



May 12, 2021

The Honorable Mike Thompson
5th District of California
Chairman, Subcommittee on Select Revenue Measures
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 205105

The Honorable Adrian Smith
3rd District of Nebraska
Ranking Member, Subcommittee on Select Revenue Measures
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 205105

Dear Chairman Thompson and Ranking Member Smith,

I submit this statement for the record for the May 12, 2021, House Ways and Means Subcommittee on Select Revenue Measures hearing titled “Funding Our Nation’s Priorities: Reforming the Tax Code’s Advantageous Treatment of the Wealthy” on behalf of the Policy and Taxation Group, which is an organization comprised of family-held businesses from throughout the country that are dedicated to reform and, ultimately, repeal of the estate tax. We appreciate the Subcommittee’s efforts to consider ways to fund many of the worthy domestic priorities that have been proposed in the *American Families Plan*. However, funding these priorities on the backs of family business owners and their employees as the Biden Administration has proposed is the wrong approach and will actually have an outsized negative impact on the low- and middle-income American’s these policies are intended to support.

Family-held businesses make up 59-percent of the private sector workforce and are responsible for more than 83 million jobs.¹ Collectively, these businesses make up 54-percent of the private sector gross domestic product (GDP) and add \$ 7.7 trillion to the U.S. economy.² As such, as the Subcommittee examines ways to “reform” the Tax Code’s “treatment of the wealthy,” it should be particularly mindful of how these policy changes would affect family-held businesses and their employees.

For example, the *American Families Plan* calls for the elimination of step-up in basis – or the ability of an heir to increase their basis in assets to fair market value without paying capital gains tax. An April 2021 EY study³ about the economic impact of eliminating step-up in basis, however, suggests that such a proposal would reduce

¹ *Update 2021: Family Businesses’ Contribution to the U.S. Economy*, Family Enterprise USA (Feb. 2021).

² *Id.*

³ *Repealing Step-Up of Basis on Inherited Assets: Macroeconomic Impacts and Effects Illustrative on Family Businesses*, EY (April 2021)

U.S. GDP by \$10 billion each year and have a significant negative impact on job creation. Specifically, such a change would result in:

- 80,000 fewer jobs in each of the first ten years;
- 100,000 fewer jobs each year thereafter; and
- a \$32 reduction in workers' wages for every \$100 raised by taxing capital gains at death.

The EY study also found that middle-class, family-held businesses would be particularly hard hit by repealing the step-up in basis provision. Currently, when someone inherits a business or assets, they are not taxed on the appreciation that happened before they inherited the business or assets. While it is not clear whether current proposals to eliminate step-up in basis will result in a tax on capital gains at death or a carryover basis regime⁴, forcing family-held businesses to pay capital gains accrued by the prior owner will result in large tax bills that put the future of these businesses – and their employees' jobs – at risk. And, with the *American Families Plan* proposal to increase the capital gains tax rate to 39.6-percent for certain taxpayers, the risk will be even greater. While we understand that President Biden has suggested an exemption for family businesses, this has been tried before by Congress and repealed because it was unworkable; defining "family business" is difficult to do.

While not included in the *American Families Plan*, certain lawmakers have also continued to push for harmful policy changes related to the estate tax. For example, some have suggested reducing the estate tax exemption, which was increased as part of the *Tax Cuts and Jobs Act*. *While we believe that eliminating the estate tax is ultimately the best approach, making permanent the doubled exemption would be a step in the right direction with regard to the taxation of family-held businesses. At the same time, others have called for increasing the rate of the estate tax. Instead, if the estate tax is not eliminated, we believe that in order to help all family-held businesses* subject to the tax, Congress should reduce the rate – which is arbitrarily the highest rate in the tax Code – while maintaining step-up in basis.

According to the 2021 Family Enterprise USA Family Business Survey⁵ released last month, capital gains and estate taxes are the second and third highest tax policy concerns, respectively, of the more than 170 family businesses surveyed. More than 90-percent of these businesses have been in business for more than 30 years – and nearly 20-percent for more than 100 years. In order to ensure our nation provides an environment where these family-held businesses can continue to thrive for another 100 years, we urge Congress to: (1) oppose the elimination of step-up in basis so long as the estate tax remains part of the Tax Code; (2) oppose efforts to increase the long-term capital gains tax rate; and (3) reduce the rate of the estate tax and making permanent the estate tax exemption or, alternatively – and preferably – repeal this harmful tax in its entirety.

On behalf of family businesses owners and their employees everywhere, we thank you for your consideration of our comments and stand ready to serve as a resource to you and your fellow Subcommittee members and staff.

Sincerely,

Pat Soldano

Pat Soldano
Founder, Policy and Taxation Group

⁴ *Return to Carryover Basis?*, Skip Fox of McGuire Woods LLP (May 2021).

⁵ *2021 Family Business Survey*, Family Enterprise USA (April 2021).

Update 2021: Family Businesses' Contribution to the U.S. Economy

prepared by

Torsten M. Pieper, Ph.D.

University of North Carolina at Charlotte
Department of Management
9201 University City Blvd Charlotte, NC 28223-0001
Phone: (704) 687-7575
tpieper@uncc.edu

Franz W. Kellermanns, Ph.D.

University of North Carolina at Charlotte
Department of Management
9201 University City Blvd Charlotte, NC 28223-0001
&
WHU (Otto Beisheim School of Management)
D- 56179 Vallendar,
Phone: (704) 687-1421
kellermanns@uncc.edu

Joseph H. Astrachan, Ph.D.¹

Kennesaw State University
jastrach@kennesaw.edu

with the support of



¹ Emeritus professor



Update 2021: Family Businesses' Contribution to the U.S. Economy

Table of Contents

Abstract	2
Introduction	3
Developments since the 2003 study and main challenges	4
Quantifying family business in 2020	5
Data collection and structure	6
Comparing the datasets	7
Quantifying the bull's eye rings	8
The broad ring	8
The middle ring	9
The narrow ring	10
Estimators	11
Results	12
Number of family businesses and business tax returns	12
Percentage of workforce	13
Contribution to GDP	14
Summary of results	15
Outlook	16
References	17
Appendices	19
Appendix 1: Questionnaire	19
Appendix 2: Further information about data collection	22
Appendix 3. Frequency of responses per employment class	23
Appendix 4: Further analysis on regressions.	24
Appendix 5. Models using previous paper's definitions for middle ring (INT)	27
Appendix 6. Bull's eye with intentions as part of the middle ring definition	29



Update 2021: Family Businesses' Contribution to the U.S. Economy

Abstract

In 1996 and 2003, a groundbreaking study of the impact of family businesses on the U.S. economy and society was conducted that helped shape policy including elements of the Contract with America, changes in estate tax laws, and the inclusion of the idea of family business in many aspects of government policy and legislation. Led by a team of internationally renowned academic researchers, including one member of the original studies, the present report provides an update and further assessment of the economic impact of family businesses. Conceiving family businesses along a continuum of definitions, ranging from narrow, to medium, to broad, depending on the level of family influence on the business, the findings provide nuanced insights into their contributions to employment and economic activity. Regardless of the definition used, family businesses are key pillars of the U.S. economy and essential to economic and social prosperity. The insights provide decision makers, regulators and legislators with data, scientific arguments and justifications to craft policy and take measures in this remarkable time of change and economic and societal progress.



Introduction

In a seminal article, Shanker and Astrachan (1996) established the foundation to assess the impact of family firms on the U.S. economy. The authors updated their framework in 2003 (Astrachan & Shanker, 2003), which has since become one of the most cited articles regarding the impact of family businesses on the overall economy (1,413 Google Scholar cites as of January 26, 2021), so much so that the results are often presented by the media without attribution.

The work's continued popularity is a testament to the validity and usefulness of their framework. However, 17 years is a long time since it was last updated. Accordingly, we revisited the framework to assess if the estimators for family and non-family firms (hereafter referred to as estimators) accurately reflect the distribution of family and non-family firms in the overall population of business organizations in the United States in 2020, and updated family businesses' contribution to the U.S. economy using the most recently available government data.

Specifically, we improved the original findings of Astrachan and Shanker (2003) on the basis of more recent and higher quality data and enhanced the conceptualization of family business under the guidance of one of the original contributors (Dr. Astrachan), who co-authored the present study. In keeping with the 2003 work, we conceptualized family businesses along three definitions (narrow, middle and broad), which depend on the degree of family involvement in the business and assessed their respective contribution to the U.S. economy.

As compared with the early 2000s we now have a much stronger empirical base due to heightened research interest in family firms, which generally show that family firms outperform their non-family counterparts (e.g., Anderson & Reeb, 2003; Wagner, Block, Miller, Schens, & Xi, 2015). Yet even with the increased interest in family business, no data bases are available in the U.S. that reliably indicate the distribution of family businesses across different firm sizes. Accordingly, the present update relies in part on empirical data collected specifically for this purpose. Drawing on these data, we calculated estimates of the distribution of family and non-family businesses in the United States and of the impact of family businesses on the U.S. economy. The fact that the federal government still does not collect information on family businesses in a separate category is curious given the estate tax and pass-through income tax implications for families of current tax policy.

Our primary contributions are twofold: First, we contribute to the current literature by assessing the impact of family businesses on the U.S. economy. Second, we support policymakers and practitioners in assessing policy implications for family businesses, by highlighting family business impact and importance on the overall U.S. economy.



Developments since the 2003 study and main challenges

It is beyond question that family businesses have a significant influence on the U.S. economy. However, quantifying their impact is a complex task. This is based on the ultimate challenge of finding a concise, measurable, commonly agreed definition of the term ‘family business’ (Astrachan & Shanker, 2003).

In 1996, Shanker and Astrachan proposed a framework for assessing the economic impact of family businesses, which they revised and improved in 2003, based on new governmental data (Astrachan & Shanker, 2003; Shanker & Astrachan, 1996). With over 1,000 citations for their 2003 article, their work is considered seminal in the field. The high relevance can be attributed to the selected scope for the framework. Instead of limiting themselves to a narrow definition of family business, Astrachan and Shanker (2003) took an approach that reflected diversity of family firm definitions within what they labelled “the bull’s eye” framework. As a result, the authors enabled comparability across a wide range of family businesses. However, Astrachan and Shanker (2003) stressed that further accurate quantitative verification of these results would be necessary. Indeed, the debate of family firm heterogeneity continues to this day (e.g., Daspit, Chrisman, Sharma, Pearson, & Mahto, 2018; Memili & Dibrell, 2019; Stanley, Hernández-Linares, López-Fernández, & Kellermanns, 2019).

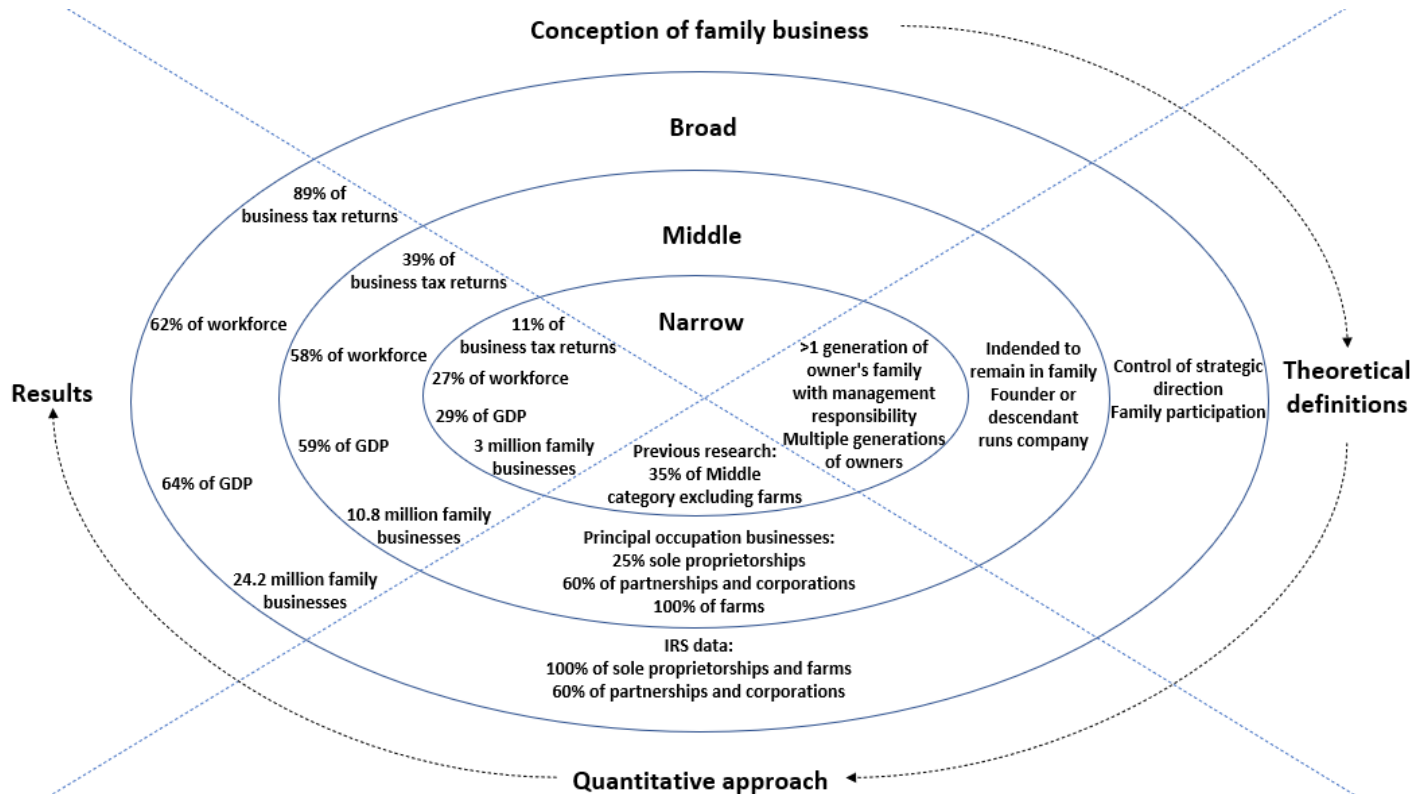
Many measurement approaches to assess family firm uniqueness have been proposed over the years, such as F-PEC (Klein, Astrachan, & Smyrniotis, 2005), Familiness (Frank, Kessler, Rusch, Suess-Reyes, & Weismeyer-Sammer, 2017), SEW-I (Debicki, Kellermanns, Chrisman, Pearson, & Spencer, 2016). For the present study, we decided to utilize Astrachan and Shanker’s (2003) bull’s eye operationalization not only because it allows comparison of our updated findings to the 2003 study, but also because it has strong intuitive appeal to practitioners not familiar with the academic literature. We describe the bull’s eye approach, portrayed in Figure 1, in more detail below.

The bull’s eye consists of three concentric circles, moving from a broad conception of family business in the outer circle to a medium conception in the middle circle and finally to a more exclusive (narrow) conceptualization in the inner circle. The level of inclusiveness depends on the perceived degree of the family’s past, current, and future involvement in the business. In the outer ring, some family participation is assumed, along with the family having control over the business’s strategic direction. In the middle ring, the founder or descendent leads the company and there is the intention to keep the company in the family. In the center of the bull’s eye are those family businesses with multiple generations of owners and more than one generation of the owning family with management responsibility. Figure 1 also summarizes the conceptions of family business, their theoretical definitions, quantitative approach and results of the 2003 Astrachan and Shanker article.



Next, we will outline how we built on the 2003 work and updated and improved the study methodologically and empirically.

Figure 1. The 2003 Bull's Eye of Family Business



Source: Family Businesses' Contribution to the U.S. Economy: A closer look (Astrachan & Shanker, 2003).

Quantifying family business in 2020

Obtaining reliable information on the number and structure of family businesses has been a considerable challenge to research and practice (Klein, 2000). Most assessments are either based on estimated data from prior studies or on tax statistics. Indeed, the 2003 calculations relied on two main sources (Astrachan & Shanker, 2003). First, we utilized tax return data from the Internal Revenue Service, as privately held companies and individuals with business income have to file a specific tax return with the IRS. Second, we relied on data from the U.S. Census Bureau.

To help us calculate new estimators of the distribution of family and non-family businesses in the overall U.S. firm population, we were only able to obtain one relevant dataset, which was generously provided by Professor Dr. James Chrisman of Mississippi State University. These data



were derived from a Small Business Development Center (SBDC) program across the United States from 2003 to 2009. The surveys sampled SBDC clients one year after receiving assistance. The SBDC allowed a limited number of questions to differentiate family and non-family businesses, as well as additional data for publication purposes (e.g., Chrisman, Chua, & Kellermanns, 2009). The overwhelming majority of respondents in this sample had 100 employees or less, thus not entirely suitable for our purposes, but beneficial for the validation of our result as further explained below. Overall, the SBDC data comprised 27,679 usable respondents over 7 years and is the largest comparison group for small businesses in the United States, which allows for the differentiation of family and non-family firms. The data further facilitated a differentiation in micro businesses with less than ten employees and small businesses with less than 100 employees. Yet, since the SBDC dataset was not fully representative of the U.S. firm population and was already somewhat dated, we deemed it necessary to collect our own data to establish the most current and methodologically sound estimates for assessing the proportion of family businesses among the overall population of U.S. firms and to gauge their impact on the U.S. economy. Thus, we decided that a priori sampling was necessary to achieve the most objective estimators for the current study.

Data collection and structure

To obtain updated estimates, we designed an online survey consisting of three modules: a short general company data section, a section on ownership, and a section on family influence on business and governance (see Appendix 1 for further details). Between September and November of 2020, a questionnaire was sent out to 12,500 randomly selected (family and non-family) business contacts purchased from Data Axle, formerly Infogroup. The selection of firms was based on a random sample separated by employment classes, closely resembling the categorization system used by the Statistics of U.S. Businesses (SUSB) of the United States Census Bureau (i.e., less than 100 employees, 100 to 499 employees, etc.) (United States Census Bureau, 2012). For the detailed classification, please refer to Appendix 2.

The initial response rate was remarkably low at 0.6%, but a series of email reminders increased the response rate to 2.9%. The low response rate could have been caused by fatigue of potential respondents from external communications due to the upcoming presidential elections at the time of data collection. As the number of responses was not ideal, alternative survey methods were pursued to supplement the initial results. We first utilized an approach by phone (which proved to be only marginally effective) and then conducted online business intelligence research. In combination, these efforts yielded a satisfactory sample size of 774 responses on which to build our subsequent analyses.

After the elimination of incomplete data, 694 out of 774 records remained for our estimator calculation (see Appendix 3). The following variables are used in the analysis and results section:



- *Percentage of the company owned by one family (FO)*
- *Intention for business to remain in family (INT)*
- *Existence of multiple generations of owners (MGO)*
- *Existence of multiple family members in significant management positions (FM)*
- *Presence of members of the family on the board of directors (FBP)*
- *Leadership of the company by a family member (CEO Fam)*

In contrast to the 2003 study, we could not use the intention variable (INT) throughout our entire analysis as we were unable to collect data on this variable via our data collection efforts beyond the survey. Therefore, we adjusted the quantitative definitions of the middle and narrow rings of the bull's eye in the analysis section accordingly (see footnote 2, Appendix 5 and Appendix 6 for operationalization with intention).

In the next section, we analyze the differences between the SDBC dataset and our survey to establish the general validity of our results.

Comparing the datasets

In order to test the validity of our sample, we compared our newly collected data with the SDBC dataset. As the SDBC data mainly contain firms under 100 employees, we compared the SBDC data with the responses of surveyed companies smaller than 100 employees in our dataset. We established the distribution of family firms and non-family firms based on three somewhat overlapping variables in the databases:

- Percentage of company owned by a family (FO-SDBC)
- Number of Family members in management (FMM-SDBC)
- Intention for business to remain in family (INT-SDBC)

While FO-SDBC and INT-SDBC have the same definition as FO and INT in our dataset, FMM-SDBC is a count of the total number of family members with a management position in the company in the SBDC dataset. To make this variable comparable to our dataset, at least one of three variables in our survey dataset – *existence of multiple family members in significant management positions (FM)*, *presence of members of the family on the board of directors (FBP)* or *company being run by a family member (CEO Fam)* would have to be larger than zero (e.g., at least one family member would have to be present on the board).



Table 1. Results Yielded by SDBC and Survey Dataset

Compared models	SDBC Data	Survey
Definition 1: Percentage of companies where a family owns at least 50% of the company's shares	84%	87%
Definition 2: Percentage of companies where a family owns at least 50% of the company's shares, while intention to keep business in the family exists and at least one family member has management responsibility	36%	30%

The datasets (Table 1) yielded similar percentages of family companies for both family firm definitions. This suggests that the estimators obtained by our current study have sufficient validity to robustly estimate the impact of family firms to the U.S. economy. In the next section, we describe how we calculated the percentages of family and non-family firms for each ring of the bull's eye.

Quantifying the bull's eye rings

The bull's eye considers three different conceptualizations of family firms: broad, middle and narrow (Astrachan & Shanker, 2003; Shanker & Astrachan, 1996). Each conceptualization is outlined in more detail below.

The broad ring

The updated broad ring implies either full strategic control of the company, or partial strategic control paired with a proven participation of the family in the company. This definition is slightly more inclusive than previous definitions, ensuring the broad ring includes companies where a family is involved in the business while boasting at the very least partial control of its strategic direction.

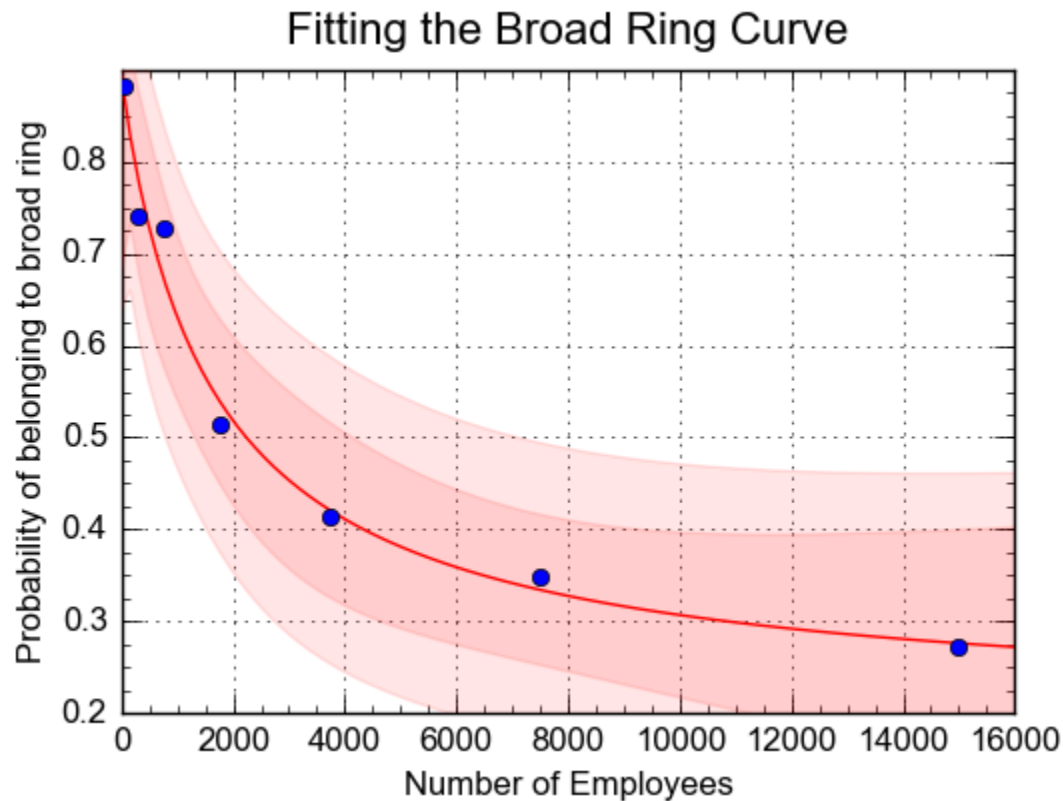
To quantify full strategic control of the company, we used a minimum *percentage of the company owned by one family* (FO), of 51%. The second part of the theoretical definition was quantified by including companies with family ownership between 5 and 50 percent, when found in combination with any of the other aforementioned variables (MGO, FM, FBP, CEOFam), i.e., the presence of at least one family member in the business. The 5 percent threshold for the lower bound of family ownership follows generally accepted research practice (e.g., Anderson & Reeb, 2003) and parallels the earlier study.

To obtain data points for our estimator construction we utilized a regression analysis (see Appendix 4 for details). The “blue dots” in Figure 2 show our actual data points, while the curve



portrayed in the figure shows the regression estimates. The shaded areas show confidence intervals, which get wider at the tail-end of the curve, as less data are available. The regression estimates allow for a more careful estimation of the family firm impact than our raw data could have provided.

Figure 2. Probability of a company belonging to the broad ring, given its number of employees



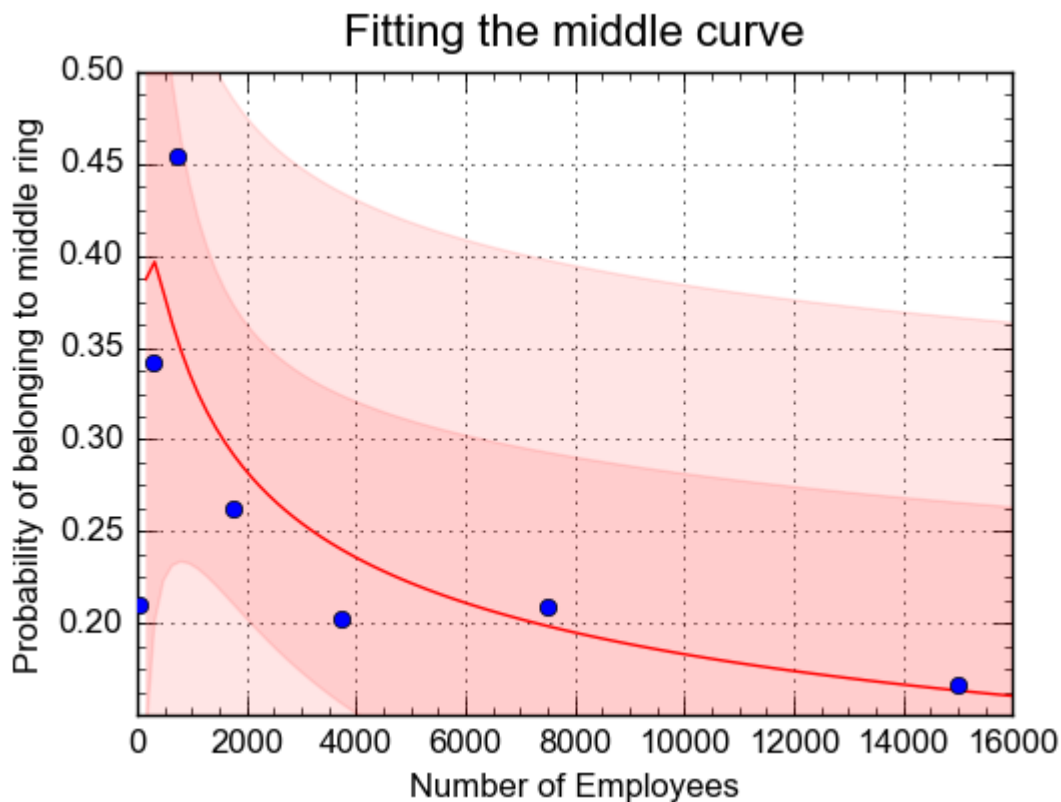
The middle ring

Due to the lack of sufficient responses, it was not possible to reliably use *intention for business to remain in the family* as an estimation variable for the middle conceptualization of family business. As such, we adjusted the middle ring utilizing the above-mentioned statistical technique.² Instead of utilizing intentions, we used the *existence of multiple generations of family owners*, as the most proximate variable for intentions. Yet, this variable is more restrictive and thus more conservative than *intention for business to remain in the family*, as it excludes companies whose shares are concentrated in the hands of one family member. Consequently, a tightening effect can be observed in the middle ring, when compared to the 2003 analysis by Astrachan and Shanker. To compensate

² Despite the missing data, we re-estimated the middle and narrow ring models in Appendix 5. While the estimators are not as robust as the analysis presented in the general write-up, the estimated economic impact is similar. Appendix 6 summarizes the result in the bull's eye figure.

for this restriction, we allowed for the existence of at least one family member with management responsibility as a second theoretical definition for the middle ring. The presence of at least one of three variables (*multiple family members in management positions*, *family member presence on the board*, or *CEO belonging to the family*) was used to make the inclusion assessment. Despite the more inclusive second definition, the middle ring remains more restrictive than in the 2003 Astrachan and Shanker article. Figure 3 displays the data points and regression, which follow the same logic otherwise as described above. (Here again, see Appendix 4 for further details of the estimation).

Figure 3. Probability of a company belonging to middle ring given its number of employees



The narrow ring

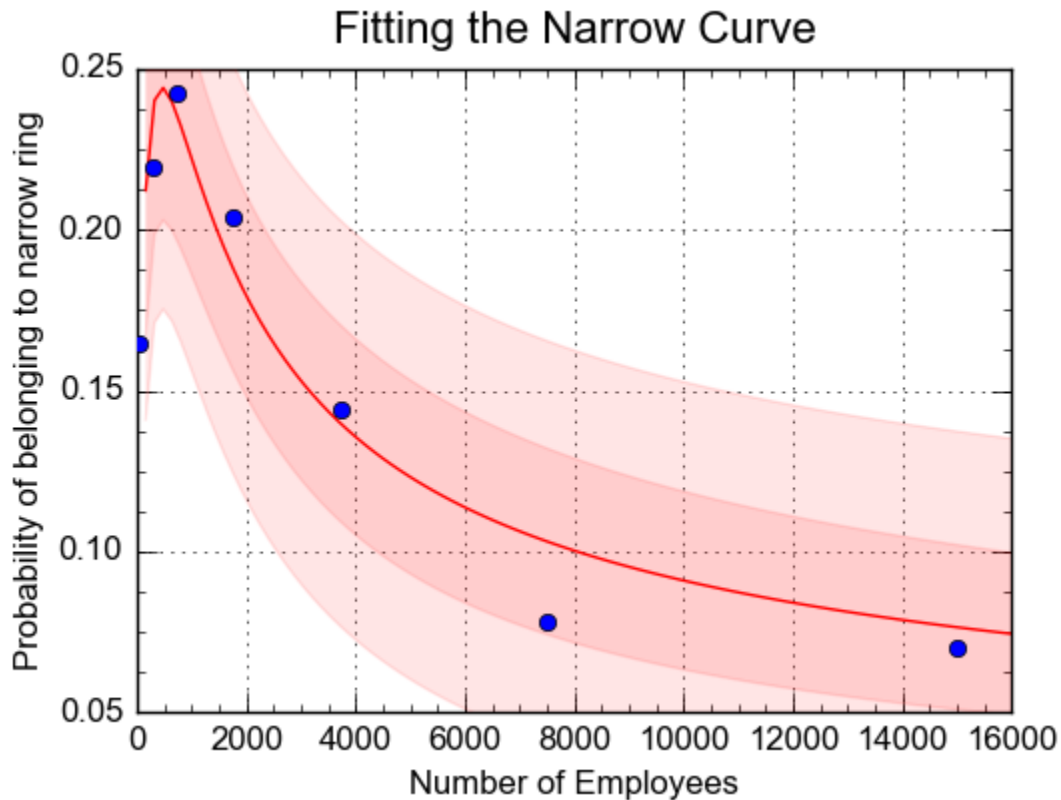
As a result of using *existence of multiple generations of family owners* as a definition in the middle ring, the narrow ring also required theoretical and empirical adjustments. The original definition requiring at least two family members with management responsibility was retained. Additionally, family presence in the most relevant company positions and full strategic control over the company were required to meet the narrow definition.

Quantitatively, a family must control at least 51% of the shares ($FO > 50$), companies must have several family members in management positions (FM) and either the CEO is a family member, or



family presence must exist on the board of directors (CEO Fam or FBP). Figure 4 displays the obtained data points and subsequent regression analyses. Due to the distribution, this regression used the Steinhart-Hart equation, as it best approximated our data. (See Appendix 4 for further details).

Figure 4. Probability of a company belonging to narrow ring given its number of employees



Estimators

The estimation of the narrow, middle and broad definitions allowed for a more reliable estimation of family versus non-family firms across firm sizes (number of employees). Table 2 shows the observed values (based on our collected data) and the estimated data (based on the regression analysis) for each of the employment classes, which correspond to the classification used by the Statistics of U.S. Businesses (SUSB) of the United States Census Bureau. Adhering to these classifications in size then allowed us to use the estimators to assess the actual impact of family firms to the U.S. economy in the next step, using publicly available economic government data.



Table 2. Observed Values and Estimator Values for the Bull's Eye Rings

Employment class\Models	Observed Values (Broad)	Estimator Values (Broad)	Observed Values (Middle)	Estimator Values (Middle)	Observed Values (Narrow)	Estimator Values (Narrow)
Less than 100 employees	0.8816	0.8699	0.2105	0.2023	0.1645	0.1488
100-499 employees	0.7397	0.7812	0.3425	0.3982	0.2192	0.2386
500-999 employees	0.7273	0.6742	0.4545	0.3530	0.2424	0.2349
1,000-2,499 employees	0.5146	0.5404	0.2621	0.2922	0.2039	0.1883
2,500-4,999 employees	0.4135	0.4203	0.2019	0.2399	0.1442	0.1394
5,000-9,999 employees	0.3478	0.3341	0.2087	0.1984	0.0783	0.1031
More than 10,000 employees	0.2719	0.2760	0.1667	0.1634	0.0702	0.0764

Results

Using the estimators calculated in the previous section, we proceeded with the assessment of the impact of family businesses on the U.S. economy. For each ring, we calculated the contribution of family businesses to Gross Domestic Product (GDP), workforce employed by family businesses, the percentage of business tax returns made by family businesses, and the total number of existing family businesses, maintaining comparability with the 2003 Astrachan and Shanker study. All findings are summarized in Figure 5.

Number of family businesses and business tax returns

To calculate the number of family businesses and the percentage of business tax returns made by family businesses, we drew information from two sources. Using the Statistics of U.S. Businesses by Employment Size (United States Census Bureau, 2012), we obtained the percentage of businesses in each employment class. The Internal Revenue Service (IRS) provided information on tax returns. There are two relevant types of tax returns that can be filed: individual tax and business tax. Within business tax returns, there are three legal forms of organization which we had to take into account in our analysis: Sole Proprietorships, Partnerships and Corporations. Please note that small farms (agricultural firms) are generally classified in individual tax income returns. As these entities generally have strong family involvement, they are also part of our analysis. See Table 3 and Table 4 for an overview of legal forms and work-force distribution that were used for our subsequent analysis.

Using the percentage of businesses per employment class obtained through the U.S. Census Bureau data, we distributed the number of Sole Proprietorships, Partnerships and Corporations between the employment classes. We subsequently combined the results with the estimators calculated for each employment class to obtain the final impact for each of the bull's eye rings.



Specifically, the broad ring of the bull's eye was estimated to contain 32.4 million family businesses, representing 87% of all business tax returns in the United States. In the middle ring, there are 9.1 million family businesses, accounting for 25% of business tax returns. Our narrowest ring encompasses 7.2 million family businesses, totaling 19% of business tax returns³.

Table 3. 2015 Total IRS Business Tax Returns by Legal Form of Organization

<i>Type of tax return</i>	<i>Number of tax returns</i>	<i>%</i>
Total	36,994,324	100
Sole Proprietorships	25,226,245	68
Partnerships	3,715,187	10
Corporations	6,119,565	17
Farms	1,933,327	5

Source: US Department of Treasury - Internal Revenue Service (2015).

Percentage of workforce

To quantify the contribution of family businesses to employment, we obtained the ratio of paid employees per employment class from the U.S. Census Bureau. These data could be directly combined with the estimators obtained in the previous section to calculate the percentage of workforce for each ring.

In the broadest ring, family businesses are responsible for employing 59% of private sector workforce, accounting for 83.3 million jobs. Family businesses in the middle ring account for 23% of the U.S. workforce or 32.6 million jobs. In the last and narrowest ring, family businesses employ 14% of the U.S. workforce or 20 million jobs.

³ As sole proprietors often operate multiple businesses and file multiple tax returns, we provide an alternative form of calculating the number of family businesses in each ring. We derived the number of non-employer businesses from the U.S. Census Bureau Non-Employer Statistics (2015) and number of employer businesses from the U.S. Census Bureau - Statistics of U.S. Businesses (2012). We then combined these data with IRS data to obtain a total family business count of 26.4 million for the broad ring, 7.4 million for the middle ring and 5.8 million for the narrow ring.

**Table 4. 2019 Division of Workforce**

<i>US Workforce in 2019</i>	<i>No. of Employees (thousands)</i>	<i>%</i>
Total Workforce	162,796	100
Private (Non-farm)	137,899	83
Private (Farm)	2,304	1
Government	22,593	15

Source: US Department of Labor - Bureau of Labor statistics (2019).

Contribution to GDP

In a final step, we estimated the family firm impact on the Real Gross Domestic Product (GDP). We drew information from the Bureau of Economic Analysis (U.S. Small Business Administration, 2019), as well as from the U.S. Census Bureau by employment class. Table 5 summarizes the data.

Table 5. 2019 Estimated Real Gross Domestic Product by Sector

<i>Gross Domestic Product by Sector</i>	<i>GDP (billions of \$)</i>	<i>%</i>
Total	21,433	100
Private industries (non-farm)	14,158	66
Private industries (farm)	175	1
Government (Federal, State and Local)	7,100	33

Source: Government Receipts and Expenditures - Bureau of Economic Analysis (2019); US Department of Commerce - Bureau of Economic Analysis (2019).

In our broadest ring, family businesses contribute 54% of private sector GDP, or 7.7 trillion USD. Family businesses in the middle ring contribute 23% of private sector GDP, or 3.2 trillion USD. Finally, family businesses in the narrow ring contribute 14% of private sector GDP, or 2 trillion USD.



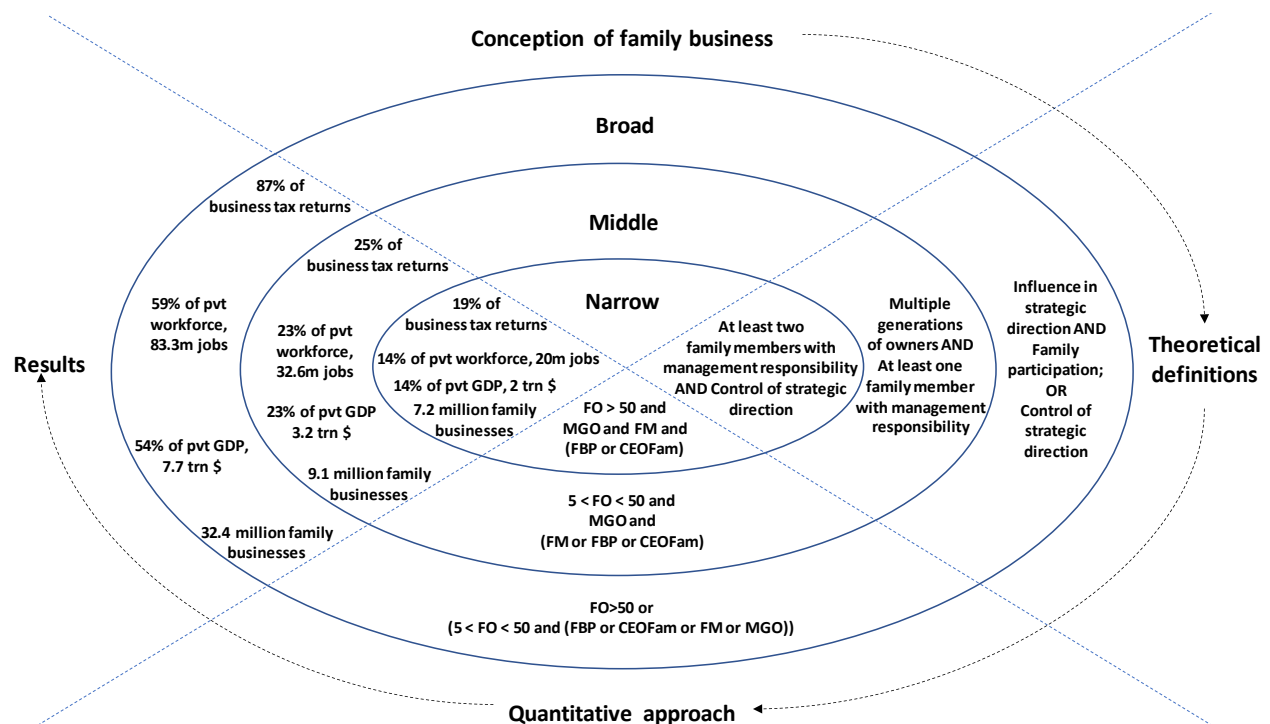
Summary of results

Using the bull's eye figure to summarize the results, we find that family firms have a tremendous impact on the overall U.S. economy. Figure 5 summarizes our results.

As can be observed, the definitional differences in each family business ring yield different results (Figure 5). Results of the broad ring are still remarkably similar to the ones obtained in 2003, with a slight decrease in the contribution to GDP and percentage of workforce. These differences can be attributed to an overall reduction in the percentage of contribution of small businesses to the U.S. GDP since the year 2000 (Kobe & Schwinn, 2018). The observed differences in the middle ring can be explained primarily by the stricter definition used for its quantification in the present study.

Differences in the narrow ring are primarily a result of differences in estimators for the smallest and largest employment classes. As over 60% of GDP and workforce contributions are attributed to these employment classes, results were disproportionately affected. It is also worth noting that some extremely large family businesses may have increased GDP and workforce contributions in the middle and narrow rings (e.g., Walmart qualifies for the narrow ring and is responsible for 2.4% of U.S. GDP).

Figure 5. The 2021 Bull's Eye of Family Business





While there is continuing debate about the appropriateness of one family business definition over another, we do not presume to make a statement on whether one ring or another of the bull's eye more accurately reflects the true impact of family businesses on the U.S. economy. We merely want to raise awareness that the obtained values vary based on the family business definition used. Yet, each of the bull's eye rings (definitions) shows a significant impact of family businesses on the U.S. economy. Policy recommendations should take into account the different definitions.

Outlook

Family business research in the U.S. and around the world has increased dramatically over time, as the importance of family firms continues to become more and more salient to business school faculty and key decision makers in both industry and politics (Debicki, Matherne, Kellermanns, & Chrisman, 2009). However, with the exception of the study by Astrachan and Shanker (2003), on which we based our current analysis, the actual impact of family businesses on the U.S. economy has been neglected and an up-to-date basis for solid policy decisions has been missing. Our current study addresses and closes this gap and is the first in almost 20 years to explore the impact of family firms on the U.S. economy. We conclude that regardless of the definition used family firms are essential to the prosperity of the United States.

Virtually all countries (in both the developed and developing parts of the world) have a significant presence of family firms in their respective economies (see also IFERA (International Family Enterprise Research Academy), 2003; La Porta, Lopez-de-Silanes, & Shleifer, 1999). Thus, in addition to further validate our estimators with a larger sample, we call on the research community to provide up-to-date estimates of family firms world-wide which would allow researchers, practitioners and policymakers to assess the global impact of family firms beyond sometimes questionable estimates and anecdotal evidence currently available.

In the light of the current Covid-19 pandemic, the relevance of this call for future research becomes urgent. The entire world is in the midst of a health and economic crisis that has the potential to lead to extreme policy decisions. Family firms and family researchers (e.g., De Massis & Rondi, 2020) have to adapt to these new realities. A critical reflection on how family businesses are, can, and will be active agents in the resolution of the crisis is unquestionably relevant (e.g. Amore, Pelucco, & Quarato, 2020; De Massis & Rondi, 2020). In this regard, please see also best practice recommendation for family firms in times of Covid-19 (Astrachan et al., 2020). Accordingly, this study provides a critical foundation for assessing the impact that policy decisions (e.g., estate taxes, income taxes, etc.) might have on family firms, which are key pillars of the U.S. economy and should also become a key focus on the federal level in the effort of bringing the country back on track and dampening the economic consequences of Covid-19.



References

- Akaike, H. (1974). A new look at the statistical model identification. *IEEE Transactions on Automatic Control*, 19(6): 716-723.
- Amore, M. D., Pelucco, V., & Quarato, F. (2020). Family Ownership During the Covid-19 Pandemic. *CEPR Discussion Paper No. DP14759*: <https://ssrn.com/abstract=3603991>.
- Anderson, R., & Reeb, D. (2003). Founding-family ownership and firm performance: Evidence from S&P 500. *The Journal of Finance*, 58(3): 1301-1327.
- Astrachan, J., Binz, C., Botero, I. C., Graves, C., Keyt, A., Kotlar, J., Pieper, T., Rüsen, T. A., & Vazquez, P. (2020). <https://ifera.org/crossing-the-crisis/>: last accessed on 01/14/2021.
- Astrachan, J., & Shanker, M. (2003). Family businesses' contribution to the U.S. economy: A closer look. *Family Business Review*, 16(3): 211-219.
- Chrisman, J. J., Chua, J. H., & Kellermanns, F. W. (2009). Priorities, resource stocks, and performance in family and non-family firms. *Entrepreneurship Theory and Practice*, 33(3): 739-760.
- Daspit, J. J., Chrisman, J. J., Sharma, P., Pearson, A. W., & Mahto, R. V. (2018). Governance as a source of family firm heterogeneity. *Journal of Business Research*, 84: 293-300.
- De Massis, A., & Rondi, E. (2020). Covid-19 and the Future of Family Business Research. *Journal of Management Studies*, 57(8): 1727-1731.
- Debicki, B., Kellermanns, F. W., Chrisman, J., Pearson, A. W., & Spencer, B. (2016). Development of a socioemotional wealth importance (SEWi) scale for family firm research. *Journal of Family Business Strategy*, 7(1): 47-57.
- Debicki, B. J., Matherne, C. F., Kellermanns, F. W., & Chrisman, J. J. (2009). Family business research in the new millennium: An overview of the who, the where, the what, and the why. *Family Business Review*, 22(2): 151-166.
- Frank, H., Kessler, A., Rusch, T., Suess-Reyes, J., & Weismeier-Sammer, D. (2017). Capturing the familiness of family businesses: Development of the family influence familiness scale (FIFS). *Entrepreneurship Theory and Practice*, 41(5): 709-742.
- Government Receipts and Expenditures - Bureau of Economic Analysis. (2019). <https://www.bea.gov/data/government/receipts-and-expenditures>. last accessed 01/14/2021.
- IFERA (International Family Enterprise Research Academy). (2003). Family businesses dominate. *Family Business Review*, 16(4): 235-240.
- Klein, S. B. (2000). Family Businesses in Germany: Significance and Structure. *Family Business Review*, 13: 157-181.
- Klein, S. B., Astrachan, J. H., & Smyrnios, K. X. (2005). The F-PEC scale of family influence: Construction, validation, and further implication for theory. *Entrepreneurship: Theory & Practice*, 29(3): 321-339.
- Kobe, K., & Schwinn, R. (2018). Small Business GDP 1998–2014. *U.S. Small Business Administration*, SBAHQ-15-M-0146.
- La Porta, R., Lopez-de-Silanes, F., & Shleifer, A. (1999). Corporate ownership around the world. *The Journal of Finance*, 54: 471-517.
- Memili, E., & Dibrell, C. C. E. (2019). (Eds.) *The Palgrave handbook of heterogeneity among family firms*. Cham, Switzerland: Palgrave Macmillan.



- Shanker, M. C., & Astrachan, J. H. (1996). Myths and realities: Family businesses contribution to the US Economy- A framework for assessing family business statistics. *Family Business Review*, 9: 107-123.
- Stanley, L., Hernández-Linares, R., López-Fernández, M. C., & Kellermanns, F. W. (2019). A taxonomy of family firms and entrepreneurial orientation. *Family Business Review*, 32(2): 174-194.
- United States Census Bureau. (2012). <https://www.census.gov/data/tables/2012/econ/susb/2012-susb-annual.html>. last accessed 01/14/2021.
- U.S. Census Bureau Non-Employer Statistics. (2015). <https://www.census.gov/programs-surveys/nonemployer-statistics/data/tables.2015.html>: last accessed 01/14/2021.
- US Department of Commerce - Bureau of Economic Analysis. (2019). <https://www.bea.gov/data/gdp/gdp-industry>. last accessed 01/14/2021.
- US Department of Labor - Bureau of Labor statistics. (2019). <https://www.bls.gov/emp/tables/employment-by-major-industry-sector.htm>: last accessed 01/14/2021.
- US Department of Treasury - Internal Revenue Service. (2015). <https://www.irs.gov/statistics/soi-tax-stats-integrated-business-data>: last accessed 01/14/2021.
- Wagner, D., Block, J. H., Miller, D., Schens, C., & Xi, G. (2015). A meta-analysis of the financial performance of family firms: Another attempt. *Journal of Family Business Strategy*, 6(1): 3-13.

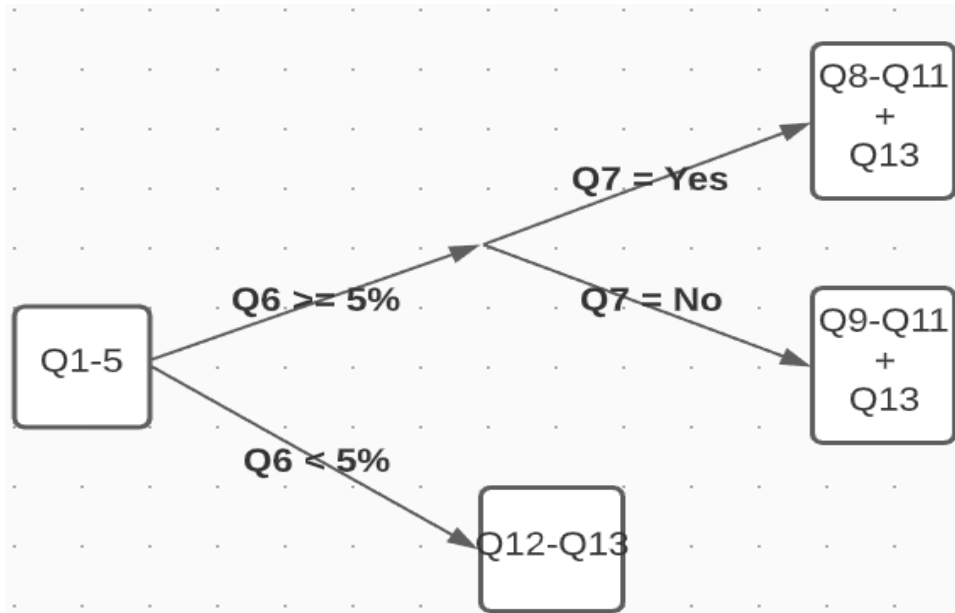


Appendices

Appendix 1: Questionnaire

To minimize the number of unfinished responses, we created a logical tree in which respondents only need to answer questions relevant for their specific case.

Logical tree of questionnaire.



Module 1:

The focus of this module was to establish general company information. The module focused on the following indicators: the primary position of surveyed individuals on the company, if the company is listed on the stock exchange, number of employees by IRS bracket and age. Below we review the questions in more detail.

Question 1: What is your primary position in the company?

The intent of this question was to establish the level of information available to the surveyed individual.

Question 2: Is the company publicly listed?

Having information on whether the companies were listed on the stock exchange helped identify differences between listed and non-listed companies regarding their family business status via online search as publicly listed companies are required to disclose far more ownership and management information than private firms. We reviewed and corrected some responses to this



question, as it became apparent that the question was misinterpreted by some of the surveyed individuals.

Question 3: How many full-time employees does the company have?

We added this question to increase the quality of data in the employment classes. While we could have taken the employment bracket information from the dataset we acquired, there was a risk of using outdated information, especially while in periods of economic uncertainty where companies tend to restructure more often.

Question 4: When was the company founded?

By establishing the age of the company, we obtained yet another indicator for potential analysis in comparison to the family business bull's eye. However, as we had more direct data on family involvement over time, this proxy was not used in our analysis.

Module 2:

This was a key module in our survey. It focused on determining if a family controlled a significant enough percentage of the company to classify as a family business. Below we review the questions in more detail.

Question 5: Is the CEO a family member?

The intent of this question was twofold. The first one was to establish if the surveyed individual viewed the company as a family business (one of the answer options was “Not a family business”). The second one was to establish if a family member had control over the strategic direction of the company.

Question 6: What percentage of the company is owned by a family?

This question was used to make the distinction between possible family businesses and companies which were not family businesses. A 5% threshold was selected to separate companies that could potentially be family businesses (in conjunction with other factors) and companies that are not family businesses. At first sight, 5% might seem a low threshold to consider, but is generally accepted in scholarly research (e.g., Anderson & Reeb, 2003).

Module 3:

This module focused on the influence of the family on corporate governance. Below we review the questions in more detail.

Question 7: Does the company have a board?

This question was meant to establish the existence of a board of directors in the company, as well as presence of the family on the board. This answer was used in conjunction with question 5 to determine the family's control of the strategic direction of the company.



Question 8: What percentage of the board is composed of family members?

This question was used to establish the degree of control the family had in the board of directors.

Question 9: Are there multiple family generations in top management positions?

This question was designed to quantify the key factor in the narrow circle of the bull's eye, whether more than one member of the company owner(s) family had management responsibilities.

Question 10: Do multiple family generations have shares in the company?

This question was designed to quantify the key factor in the narrow circle of the bull's eye, whether multiple generations of the same family owned the company.

Question 11: On a scale from 1-10, what is the likelihood that the company will be handed over to the next generation?

This question was used to answer the key factor in the middle circle of the bull's eye, to what extent the company was intended to remain in the owning family.

Question 12: Does the company have a board?

This question was a variation of question 7 with fewer options, in that it was only asked to companies in which no family controlled at least 5% of the company shares. It was used only to establish the presence of a board of directors in these companies.

Question 13: Would you like to receive the study once it is published?

This question was meant to provide a small token of gratitude to the respondents that participated in the study by providing them with the results of their contribution upon their request.



Appendix 2: Further information about data collection

Employment classes:

- Less than 100 employees
- 100 to 499 employees
- 500 to 999 employees
- 1000 to 2,499 employees
- 2,500 to 4,999 employees
- 5,000 to 9,999 employees
- More than 10,000 employees

Sampling the sample: To reduce the risk of response bias, two samples of 150 contacts were extracted from the dataset to test different approaches of communication: a family-business specific email and neutral email. There was no noticeable difference in the ratio of family/non-family businesses responding to or opening either version of the email. However, the response rate was relatively low (2%) and therefore results were marginally conclusive.



Appendix 3. Frequency of responses per employment class

Employment Class\Frequency	FO	FM	MGO	FBP	CEOFam	INT
Less than 100 employees	103	103	103	103	103	27
100-499 employees	73	73	73	73	73	62
500-999 employees	104	104	104	104	104	6
1,000-2,499 employees	115	115	115	115	115	10
2,500-4,999 employees	33	33	33	33	33	26
5,000-9,999 employees	152	152	152	152	152	151
More than 10,000 employees	114	114	114	114	114	20
Total	694	694	694	694	694	302

Legend:

FO - Percentage of the company owned by one family

INT - Intention for business to remain in family

MGO - Existence of multiple generations of owners

FM - Existence of multiple family members in significant management positions

FBP - Presence of members of the family on the board of directors

CEOFam – Leadership of the company by a family member



Appendix 4: Further analysis on regressions

Regression Methods

To fit the curves to our models, a number of regression methods were tested: linear, log-linear, polynomial, several forms of non-linear regression, and smoothing techniques. Ultimately, non-linear regression techniques yielded the closest fit to our data, and were subsequently selected for each ring. It is important to note that due to the limited number of responses obtained, it was not possible to perform out-of-sample validation.

The broad ring

We selected a curve based on the Hill equation for fitting the broad ring of our bull's eye. As we cannot use Pearson Correlation and R Squared for assessing goodness of fit of non-linear models, we use Standard Error as an indicator. A standard error of 0.043 indicates the model is a good fit to our data points. Additionally, the model's parameters are well within the 95% confidence interval of the estimate.

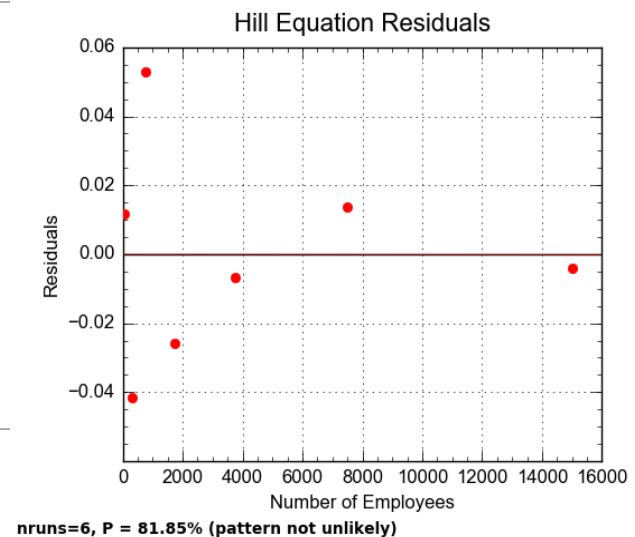
Overview of regression and residuals of curve selected for the broad ring.

Overview

Name	DR-Hill
Kind	Regression
Family	Dose-Response Models
Equation	$y = \alpha + \theta x^\eta / (\kappa x^\eta + x^\eta)$
# of Indep. Vars	1
Weighting	Default
Standard Error	0.04318981655232548
Correlation Coeff. (r)	0.991082
Coeff. of Determination (r ²)	0.9822434021235597
DOF	3
AICC	-35.921193

Parameters

	Value	Std Err	Range (95% confidence)
alpha	0.893349	0.066790	0.680794 to 1.105904
theta	-0.694421	0.168730	-1.231395 to -0.157447
eta	0.952747	0.391319	-0.292604 to 2.198098
kappa	1689.823497	710.840151	-572.387116 to 3952.034111





While the Akaike Information Criterion (Akaike, 1974) indicates this curve is not the best choice among our tested models (albeit a close second), the subsequent residual analysis was more favorable towards this curve, leading to our final choice for the broad ring.

The middle ring

For the middle ring, we selected a curve based on the modified Hoerl equation. A low Standard Error could also be observed for this model, along with the Akaike Information Criterion indicating this model to be among the best possible models we tested.

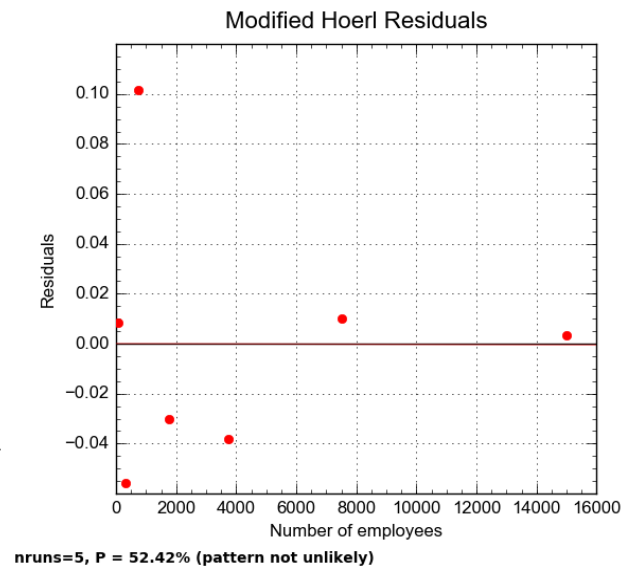
Overview of regression and residuals of curve selected for the middle ring.

Overview

Name	Modified Hoerl
Kind	Regression
Family	Power Law Family
Equation	$y = a*b^{(1/x)}*x^c$
# of Indep. Vars	1
Weighting	Default
Standard Error	0.06311755989856284
Correlation Coeff. (r)	0.861269
Coeff. of Determination (r ²)	0.7417840397337925
DOF	4
AICC	-35.595898

Parameters

	Value	Std Err	Range (95% confidence)
a	2.603340	1.763055	-2.291686 to 7.498366
b	0.000000	0.000000	-0.000000 to 0.000000
c	-0.287417	0.090642	-0.539079 to -0.035754



The parameters are also found well within the 95% confidence interval of the estimate. Unfortunately, residual analysis was inconclusive, as it did not yield better results than other well-fitted models.

The narrow ring

The best fitting curve for the narrow ring is based on the Steinhart-Hart equation. This curve yielded a standard error of 0.019 in relation to our sample. Additionally, as with previous selected models, equation parameters were well within the 95% confidence interval.



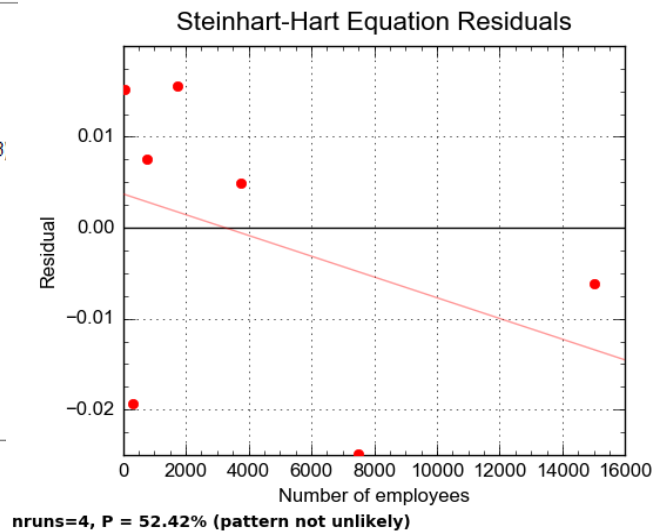
Overview of regression and residuals of curve selected for the narrow ring.

Overview

Name	Steinhart-Hart Equation
Kind	Regression
Family	Miscellaneous
Equation	$y = 1/(A + B*\ln(x) + C*(\ln(x))^3)$
# of Indep. Vars	1
Weighting	Default
Standard Error	0.01989918787889378
Correlation Coeff. (r)	0.970490
Coeff. of Determination (r^2)	0.9418513553885614
DOF	4
AICC	-51.756380

Parameters

	Value	Std Err	Range (95% confidence)
A	19.359205	3.642566	9.245819 to 29.472591
B	-3.749046	0.845370	-6.096170 to -1.401921
C	0.033496	0.006626	0.015101 to 0.051892



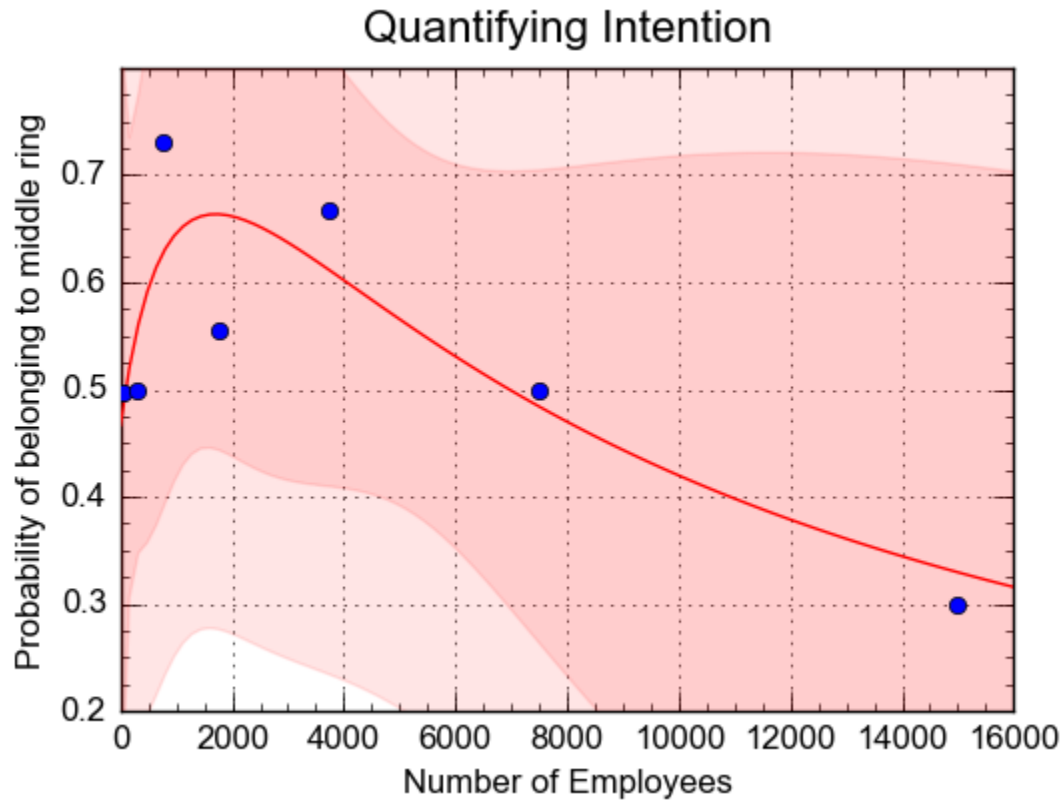
The Akaike Information Criterion indicated the curve to be among the best we tested. Finally, residual analysis did not allow us to further distinguish the competing models. As we know that business volume from very large businesses is likely to impact results of the highest employee class for GDP and employment, we considered, among our best fitted models, a model with a slightly heavier tail.



Appendix 5. Models using previous paper's definitions for middle ring (INT)

The theoretical definitions behind the previous paper's middle ring were the existence of *intention for business to remain in the family* and the *CEO being a family member*. This led to the direct usage of the INT and CEOFam variables to quantify this middle ring.

Selected middle ring curve using intention





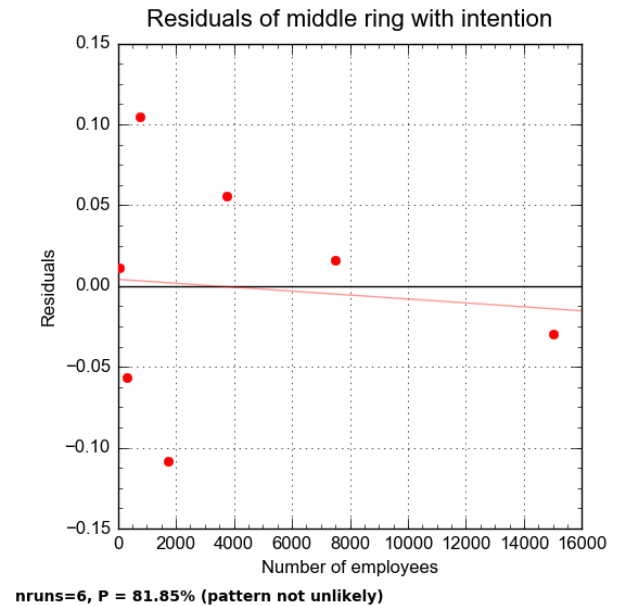
Overview of regression and residuals of curve selected for the middle ring using intention.

Overview

Name	Rational Model
Kind	Regression
Family	Miscellaneous
Equation	$y = (a+b*x)/(1 + c*x + d*x^2)$
# of Indep. Vars	1
Weighting	Default
Standard Error	0.1001764322662609
Correlation Coeff. (r)	0.859515
Coeff. of Determination (r^2)	0.7387667567903905
DOF	3
AICC	-24.142598

Parameters

	Value	Std Err	Range (95% confidence)
a	0.466561	0.119266	0.087003 to 0.846119
b	0.000758	0.001573	-0.004249 to 0.005765
c	0.000794	0.002044	-0.005711 to 0.007298
d	0.000000	0.000000	-0.000000 to 0.000001



The best fitting curve for the middle ring using intention was based on a model using a variation of a rational equation. This curve yielded a standard error of 0.1. Additionally, equation parameters are well within the 95% confidence interval and residuals were random.

Using this model, we calculated the estimator results based on the probability value generated by the mean of each employment class.

Observed and Estimator values for the middle ring using intention.

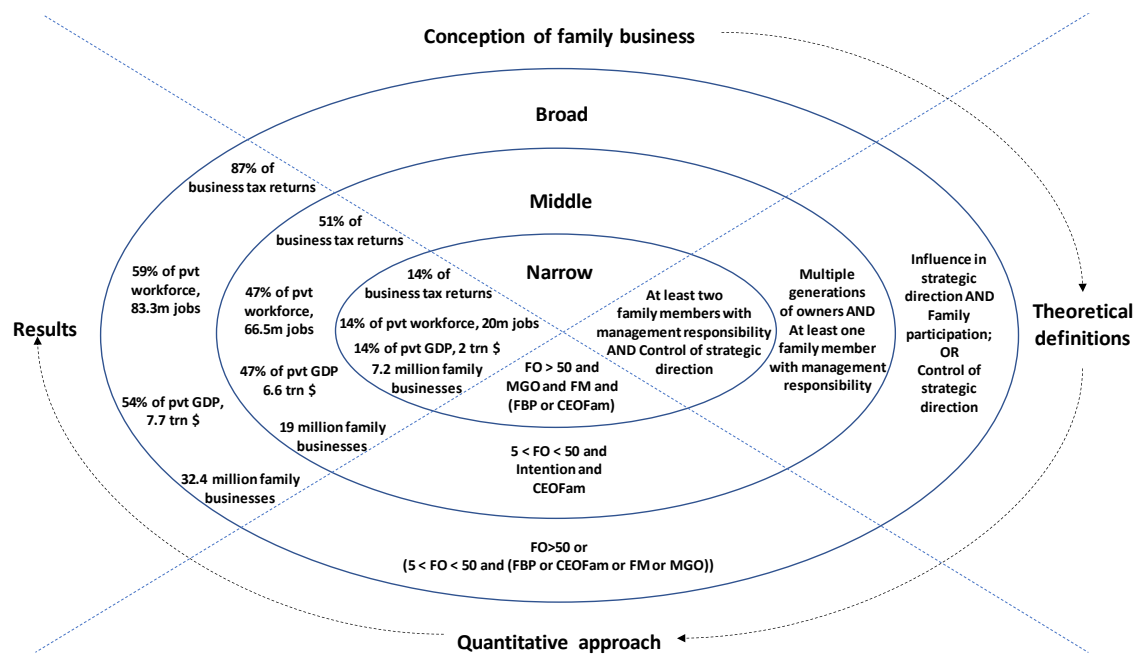
Employment class\Models	Observed values (Middle)	Estimator values (Middle)
Less than 100 employees	0.4967	0.4849
100-499 employees	0.5000	0.5563
500-999 employees	0.7308	0.6262
1,000-2,499 employees	0.5556	0.6636
2,500-4,999 employees	0.6667	0.6112
5,000-9,999 employees	0.5000	0.4841
More than 10,000 employees	0.3000	0.3295



Appendix 6. Bull's eye with intentions as part of the middle ring definition

Using the obtained estimators, the middle ring using intention includes 49% of business tax returns, 19 million companies, 47% of private workforce and 47% of private sector GDP.

Bull's eye using middle ring with intention.



Repealing step-up of basis on inherited assets: Macroeconomic impacts and effects on illustrative family businesses

Prepared for the Family Business Estate Tax Coalition (FBETC)

April 2021



Building a better
working world

Repealing step-up of basis on inherited assets: Macroeconomic impacts and effects on illustrative family businesses

Executive summary

This report presents:

1. estimates of the impacts of repealing step-up of basis on the US economy and
2. case studies illustrating the potential impact of repeal on family-owned businesses.

Analysis shows that this tax increase, whether via tax at death or carryover of basis, will have negative impacts on family-owned businesses, US gross domestic product (GDP), and job creation both in the immediate and long term. Repeal of step-up of basis would impose a tax burden on top of the existing estate tax regime, further compounding these negative impacts.

Background

A capital gain is a measure of an asset's appreciation in value over a period of time. In the usual case, a capital gain is the difference between the amount received when an asset is sold and the asset's basis, which is the purchase price plus a number of adjustments such as depreciation and the value of improvements. Typically, capital gains are taxed when an asset is sold.

Untaxed appreciation could be measured and taxed when the asset or business owner dies and the assets or businesses are transferred to the heirs. However, a longstanding provision of US tax law, in place since the Revenue Act of 1921, is that a capital gains tax is not imposed when assets are transferred at death to an heir. Furthermore, tax law allows the heir to increase their basis in the bequeathed assets to fair market value without paying capital gains tax. This is referred to as a step-up of basis. The basis step-up prevents a potential future capital gains tax on inherited assets by removing from taxable gain the appreciation in the asset's value that occurred during the decedent's ownership. If the heir were to sell the asset in the future, then capital gains tax would generally apply to appreciation in the asset's value from after the bequeathal.

For example, suppose a business was purchased for \$1 million and valued at \$5 million at the time of the owner's death. Under current law, there would be no tax on the \$4 million appreciation that accrued during the owner's lifetime. The heirs would take the \$5 million value of the business as tax basis – the basis would be “stepped-up” by the \$4 million unrecognized capital gain without having to pay tax on that gain. Were the heirs to sell the business in a future year for \$7 million, they would owe capital gains tax on just the \$2 million in appreciation under their ownership.

There have been a number of proposals to repeal the step-up in basis at death and so tax capital gains that were not recognized during the decedent's lifetime. One is to tax gains at death – to deem death to be a “recognition event.” The second is to replace basis step-up with carryover of the decedent's basis.

- ▶ With *tax at death*, the transfer of the asset would be treated as a recognition event and capital gains taxes would be paid at the time of the decedent's death. The tax would be imposed on the fair market value of the asset received less the decedent's basis. This tax would be in addition to any estate taxes owed by the decedent's heirs. The heir would then take a fair market value basis to prevent double taxation in the future.
- ▶ With *carryover of basis*, the transfer at death would not be a recognition event, so no capital gains tax would be paid at that time. However, the heir would not be allowed the

step-up of basis. Instead, with carryover basis the heir's basis in the bequeathed asset would be the same as the decedent's basis prior to death. As a result, when the heir sells the asset, the heir would be liable for capital gains tax on any appreciation in the asset's value that occurred during both the decedent's and the heir's ownership.

Returning to the example above, under tax at death the founder's heirs would owe capital gains tax on \$4 million of gains upon inheriting the business. Under carryover of basis, the heirs would not pay tax at death, but upon selling the business for \$7 million, they would owe capital gains tax on \$6 million in gains (i.e., \$4 million in appreciation under the founder plus \$2 million in appreciation under the heirs). Both cases represent a significant tax increase over current law, as the gains subject to tax are \$6 million for both tax at death and carryover of basis (generally with only a difference in timing) as compared to \$2 million under current law. In both cases, appreciation during the decedent's lifetime eventually is taxed, assuming the asset is sold, although the tax is paid much sooner when gains are taxed at death than when carryover basis is allowed.

While the primary focus of this report is on taxing gains at death, the report also outlines some similarities and differences between the issues caused by taxing gains at death and those caused by carryover basis and in an appendix presents macroeconomic estimates for carryover basis.

Key macroeconomic results

By raising the tax burden on investment, the repeal of step-up of basis via tax at death increases the cost of capital, which discourages investment and results in less capital formation. With less capital available per worker, labor productivity falls. This reduces the wages of workers and, ultimately, GDP and Americans' standard of living.

This report estimates the repeal of step-up of basis via tax at death to have the following economic impacts:ⁱ

- ▶ **Job equivalents.** A significant portion of the burden of repeal of step-up of basis would fall on workers through reduced labor productivity, wages, and employment. Repealing step-up of basis via tax at death is estimated to decrease job equivalents, by approximately:ⁱⁱ
 - ▶ 80,000 jobs in each of the first ten years; and
 - ▶ 100,000 jobs each year thereafter.

Additionally, this analysis estimates that for every \$100 of revenue raised by repeal via tax at death the wages of workers would decline \$32. That is, the burden of the tax is such that nearly one-third of every dollar of revenue raised comes out of the paychecks of US workers.

Gross domestic product. Repeal of step-up of basis via tax at death is estimated to decrease US GDP by:

- ▶ \$10 billion annually or
- ▶ \$100 billion over 10 years.

ⁱ Estimated dollar amounts are presented relative to the size of the US economy in 2021.

ⁱⁱ Job equivalents summarize the impact of both the reduction in hours worked and reduced wages.

- **Impact on family-owned businesses.** In addition to a reduction in US GDP, wages, and jobs, the repeal of step-up of basis could result in significant financial and administrative problems for family-owned businesses and for the Internal Revenue Service (IRS):

Liquidity impacts. Many family-owned businesses have value tied up in illiquid land, structures, and equipment that may need to be liquidated, or leveraged to finance loans, to pay for the new tax burden at death. This is because the size of this one-time capital gain tax can be much larger than the annual income of the business, necessitating liquidation of key assets, or taking on significant new debt—limiting the business' viability as an ongoing concern.

Increased compliance costs/disputes with IRS. Family-owned businesses may also find it difficult to comply because of problems in determining the decedent's basis and in valuing the bequeathed assets. It seems likely that these administrative problems could lead to costly disputes between taxpayers and the IRS. Additionally, if sufficient evidence is not available to prove basis, then \$0 may be used for tax purposes. This may result in an inappropriately large tax at death.

Repealing step-up of basis via carryover basis

While carryover basis delays payment of tax until inherited assets are sold, once the asset is sold the total tax bill will be the same as if gains were taxed at death. This delay of tax payment changes the timing of the tax burden, but as a tax increase relative to current law it still discourages capital formation and has macroeconomic effects similar to, but smaller than, those from taxing gains at death.

Compared to taxing gains at death, carryover basis may mitigate liquidity concerns because no tax is triggered until the assets are sold. Nonetheless, it leaves in place challenges in documenting and tracking basis that can inappropriately increase tax bills and increase tax compliance costs and disputes with the IRS. A previous attempt to implement carryover basis, the Tax Reform Act of 1976, was initially postponed three years by the Revenue Act of 1978 and ultimately repealed before ever being implemented by the Crude Oil Windfall Profit Tax Act of 1980. Prior to repeal, tax practitioners noted significant difficulties in attempting to determine the basis of inherited assets.

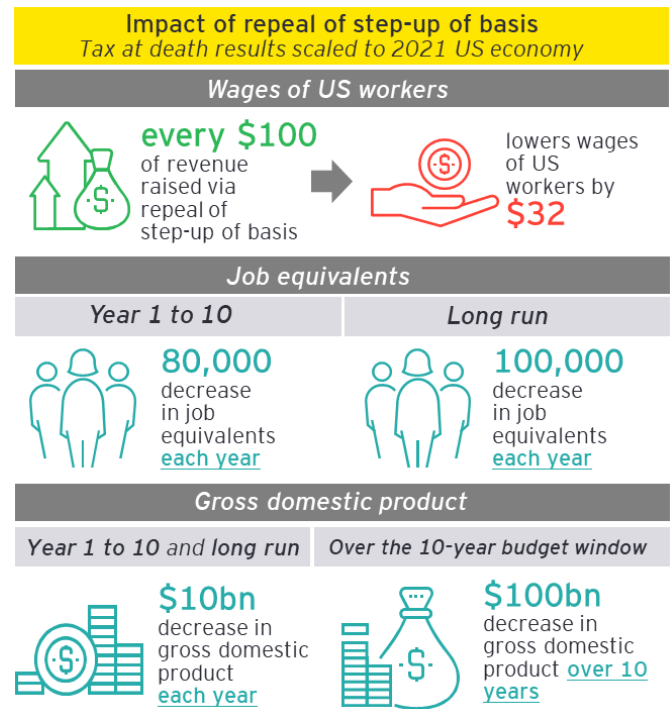
Interaction with the estate tax

In discussions of US policy, taxing gains at death would not be accompanied by repeal of the estate tax. Rather both would be imposed. Taxing gains at death on top of taxing an estate can create a very high tax burden. For example, with a potential estate tax rate of 40% and capital gains tax rate of 20% this double taxation of gains could result in a 52% tax rate, assuming that the capital gains tax is deductible from the estate tax. That is, for every \$100 of gain the heir would only receive \$48 and remit the other \$52 in tax. This high tax burden can be especially problematic when the primary asset in the estate is a business as there may be little cash available with which to pay estate and capital gains taxes. Furthermore, repeal of step-up in basis would make death a taxable event even for families below the current estate tax exemption threshold (\$11.7 million in 2021)—significantly broadening the scope of the United States' death and inheritance taxes.

Some other countries, for example Canada and Australia, that tax capital gains on inherited assets do not have this double taxation via additional estate or inheritance taxes. Rather, taxing

gains on inherited assets is a substitute method of taxing wealth transfers. In the United States, both the estate tax and any efforts to repeal step-up in basis will create cash flow problems for family businesses and increase the likelihood that these job creators will be forced to close or liquidate part of their operations, resulting in job losses and economic damage.

Figure ES-1. Repeal step-up of basis via tax at death



Note: Job-equivalent impacts are defined as the change in labor income divided by baseline average income per job. Changes relative to 2021 US economy. Long-run denotes when the economy has fully adjusted to policy change; generally, 2/3 to 3/4 of this adjustment occurs within 10 years.

Contents

I. Introduction	1
Step-up of basis for an illustrative family-owned business	2
II. Estimated macroeconomic impacts of taxing gains at death	6
III. Family-owned business case studies	8
Illustrative example of a family-owned steel manufacturer	8
Illustrative example of a family-owned farm	10
Illustrative example of beer distributor	12
Illustrative example of apartment property	14
Illustrative example of ingredients manufacturer	16
Additional considerations.....	18
IV. Caveats and limitations.....	20
Appendix A. Description of EY General Equilibrium Model of the US Economy	22
Appendix B. Estimated macroeconomic impacts of carryover basis	27

Repealing step-up of basis on inherited assets: Macroeconomic impacts and effects on illustrative family businesses

I. Introduction

A capital gain is a measure of an asset's appreciation in value over a period of time. In the usual case, a capital gain is the difference between the amount received when an asset is sold and the asset's basis, which is the purchase price plus a number of adjustments such as depreciation and the value of improvements. Typically, capital gains are taxed when an asset is sold. The top long-term statutory capital gains tax rate is 20%.¹

Untaxed appreciation could be measured and taxed when the asset or business owner dies and the assets or businesses are transferred to the heirs. However, a longstanding provision of US tax law, in place since the Revenue Act of 1921, is that the transfer of assets at death to an heir does not trigger a capital gains tax. Furthermore, tax law allows the heir to increase their basis in the bequeathed assets to fair market value without payment of capital gains tax. This is referred to as a step-up of basis.² The basis step-up prevents potential future capital gains tax on inherited assets by removing from taxable gain the appreciation in the asset's value that occurred during the decedent's ownership. If the heir were to sell the asset in the future, then capital gains tax would generally apply to appreciation in the asset's value from after the bequeathal.

For example, if a business was purchased for \$1 million and valued at \$5 million at the time of the founder's death, it would have a tax basis of \$5 million for the founder's heirs (i.e., the \$4 million in appreciation over the founder's lifetime contributes to stepped-up basis for the heirs). Were the heirs to sell the business in a future year for \$7 million, they would owe capital gains tax on just the \$2 million in appreciation under their ownership.

There are two ways that the step-up of basis can be repealed. One is to tax gains at death. The second is to replace basis step-up with carryover of the decedent's basis.³

- ▶ With *tax at death*, the transfer of the asset would be treated as a recognition event and capital gains taxes would be paid at the time of the decedent's death. The tax would be imposed on the fair market value of the asset received less the decedent's basis. It would be in addition to any estate tax owed. The heir would then take a fair market value basis to prevent double taxation in the future.
- ▶ With *carryover of basis*, the transfer at death is not a recognition event, so no capital gains tax is paid at that time. However, the heir is not allowed the step-up of basis. Instead, with carryover basis the heir's basis in the bequeathed asset is the same as the decedent's basis prior to death. As a result, when the heir sells the asset, the heir is liable for capital gains tax on any appreciation in the asset's value that occurred during both the decedent's and the heir's ownership.

Returning to the high-level example above, with tax at death the founder's heirs would owe capital gains tax on \$4 million of gains upon inheriting the businesses and, when they later sold the business, would owe tax on the \$2 million in appreciation that occurred during their ownership.

With carryover of basis, the heirs would not pay tax when they inherited the asset from the decedent but would pay tax on the \$6 million gain realized when they sold the business for \$7 million.

This analysis presents:

1. estimates of the economic impacts of repealing step-up of basis and
2. case studies illustrating the potential impact of repeal of step-up of basis on family-owned businesses.

The focus of the report is on replacing step-up in basis with taxing gains at death but moving to carryover basis is briefly discussed and a macroeconomic analysis of carryover basis is presented in an appendix.

Step-up of basis for an illustrative family-owned business

The role of step-up of basis in the lifecycle of an illustrative family-owned business can be seen below in Figure 1.

This illustrative family-owned business was started from scratch in 2000 with an initial market value of \$0. By 2025, when the founders of the business passed away and the heir became the owner, the business has grown to a market value of \$550,000 with annual income of \$40,000.⁴

Under current law, no capital gains tax would be due when the original owner dies and passes the business onto her heir. In addition, the heir is allowed to step up (increase) basis from the former owner's basis of \$0 to the fair market value of \$550,000. This basis step-up shields from future tax the appreciation that occurred during the original owner's lifetime.

By 2030 the heir has further grown the business to a market value of more than \$710,000 with annual income of \$50,000 and decides to sell. Under current law (step-up of basis), the heir would owe tax on a capital gain of \$160,000, resulting in a tax liability of \$32,000 (i.e., \$160,000 x 20% tax rate).⁵ The \$160,000 capital gain reflects the increase in the value of the business since inherited calculated as the \$710,000 sales price minus the basis of the business of \$550,000.

As previously noted, there are two ways that step-up of basis can be repealed. One is to tax gains at death. The second is to replace basis step-up with carryover of the decedent's basis.

Repeal via tax at death

With tax at death, there is an immediate capital gains tax applied at the time of the founders' death. In the example of Figure 1, with a market value of \$550,000 and cost basis of \$0 there is a \$550,000 capital gain triggered by the death of the founders. This results in a capital gains tax liability of \$110,000 (i.e., 20% of market value less cost basis). Because the gain is taxed, the heir's basis is increased from \$0 to \$550,000 to prevent double taxation of the gain. When the heir sells the business in 2030, the capital gain at that time is \$160,000, the market value (\$710,000) less the cost basis (\$550,000). This triggers another capital gains tax of \$32,000 (\$160,000 capital gain x 20% tax rate). Thus, summing the capital gains tax paid at the time of the founders' death (\$110,000) and that paid when the heir sells the business (\$32,000), there is a total of \$142,000 of capital gains tax paid by this illustrative family-owned business. Overall, in

this example taxing gains at death raises the capital gains tax by over 340% relative to the tax imposed under current law (i.e., \$142,000 relative to \$32,000 under current law). All the capital gain over the lifespan of the family-owned business between founding and sale is taxed.

Compared to current law, taxing gains at death can be especially burdensome on the business because there is no sale out of which to pay the tax. In the example the \$110,000 tax bill due upon the death of the original owner represents 275% of the business' income in that year (i.e., \$110,000 tax bill relative to \$40,000 annual income in 2025). If there is not an additional source of ready cash, the liquidity squeeze from the tax may require the heirs to liquidate all or part of the business or secure a large loan. Both these and other potential financing options can impair the continued ownership of the business by the heir.

Repeal via carryover of basis

With carryover of basis, the transfer at death does not trigger an immediate capital gains tax. However, the heir is not allowed the step-up of basis. Instead, with carryover basis the heir's basis in the bequeathed asset is the same as the decedent's basis prior to death, \$0 in the example. When the heir sells the business in 2030 the heir is liable for capital gains tax on any appreciation in the asset's value that occurred during both the decedent's and the heir's ownership. That is, when the heir sells the business in 2030 there is a capital gain of \$710,000, the market value of the business at sale (\$710,000) less cost basis (\$0). This results in a large tax liability of \$142,000, or 284% of annual income in 2030.

Assuming that the heir eventually sells the business, the total capital gains tax paid is the same when gains are taxed at death as when the heir receives a carryover basis. As noted above, this tax can be large; in the example it is more than 340% larger than the tax imposed under current law and represents 284% of annual income. However, compared to taxing gains at death, carryover basis delays the payment of the tax, making it less burdensome (because of deferral and the time value of money)⁶ and easier to plan for the eventual tax payment. In addition, it times the tax payment with the sale of the family-owned business, easing liquidity burdens on the owners.

Nonetheless, carryover basis shares with taxing gains at death the problem of tracking and identifying the basis on inherited property and businesses. Properly measuring basis can be difficult because of incomplete records available to the heirs. An inability to document basis can have large tax consequences, especially if the alternative is to use a basis of \$0. A previous attempt to implement carryover basis, the Tax Reform Act of 1976, was initially postponed three years by the Revenue Act of 1978 and ultimately repealed before ever being implemented by the Crude Oil Windfall Profit Tax Act of 1980. Prior to repeal tax practitioners noted significant difficulties in attempting to determine the basis of inherited assets.⁷

Interaction with the estate tax

In discussions of US policy, taxing gains at death would not be accompanied by repeal of the estate tax. Rather both would be imposed on the decedent (and ultimately fall on the heirs). Taxing gains at death on top of taxing an estate can impose a very high tax burden. For example, with a potential estate tax rate of 40% and capital gains tax rate of 20% this double taxation of gains could result in a 52% tax rate, assuming that the capital gains tax is deductible from the estate tax. That is, for every \$100 of gain the heir would only receive \$48 and remit the other \$52 in tax.

This large tax liability can be especially problematic when the primary asset in the estate is a business as there may be little cash available with which to pay estate and capital gains taxes.

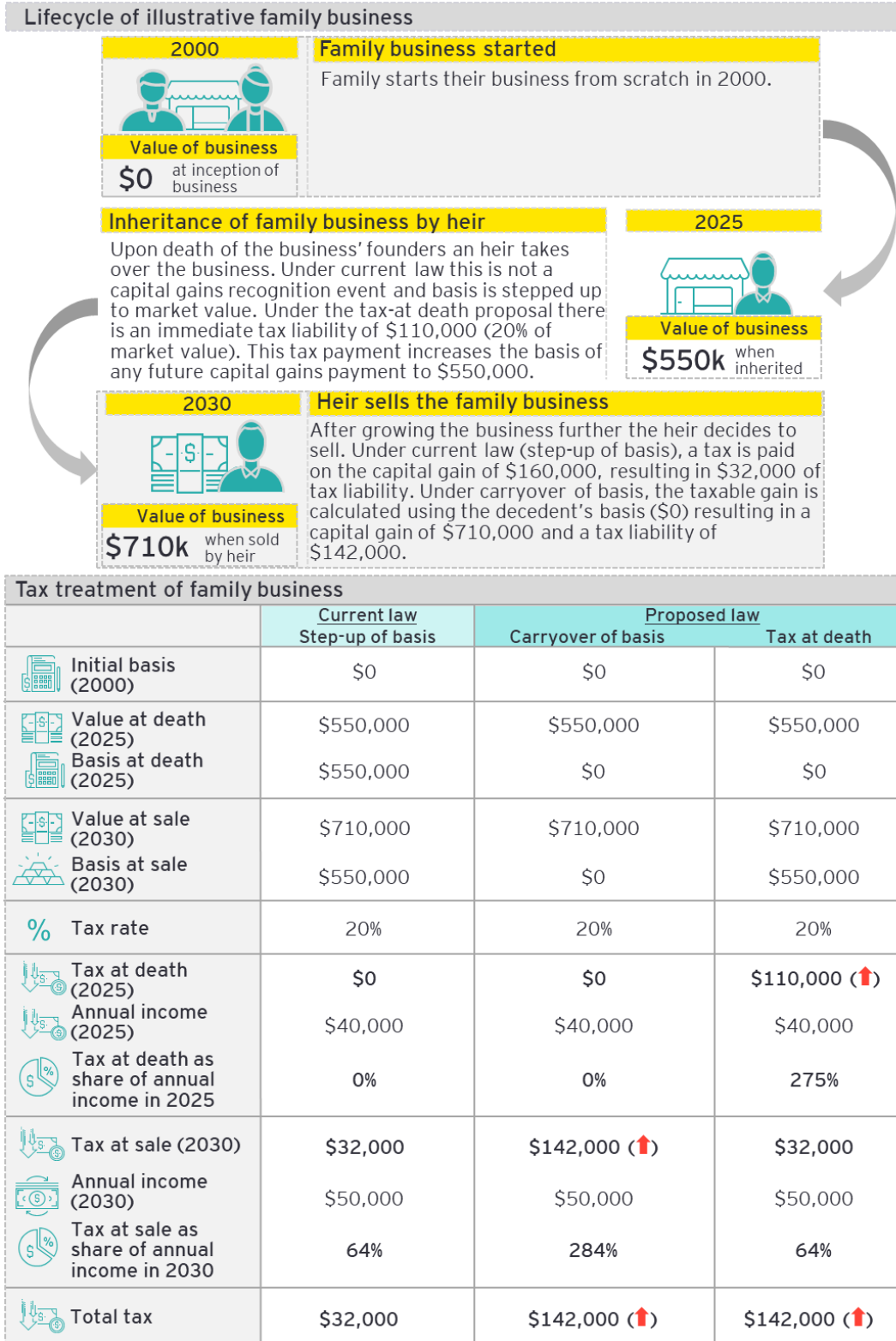
Some other countries, for example Canada and Australia, that tax capital gains at death do not have this double taxation via additional estate or inheritance taxes. Rather, taxing gains at death is a substitute method of taxing wealth transfers. In the United States, both the estate tax and any efforts to repeal step-up in basis will create cash flow problems for family businesses and increase the likelihood that these job creators will be forced to close, liquidate, or leverage part of their operations, resulting in job losses and economic damage.

Macroeconomic effects

Taxing gains at death is estimated to have a number of adverse effects on the macroeconomy. These include:

- ▶ a reduction in GDP of about \$10 billion per year, or \$100 billion over 10 years;
- ▶ job losses of about 80,000 per year; and
- ▶ lower wages given that about 1/3 of the burden of the tax increase is shifted onto labor because the tax-induced reduction in investment makes labor less productive.

Figure 1. Step-up of basis for an illustrative family-owned business



II. Estimated macroeconomic impacts of taxing gains at death

This report examines the macroeconomic impact of repealing step-up of basis via tax at death. The effect of repealing step-up and taxing gains at death is to increase the tax cost of investment, which increases the rate of return that investments must earn in order to be profitable. As a result, investment falls. With less investment there is less capital available to each worker, labor productivity and the wages of workers drop, and, ultimately, Americans' standard of living declines.

Estimates are produced using the EY Macroeconomic Model of the US Economy. In particular, step-up of basis is modeled as an increase in the cost of capital and the EY Macroeconomic Model of the US Economy then simulated how households and businesses would respond to such a policy shock. The modeling approach is described in more detail in the appendix. Estimates are presented relative to the size of the US economy in 2021.

Summary of effects

- ▶ *The repeal of step-up of basis increases the cost of capital, which discourages investment and results in less capital formation. With less capital available to each worker, labor productivity is lowered. This reduces the wages of workers and, ultimately, Americans' standard of living.*
- ▶ **Job equivalents.** *A significant portion of the burden of repeal of step-up of basis would fall on workers through reduced labor productivity, wages, and employment. Repealing step-up of basis via tax at death is estimated to decrease job equivalents by approximately:⁸*
 - ▶ *80,000 jobs in each of the first ten years,*
 - ▶ *100,000 jobs each year thereafter.*

Moreover, because labor productivity declines, about 1/3 of the burden of the tax is imposed on workers in the form of lower wages.

- ▶ **Gross domestic product (GDP).** *Repeal of step-up of basis via tax at death would reduce US GDP. Repealing step-up of basis via tax at death is estimated to reduce US GDP by approximately:*
 - ▶ *\$10 billion in each of the first ten years; and*
 - ▶ *\$10 billion each year thereafter.*

These GDP losses represent an approximately \$100 billion decline over 10 years.

Discussion

In the EY Macroeconomic Model of the US Economy, a significant portion of the burden of repeal of step-up of basis would fall on workers through reduced wages and employment. Hours worked are estimated to decline, on average, 0.04% over the first ten years and 0.02% in the long run relative to the level that otherwise would have occurred under current law. This is primarily a result of the decline in the after-tax wage rate, which is estimated to decline, on average, 0.02% over the first ten years and 0.05% in the long run relative to what would have occurred under current law. Results can also be seen in Table 1.

These two labor market impacts – a decline in hours worked plus a decline in the after-tax wage rate – are summarized in the estimate of the decrease in job equivalents. This measure represents the equivalent change in jobs, holding the average wage rate under current law constant. When scaled to the 2021 US economy, job equivalents are estimated to decline by 80,000 jobs (0.05%) in each of the first ten years and nearly 100,000 jobs (0.06%) in the long run relative to the level under current law. Moreover, about 1/3 of the revenue raised from the tax effectively is paid by workers in the form of the tax-induced decline in labor productivity and hence in wages.⁹

The repeal of step-up of basis is estimated to decrease the level of GDP by, on average, 0.04% over the first ten years and 0.04% in the long run. The long run denotes when the US economy has fully adjusted to the change in policy. When scaled to the US economy in 2021 this 0.04% decrease in GDP amounts to a \$10 billion annual decline in the level of GDP relative to what it otherwise would have been under current law. These GDP losses represent an approximately \$100 billion decline over 10 years.

Table 1. Repeal of step-up of basis via tax at death

	First ten years	Long run
GDP	-0.04%	-0.04%
After-tax wage rate	-0.02%	-0.05%
Hours worked	-0.04%	-0.02%
Job equivalents	-0.05%	-0.06%
Capital	-0.04%	-0.08%

Note: Job-equivalent impacts are defined as the change in labor income divided by baseline average income per job. Changes relative to 2021 US economy. Long-run denotes when the economy has fully adjusted to policy change; generally, 2/3 to 3/4 of this adjustment occurs within 10 years.

III. Family-owned business case studies

The impact of step-up of basis on a business will depend on that particular business' facts and circumstances. This section presents examples of how five illustrative family-owned businesses across different industries would be impacted by the repeal of step-up of basis. These illustrative businesses are as follows:¹⁰

1. Family-owned steel manufacturer
2. Family-owned farm
3. Family-owned beer distributor
4. Family-owned real estate development
5. Family-owned ingredients manufacturer

Illustrative example of a family-owned steel manufacturer

Figure 2 displays the role of step-up of basis for an illustrative family-owned steel manufacturer and the implications of its repeal by taxing gains at death.



This family-owned steel business was purchased for \$10 million in 1990. After initially employing 500 workers the business thereafter grew both organically and through a \$5 million acquisition. By 2025, the value has increased to \$50 million, the number of workers employed has grown to 1,000, and annual income is \$2.8 million per year.¹¹ When the owners pass away in 2025 their family heir inherits the steel business.












Under current law no capital gains tax is owed upon the owners' death in 2025 and the heir's basis would be stepped up to \$50 million. In contrast, if gains were taxed at death, there would be an immediate capital gains tax liability of \$7 million. This \$7 million is calculated as the capital gains tax rate – here assumed to be the top statutory capital gains tax rate of 20% – times the capital gain triggered by the transfer of the business to the heir (\$35 million). The \$35 million capital gain is calculated as the market value at the time of death (\$50 million) less cost basis (\$15 million). In this example, the cost basis is the amount the founders paid when they purchased the business (\$10 million) plus the cost of acquisitions they made as they grew the business (\$5 million).

The tax payment of \$7 million under tax at death is equivalent to 250% of annual income in 2025 and could create a significant liquidity squeeze for the family-owned steel manufacturer. This is because, as a capital-intensive business, a significant portion of the business' value is tied up in illiquid manufacturing structures and equipment. To the extent other funds are unavailable and the tax is due immediately this could require the liquidation of some of the family-owned steel manufacturer and could negatively impact the distributor business' ability to maintain its 1,000 employees.

If the business were later sold by the heir any appreciation during the heir's ownership tenure would be taxed as a capital gain. This second capital gain, which would occur in addition to the tax at death, would be computed using a cost basis that reflects the market value of the business at the time of founders' death to prevent double taxation.

Figure 2. Illustrative example of tax treatment of a family-owned steel manufacturer

Lifecycle of illustrative family-owned steel manufacturer			
1990		Purchase and growth of family-owned steel manufacturer	
		<p>Purchase: A family-owned steel business was purchased for \$10 million in 1990.</p> <p>Growth: The business has since grown organically and through a \$5 million acquisition. By 2025, annual income is \$2.8 million per year, and the value has increased to \$50 million. After the owners died in 2025, the deceased owners' heir inherited the steel business.</p>	
Value	Employees		
\$10m	500		
Inheritance of family business by heir		2025	
<p>Step-up of basis: Under current law, the heir would owe no capital gains tax upon the owners' death in 2025 and the basis would be stepped up to \$50 million.</p> <p>Tax at death: Under the tax at death proposal there would be an immediate capital gains tax of \$7 million (20% of \$35 million). This accounts for the original basis of \$10 million and acquisitions of \$5 million. This tax payment - 250% of annual income - can create a significant liquidity squeeze as much of the family-owned business' value is tied up in illiquid manufacturing structures and equipment.</p>			
Value	Employees		
\$50m	1,000		

Tax treatment of family-owned steel manufacturer			
Year		Current law Step-up of basis	Proposed law Tax at death
1990	 Initial basis	\$10 million	\$10 million
1990-2025	 Acquisitions	\$5 million	\$5 million
2025	 Adjusted basis at death, before step-up	\$15 million	\$15 million
	 Annual income	\$2.8 million	\$2.8 million
	 Value at death	\$50 million	\$50 million
	 Basis at death	\$50 million	\$15 million
	 Capital gain at death (A)	\$0	\$35 million
	 Tax rate (B)	20%	20%
2025	 Tax at death (A*B)	--	\$7 million (↑)
	 Tax as a share of annual income	--	250%
	 Basis taken by heir after tax at death	\$50 million	\$50 million

Illustrative example of a family-owned farm

The example outlined in Figure 3 demonstrates the impact of repealing step-up of basis by taxing gains at death on an illustrative family-owned cow-calf farm.

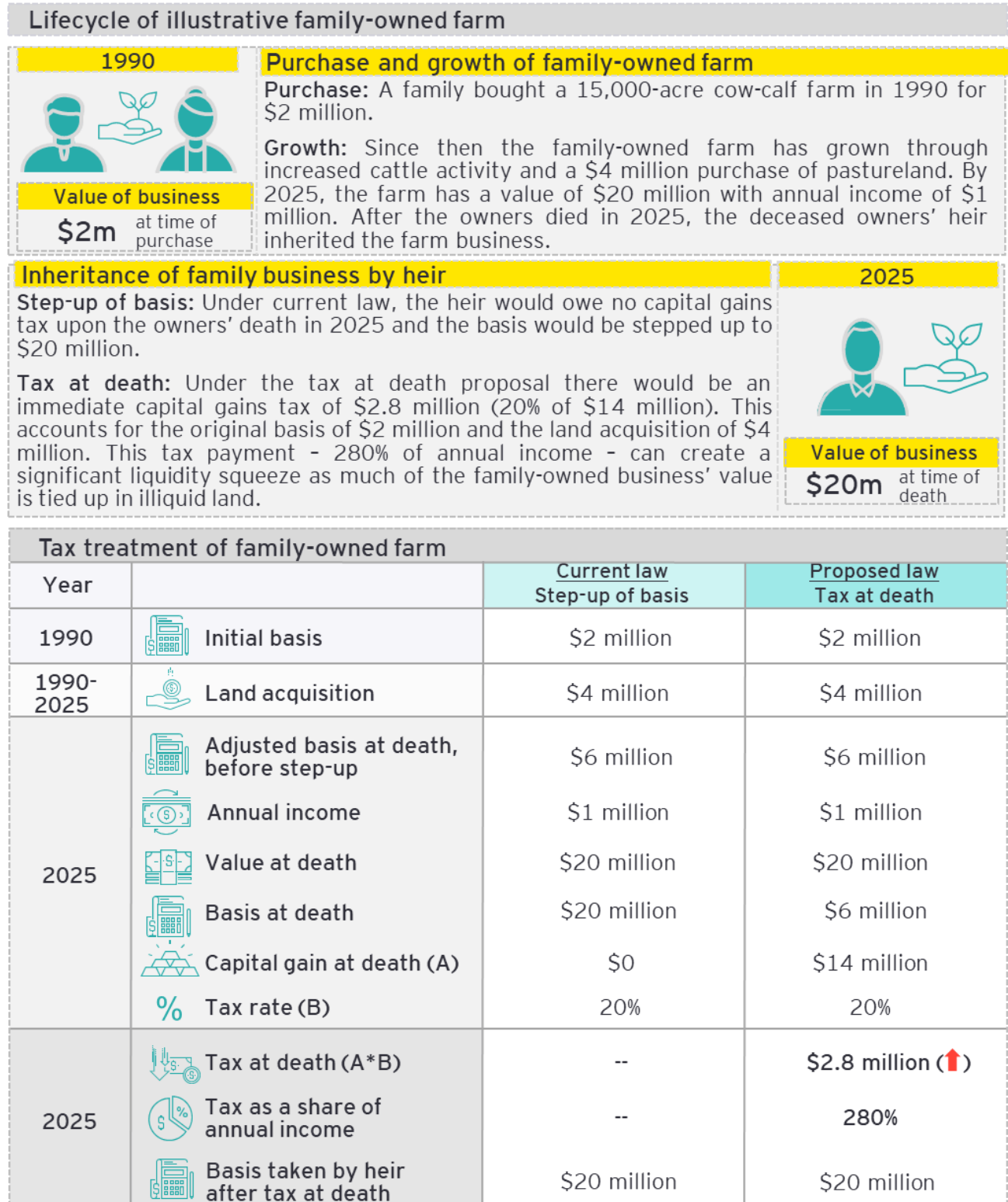
This family-owned cow-calf farm was purchased in 1990 for \$2 million. Over the following years, the family grew the farm by purchasing \$4 million of pastureland and growing and improving the cattle herd. By 2025, the farm's value increased to \$20 million with an annual income of \$1 million.¹² The owners' heir inherited the farm in 2025 after the death of the owners.

Under the current step-up of basis law, there would be no capital gains tax on the transfer of the farm ownership in 2025 after the death of the previous owners. That is, the transfer of the ownership as inheritance does not trigger a capital gains tax payment.

In contrast, if gains were taxed at death, there would be an immediate capital gains tax liability of \$2.8 million. This tax is calculated based on the increase in the value of the family-owned farm since 1990. After subtracting the original basis (\$2 million) and the land acquisition cost (\$4 million) from the market value at death (\$20 million), the capital gains tax would be paid on the remaining \$14 million increase in value. At a 20% tax rate, the tax bill would be \$2.8 million. This one-time tax payment is equivalent to 280% of annual income of the farm. Given the land- and capital-intensive nature of the business, a one-time payment of \$2.8 million (280% of annual income) could create a significant burden on the new farm owners and could force them to sell this family-owned farm.

If the business were later sold by the heir, then any appreciation during the heir's lifetime would be taxed as a capital gain. This second capital gain, which would occur in addition to the tax at death of the founder, would be calculated using a cost basis that reflects the market value of the business at the time of founders' death (\$20 million) to prevent double taxation.

Figure 3. Illustrative example of tax treatment of a family-owned farm



Illustrative example of beer distributor

Figure 4 presents an illustrative example for the impact of repealing step-up of basis by taxing gains at death for a beer distributor.

A family-owned distributor of beer and malt beverages was purchased in 1995 for \$5 million. This business had 20 employees at the time of purchase but has grown between 1995 and 2025 through natural growth and a \$45 million acquisition. By 2025, the family-owned distributor has 200 employees and is valued at \$200 million. The business generates \$12 million annually in income.¹³ In 2025, the owner died, and the heir inherited the business.













Under the current step-up of basis law, the heir would inherit the beer distributor business at a stepped-up basis of \$200 million without capital gains tax liability.

If step-up of basis were repealed via tax at death, the decedent's basis at death of \$50 million (\$5 million initial basis and \$45 million acquisition) would be used to calculate capital gains tax liability. Given that the distributor of beer and malt beverages is now valued at \$200 million, there would be a capital gain of \$150 million and tax liability of \$30 million (20% of \$150 million) upon the death of the original owner.

The \$30 million capital gains tax payment is equivalent to 250% of the distributor's annual income (\$12 million). With the value of this family-owned business tied up in illiquid distribution structures and equipment, the immediate \$30 million capital gains tax could create significant cash flow problems. This financial burden might threaten the survival of the business after the death of the original owner and could negatively impact the distributor business' ability to maintain its 200 employees.

If the business were later sold by the heir any appreciation during the heir's lifetime would be taxed as a capital gain. This second capital gain, which would occur in addition to the tax at death, would be calculated using a cost basis that reflects the market value of the business at the time of founders' death (\$200 million) to prevent double taxation.

Figure 4. Illustrative example of tax treatment of a family-owned distributor

Lifecycle of illustrative family-owned distributor			
1995		Purchase and growth of family-owned distributor	
		<p>Purchase: A family-owned distributor of beer and malt was purchased for \$5 million in 1995.</p> <p>Growth: The business has since grown naturally and through a \$45 million acquisition. By 2025, annual income is \$12 million per year, and the value has increased to \$200 million. After the owners died in 2025, the deceased owners' heir inherited the wholesale business.</p>	
Value	Employees		
\$5m	20		
Inheritance of family business by heir		2025	
<p>Step-up of basis: Under current law, the heir would owe no capital gains tax upon the owners' death in 2025 and the basis would be stepped up to \$200 million.</p> <p>Tax at death: Under the tax at death proposal there would be an immediate capital gains tax of \$30 million (20% of \$150 million). This accounts for the original basis of \$5 million and an acquisition of \$45 million. This tax payment - 250% of annual income - can create a significant cash flow issue as much of the family-owned business' value is tied up in illiquid distribution structures and equipment.</p>			
		Value	Employees
		\$200m	200
Tax treatment of family-owned distributor			
Year		Current law Step-up of basis	Proposed law Tax at death
1990	 Initial basis	\$5 million	\$5 million
1990-2025	 Acquisitions	\$45 million	\$45 million
2025	 Adjusted basis at death, before step-up	\$50 million	\$50 million
	 Annual income	\$12 million	\$12 million
	 Value at death	\$200 million	\$200 million
	 Basis at death	\$200 million	\$50 million
	 Capital gain at death (A)	\$0	\$150 million
	% Tax rate (B)	20%	20%
2025	 Tax at death (A*B)	--	\$30 million (↑)
	 Tax as a share of annual income	--	250%
	 Basis taken by heir after tax at death	\$200 million	\$200 million

Illustrative example of apartment property

The illustrative example in Figure 5 shows the impact of repealing step-up of basis by taxing gains at death on a family-owned apartment property.

A family-owned apartment building with 150 units was purchased for \$4 million in 1990. Since then, the development has grown through \$3 million of routine capital expenditures. Over this same time period, depreciation has totaled \$6 million. By 2025, the value of this family-owned real estate has increased to \$20 million with an annual income of \$1.4 million.¹⁴

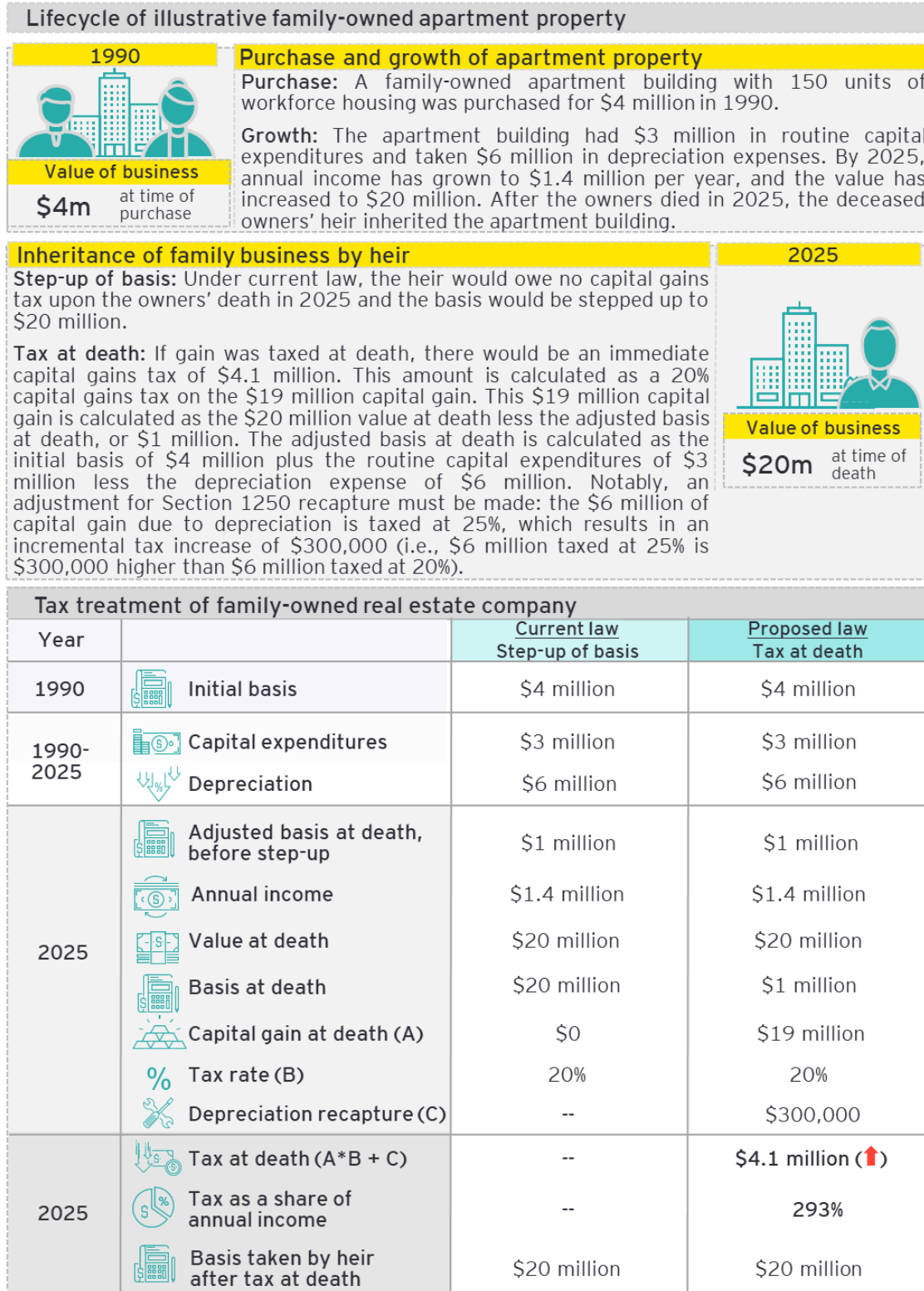
The owners of the property died in 2025 and their heir inherited the apartment building. There would be no capital gain tax upon the death of the owners under the current step-up of basis law. The tax basis will be stepped up to \$20 million in 2025, reflecting the value of the property upon the death of the previous owners.

If gain was taxed at death, the owner's death would trigger an immediate capital gains tax of \$4.1 million. The gain at death is \$19 million, calculated as the \$20 million value at death less the adjusted basis at death of \$1 million. The adjusted basis at death is calculated as the initial basis of \$4 million plus the routine capital expenditures of \$3 million less the depreciation expense of \$6 million. If all of the gain were taxed at a 20% rate, then the tax due would be \$3.8 million. However, a 25% tax rate must be used to calculate the \$6 million of the gain that is due to depreciation. This is referred to as a Section 1250 recapture and raises the tax due by \$300,000 to a total of \$4.1 million (i.e., \$6 million taxed at 25% is \$300,000 higher than \$6 million taxed at 20%).

This \$4.1 tax amount represents 293% of the property's annual income of \$1.4 million. For a small family business, this immediate expense can create a significant burden, especially for a business whose value is tied up in illiquid structure and land assets.

If the business were later sold by the heir any appreciation from during the heir's lifetime would be taxed as a capital gain. This second capital gain, which would occur in addition to the tax at death, would be computed using a cost basis that reflects the market value of the business at the time of founders' death to prevent double taxation.

Figure 5. Illustrative example of tax treatment of a family-owned apartment property



Illustrative example of ingredients manufacturer

Figure 6 displays an illustrative example of a family-owned ingredients manufacturer and the implications of taxing gains at death for this business.



The family-owned ingredients manufacturer for health and hygiene products was purchased in 1985 for \$5 million. Through organic growth and a \$30 million investment into a new manufacturing site, the business' value has increased to \$80 million. By 2025 the annual income of the business is \$3.5 million, and it employs 130 workers (up from 40 in 1985).¹⁵












In 2025 the original owners of the business have died, and their heir has inherited the family-owned business. Under the current step-up of basis law, there would be no capital gains tax and the basis would be stepped up to \$80 million. In contrast, if gains were taxed at death, there would be an immediate capital gains tax liability of \$9 million upon the death of the previous owners. This amount is calculated as 20% of the \$45 million capital gain. This \$45 million capital gain is calculated as the market value (\$80 million) less the initial \$5 million basis and the \$30 million expansion costs.

The \$9 million capital gains tax liability represents 257% of annual income. Because the ingredients manufacturer's value is tied up in illiquid operating structures used for the manufacturing process, a \$9 million immediate payment can significantly harm the family-owned business cash flow. This significant tax liability could be problematic for sustaining the business and retaining its 130 workers.

If the business were later sold by the heir any appreciation from during the heir's lifetime would be taxed as a capital gain. This second capital gain, which would occur in addition to the tax at death, would have a cost basis equal to the market value of the business at the time of founders' death to prevent double taxation.

Figure 6. Illustrative example of tax treatment of a family-owned ingredients manufacturer

Lifecycle of illustrative family-owned ingredients manufacturer			
1985		Purchase and growth of family-owned ingredients manufacturer	
		<p>Purchase: A family-owned ingredients manufacturer for health and hygiene products was purchased for \$5 million in 1985.</p> <p>Growth: The business has since grown organically and through a \$30 million investment in a new manufacturing site. By 2025, annual income is \$3.5 million per year, and the value has increased to \$80 million. After the owners died in 2025, the deceased owners' heir inherited the ingredients business.</p>	
Value	Employees		
\$5m	40		
Inheritance of family business by heir		2025	
<p>Step-up of basis: Under current law, the heir would owe no capital gains tax upon the owners' death in 2025 and the basis would be stepped up to \$80 million.</p> <p>Tax at death: Under the tax at death proposal there would be an immediate capital gains tax of \$9 million (20% of \$45 million). This accounts for the original basis of \$5 million and expansion of \$30 million. This tax payment - 257% of annual income - can create significant cash flow issues as much of the family-owned business' value is tied up in illiquid manufacturing equipment and structures.</p>			
Value	Employees		
\$80m	130		

Tax treatment of family-owned ingredients manufacturer			
Year		Current law Step-up of basis	Proposed law Tax at death
1985	 Initial basis	\$5 million	\$5 million
1985-2025	 Expansion	\$30 million	\$30 million
2025	 Adjusted basis at death, before step-up	\$35 million	\$35 million
	 Annual income	\$3.5 million	\$3.5 million
	 Value at death	\$80 million	\$80 million
	 Basis at death	\$80 million	\$35 million
	 Capital gain at death (A)	\$0	\$45 million
	 Tax rate (B)	20%	20%
2025	 Tax at death (A*B)	--	\$9 million (↑)
	 Tax as a share of annual income	--	257%
	 Basis taken by heir after tax at death	\$80 million	\$80 million

Additional considerations

The examples in this section illustrate the very large and lumpy tax burden that taxing gains at death can impose on family-owned businesses. This tax burden can exceed the annual income generated by the business, and so can impose significant liquidity problems on the heirs. The heirs might be forced to liquidate the business, which may mean that it is transferred to those less able to run it, damaging the heirs, their (former) employees, who may lose their jobs, and the economy at large. Partial liquidation could have similar effects. Even borrowing to pay the tax may impose financial constraints on the business that could be challenging to address, even if the business is able to survive. The deleterious effects of taxing gains at death can spread well beyond the business' owners. Indeed, as shown in the macroeconomic analysis section, a substantial share of the burden of the tax is paid by workers in the form of lower earnings.

A problem not emphasized in the examples above is the difficulty in determining basis upon sale. Proper records supporting a determination of basis may not be easily obtainable. As a result, it may be difficult to assess the proper tax payment. Measuring and adjudicating basis could impose large compliance costs on taxpayers and administrative and enforcement costs on the Internal Revenue Service. A previous attempt to implement carryover basis, the Tax Reform Act of 1976, was initially postponed three years by the Revenue Act of 1978 and ultimately repealed before ever being implemented by the Crude Oil Windfall Profit Tax Act of 1980. Prior to repeal tax practitioners noted significant difficulties in attempting to determine the basis of inherited assets.¹⁶ An inability to document basis can have large tax consequences if the alternative is to use a basis of \$0.

A similar challenge is created by the need to value assets at death when the assets are held rather than sold to a third party. This challenge can be severe for assets, such as family owned, closely held businesses, that do not trade on active markets. While in some cases these assets may have to be valued for estate tax purposes anyway, the estate tax might not require a detailed evaluation for smaller estates. Furthermore, valuation is more important when used to determine the combined burden of the estate tax and the capital gains tax, as discussed below. These administrative challenges suggest that taxing gains at death does not promote the goal of having a simple and easily administrable tax system.¹⁷

Finally, there is the issue of the tax burden created by the estate tax. In the Obama Administration's proposal to tax gains at death¹⁸, and in other discussions of US policy, taxing gains at death would not be accompanied by repeal of the estate tax. Rather both would be imposed. Taxing gains at death on top of taxing an estate can impose a very high tax burden. For example, with a potential estate tax rate of 40% and capital gains tax rate of 20% this double taxation of gains could result in a 52% tax rate, assuming that the capital gains tax is deductible from the estate tax. That is, for every \$100 of gain the heir would only receive \$48 and remit the other \$52 in tax.

In addition, when the primary asset in the estate is a business, there may be little cash available with which to pay estate and capital gains taxes. The estate tax can exacerbate the liquidity problems faced in the transfer of a family-owned business. Some other countries, for example Canada and Australia, that tax capital gains on inherited assets do not have additional estate or inheritance taxes. Rather, taxing gains on inherited assets is their primary method of taxing wealth

transfers.¹⁹ These countries seem to recognize the economic harm that can be caused by imposing a large, double tax, on business owners when assets are transferred at death.

IV. Caveats and limitations

Any modeling effort is only an approximate depiction of the economic forces it seeks to represent, and the economic models developed for this analysis are no exception. Although various limitations and caveats might be listed, noteworthy limitations of the macroeconomic model used in this report include these eight:

- ▶ **Estimated macroeconomic impacts limited by calibration.** This model is calibrated to represent the US economy and then forecast forward. However, because any particular year may reflect unique events and also may not represent the economy in the future, no particular baseline year is completely generalizable.
- ▶ **Estimates are limited by available public information.** The analysis relies on information reported by government agencies (primarily the Bureau of Economic Analysis and Internal Revenue Service). The analysis did not attempt to verify or validate this information using sources other than those described in this appendix.
- ▶ **Industries are assumed to be responsive to normal returns on investment.** The industries comprising the United States economy in the EY Macroeconomic Model of the US Economy are assumed to be responsive to the normal returns on investment. This contrasts to industries that earn economic profits and thereby have an increased sensitivity to statutory tax rates relative to marginal effective tax rates.
- ▶ **Full employment model.** The EY Macroeconomic Model of the US Economy, like many general equilibrium models, focuses on the longer-term incentive effects of policy changes. It also assumes that all resources throughout the economy are fully employed; that is, there is no slackness in the economy (i.e., a full employment assumption with no involuntary unemployment). Any decrease in labor supply is a voluntary response to a change in income or the return to labor that makes households choose to substitute between consumption and leisure. To provide a high-level measure of the potential employment impacts, a job-equivalents measure has been estimated. Job-equivalent impacts are defined as the change in total labor income divided by the baseline average labor income per job.
- ▶ **Lock-in effects.** The analysis does not consider explicitly the economic effects of taxing gains at death on asset holding periods and portfolio reallocations. By reducing the tax benefit of holding assets until death, taxing gains at death reduces tax considerations in portfolio trading decisions and so may encourage more efficient portfolio allocations. Carryover basis has a similar, but attenuated, effect on asset holding periods and portfolio reallocations.
- ▶ **Distributional analysis.** The analysis does not explore the effects of taxing gains at death on the distribution of the tax burden across income groups.
- ▶ **Government's budget constraint.** The estimated effects on GDP depend to an extent on how the tax revenue is used by the government. The estimates in this report assume

that the revenue is returned to the private sector by an increase in government transfer payments, which is a standard assumption.

- **Analysis does not reflect impacts of COVID-19.** This analysis does not reflect any potential impacts of the COVID-19 health crisis.

Appendix A. Description of EY General Equilibrium Model of the US Economy

Estimates are produced using the EY Macroeconomic Model of the US Economy. In particular, step-up of basis is modeled as a change in the cost of capital and the EY Macroeconomic Model of the US Economy then simulated how households and businesses would respond to such a policy shock.

Cost of capital

In general, companies will make new investments as long as they earn a pre-tax return that exceeds what is required to cover taxes and compensate investors for the use of their capital. A company would not make an investment that earns less than the cost of taxes and compensation to investors because such an investment would be unprofitable. As a result, companies would continue to make (successively less profitable) new investments up to the point at which the last investment earns just enough to cover the taxes due plus enough to compensate investors for the use of their funds. This investment is referred to as the marginal investment. The pre-tax return that it earns is called the cost of capital. As cost of capital increases, fewer investments are feasible because costs are higher. As a result, as the cost of capital increases less investment occurs.

Taxes are an important component of the cost of capital. Taxes raise a company's cost of capital because the company has to earn enough to cover taxes and still pay a competitive return to its investors. Taxes also can increase the return investors demand on their investments because they have to cover their tax obligations out of the payments they receive from the companies in which they invest. Higher taxes discourage investment by raising the cost of capital.

The Congressional Budget Office (CBO), Congressional Research Service, JCT, and US Treasury Department frequently use the cost of capital framework to quantify the impact of tax changes on investment incentives. The cost of capital framework accounts for the major features of the federal income tax system (e.g., tax depreciation, tax rates, investor-level taxes).

Formally, the cost of capital is the real before-tax rate of return that a barely profitable new investment needs to earn to both cover taxes over its life and provide investors their required after-tax rate of return. The change in taxation on a new, barely profitable investment is a key margin on which to measure the impact of a policy change. For example, an investment that is profitable prior to a policy change and becomes less so, but still profitable, would likely occur with or without the policy change. Consequently, whether or not this investment occurs is largely unaffected by the policy change. A barely profitable investment, however, could become unprofitable with a policy change and, consequently, whether or not it occurs can be affected by the policy change.

Repeal of step-up of basis would generally increase investors' tax liability, raise the cost of capital, and reduce new investment in the United States. With less investment there is less capital available for each worker to work with, labor productivity and the wages of workers drop, and ultimately, Americans' standard of living declines.

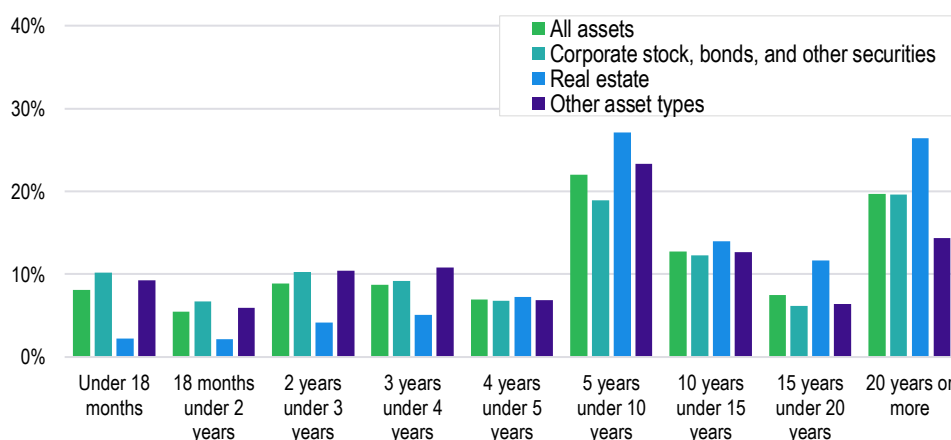
Capital asset transactions and their holding periods

Data on sales of capital assets as reported on individual tax returns are available from the Internal Revenue Service. Across all asset types 16% of gains and losses are short-term gains and losses. These are generally gains and losses on assets held for less than one year. The distribution for long-term gains and losses, which are generally gains and losses on assets held for more than one year, is displayed in Figure 7. Nearly 40% of long-term gains and losses are on assets held for less than 5 years and 60% of long-term gains and losses are on assets held for less than 10 years.

There is some variation in holding periods across asset types. Short-term gains and losses as a share of all gains and losses are 19% for corporate stock, bonds, and other securities, 3% for real estate, and 17% for all other asset types. The distribution of long-term capital gains and losses for these categories can be seen in Figure 7. Generally, each of these categories has similar holding periods except for real estate, which generally has longer holding periods.

These Internal Revenue Service Sales of Capital Assets data suggest 42.9% of capital gains receive step-up of basis at death. With repeal via tax at death the transfer of the asset would be treated as a recognition event and capital gains taxes would be paid at the time of the decedent's death.

Figure 7. Long-term capital gains and losses, by asset type and length of time held



Source: Internal Revenue Service.

EY Macroeconomic Model of the US Economy

The EY Macroeconomic Model of the US Economy is an overlapping generations (OLG) dynamic computable general equilibrium model similar to those used by the CBO, JCT, and US Treasury Department. The general equilibrium framework accounts for changes in equilibrium prices in factor (i.e., capital and labor) and goods markets and simultaneously accounts for the behavioral responses of individuals and businesses to changes in tax treatment. Included in this framework is a foreign sector that responds to both the United States' after-tax rate of return (for investment choices) and after-tax prices in goods markets (for import/export decisions).

The OLG model used for this analysis is similar to those used by the Congressional Budget Office, Joint Committee on Taxation, and US Treasury Department.²⁰ In this model, tax policy affects the incentives to work, save and invest, and to allocate capital and labor among competing uses. Representative individuals and firms incorporate the after-tax return from work and savings into their decisions on how much to produce, save, and work.

The general equilibrium methodology accounts for changes in equilibrium prices in factor (i.e., capital and labor) and goods markets and simultaneously accounts for the behavioral responses of individuals and businesses to changes in taxation. Behavioral changes are estimated in the OLG framework, whereby representative individuals with perfect foresight incorporate changes in current and future prices when deciding how much to consume and save in each period of their lives.

Production

Firm production is modeled with the constant elasticity of substitution (CES) functional form, in which firms choose the optimal level of capital and labor subject to the gross-of-tax cost of capital and gross-of-tax wage. The model includes industry-specific detail through use of differing costs of capital, factor intensities, and production function scale parameters. Such a specification accounts for differential use of capital and labor between industries as well as distortions in factor prices introduced by the tax system. The cost of capital measure models the extent to which the tax code discriminates by asset type, organizational form, and source of finance.

The industry detail included in this model corresponds approximately with three-digit North American Industry Classification System (NAICS) codes and is calibrated to a stylized version of the 2014 US economy. Each of 36 industries has a corporate and pass-through sector except for owner-occupied housing and government production. Because industry outputs are typically a combination of value added (i.e., the capital and labor of an industry) and the finished production of other industries (i.e., intermediate inputs), each industry's output is modeled as a fixed proportion of an industry's value added and intermediate inputs to capture inter-industry linkages. These industry outputs are then bundled together into consumption goods that consumers purchase.

Consumption

Consumer behavior is modeled through use of an OLG framework that includes 55 generational cohorts (representing adults aged 21 to 75). Thus, in any one year, the model includes a representative individual optimizing lifetime consumption and savings decisions for each cohort aged 21 through 75 (i.e., 55 representative individuals) with perfect foresight. The model also distinguishes between two types of representative individuals: those that have access to capital markets (savers) and those that do not (non-savers or rule-of-thumb agents).

Non-savers and savers face different optimization problems over different time horizons. Each period non-savers must choose the amount of labor they supply and the amount of goods they consume. Savers face the same tradeoffs in a given period, but they must also balance consumption today with the choice of investing in capital or bonds. The model assumes 50% of US households are permanently non-savers and 50% are permanently savers across all age cohorts.

The utility of representative individuals is modeled as a CES function, allocating a composite commodity consisting of consumption goods and leisure over their lifetimes. Representative individuals optimize their lifetime utility through their decisions of how much to consume, save, and work in each period subject to their preferences, access to capital markets, and the after-tax returns from work and savings in each period. Representative individuals respond to the after-tax return to labor, as well as their overall income levels, in determining how much to work and thereby earn income that is used to purchase consumption goods or to consume leisure by not working. In this model the endowment of human capital changes with age — growing early in life and declining later in life — following the estimate of Altig et al. (2001).²¹

Government

The model includes a simple characterization of both federal and state and local governments. Government spending is assumed to be used for either: (1) transfer payments to representative individuals, or (2) the provision of public goods. Transfer payments are assumed to be either Social Security payments or other transfer payments. Social Security payments are calculated in the model based on the 35 years in which a representative individual earns the most labor income. Other transfer payments are distributed on a per capita basis. Public goods are assumed to be provided by the government in fixed quantities through the purchase of industry outputs as specified in a Leontief function.

Government spending in the model can be financed by collecting taxes or borrowing. Borrowing, however, cannot continue indefinitely in this model. Eventually, the debt-to-GDP ratio must stabilize so that the government's fiscal policy is sustainable. The model allows government transfers, government provision of public goods, or government tax policy to be used to achieve a selected debt-to-GDP ratio after a selected number of years. This selected debt-to-GDP ratio could be, for example, the initial debt-to-GDP ratio or the debt-to-GDP ratio a selected number of years after policy enactment. The baseline of the model is calibrated such that federal revenue as a share of GDP, federal spending on Social Security as a share of GDP, and the federal debt-to-GDP ratio matches the Congressional Budget Office's *The 2019 Long-Term Budget Outlook*.²²

Modeling the United States as a large open economy

The model is an open economy model that includes both capital and trade flows between the United States and the rest of the world. International capital flows are modeled through the constant portfolio elasticity approach of Gravelle and Smetters (2006).²³ This approach assumes that international capital flows are responsive to the difference in after-tax rates of return in the United States and the rest of the world through a constant portfolio elasticity expression. Trade is modeled through use of the Armington assumption, wherein products made in the United States versus the rest of the world are imperfect substitutes.

Table A-1. Key model parameters

Intertemporal substitution elasticity	0.4
Intratemporal substitution elasticity	0.6
Leisure share of time endowment	0.4
International capital flow elasticity	3.0
Capital-labor substitution elasticity	0.8
Adjustment costs	2.0

Source: Key model parameters are generally from Joint Committee on Taxation, *Macroeconomic Analysis of the Conference Agreement for H.R. 1, The 'Tax Cuts and Jobs Act,'* December 22, 2017 (JCX-69-17) and Jane Gravelle and Kent Smetters, "Does the Open Economy Assumption Really Mean that Labor Bears the Burden of a Capital Income Tax?" *Advances in Economic Analysis and Policy* 6(1) (2006): Article 3.

Appendix B. Estimated macroeconomic impacts of carryover basis

While carryover basis delays payment of tax until inherited assets are sold, once the asset is sold the total tax bill will be the same as if gains were taxed at death. This delay of tax payment changes the timing of the tax burden, but as a tax increase relative to current law it still discourages capital formation and has macroeconomic effects similar to, but smaller than, those from taxing gains at death.

Compared to taxing gains at death, carryover basis may mitigate liquidity concerns because no tax is triggered until the assets are sold. Nonetheless, it leaves in place challenges in documenting and tracking basis that can inappropriately increase tax bills and increase tax compliance costs and disputes with the IRS. A previous attempt to implement carryover basis, the Tax Reform Act of 1976, was initially postponed three years by the Revenue Act of 1978 and ultimately repealed before ever being implemented by the Crude Oil Windfall Profit Tax Act of 1980. Prior to repeal, tax practitioners noted significant difficulties in attempting to determine the basis of inherited assets.

Key macroeconomic results

This appendix examines the macroeconomic impact of repealing step-up of basis via carryover basis. The effect of repealing step-up is to increase the tax cost of investment, which increases the rate of return that investments must earn in order to be profitable. As a result, investment falls. With less investment there is less capital available to each worker, labor productivity and the wages of workers drop, and, ultimately, Americans' standard of living declines.

Estimates are produced using the EY Macroeconomic Model of the US Economy. In particular, step-up of basis is modeled as an increase in the cost of capital and the EY Macroeconomic Model of the US Economy then simulated how households and businesses would respond to such a policy shock.

This report estimates the repeal of step-up of basis via carryover basis to have the following economic impacts:

- ▶ **Job equivalents.** A significant portion of the burden of repeal of step-up of basis would fall on workers through reduced labor productivity, wages, and employment. Repealing step-up of basis via carryover basis is estimated to decrease job equivalents, by approximately:
 - ▶ 40,000 jobs in each of the first ten years; and
 - ▶ 50,000 jobs each year thereafter.
- ▶ **Gross domestic product.** Repeal of step-up of basis via carryover basis is estimated to decrease US GDP by:
 - ▶ \$5 billion annually or
 - ▶ \$50 billion over 10 years.

¹ Depending on the particular facts and circumstances of the capital gain other rates may apply. In addition to this, there is also the 3.8% net investment income tax that can apply to capital gains. This tax is included in estimation of macroeconomic effects, but for simplicity is ignored in the examples.

² In this report, in most instances “step-up of basis” means “tax-free step-up of basis.”

³ Under current law, gifts generally receive carry-over basis treatment. Taxing gains at death would require conforming treatment for gifts in order to limit the incentive to transfer assets as gifts prior to death. Our discussion implicitly assumes that this occurs.

⁴ This illustrative business is generated through use of a high-level discounted cash flow model that assumes a 5% growth rate in income each year and uses a discount rate of 10%. Numbers generated from the high-level discounted cash flow model are rounded for illustrative simplicity.

⁵ This illustration uses the top statutory capital gains tax rate (20%). It does not take into account the 3.8% net investment income tax.

⁶ This deferral benefit is larger, the longer the sale is delayed. In the extreme case, where assets are handed down from generation to generation, capital gains tax may never be paid.

⁷ See Congressional Research Service, “Step-Up vs. Carryover Basis for Capital Gains: Implications for Estate Tax Repeal,” 2001.

⁸ Job equivalents summarize the impact of both the reduction in hours worked and reduced wages.

⁹ This calculation compares the total change in labor compensation to the total revenue raised. That is, the effective tax is the change in labor compensation per dollar of revenue raised. This calculation uses the long-run result to report the effective tax on labor when the policy is fully phased in. Conventional revenue estimate from Penn Wharton Budget Model, “The Biden Tax Plan: Budgetary, distributional, and economic effects,” January 23, 2020.

¹⁰ Numbers generated for examples have been rounded for illustrative simplicity. Depreciation is generally ignored in examples. Its effects, however, are highlighted in the illustrative family-owned apartment property.

¹¹ Annual income is assumed to be 5.6% of value.

¹² Annual income is assumed to be 5.0% of value.

¹³ Annual income is assumed to be 6.0% of value.

¹⁴ Annual income is assumed to be 7.0% of value.

¹⁵ Annual income is assumed to be 4.4% of value.

¹⁶ See Congressional Research Service, “Step-Up vs. Carryover Basis for Capital Gains: Implications for Estate Tax Repeal,” 2001.

¹⁷ Some proposals to tax gains at death have included features intended to relieve some of the liquidity, measurement, and other problems with attempting to tax gains at death. For example, the Obama Administration’s proposal allows capital gains tax to be postponed until sale in the case of certain family owned and operated businesses, and in general allows tax to be paid over 15 years. These provisions certainly could provide a measure of relief and represent major improvements over an approach that would tax all gains at death without exception. See Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals*, February 2015, pp. 156-157.

Nonetheless, serious problems remained, as pointed out by the Joint Committee on Taxation (JCT) in their analysis of the Obama Administration’s proposal.¹⁷ The JCT particularly emphasized the complexity inherent in taxing gains at death and pointed out that the proposal did not define such key terms as a “family owned and operated business.” See the discussion in Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in the President’s Fiscal Year 2016 Budget Proposal*, September 2015, p. 192.

¹⁸ The FY 16 Obama revenue proposals would have increased the burden of the estate tax. See Department of the Treasury, *General Explanations of the Administration’s Fiscal Year 2016 Revenue Proposals*, February 2015, pp. 193-206.

¹⁹ See the discussion in Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in the President’s Fiscal Year 2016 Budget Proposal*, September 2015, p. 192.

²⁰ See, for example, Shinichi Nishiyama, “Fiscal Policy Effects in a Heterogeneous-Agent Overlapping-Generations Economy With an Aging Population,” Congressional Budget Office, Working Paper 2013-07, December 2013; Joint Committee on Taxation (JCT), *Macroeconomic Analysis of the ‘Tax Reform Act of 2014,’* February 2014 (JCX-22-14); JCT, *Macroeconomic Analysis of Various Proposals to Provide \$500*

Billion in Tax Relief, March 2005 (JCX-4-05); and, US Department of the Treasury, *The President's Advisory Panel on Federal Tax Reform, Simple, Fair, & Pro-Growth: Proposals to Fix America's Tax System*, November 2005.

²¹ See David Altig, Alan Auerbach, Laurence Koltikoff, Kent Smetters, and Jan Walliser, "Simulating Fundamental Tax Reform in the United States," *American Economic Review* 91(3) (2001): 574-595.

²² See Congressional Budget Office, *The 2019 Long-Term Budget Outlook*, June 2019.

²³ See Jane Gravelle and Kent Smetters, "Does the Open Economy Assumption Really Mean That Labor Bears the Burden of a Capital Income Tax?" *Advances in Economic Analysis and Policy* 6(1) (2006): Article 3.

Comments on a Possible Return to Carryover Basis

Charles D. Fox IV
Partner, McGuireWoods LLP
cfox@mcguirewoods.com
434 977-2597

Section 1014 of the Internal Revenue Code provides for the basis of appreciated assets held by a decedent on the date of his or her death to be increased or “stepped-up” to the value of the assets on the date of death (or the alternate valuation date if an estate chooses to and is permitted to value assets on the date six months after the date of death). The reasons why the Internal Revenue Code currently provides for a stepped-up basis include:

1. The avoidance of double taxation. If there was no step-up in basis, an estate would pay estate tax based on the fair market value of the assets as of the date of death (or alternate valuation date). In addition, a decedent’s estate or the beneficiary of a decedent’s estate who received assets with the decedent’s basis would pay capital gains tax when those appreciated assets were subsequently sold. The payment of an estate tax and a capital gains tax on the same asset if there was no step-up in basis (a “carryover basis regime”) will result in two taxes being paid. Many view such double taxation as unfair. The current proposal with its double taxation, differs, for example, from Canada which replaced its federal estate and gift tax with a capital gains tax on gifts and at death on January 1, 1972.
2. Determining a decedent’s basis in appreciated property can be difficult if not impossible. The Internal Revenue Service has previously taken the position that if a decedent’s basis in property cannot be determined, the basis will be treated as zero. Taking such a position could impose unnecessary tax since most appreciated assets will have some amount of basis that reduces the appreciation subject to capital gains tax.

Prior attempts to enact a carryover basis regime at death include:

1. The 1976 Tax Reform Act would have imposed a carryover basis on all inherited assets after its effective date. The carryover basis regime was subsequently repealed retroactively after many commentators raised concerns as to how the carryover basis regime would be administered, the difficulties in determining a decedent’s basis in appreciated property, and that carryover regime caused double taxation.
2. The 2001 Tax Act provided for a carry-over basis regime in 2010 when the estate tax was repealed for one year. This was a modified carryover basis regime which permitted a decedent’s executor to allocate \$1.3 million of basis increase to any recipient of property from a decedent and an additional \$3 million of basis increase to a surviving spouse either outright or in a QTIP marital trust for the benefit of the surviving spouse. As a result of the reinstatement of the estate tax in December 2010, estates of decedents dying in 2010 could elect to pay estate tax and receive a step-up in basis or opt out of the estate tax and take a carryover basis. Dealing with the carryover basis rules when administering the estates of 2010 decedents that opted out of the estate tax was challenging.
3. Subsequently, the Obama Administration proposed repealing the step-up in basis subject to various exemptions, but that proposal never received traction in Congress.

Past experiences with carryover basis shows that a carryover basis regime is difficult to administer, often leads to unfair results when a decedent’s basis in appreciated property cannot be determined (or is difficult to determine) and results in double taxation on the same assets, thereby reducing the amounts that the beneficiaries of a decedent’s estate actually receive.

Family Enterprise USA (FEUSA), a 501 (C)(3), is the organization that family business owners and legislators in Washington DC go to for information on the family business industry. FEUSA has established itself as a trusted resource through research work, an annual survey of family businesses across the country, focus groups and general data gathering about the issues and challenges family businesses face every day.

FEUSA's membership consists solely of, and is supported by, family businesses with the single purpose of promoting family business in America, so they can continue to grow, thrive and add jobs.

How You Can Help

Membership in FEUSA is open to all family businesses. Please visit **www.familyenterpriseusa.com** to find out how you can join as a member of FEUSA and help educate legislators and others about family businesses in the USA.





2021 FEUSA Family Business Survey



— Survey Highlights —

- **This year's survey was conducted between January 6, 2021, and March 31st, 2021, and a total of 172 responses were collected; note this was during the Corona Virus pandemic.**
- **Almost 82% of the respondents are CEO/President/Chairman or Senior Management in the family businesses; 58% have annual revenues in excess of \$10 million and 30% have \$50 million or more; 2021 59% over \$20 million.**
- **35% have 50 to 500 employees and 17% have more than 500 employees. 52% of business owners believe they pay above average wages and benefits to their employees.**
- **Almost 17% of business owners have been in business 100 years or more and 76% have been in business for more than 30 years.**
- **Income tax is the key tax policy concern for business owners then Capital Gains and next the Estate tax. Business owners would prefer to have the current lifetime exemption made permanent, then have the rate reduced and then a repeal of the tax.**
- **Economic Policy issues are 1) the Estate tax, 2) too much government regulations, and 3) would like a simplification of the tax code**

What is your role in the family business?

82% of Respondents are President/CEO/Chairman or Senior Mgt

57.7 %



CEO/President

16.1%



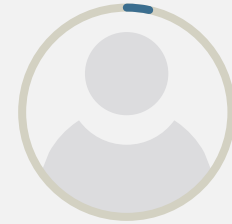
Vice President or
Other C-Suite Exec

8.1%



Board Chair

4.0 %



Board Director

3.4 %



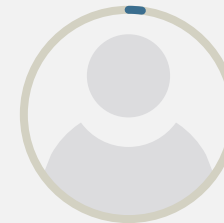
Retired

2.0 %



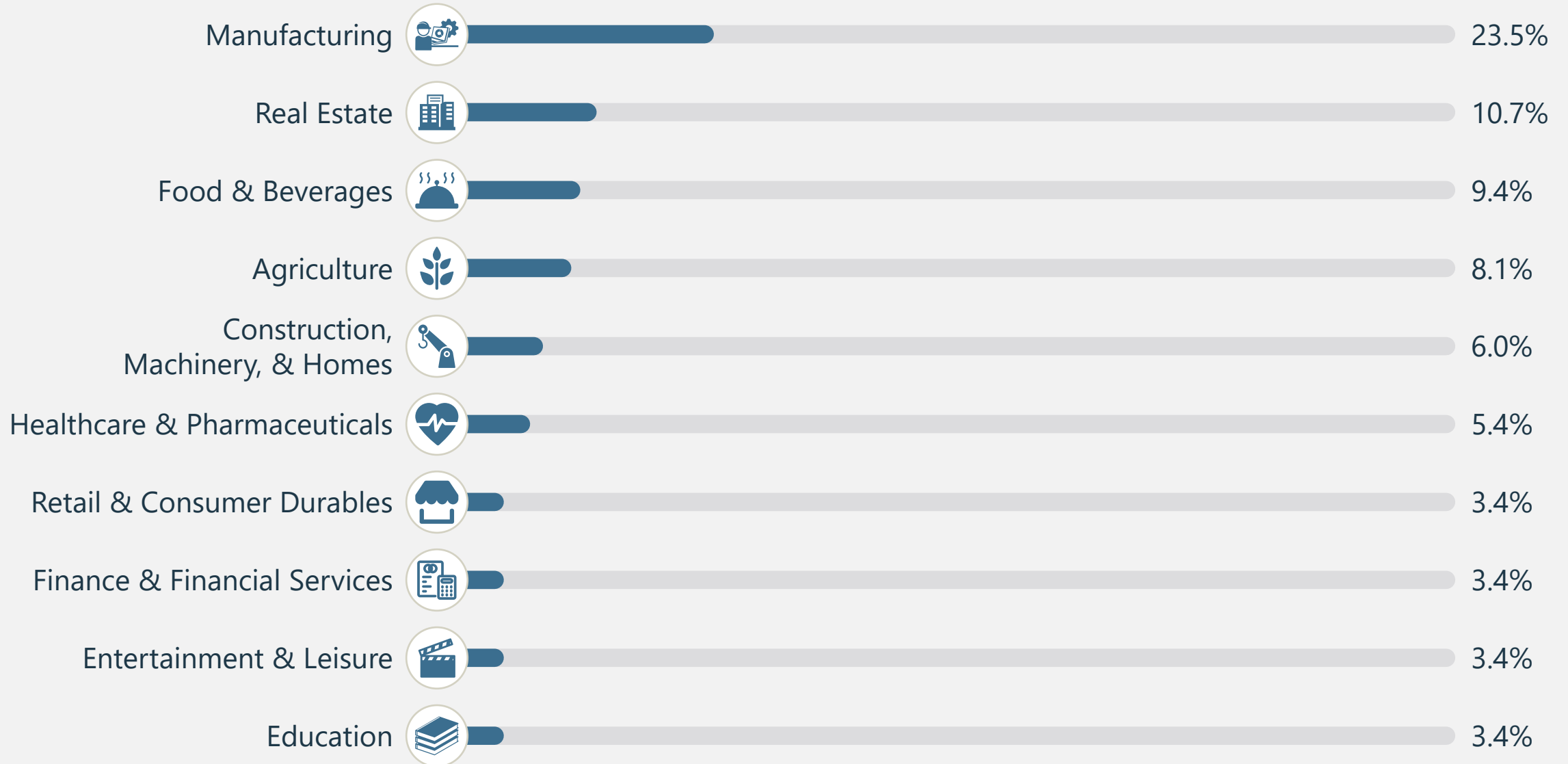
Other

2.0 %



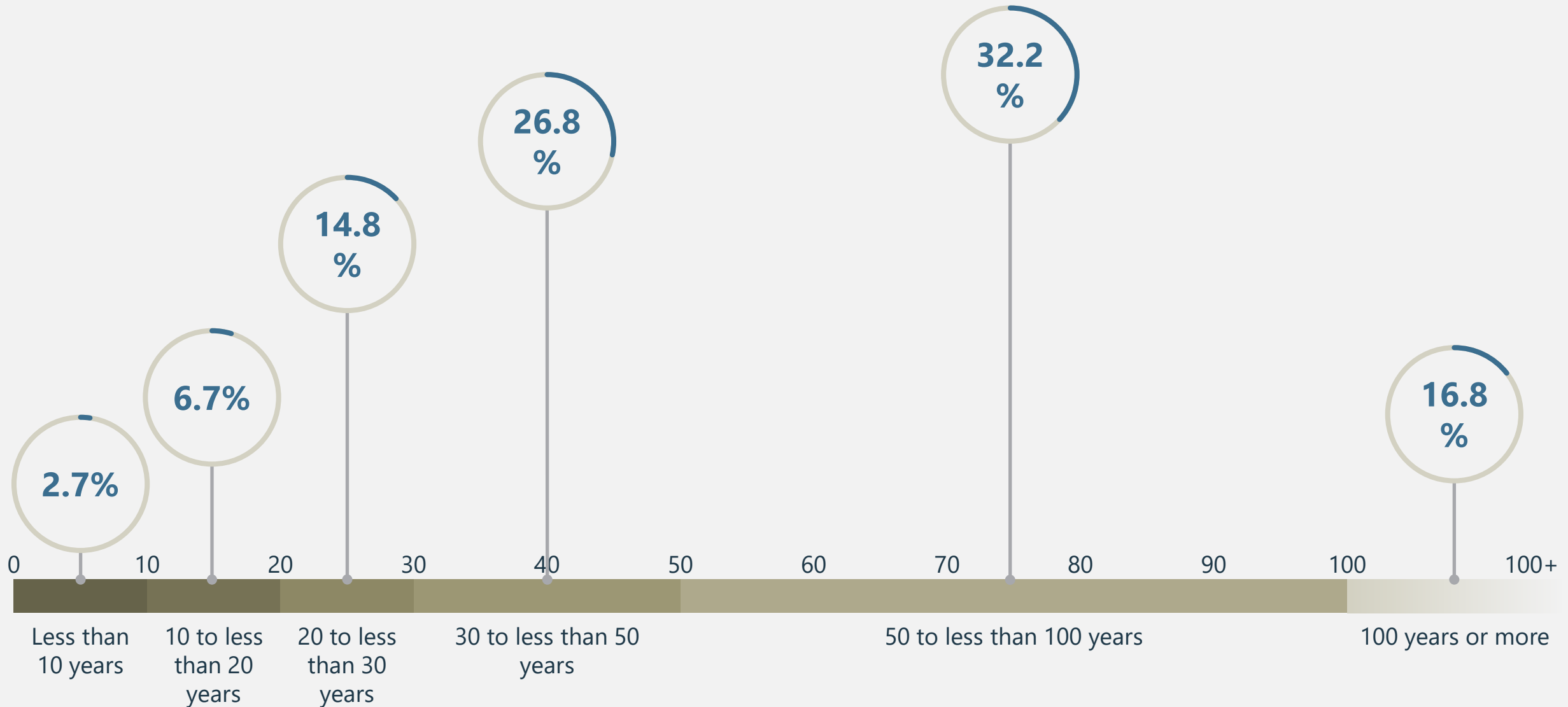
Owner

Which Of The Following Best Describes The Principal Industry Of Your Family Business?



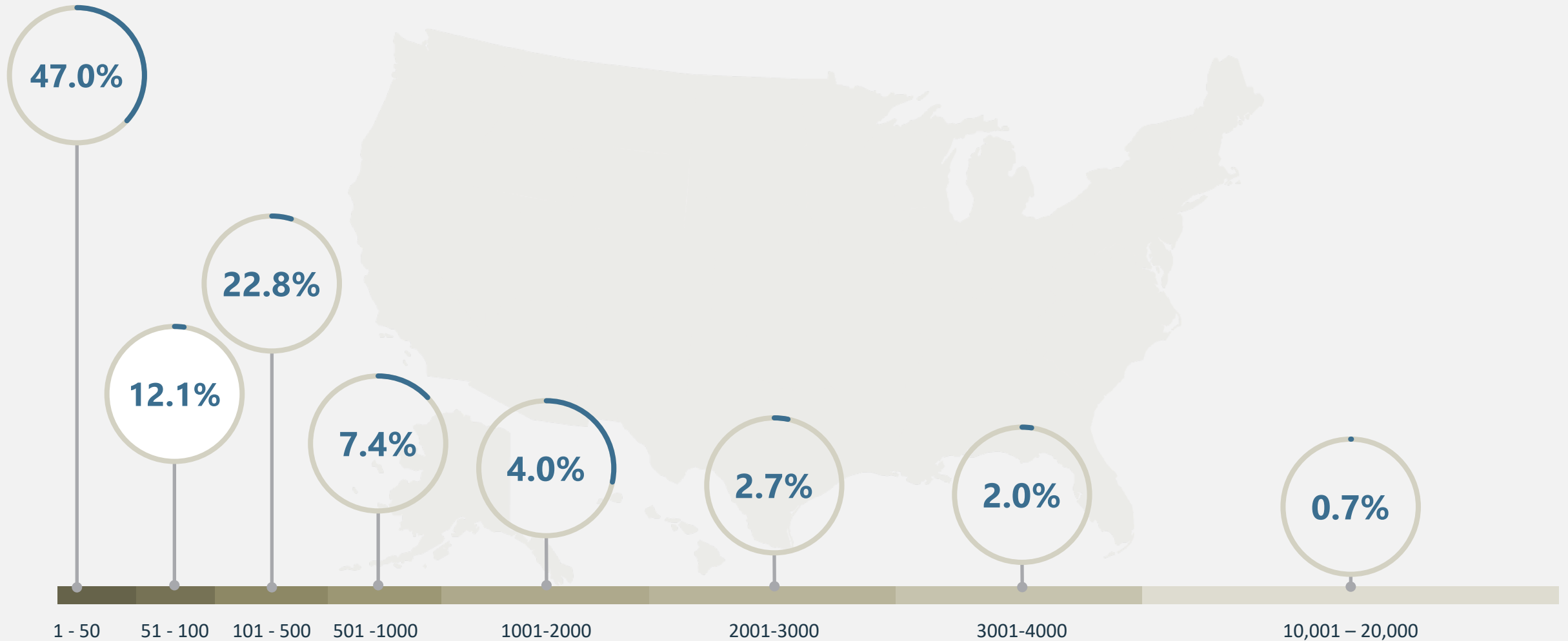
How Many Years Has Your Family Business Been In Operation?

17% of businesses in business over 100 years and 76% more than 30 years

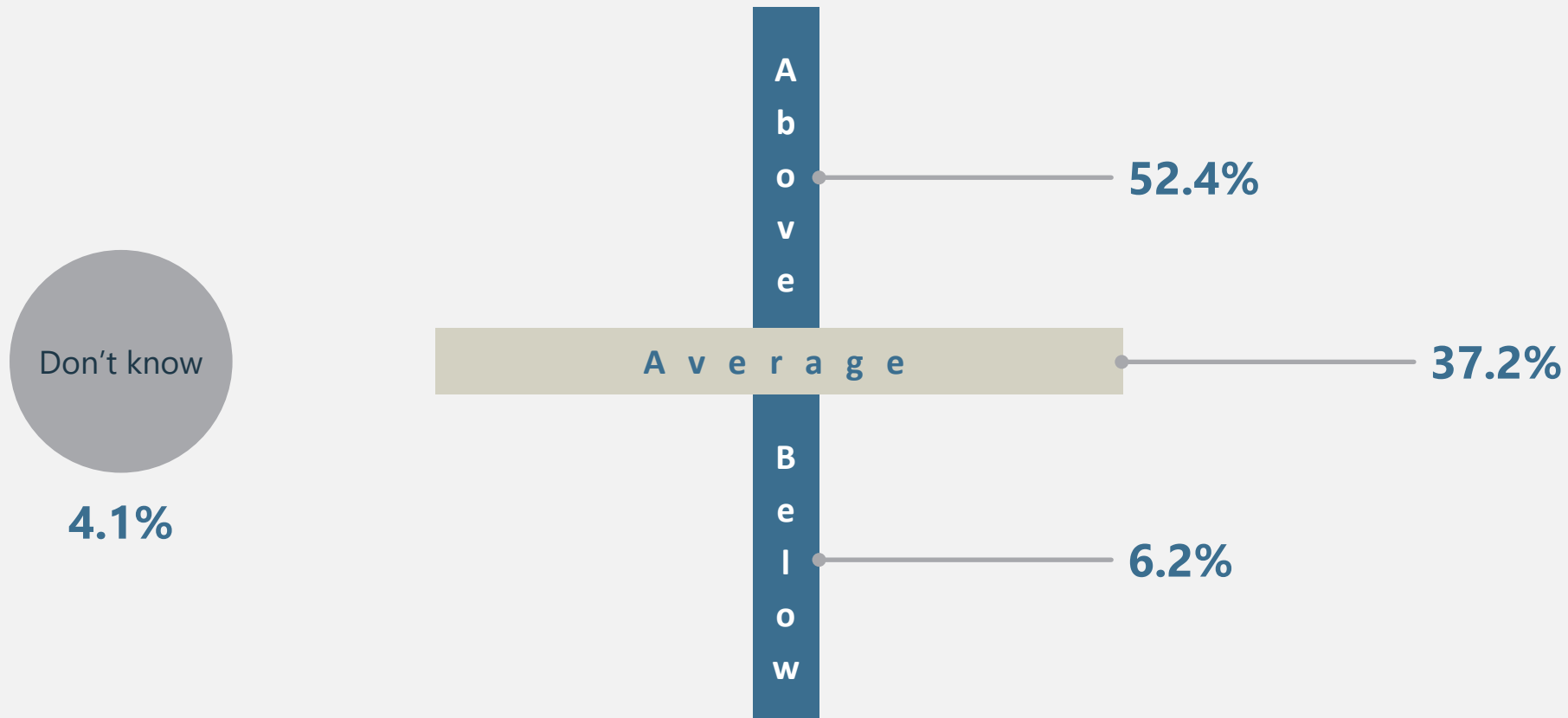


How many people did your firm employ in the US?

35% have 50 to 100 employees and 17% have over 500 employees

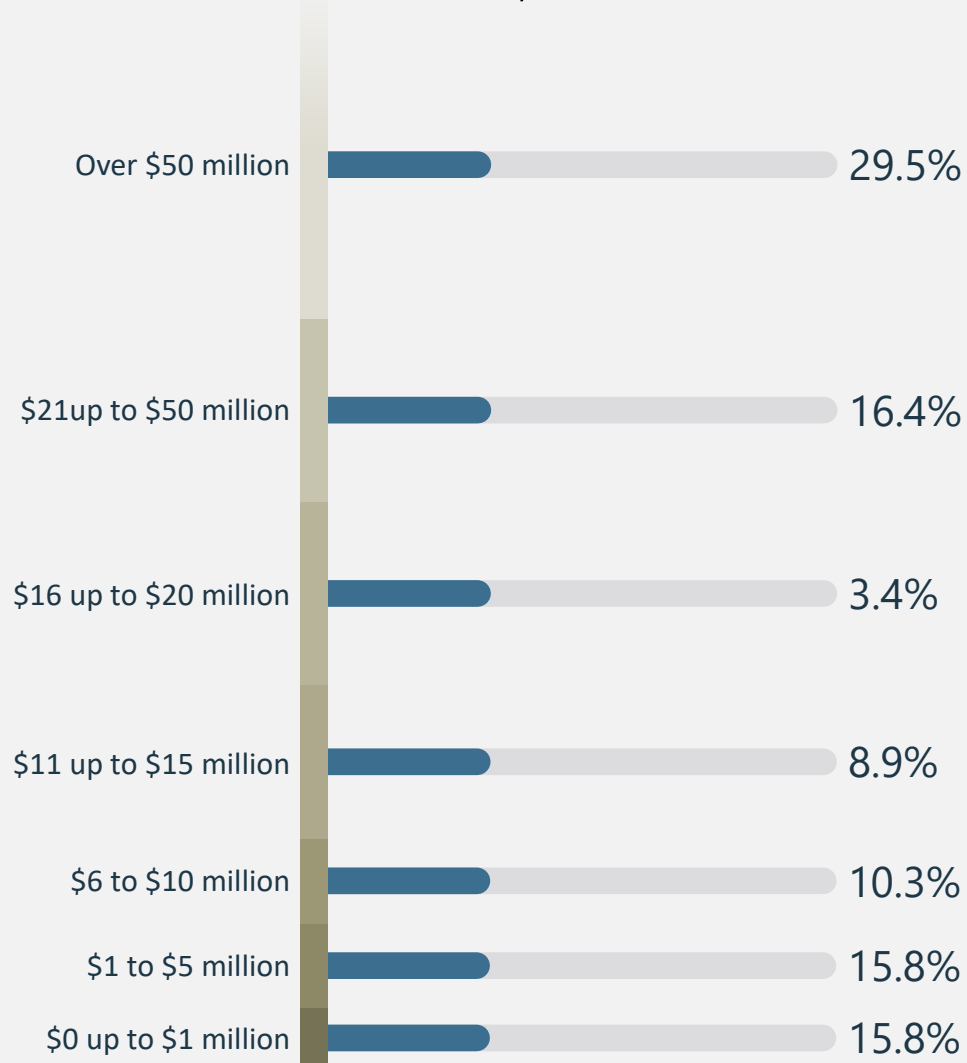


How would you measure the salary and benefits that you pay your employees as compared to your non-family business competition?

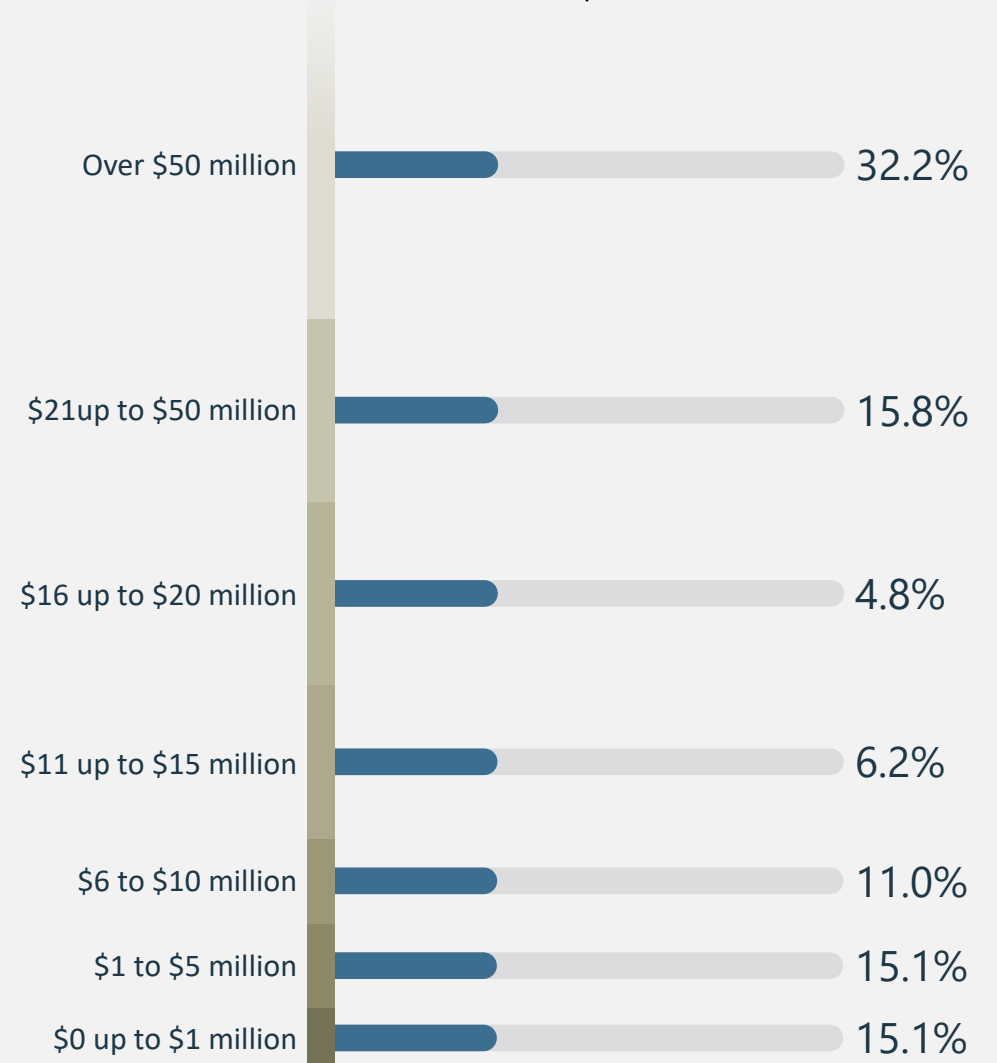


What were the gross US revenues of your business in 2020?

30% have over \$50 million in annual revenue and 58% have revenues over \$10 million

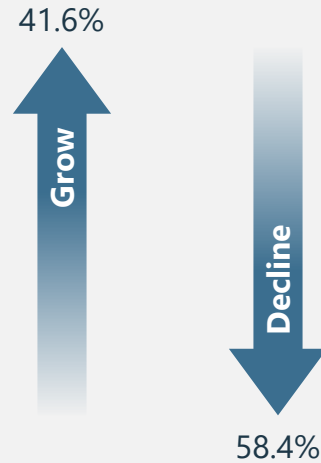


What are the estimated gross US revenues for 2021?

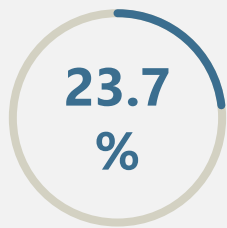


Did your business' revenue grow or decline in 2020?

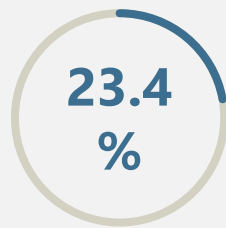
Note all top 3 are almost the same



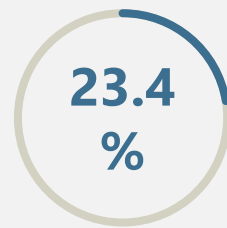
Why did your business' revenue grow or decline in 2020?



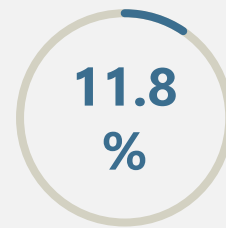
Industry conditions



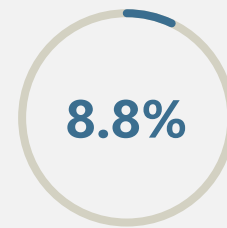
Economic conditions



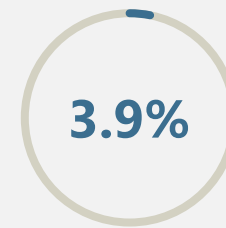
Coronavirus



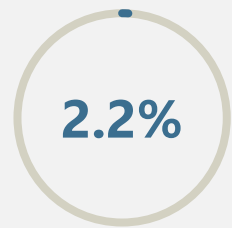
Strategic business choices



Government regulation



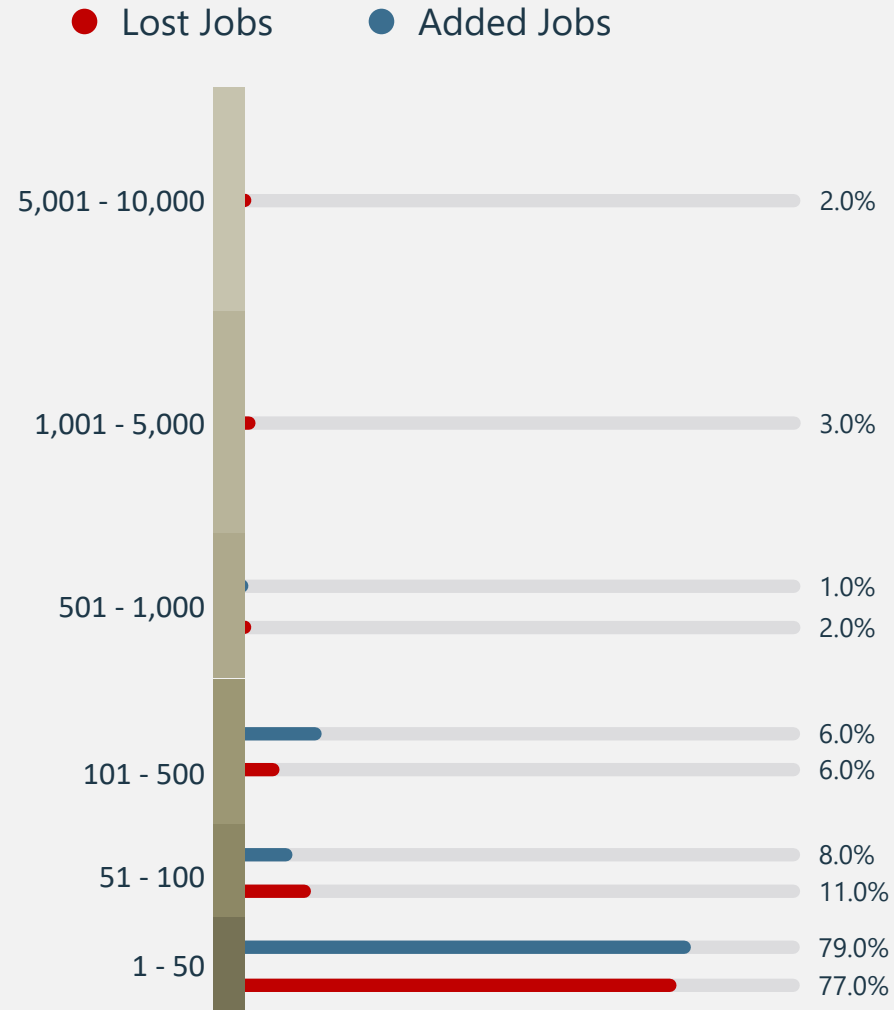
Capital investments into business



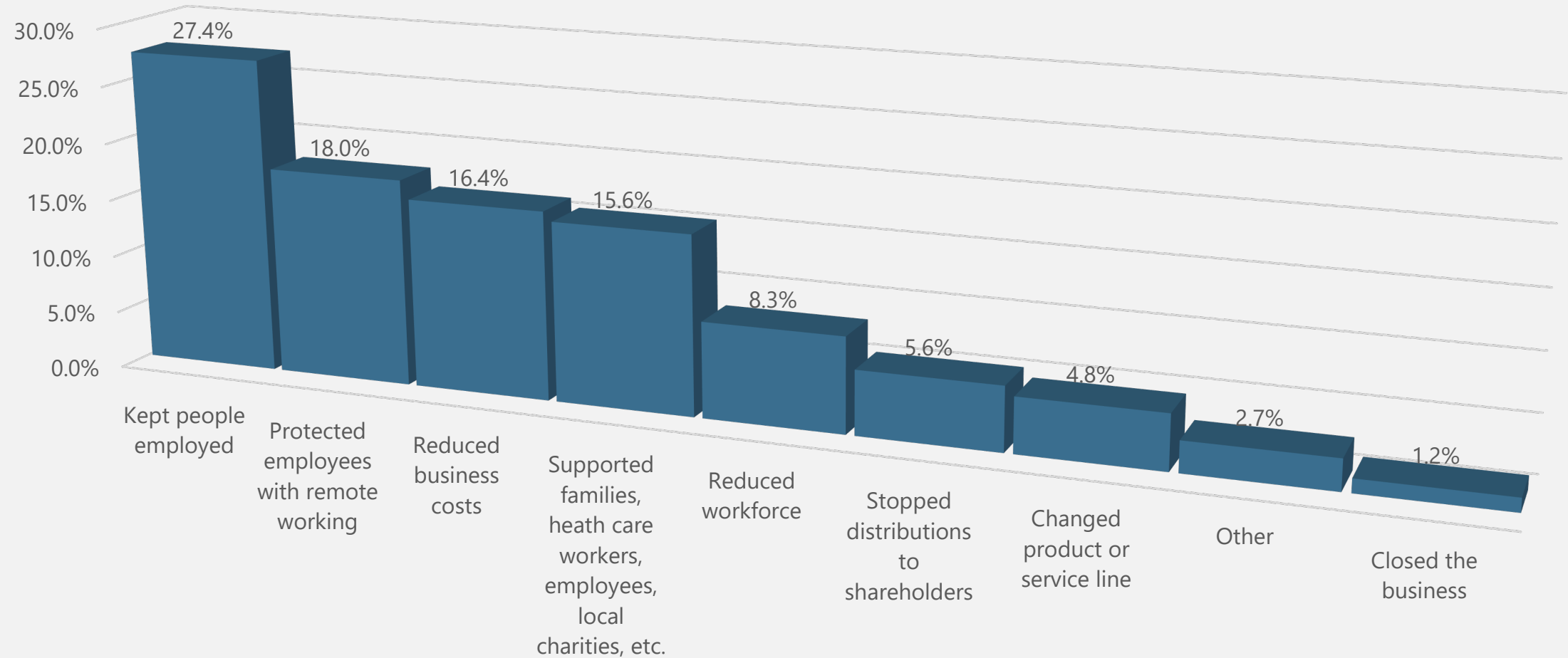
Trade regulation

How many net US jobs did you ADD or LOSE in 2020?

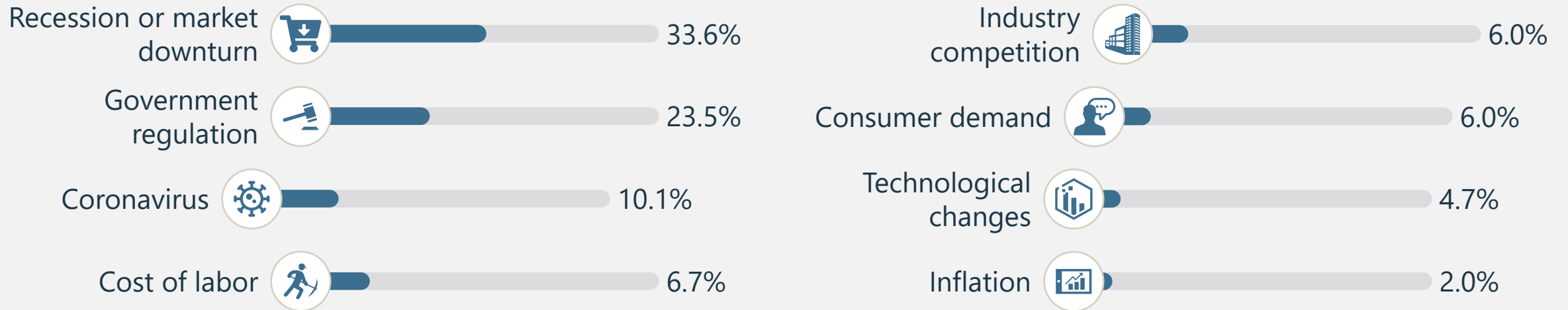
Most job change, add or lost, was in 1 to 50 employee



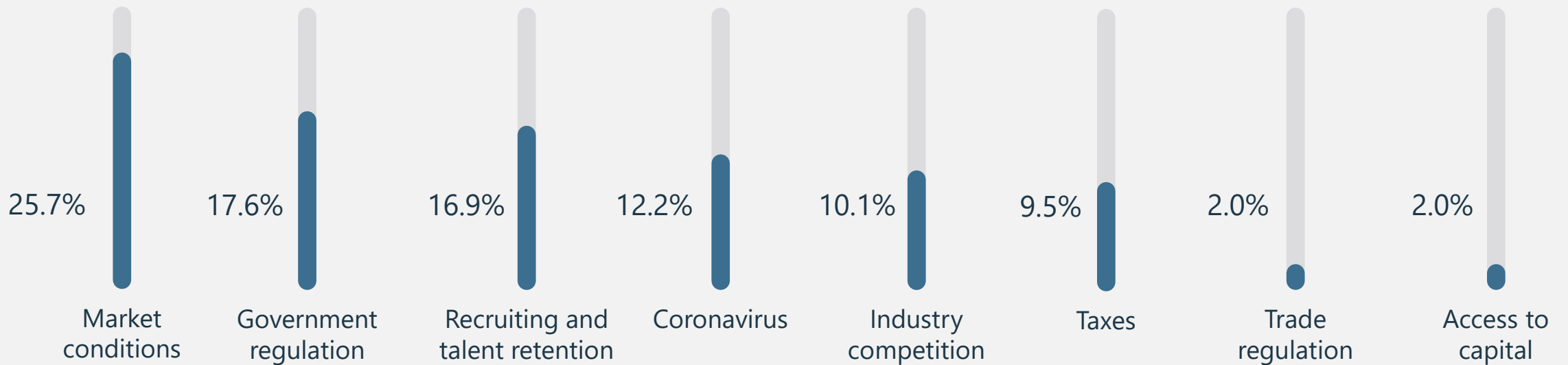
How have you managed the business during the pandemic?



What is the top business risk to the success of your business?



What will be the greatest impediment to your business growth in 2021/2022?



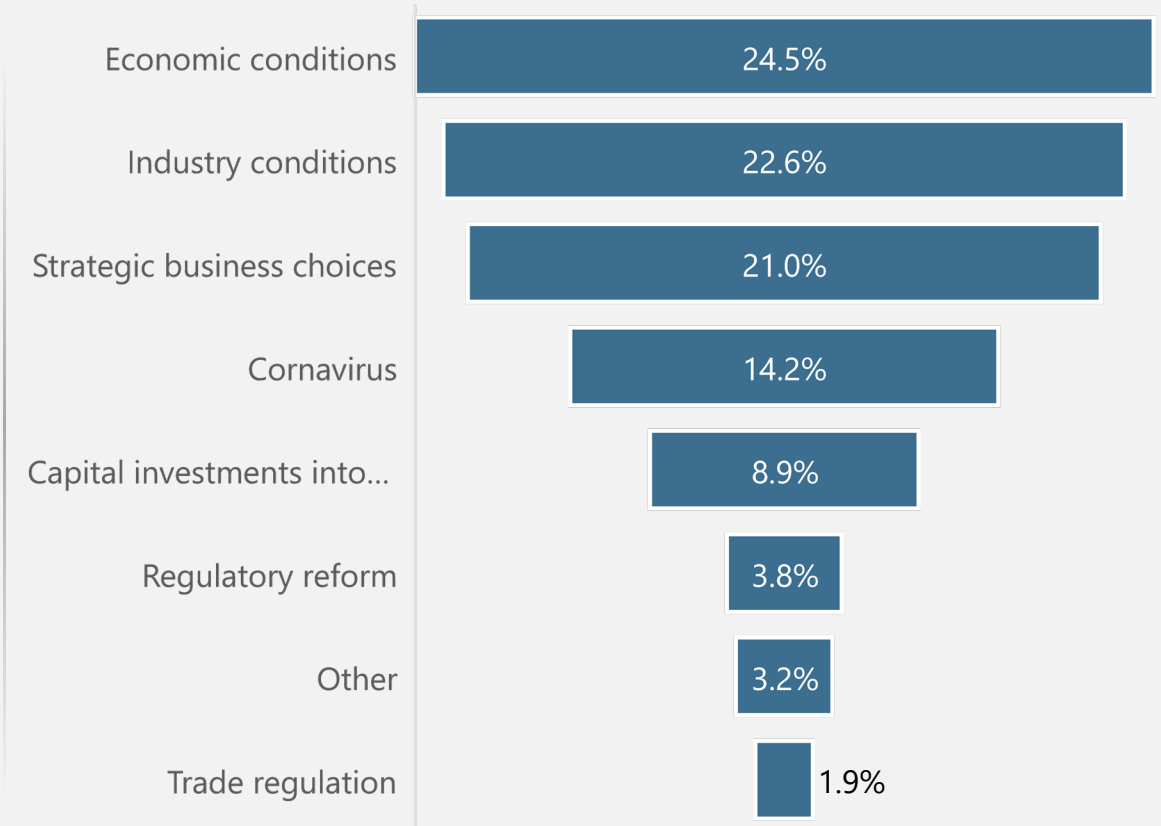
Do you expect your business' revenue to grow or decline in 2021?

85.1%

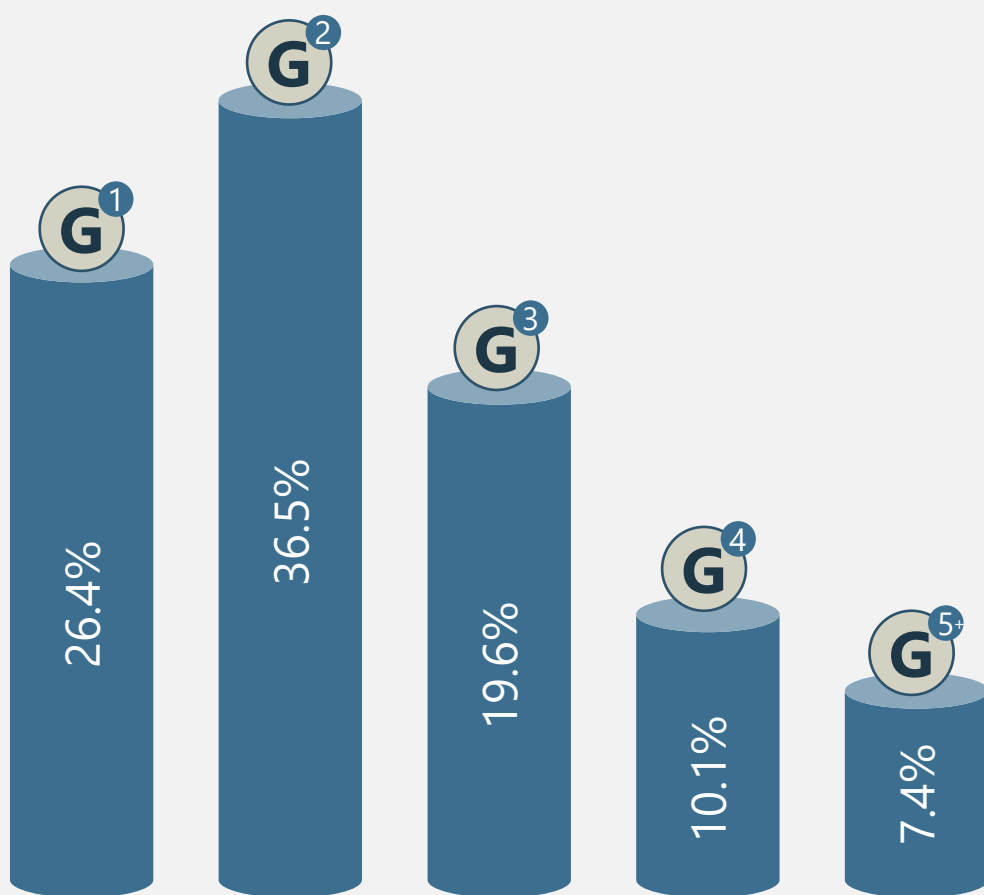


14.9%

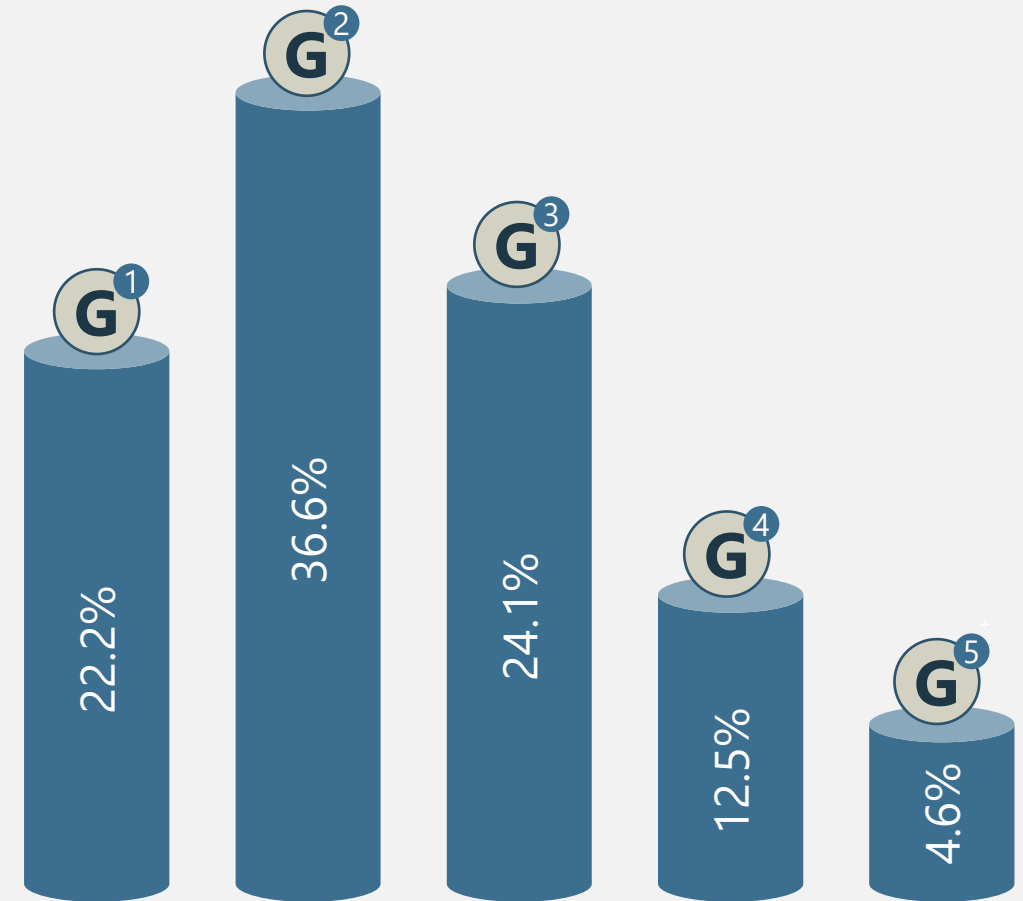
Where would that come from?



What generation is the
OWNERSHIP of your
family business?



Which generations are
active in the
MANAGEMENT of the
family business?



Have you passed ownership of the business on to the next generation?



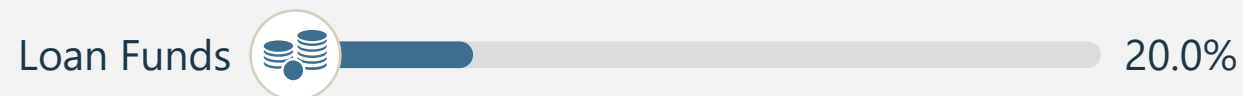
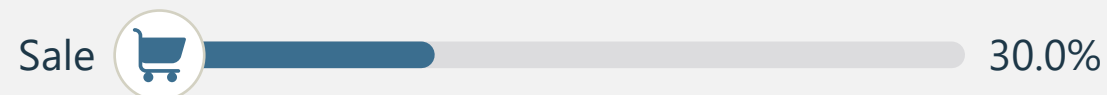
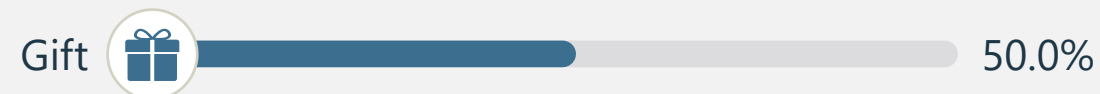
Do you think that passing ownership on to the next generation is important to the sustainability of your business over generations and the creation of more jobs?



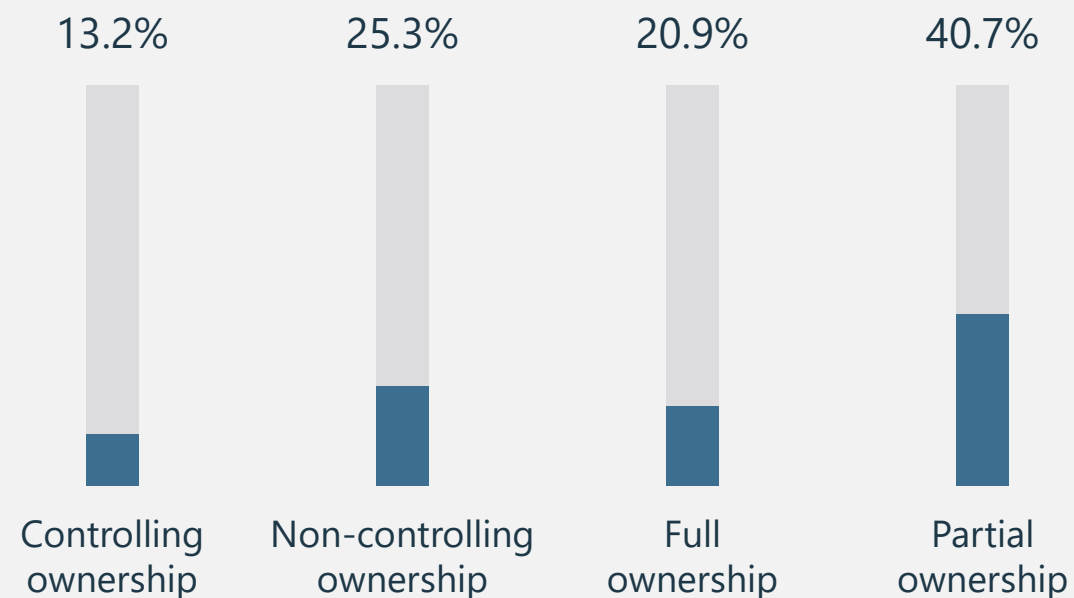
Do you consider your family business to be part of your children's legacy?



What strategy did you use to pass ownership of your business?

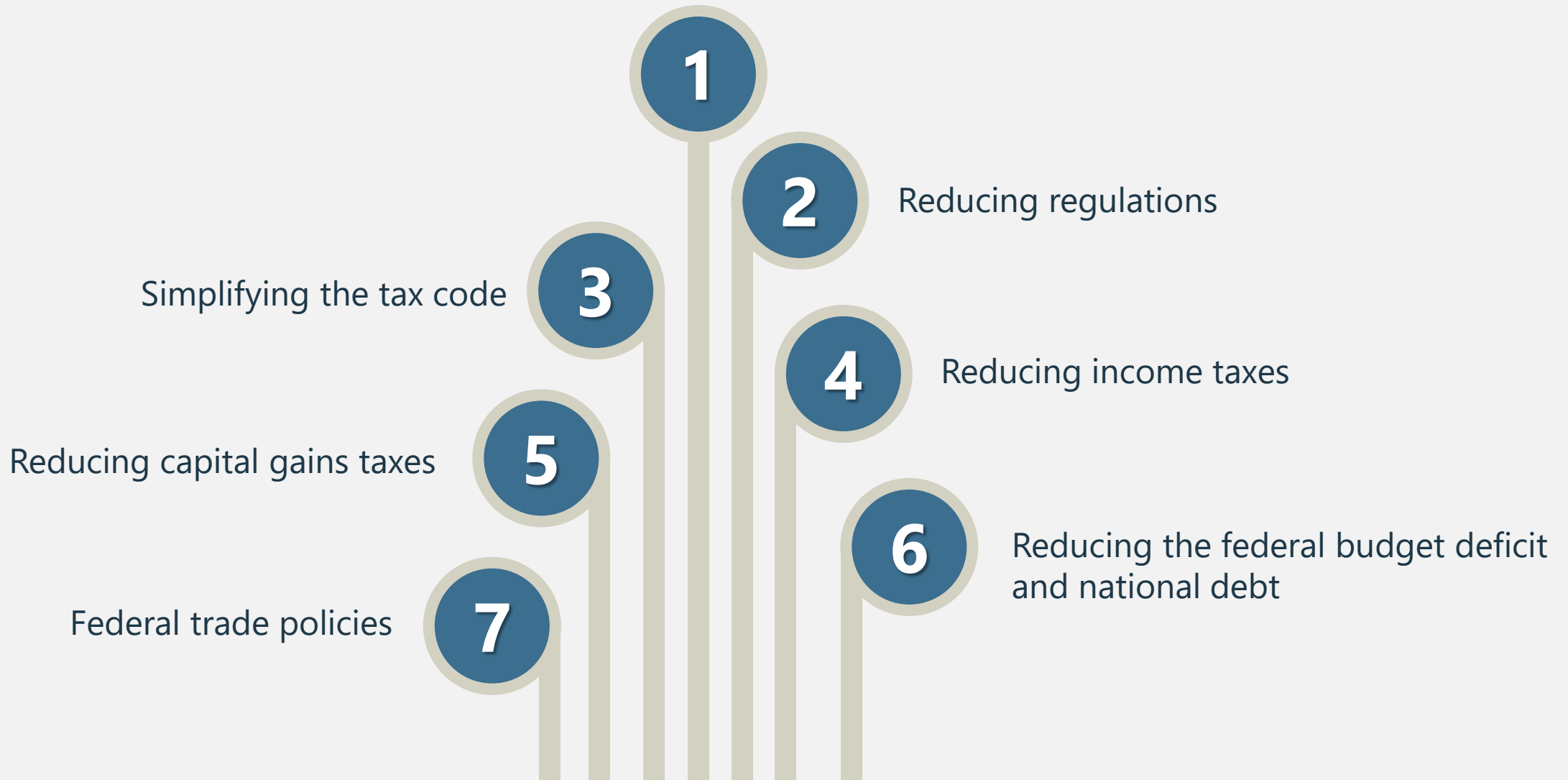


Portion of ownership passed

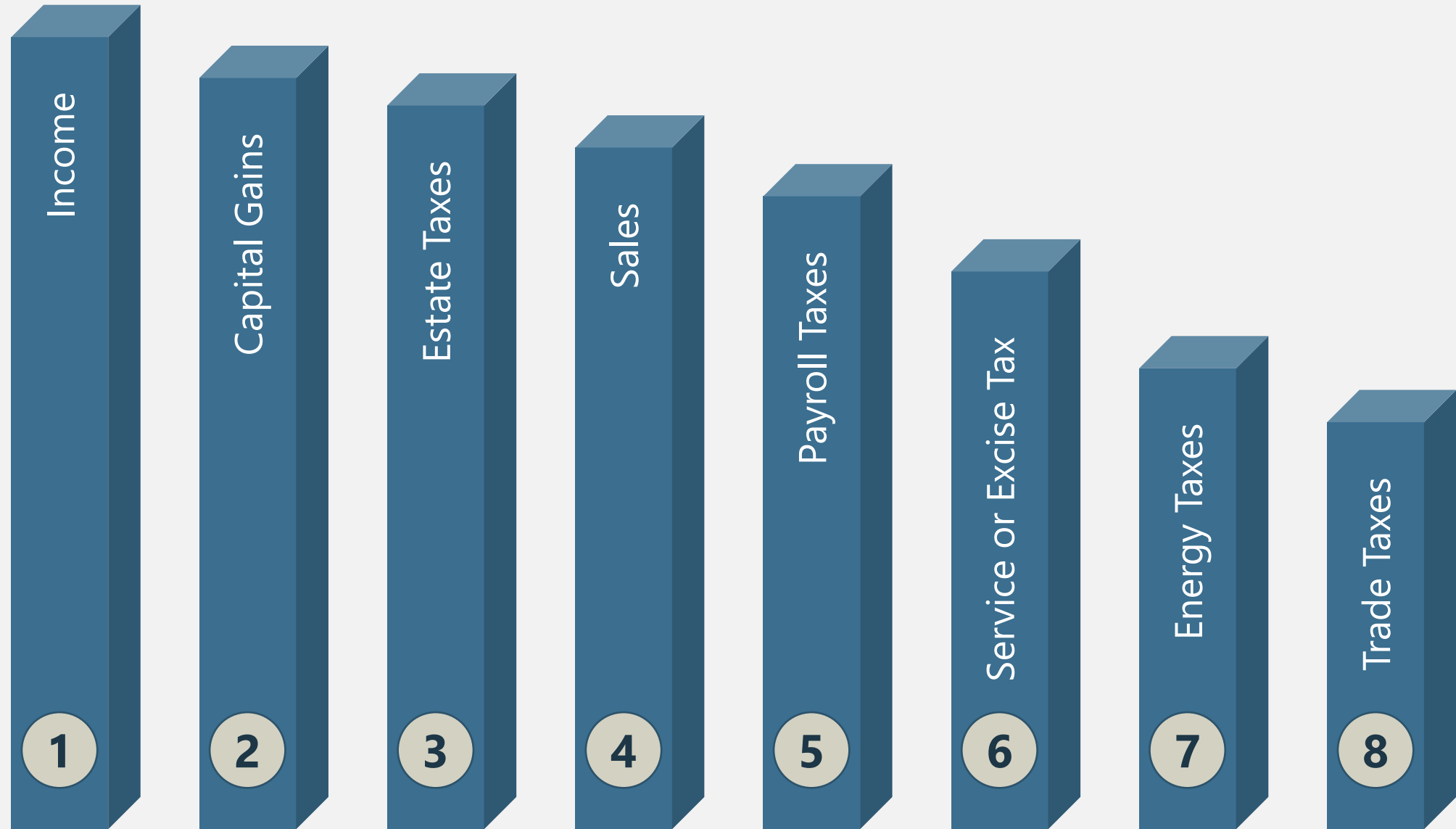


Rate Economic Public Policy Priorities In Terms Of Their Importance

Reducing or eliminating estate taxes



Ranking Of Tax Policies Concerns



Support Of Estate Tax Provisions

1

Make the current level of lifetime exemption permanent and not expire in 2025

2

Reduce the rate of estate tax from 40% to that of a capital gains tax rate

3

Repeal the estate tax

4

Increase the lifetime exemption from current level

5

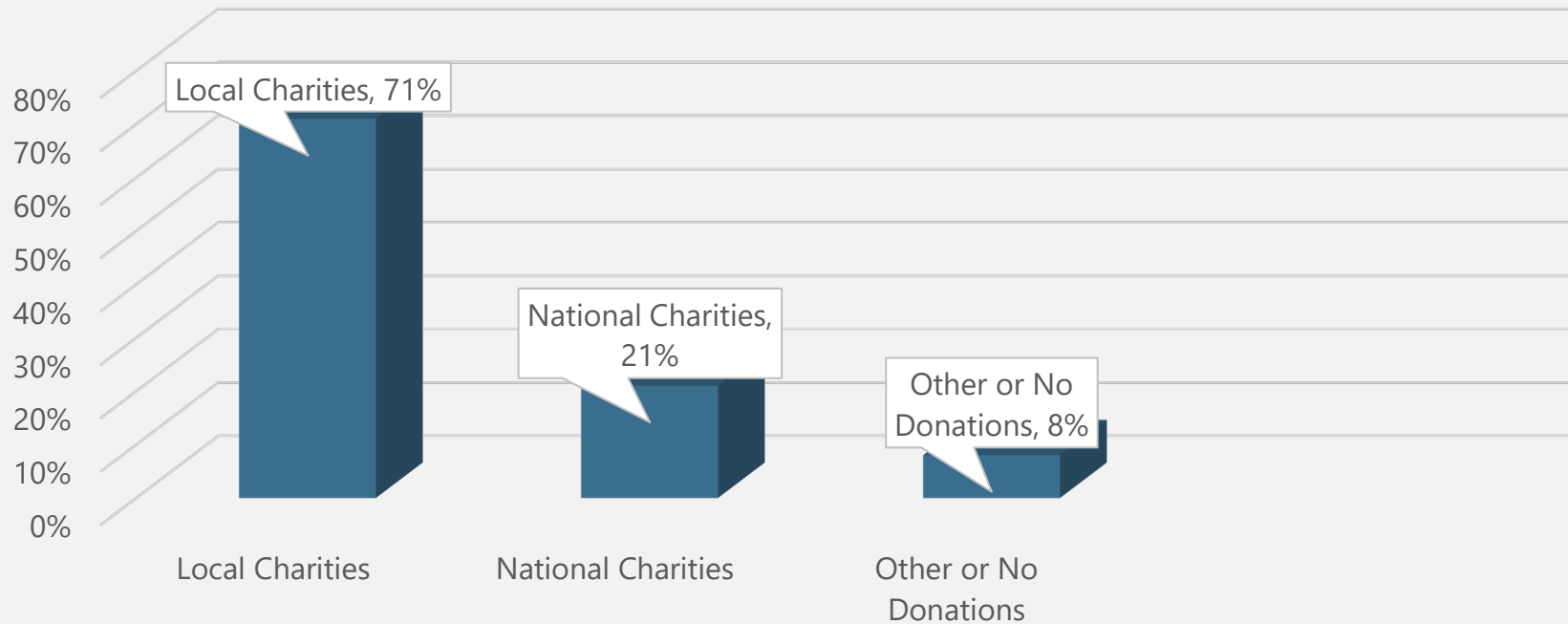
Increase the estate tax

6

None of these

Bulk of Charitable Contributions Allocated Locally

Average Allocation of Contributions to Charities:
Local vs. National



— Quotes About Estate Tax —

The estate tax will drain capital from our business and force us to limit growth and liquidate some assets. It drastically reduces our ability to grow our business, acquire, renovate, improve and develop properties.

Donald - Seattle, WA

Extremely unfair to tax assets and income over life and then tax again on death. Diverts our attention, adds to cash flow risk.

Chicago, IL

We would be able to grow at a fast pace and add more jobs if the tax laws were more favorable to family businesses.

Jackson - Anaheim, CA

Our business pays millions in taxes every year. It is a goose that lays an egg that grows tax payments every year. However, the estate tax is a destroyer of wealth...not only for the taxpayer but also the collector. Raising the estate tax rate directly reduces investment and growth of the business; lowering the unified credit will likely force the sale and destruction of a family business employing 1,700 (pre-pandemic). It is not fair nor in societies best interest.

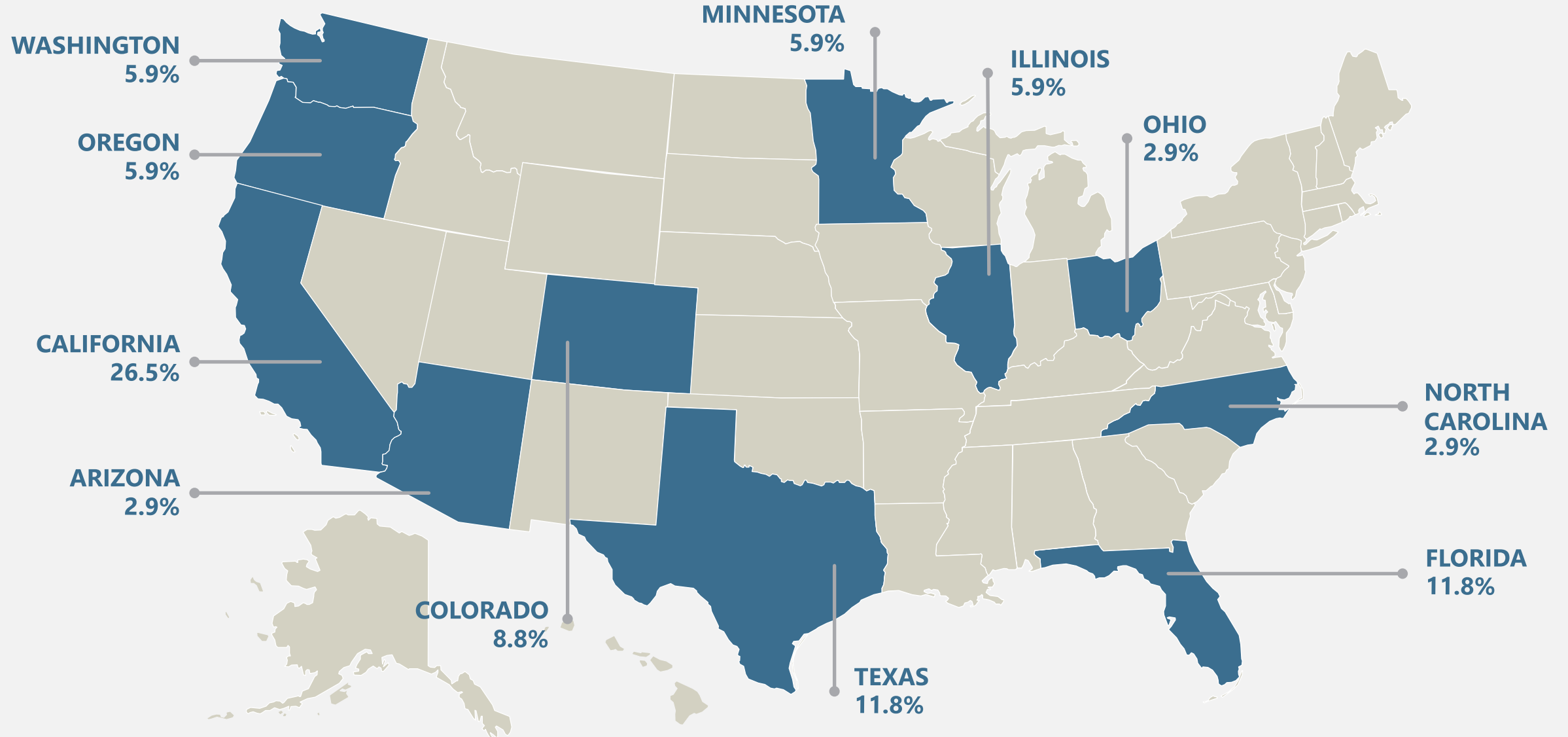
The taxes will either force a sale of the business or substantially burden the business. It depends on the strength of the business at that time. At this time, it puts a damper on investments for growth.

James - Kingsville, TX

They drain the passion out of generational involvement. The business just shrinks until no one can work here.

Pennsylvania

State Of Respondent





About FEUSA

Focus

There are 32.4 million Family Businesses
in the US
who create

59% of the WORKFORCE

83.3 MILLION JOBS

Generate 54% of the GDP

\$7.7 TRILLION

Mission and Approach

Family Enterprise USA (FEUSA), (501.c3) is dedicated to educating the public and legislators about the implications of public policy upon closely held and family-owned businesses. FEUSA conducts non-partisan research that highlights the contributions of family enterprise to the American economy and the challenges these businesses face, which is then used to educate legislators, policy makers and the public on the important role of family businesses in the economy and local communities.

Impact; FEUSA Annual Family Business Survey

Through its annual Family Business Survey, FEUSA has distinguished itself as an expert in data collection and research on family business across the United States.

For more information visit www.familyenterpriseusa.com



BNY MELLON

WEALTH MANAGEMENT

BNY Mellon Wealth Management is proud to support FEUSA

For more than two centuries, BNY Mellon Wealth Management has helped families build, manage and preserve their wealth. Our specialized teams have the tools, knowledge and experience to develop comprehensive solutions for our business owner clients that address each client's personal financial objectives and family dynamics, as well as issues specific to his or her business. For business owners considering a family office, our dedicated Family Office team brings more than 50 years of experience providing solutions and strategic insights to help family offices grow and preserve wealth across generations. For more information, visit www.bnymellonwealth.com or follow us on Twitter @BNYMellonWealth.

Thank You For Participation

FEUSA is grateful to the university-based family business centers and other organizations who distributed the survey and, most of all, to the family business leaders who took time to share their perspectives by completing this survey.

- BNY Mellon Wealth Management
- Capital Region Family BS Center, Roseville, CA
- Goering Center for Family & Private Business
- Drucker School Global Family Business
- Smith Family BS Initiative
- Family Business Coalition
- Family Office Exchange - FOX
- Mississippi State Center of Family Enterprise Research
- Schulze School and Family Business Center
- Family Business Council
- Institute for Family-Owned Business
- University of North Carolina
- The Institute for Entrepreneurial Excellence
- Loyola Family Business Center
- Prairie Family Business Association
- LA Consulting Group
- Dr Jeremy Lurey
- National Association of Wholesale Distributors
- American Farm Bureau Federation
- National Cattlemen's Beef Association



Family Enterprise USA

Research

Advocacy

Legacy

**Advocating for
Families in DC**

THANK YOU!

Pat Soldano

President; Family Enterprise USA

714 357 3140

pmsoldano@family-enterpriseusa.com