons who have wealth. It is necessary to rewrite the laws to encourage rather than discourage the transfer of farms and small business to members of the family.

The situation with small non-farm family businesses is similar. Here, again, estate taxes often force the sale of businesses and preclude the possibility of keeping the business in the family--and keeping the business itself alive.

As a partial solution to this problem, I recommend that the federal estate tax exemption on a family farm or small business inherited by a family member be increased from $60,000 to $200,000.

I am currently drafting legislation to introduce in the Minnesota House of Representatives to accomplish in Minnesota tax law what I recommend for the country as a whole.

APPENDIX III

NORTH DAKOTA Farmers Union

Box 651 — Jamestown, North Dakota 58401 — Phone: 252-2340

August 15, 1975

Senator Walter F. Mondale
Senate Select Committee on Small Business
443 Old Senate Office Building
Washington, D. C.

Dear Senator Mondale:

The North Dakota Farmers Union wishes to commend you for your leadership in reviewing the federal estate and gift taxes as they affect family farmers.

During the past session of the North Dakota legislative assembly, major changes were made in the state's estate tax laws to update them to reflect the economic changes that have occurred in farming in recent years. The North Dakota Farmers Union actively supported these changes; however, federal estate laws still present problems for family farmers in our state.

We would appreciate an opportunity to present the position of our 32,000 members at the hearing that you will be chairing in Minneapolis on August 26th.

I have designated Mr. Robert Sanders, our Director of Land Use Policy Development, to prepare testimony and present our views to the hearing if the committee's hearing schedule would permit us such an opportunity.

Please advise us if arrangements can be made to present our views to this hearing.

Sincerely yours,

NORTH DAKOTA FARMERS UNION

Stanley M. Moore

Stanley M. Moore
President

SMM:jet

NORTH DAKOTA FARMERS UNION TESTIMONY

JOINT HEARING

SENATE SMALL BUSINESS COMMITTEE

& JOINT ECONOMIC COMMITTEE

MINNEAPOLIS, MN, AUGUST 26, 1975.

PRESENTED BY ROBERT E. SANDERS, DIRECTOR OF LAND USE PLANNING

The North Dakota Farmers Union commends the leadership of the Senate committees sponsoring today's hearing for recognition of the serious problem of federal estate taxes on the family farm enterprise.

Our organization, which represents over 32,000 farm families in North Dakota, believes that a review of federal estate and gift taxes is long overdue. The estate tax laws have not undergone a major revision in over thirty years and they are completely out of line with today's values.

For a number of years Farmers Union members at their state convention have called for revisions in both the state and federal estate tax laws.

At the last North Dakota Farmers Union state convention, delegates stated in the adopted program of policy and action that "the present $60,000 inheritance exemption is inadequate, and a more realistic value should be established because of the inflated dollar value of land and property."

During the past North Dakota legislative session, the state's laws were revised to correspond with the federal estate tax exemption of $60,000. The state legislature utilized the federal exemption level in order to provide uniformity to estate taxes and to reduce paperwork for estates.

Many North Dakota legislators recognized that the $60,000 specific exemption was inadequate; however, they did not feel that they could go beyond the federal level if they were to maintain some uniformity between state and federal laws.

When the rate schedules and exemptions in federal estate tax laws were established in the early 1940's, a family farm unit could pass from one generation to the next with little or no estate tax obligation.

For example, consider an 800 acre farm. The land on that farm might have been appraised at $30 per acre for a total valuation of $24,000. Livestock and machinery, together with any other assets would have left the total value of the estate well below the $60,000 specific exemption for federal estate tax purposes.

Today, we have a totally different picture. That same land today would be appraised at between $225 and $300, if not more. According to statistics compiled by North Dakota State University, land values in the state have increased 40% just in the past year. In the past two years North Dakota land values have nearly doubled. Yet the same land generates no more real income than it did thirty years ago.

Obviously, land values by themselves have substantially increased estate taxes for the family farm. The combined effect of federal and estate taxes on such a farm can seriously deplete the working capital or in some cases will mean a substantial mortgage to pay the estate tax, or even the forced sale of the farm.

If it was socially and economically desireable that a fairly modest family farm could pass from one generation to another in the early 1940's, when Congress last looked at the estate tax laws, it should be equally desireable in 1975. It would appear therefore, that Congressional action on estate taxes are long overdue.

The board of directors of the North Dakota Farmers Union in line with the action of the delegates to our state convention are urging that the $60,000 specific exemption for federal estate taxes be increased to $150,000.

While Farmers Union believes that the exemption should be increased to better reflect the inflationary trends of the past thirty years, we do not believe that the federal estate tax exemption should be increased to the point that huge farming units could pass on to the next generation without tax consequences.

We are seeking a revision in federal estate taxes in order to permit the family-farm unit to pass from one generation to the next without a crippling tax burden. We do not wish to permit a new system of a landed gentry to emerge. This would be just as damaging to the social fabric of our rural society as large corporate factory farms.

We further believe that federal gift tax rates should be realigned to reflect our suggested increase to $150,000 in federal estate tax exemptions.

We are also concerned that gift taxes have a decreasing effect as the size of the gift increases. We believe this is a distinct disadvantage to the family farm system, because it provides an escape hatch through which the very rich can transfer fortunes to succeeding generations without paying their fair share of taxes.

This places an added tax burden on all people of ordinary means. More importantly, it puts the family farm at a competitive disadvantage when compared to the large "super-farms."

In regards to liberalizing the provisions which now permit estate taxes to be paid over a ten-year period in limited circumstances, we are not sure that it needs to be liberalized as much as this provision needs to be clarified and publicized.

Certainly, this provision needs clarification so that the small farmer can more readily exercise this option in order to preserve the family farm unit.

This is an important provision that must be available to those who truly need it; however, the North Dakota Farmers Union would have to oppose any changes within this provision that would permit the very large farmer to receive undue or unearned rights or benefits.

The North Dakota Farmers Union believes that the federal estate tax should be so designed that no family-farm unit is seriously jeopardized or put out of business by the estate tax that applies when the farm ownership changes from one generation to the next.

We believe that if the federal exemption were increased to $150,000 and the ten-year payment provision were clarified so that it can be more readily understood and applied to the family-size farm unit, that there would be no pressing to otherwise postpone or substantially reduce estate taxes for family farms beyond the recommendations suggested in this statement. Our major objective is that farm units will be more likely to remain within the family and continue to be used for farming.

Serious consideration should be given by Congress to basing the value of land on its agricultural productivity for estate tax purposes rather than on the speculative value of the land.

While North Dakota farmers are not as seriously affected by increased land vaulations due to the proximity of land to urban expansion as their neighbors in Minnesota, in many instances in North Dakota the speculative value of agricultural land has exceeded the value of the land for agricultural use.

We believe it would be appropriate that farmland be appraised at its agricultural productivity value. However, in such circumstances a provision must be included to that if the farmland were to be sold within a stated period of time for the speculative value of that property, the difference in estate taxes between its agricultural productivity value and its speculative value would become due immediately following the sale.

At this time, the North Dakota Farmers Union must oppose proposals to tax capital gains at death on farm property. For most North Dakota family farmers, to apply a capital gains tax at the death of the present farmer would have much more serious economic consequence to the continuance of the family farm unit that would the application of today's unrevised estate tax.

The North Dakota Farmers Union believes that the present system of capital gains taxation is not consistent with our belief that the tax system should accurately reflect the ability to pay.

While we believe capital gains taxation should be a subject for Congressional review and revision, we do not believe that the present capital gains taxation system should be either added to the burden of estate taxes at death or be substituted for estate taxation.

Instead, we believe that increasing the federal estate specific exemption to $150,000, clarifying the provision which permits estate taxes to be paid over a ten-year period in certain circumstances, and basing the value of farm land on its agricultural productivity for estate tax purposes, would bring about the necessary reforms in the federal estate tax systems so that it would once again be consistent with the apparent intent of Congress back in 1942 that the family farm unit should be able to pass from one generation to the next with little or no estate tax obligation.

We appreciate the opportunity to present our views to this joint hearing, and again wish to commend you for the leadership you are providing in bringing about the necessary revisions in the federal estate tax systems.

APPENDIX IV

MINNESOTA FARM BUREAU FEDERATION
3110 Wooddale Dr., P.O. Box 3370, St. Paul, Minnesota 55165/(612)739-7200

September 22, 1975

The Honorable Walter F. Mondale
443 Old Senate Office Building
Washington, D. C. 20510

Dear Senator Mondale:

In compliance with your request of September 9, 1975, we submit herewith a statement from the Minnesota Farm Bureau Federation on the subject of federal estate and gift taxes as they affect farmers and ranchers.

It is our desire that the enclosed statement be entered in the record of the hearing held in Minneapolis, Minnesota, on August 26, 1975, before the U. S. Senate Select Committee on Small Business.

We appreciate the opportunity to formally present our views on this important issue of federal estate tax reform.

Sincerely yours,

Ed Grady

Ed Grady, Manager
INFORMATION DIVISION

EG/clm

Encl. (1)

cc: Honorable Hubert H. Humphrey

STATEMENT

of the

MINNESOTA FARM BUREAU FEDERATION

to the

Select Committee on Small Business

of the

U. S. Senate

on the subject

of

THE IMPACT OF FEDERAL ESTATE AND GIFT TAXES ON FARMERS

September 22, 1975

The United States has long pursued public policies designed to encourage family farming. The federal farm programs of the last 40 years are an example of such policies. While many of these policies have been unsuccessful, it appears that the recent movement toward a more market-oriented economy for agriculture has slowed the exodus from the nation's farms and ranches.

However, as more and more young people have moved into agriculture, frequently in partnership with a father or father-in-law, there has surfaced a new problem which poses a serious threat to the future of family farms.

Over the past 30 years or so, inflation and urban development have combined to push up land values drastically. Farms located in populous areas have been threatened with extinction by rising assessed values based on higher uses. States such as Minnesota have generally recognized this and have adopted, in some form or other, farmland assessment laws to resolve--or at least alleviate--the problem as it relates to property taxes. But the Congress has not yet come to grips with problems encountered in the application of excessive federal taxes to the transfer of an estate to his heirs upon the death of a farmer or rancher.

Farm Bureau for the past several years has been aware of the need and the strong sentiment for corrective action to update the federal estate and gift tax statute.

The present law provides for a $60,000 exemption. Current law also provides that the marital deduction shall not exceed 50 percent of the value of the adjusted gross estate.

These provisions were written into the federal Internal Revenue Service Code in 1942. Obviously, if these levels were appropriate at that time, they are now grossly outmoded and no longer realistic. Because of inflation, it would require a federal estate tax exemption today of nearly $200,000 to be equivalent to the $60,000 exemption of 33 years ago.

Legislation carrying out proposals of Farm Bureau policy relating to estate taxes has been developed and introduced in the 94th Congress. Representative Omar Burleson (D., Texas), a ranking member of the House Ways and Means Committee, is its chief sponsor.

This bill, H. R. 1793, not only calls for increasing the personal exemption figure from $60,000 to $200,000 but also proposes an increase in the marital deduction.

Increasing the $60,000 estate exemption to $200,000 recognizes the inflation which has occurred since 1942. This exemption figure increase, which Farm Bureau strongly supports, would apply not only to farm estates but to all estates.

Raising the marital deduction from 50 percent of the adjusted gross estate to $100,000, plus 50 percent of the total value of the adjusted gross estate, recognizes the importance of partnerships between husbands and wives in farming and in other small businesses. Again, this would apply to all estates and Farm Bureau is in support of this change as proposed by H. R. 1793.

Of particular importance to farmers is that portion of H. R. 1793 which proposes changing the method of valuing farmland for estate tax purposes. The new calculation procedure would value such real estate at its current use level rather than evaluate it on the basis of its highest potential use as is now federal law.

If farm estates elect to be assessed in this manner, H. R. 1793 provides that the land in the estate must have been devoted to farming during the five (5) years prior to the decedent's death and must remain in farming or ranching for a period of five (5) years or the higher use value would be assessed and the higher tax collected.

While the 5-year period is arbitrary, a longer term would, in Farm Bureau's view, create a hardship by clouding the title to land in an estate, thereby impairing its collateral value.

The advantages of the method of estate valuation for tax assessment purposes as detailed in H. R. 1793 would be offset in part by other tax laws. Since the value for farming purposes established in settling the estate would become its base value, any future sale above that base would be subject to taxation as capital gains.

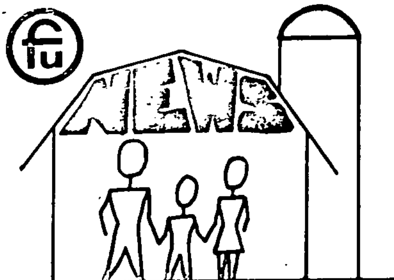
While there is no firm estimate as to the fiscal impact of H. R. 1793, we would not anticipate its enactment resulting in any substantial loss of federal revenue. We base this on the fact that total estate taxes represent less than 2 percent of all federal receipts.

In conclusion, the burden of excessive federal estate taxes creates serious problems for farmers when estates are transferred to heirs. Farm Bureau has long had an intense and on-going interest in the federal estate and gift tax issue. In both the 93rd and 94th Congresses, we have been--and continue to be--in the forefront in pressing for legislation to alleviate these problems.

Farm Bureau looks upon H. R. 1793 as a bill which would, if enacted, bring about sorely needed revisions in the federal estate and gift tax statute.

Such changes would make a major contribution toward keeping family farms intact.

APPENDIX V



For the Modern Farm Family

AUGUST, 1975 --- No. 13

from
MINNESOTA FARMERS UNION
1275 UNIVERSITY AVENUE, ST PAUL, MINN. 55104
PHONE 612 646-4861

WHAT'S HAPPENING---

SPECIAL ITEM --- Estate Taxes

Special Item

Many of you know all too well what inheritance and gift taxes can do to heirs of a family farm. Excessive taxes often result in the family being forced to sell part or all of the farm.

Finally, somebody is attempting to do something about it --- and you can contribute to it.

Senator Walter F. Mondale is holding a hearing on inheritance, gift, and estate taxes, especially as they relate to family farms. The hearing will be in the Twin Cities on August 26th (time and place have not been affirmed yet.) Mondale has been a leader in Congress in attempting to come up with some answers to the estate problem, but he needs help from you.

He wants young farmers to testify at the hearings to tell their side of what happens when a farm is forced into transfer by a death or any written documentation received by mail. He would like witnesses who have suffered some sort of hardship due to the present tax system --- for instance, widows and children who have been forced to sell all or part of the inherited farm in order to pay the taxes; farms that have been left to more than one child and have been divided to pay taxes; farms where operations have been curtailed because the young heir had to borrow in order to pay excessive taxes on the farm; or any other instance related to this problem. Written documentation on these matters would be added to the official record to be used later as evidence by the Senator of Congressional hearings.

Senator Mondale is proposing several solutions to the estate problem, including raising the threshhold at which taxes must be paid and spacing the taxes out over several years. In order to pass such reforms, he needs ammunition (documentation) from you showing the severity of the problems. He remembers that you came through before when we asked you for documentation on the veteran's agriculture training program --- and he followed through by extending eligibility through Congressional action. Let's give him the chance to help again. After all, any of you now farming with your father or other relative could be hit by these excessive taxes that are not designed to be fair to family farmers.

If you would be willing to testify, please send a letter with your phone number to:

Bob Rumpza
Minnesota Farmers Union
1275 University Ave. OR CALL 612-646-4861
St. Paul, Minnesota 55104

Following your contact, we will consult with Senator Mondale's office on the list of those who wish to testify.

It's in your hands, now.

Appendix VI

August 12, 1975.

Bob Rumpza,
Minnesota Farmers Union,
St. Paul, Minn.

Dear Bob: I will not be able to testify at Senator Mondale's hearing in person but would like to express my feelings via letter .

We certainly need some reform in Estate Taxes and Inheritance tax. After the passing away this spring of my father-in-law we have just been thru trying to settle an estate. In the first place this is one of the most unfair taxes. I fail to see why the government thinks they deserve anymore. Income tax was paid on this money once and it rightfully belongs to the heirs.

Just let me tell you what would have happened if my father-in-law had not had a will and good legal council. We live on a 240-acre farm. The land around here is selling around $1,000 per acre. If we would have had to have this farm appraised, you can see where we would have been. No way could we have come up with $240,000.00. From little on we are taught to save our money but this is in absolute reverse. My husband and I will give to our five children their inheritance while we are still living so the government will not get a second chance to get their hands on any more of my money.

Senator Mondale, you lawmakers better also take a hard look at real estate tax. This is another tax that is also backward. We, that live on our farms and continue to improve the buildings are being penalized with higher taxes while the guy that owns land with no buildings pays very little taxes. This ought to be turned around. How do you expect the young person to start farming? My idea of making this tax more fair would be a bigger homestead exemption and more taxes on barren land. Let's put people back on the farms instead of making it impossible for people to start farming.

Thank you,

Mrs. Wayne Tepfer,
Danube, Minn.

Albany, Minn., *August 21, 1975.*

Dear Bob Rumpza: Since I would not find my way around in St. Paul (was country born and raised) I will not be able to testify at Senator Mondale's meeting, I will, however, send you this letter which you can read to Senator Mondale, or give him.

There is no question but that Estate taxes are very unjust. First a family farmer has to buy the farm, pay for it at the same time he is paying real estate taxes (at one time property taxes also) then State and Federal income taxes, then sales taxes, plus the upkeep of building buildings and repairing. He must buy expensive equipment, and expensive fertilizer, seeds, and if the harvest was poor expensive feed. After doing all this for 30 or 40 years, shouldn't he be able to sell this property, or after death, pass it on to his heirs without estate taxes. A dairy farmer has had to do chores seven days a week, cows must be milked every day; also his children have had to help him with his farm operation until they leave home; or, if one son does stay home and provide a home for his parents, shouldn't he be able to buy this at a reasonable price without taxes, and not at the inflated farm land prices we now have. Wasn't it the speculators & professionals, who made lots of money and bought farms for tax loop holes who caused this inflated price.

Stop the tax loop hole buyers, give the family farmer and his family a fair share for their hard long hours of daily labor to feed the people of this world. Remember, too, they have had to work under the heat of the sun under 90 degree heat & more than 90 degree at times; they can't work in air conditioned buildings. In winter they have to work in extreme cold weather.

Just how do most of our Congressmen think, don't they have any respect for the poor, middle income, or small family farmers. Why not stop creating more agencies & more taxes, throw out the computers & all equipment that could give people work.

Here is one thing I think every Congressman should consider: Doesn't God want every person to have a fair share for his labor? How will our law makers give account for the laws they help pass, etc. I believe that in everyone's life they some day will have to give an account of their labor, and the question will be, did their labor fulfill the laws laid down by God in the Ten Commandments?

Yours sincerely,

Mrs. ALOYS MILLER,
Albany, Minn.

P.S. Good Luck to Senator Mondale in trying to do something for people in regard to Estate Taxes. If it wouldn't be for so many taxes, we could retire after 36 years of hard work on the farm, now we must still struggle on.

APPENDIX VII

[Western Union telegram, August 20, 1975]

HIBBING, MINN.

Senator WALTER MONDALE,
Select Committee on Small Business,
Washington, D.C.

It was with great interest that we heard of the estate and gift tax hearings that your Senate Small Business Committee will hold in Minneapolis on August 26.

That the small businessman is often faced with unsurmountable tax burdens in passing on his business to members of his family and other co-workers is a truism that brooks no dispute. We were most pleased to discover that your committee will address this problem area. You and the committee deserve a strong vote of thanks for your attention and particularly, for seeking comments directly from the American grass roots. We appreciate that, by force of circumstances, most of your work has to be carried on in Washington. However, often it is forgotten that the great majority of American people who are not in Washington have ideas and points of view from which the governmental process can benefit. Your hearings in Minneapolis are a welcome step in that direction.

The signatures to this letter are all life insurance agents residing and working in the State of Minnesota. Our efforts are almost exclusively directed to the life insurance problems of small business and of the persons who own or operate such businesses. In that capacity, we meet daily the kind of estate and gift tax problem about which you are seeking information.

We are also members of the Association for Advanced Life Underwriting (AALU) a nationwide group of life insurance agents, each of whom is engaged in the same kind of daily effort on behalf of small business as are we. Information respecting your hearings was brought to our attention by AALU and its counsel in Washington. They advised us of your anticipated presence in Minnesota and suggested that we might make our views known to you. We are most anxious to offer such assistance as you may desire.

In view of the distance you are traveling to join with the citizens of Minnesota we feel that we can do nothing less than take the shorter trip to support you with our physical presence at your hearings. As many of the signatories to this letter as can possibly make it will be attending those hearings. We would further appreciate the opportunity of having one of our group formally appear at those hearings and express our thanks for your efforts. If that is not possible within the limits of the hearings agenda, we would like to meet with you briefly and informally to express our thanks. In any event, we ask that this telegram be made part of the formal record.

We are advised that our national group, AALU, is preparing detailed technical materials which consider the estate and gift tax problems of small business. These technical materials will be designed to present to you our view of the problems to which attention can fruitfully be devoted and of possible solutions which might be considered. We understand that those materials will be supplied to your committee staff at the earliest possible time.

These tax problems of small businessmen have not received adequate consideration in the past. We are encouraged that your committee is now giving them the kind of attention they deserve. Again, thanks for your fine work in this regard.

Responding communications can be addressed to John R. Ryan at the address below: Suite 2, Ryan Building, Hibbing, Minnesota 55746; or to AALU's counsel in Washington: Gerald Sherman, Washington, D.C.

JOHN R. RYAN,
Hibbing, Minn.
MILES MCNALLY,
Minneapolis, Minn.
HERBERT F. MISCHKE,
St. Paul, Minn.
DONALD M. WOLKOFF,
St. Paul, Minn.
RICHARD C. REED,
Minneapolis, Minn.
VINCENT MURPHY,
Fargo, N. Dak.
JOHN E. STEGER,
St. Paul, Minn.

Appendix VIII

John E. Steger,
St. Paul, Minn., September 2, 1975.

Hon. Walter F. Mondale,
Senate Office Building,
Washington, D.C.

Dear Senator Mondale: You suggested that I express in writing my suggestions regarding modifications in the Gift and Income Tax laws which would be helpful to farmers and small businessmen who desire to pass the family farm or family business on to their children.

The present law and regulations could be modified to permit:

(1) The application of the $3,000 annual Gift Tax Exclusion to gifts of a *future* interest in the family farm or the family business. Within modest limits this would permit a series of tax-free gifts which provide the donee with ownership rights at a future date (the death or retirement of the owner of the farm or business). The gifted property would not be subject to Estate Tax at the owner's death.

(2) The accumulation of surplus by a corporation for the purpose of redeeming stock under a "Section 303 Redemption". As you know, funds now accumulated in a reserve or in a life insurance policy for this purpose are subject to attack as unreasonable accumulations of surplus except in the year of the owner's death.

(3) The expansion of Section 264 to include as a "business purpose" the purchase of life insurance to provide funds for a Section 303 Redemption, so that interest on loans incurred to purchase such life insurance can be deducted as an ordinary and necessary business expense. It seems to me that provision for payment of estate taxes is as essential to the continued operation of a business as the expansion of inventory.

I am a member of the Association For Advanced Life Underwriting which is very much concerned with the problems encountered by farmers and small businessmen in this area, and a contributor to L.U.P.A.C. (Life Underwriters Political Action Committee) which has supported you in the past. I am also Past President of the St. Paul Chapter of Chartered Life Underwriters and Past President of the Minnesota State Association of Life Underwriters.

I want to thank you for your interest in this matter and for the opportunity to add my comments.

Cordially,

John E. Steger.

APPENDIX IX

TAXATION OF ESTATES IN MINNESOTA AND GIFTS, NOVEMBER 1971, EXCERPTS

ILLUSTRATIONS OF TAX ON MINNESOTA ESTATES (NO MARITAL DEDUCTION)

Based on assumed transfer of entire estate to a minor child.

TAXABLE ESTATE (Before Specific Exemptions)	FEDERAL TAX	MINNESOTA TAX	TOTAL TAX
$ 10,000	None	None	None
25,000	None	$ 150.00	$ 150.00
40,000	None	450.00	450.00
50,000	None	650.00	650.00
60,000	None	950.00	950.00
75,000	$ 1,050.00	1,368.50	2,418.50
100,000	4,800.00	2,006.00	6,806.00
125,000	10,700.00	2,722.00	13,422.00
150,000	17,500.00	3,450.00	20,950.00
175,000	24,400.00	4,180.00	28,580.00
200,000	31,500.00	5,075.00	36,575.00
250,000	45,300.00	6,932.00	52,232.00
300,000	59,100.00	9,104.00	68,204.00
400,000	87,700.00	13,511.00	101,211.00
500,000	116,500.00	18,495.00	134,995.00
600,000	145,700.00	23,994.00	169,694.00
700,000	176,700.00	29,747.00	206,447.00
800,000	206,900.00	36,029.00	242,929.00
900,000	238,900.00	42,149.00	281,049.00
1,000,000	270,300.00	48,323.00	318,623.00
1,250,000	351,400.00	63,524.00	414,924.00
1,500,000	438,600.00	78,790.00	517,390.00
1,750,000	532,100.00	94,440.00	626,540.00
2,000,000	626,600.00	109,990.00	736,590.00
3,000,000	1,049,400.00	182,000.00	1,231,400.00
5,000,000	2,038,800.00	391,600.00	2,430,400.00
10,000,000	4,975,000.00	1,067,600.00	6,042,600.00
20,000,000	11,075,200.00	2,666,800.00	13,742,000.00
50,000,000	29,375,200.00	7,466,800.00	36,842,000.00

The Minnesota Tax is computed on the net value of the share of each transferee. The percentage of tax depends upon the relationship of the transferee to the decedent. See page 7.

Important tax savings can often be effected by the use of Trusts. See page 12.

ILLUSTRATIONS OF TAX ON MINNESOTA ESTATES (FULL MARITAL DEDUCTION)

Based on assumed transfer of entire estate outright to wife

TAXABLE ESTATE (Before Specific Exemptions)	FEDERAL TAX	MINNESOTA TAX	TOTAL TAX
$ 10,000	None	None	None
25,000	None	None	None
40,000	None	$ 200.00	$ 200.00
50,000	None	400.00	400.00
60,000	None	700.00	700.00
75,000	None	1,150.00	1,150.00
100,000	None	1,900.00	1,900.00
125,000	$ 75.00	2,897.00	2,972.00
150,000	1,050.00	3,858.00	4,908.00
175,000	2,650.00	5,017.50	7,667.50
200,000	4,800.00	6,160.00	10,960.00
250,000	10,700.00	8,758.00	19,458.00
300,000	17,500.00	11,350.00	28,850.00
400,000	31,500.00	17,195.00	48,695.00
500,000	45,300.00	23,776.00	69,076.00
600,000	59,100.00	31,081.00	90,181.00
700,000	73,300.00	38,803.00	112,103.00
800,000	87,700.00	46,507.00	134,207.00
900,000	102,100.00	54,211.00	156,311.00
1,000,000	116,500.00	61,915.00	178,415.00
1,250,000	153,450.00	82,055.00	235,505.00
1,500,000	191,800.00	103,220.00	295,020.00
1,750,000	230,850.00	124,315.00	355,165.00
2,000,000	270,300.00	145,370.00	415,670.00
3,000,000	438,600.00	228,540.00	667,140.00
5,000,000	830,000.00	389,400.00	1,219,400.00
10,000,000	2,038,800.00	768,520.00	2,807,320.00
20,000,000	4,975,000.00	1,474,900.00	6,449,900.00
50,000,000	14,125,200.00	3,559,880.00	17,685,080.00

The lower Federal Estate Taxes in this table as compared with those on page 1 are explained by the fact that the Federal Law exempts all property passing to the surviving spouse, not to exceed 50% of the adjusted gross estate.