NATIONAL ASSOCIATION OF Manufacturers

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Internal Revenue Service
CC:PA:LPD:PR (REG-163113-02)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

Federal eRulemaking Portal: www.regulations.gov (IRS REG 163113-02)

Attention: Mr. John D. MacEachen

RE: Estate, Gift and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest

Dear: Mr. MacEachen,

The National Association of Manufacturers (NAM) – the largest manufacturing association in the United States representing manufacturers in every industrial sector and in all 50 states – have very significant concerns about the proposed regulations on valuing minority interests in family owned businesses, “Estate, Gift and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest” (IRS REG 163113-02), from both a policy and a legal perspective.

Specifically, manufacturers believe that the proposed regulations–which incorporate some of the most sweeping changes to estate tax policies in the last 25 years–-would unnecessarily increase estate and gift taxes on family-owned manufacturing companies by an estimated 30 percent or more, severely impacting the ability of owners of these family businesses to transfer their companies to the next generations. As outlined in more detail below, we believe that, if finalized in their current form, these regulations would harm their ability to invest and grow their businesses and reduce their competitiveness versus non-family-owned firms.

From a legal perspective, the NAM–a co-director and charter member of the Family Business Estate Tax Coalition (FBETC)–strongly supports and incorporates by reference FBETC’s comments on the proposed regulations that challenge Treasury’s authority to promulgate the regulations.

Overview

Family-owned businesses have long played a central role in our nation’s history and economic and social fabric. Indeed, the manufacturing sector has a long history of strong, family-owned businesses that are key to our nation’s supply chain, provide well-paying jobs to millions of workers and are mainstays of communities across the country.

Even with the tradition and success of family-owned businesses in our country, the long-term viability of active family-owned enterprises declines with each successive generation.

According to a recent study, "one-third of family-owned businesses survive into the second generation and of those 12 percent are viable into the third generation, with only 3 percent of all family businesses operating at the fourth-generation and beyond."[1] Unfortunately, for on-going manufacturing firms, the proposed regulations have the potential to make succession planning for the next generation significantly more costly and difficult.

The negative impact of these proposed regulations on NAM family-owned businesses cannot be overstated. In a recent letter, the third generation owner of an active manufacturing enterprise explained the potential impact of the regulations:

> Our board has been working an ownership succession plan for years. Stock valuation and financing stock transfer are an ongoing challenge. Stock is transferred through the sales, gifts and redemptions of shares and the value of the stock is the fair market value at time of transfer. We are within a couple of years of completing the transfer of ownership from the 3rd to the 4th and 5th generations. Our advisors have informed us the proposed regulations will eliminate discounts that have traditionally been applied. If this happens, the cost of transferring the stock will increase by 43%. This will put an additional strain on our capital and would lead us to underinvest the capital required to grow or even sustain our company. It means diminished ability to invest in job creating, value creating and value-retaining projects.

Minority Valuation Discounts

In particular, manufacturers are concerned that the proposed regulations would severely restrict the availability of well-established minority valuation discounts in intra-family transfers of family-owned enterprises.

The concept of a valuation discount for a minority interest in an enterprise that lacks control or marketability is widely accepted throughout the free market. In the case of a family-owned entity, when there is a transfer of an interest that lacks control and that cannot be offered on the open marketplace, the value of the interest is appropriately discounted. This is not a contrivance but a reflection of the economic reality of the interest.

Another NAM member–a second generation family-owned manufacturer–explains:

> The ability to use minority valuations to discount the value of transferred interests within a family-owned business is crucial for family-owned operating companies. These shares cannot be sold on the market, and since they are a minority, they have no control over the company. [These regulations] would divert capital from business investment, cost jobs and threaten the ability of families to pass businesses on to the next generation. This will have the unintended consequence of benefitting private equity firms and large companies that like to buy out family businesses at the death of a family owner."

In this case, the third generation already is actively involved and succession planning has begun. Manufacturers believe that Treasury's proposal would disrupt succession planning for this NAM member and for thousands of other family-owned manufacturers across the country. In a recent NAM survey of our family-owned members, over 40 percent of respondents indicated that they have spent over $50,000 – with half of these over $100,000 – in the past three years in estate planning costs. Over 60 percent of respondents indicated that they would

[1] Conway Center for Family Business, http://www.familybusinesscenter.com/resources/family-business-facts/

need to undertake new succession planning due to these regulations as they would disrupt much of those plans. These owners likely will face significant additional planning costs if the regulations are finalized.

In addition, by limiting the use of minority valuation discounts in family businesses, the proposal would artificially inflate the value of the minority shares, increasing estate and gift taxes. Family-owned manufacturers, unlike non-family businesses, would have to set aside additional resources to cover these increased tax and planning costs, reducing the amount of resources available to invest in their business's growth. In fact, according to a recent survey of NAM members, over half of respondents indicated that the increased resources they would need to dedicate to succession planning took away from their investment in equipment, facility upgrades and improvements and new jobs.

Disregarded Restrictions

Manufacturers also are concerned with the proposal's concepts of "disregarded restrictions" and "family attribution," which assume that, if related parties own an enterprise, the operating agreements and any additional restrictions placed on interests are not actual restrictions because they would be easily overridden or removed by the family.

Unfortunately as many of our family-owned businesses have indicated, family members do not always act in concert with one another. According to NAM members, there are a range of limitations on interests within their family entities, from restrictions on to whom a family member can transfer or sell the shares (e.g., a direct decedent of the original founder) to restrictions on the duration of the ownership. The purpose of these restrictions is often to set expectations and ensure continuity of operations and ensure succession planning is possible. Additionally, the existence of these restrictions, in addition to having a true value to the business, also have an impact on valuation of interests in an ongoing entity.

Moreover, by only targeting minority valuation discounts in family-owned businesses, the proposed regulations put these active enterprises at a competitive disadvantage to non-family owned businesses. This is patently unfair.

Manufacturers question Treasury's authority to advance regulations that would negatively affect minority discounts. As made clear by the legislative record in creating this section,[2] "[T]hese rules do not affect minority discounts or other discounts available under present law." The conference report also states that, "[T]he provisions also grant to the Treasury Secretary regulatory authority to disregard other restrictions *which reduce the value of the transferred interest to transfer tax purposes but which do not ultimately reduce the value of the interest to the transferee."[3] (emphasis added).*

Three Year Rule on Transfers Before Death

In addition to concerns about the impact of the proposed rules on the use of valuation discounts, manufacturers also have serious concerns about the application of a three year "look-back" period to determine if the minority share discounts should apply to a given estate.

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[2] P.L.101-508, Conference Committee Report Concerning the Omnibus Budget Reconciliation Act of 1990, https://www.govtrack.us/congress/bills/101/hr5835/text/enr

[3] Ibid.

The proposed “look-back” rule would give the IRS the ability to determine whether the shares were transferred within a three-year period of the death of the original owner. We do not believe that the Treasury has the authority to extend Section 2035 of the tax code, “Adjustments for certain gifts made within 3 years of decedent’s death,” to transfers of family-owned businesses.

Moreover, the application of the three-year rule also would significantly complicate succession planning. As vigilant as business owners are in planning for the transfer of their business, it is impossible an owner to anticipate his death three year’s ahead of time. As proposed, the only way for a business owner to be sufficiently prepared for a sudden death, under this proposal, would be to set aside enough capital, or have un-tapped credit available, to pay any additional taxes arising from a sudden death and a situation where transfers within a three-year window are disregarded. As the typical minority valuation discount is upwards of 30 percent, the application of a three-year look-back would have the effect of inducing companies to hold aside that amount in order to have access to the funds necessary to pay any unexpected taxes. This is especially true in operating businesses where there is a high capital requirement and assets may not be liquid. For too many family-owned manufacturers, an unexpected tax bill could cause them to eliminate jobs, reduce investment or sell off a part, or all of the business.

Again, as noted above, the three year look-back rule would harm only those owners whose interests were given to family members, putting related parties at a disadvantage as compared to businesses where owners transferred shares to unrelated parties during the same three-year period.

Finally, the NAM opposes any retroactive application of these proposed rules should they be finalized. The retroactive application would be harmful to the continued successful operation of hundreds of family-owned manufacturers across the U.S. particularly if the three year rule is applied retroactively. Such application would be unfair as taxpayers would not be able to prepare to comply with the regulation.

Conclusion

Manufacturers oppose regulations that would about impose significant new costs and taxes on on-going, active enterprises that employ millions of workers in the United States. In our recent survey of family-owned manufacturers, over half of respondents indicated that their business was likely to spend over $50,000 on additional estate and succession planning due to this regulation in the coming months. We believe strongly that that these resources are better spent on innovation, training and capital investment rather than on legal fees and increased transfer taxes.

In light of the potential harm to family-owned manufacturers created by these proposed regulations, we strongly urge Treasury to withdraw this proposal.

Sincerely,

Carolyn Lee