FOOD MARKETING INSTITUTE

Your Neighborhood Supermarkets

TESTIMONY FOR THE RECORD

United States Senate Committee on Finance
Hearing on

"Federal Estate Tax: Uncertainty in Planning Under the Current Law"
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10:00 am

Testimony by

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Chairman Baucus, Ranking Member Grassley, and Members of the Senate Finance Committee:

On behalf of the Food Marketing Institute[1] (FMI) and its family-owned supermarket members, I would like to thank you for holding today's hearing on the costs of planning for the federal estate tax. While critics of the estate tax focus on the damage it does upon the death of a business owner or head of family, they often overlook the fact that it exacts a heavy toll long before it is ever applied. The effort to minimize the impact of the tax and guarantee that a strong and thriving business can be handed down from one generation to the next is in many cases a years-long process that is not only expensive in dollars, but also in terms of lost productivity, limited growth and emotional strain.

The 2001 reform of the estate tax had the unfortunate effect of making estate tax planning even more complex. While it had the salutary effect of beginning to bring down the rate of the tax, it also created an unusual structure where the tax is repealed altogether in 2010 only to snap back to 55% or more in 2011. This change has provided a lot of comedic fodder about the desirability of passing away on December 31, 2010, but it also made estate planning with any kind of confidence nearly impossible. Despite the best intentions of Congress and this Committee, a business trying to survive the estate tax is faced with an evermore complex and expensive process with each passing year.

FMI and its members have called for repeal of the estate tax for over twenty years, and we continue to believe that this is the best possible solution for our industry and the American economy. But as 2010 draws closer, we need certainty and predictability just as much as we need repeal.

The Estate Tax and the Supermarket Industry

The estate tax has an especially pernicious effect on the supermarket and grocery store industry, since many of our members are asset-rich but cash-poor. According to IRS figures, as much as 60 to 65 percent of the assets of a family-owned grocery can be tied up in the form of physical inventories, buildings, and equipment. These assets cannot easily be converted into cash and yet upon the death of the business owner, the remaining family is left to pay a tax of 45 percent[2] upon them.

Complicating matters further, the value of the physical store – particularly in the case of older grocery stores - has often grown far beyond the value of the business. More than one of our members has been stunned by estate tax bills literally in the millions of dollars. Paying these bills is not a matter of merely selling some stock or tapping cash

[1] Food Marketing Institute (FMI) conducts programs in research, education, industry relations and public affairs on behalf of its 1,500 member companies — food retailers and wholesalers — in the United States and around the world. FMI's U.S. members operate approximately 26,000 retail food stores with a combined annual sales volume of $680 billion — three-quarters of all retail food store sales in the United States. FMI's retail membership is composed of large multi-store chains, regional firms and independent supermarkets. Its international membership includes 200 companies from 50 countries.

[2] In 2007, the maximum estate tax rate is 45%, with an exemption $2 million.

reserves. Because so many of the industry's assets are not liquid, store owners faced with the estate tax are often left with no choice but to sell stores to raise the necessary funds. Unfortunately, in an industry as competitive as the supermarket and grocery store business - which averages an annual profit margin of only one percent - companies weakened by sell-offs often find it hard to continue to compete and grow. Again, the impact of this extends far beyond dollars and cents and exacts a real human toll in terms of lost jobs and diminished growth.

It is important to point out that these owners are not Carnegies, Mellons, Rockefellers or even Buffetts who have inherited wealth and position, but business people who have built successful companies from the ground up and forged an important role for themselves in the life of their communities. One can only imagine how painful it must be when faced with the death of a family member to have to sell-off part of their legacy at the very time when you most want to celebrate and build upon it.

Planning for the Estate Tax

Despite claims to the contrary, the estate tax is not a one-time levy. It is a constant expense hanging over virtually every family-owned business in the United States. Careful planning by lawyers and accountants is necessary to help mitigate the impact of the tax and prepare an orderly succession of management. Expensive life insurance policies – many costing as much as $40,000 a year in premiums – must be purchased by cash-poor companies that will need an infusion of funds to pay their estate tax bill. Proponents of the estate tax often misunderstand the planning process, and point to these options in seeming frustration. "What is the big deal," they wonder, "when you can plan your way out of the tax?"

The answer, of course, is that you cannot plan your way out, you can only hope to minimize its impact on your business. This process is expensive and drains money and resources away from a company that should be focused on building new stores, creating jobs and giving back to the community. And what of those business owners who either cannot afford the life insurance necessary as a reserve fund or are not healthy enough to qualify? No amount of planning or time can spare them from the full brunt of the tax.

The simple fact is that every dollar spent on estate planning is a dollar not going towards growth and job creation. The estate tax does not impact a business only when it is applied at the death of an owner; it is a chronic expense that leaves family-owned businesses less competitive on a daily basis. It seems unlikely that anyone who asks, "what is the big deal," ever made a payroll, built a business, or had to pay the estate tax.

The Paris Hilton Tax? – Industry Faces of the Death Tax

For members of the supermarket industry, the only myth more frustrating than the idea that you can plan your way out of the estate tax is that it only impacts the wealthy. Proponents of the tax have even begun to jokingly refer to it as the "Paris Hilton tax."

But for members of our industry, there is nothing funny about it – it affects the way they do business every day:

> ***Niemann Foods, Inc. (Quincy, IL)*** – As the second-generation owner of Niemann Foods, Chairman Rich Niemann knows how seriously the estate tax hits his company. When his father Ferd passed away suddenly in 1969, the family was faced with an estate tax bill of several hundred thousand dollars (a significant amount of money even today, but a near fortune 39 years ago). To pay it, a wholesale distribution operation that was going to be spun-off to expand the retail side of the business had to be sold to cover their tax bill. Under Rich Niemann's guidance, Niemann Foods survived this blow and has grown into a 33 store chain. A third-generation of Niemann's is active in the business, but even after spending more than $600,000 in estate planning, Rich cannot help but wonder if a second round of estate taxes will deal his business a mortal blow.
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> ***ShopRite of Hunterdon County, Inc. (Flemington, NJ)*** – Joseph Colalillo, the Chief Executive Officer of the three store, family-owned ShopRite of Hunterdon County, has spent nearly 35 years battling national chains and regional operators to carve out a loyal customer-base and an important place in his community. But the estate tax has been a constant drag on his business. "Public companies don't have to fund for estate taxes the way privately-owned companies do, and from that standpoint, the estate tax is a constraint to growth that puts us at a competitive disadvantage," Mr. Colalillo explains. And he should know – when his father passed away in 1993, the company was hit with a huge estate tax bill. His father had done all the planning that he could, but the trusts he had established had not yet taken effect. The end result is that growth was put on hold for nearly the next seven years.
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> ***D'Agostino Supermarkets, Inc. (Larchmont, NY)*** – D'Agostino Supermarkets was founded in 1932, and in its early days survived both the Great Depression and World War II. But its current Chief Executive Officer, Nick D'Agostino Jr. can't help but wonder if it can survive the estate tax. Despite spending over $350,000 on estate planning, insurance premiums and legal bills and the active participation of all five of his children in the family business, the anxiety never really goes away. "The federal estate tax moves right along with each generation of your family and the potential liability increases the more successful you become until the amount of the deduction is no longer realistic," Mr. D'Agostino explains. D'Agostino's is internationally known as "New York's Grocer" and there can be no doubt that the third generation of the family is inheriting a proud legacy of service. Unfortunately, it looks like they will also be inheriting a less glamorous legacy faced by all family-owned businesses – the cost of the estate tax.
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> ***Chatham Food Center, Inc. (Chicago, IL)*** – Leonard Harris founded the Chatham Food Center in 1973 and remains one of only two African American food store operators in Chicago. In its 33 years, the Chatham Food Center has emerged as a keystone in its neighborhood. Mr. Harris has not only employed

hundreds of neighborhood kids in their first real jobs, he has also served as a mentor and living example of just what can be accomplished. It is a legacy anyone would be proud to pass on, but there is the very real possibility he will not be able to see a second generation take charge. “Cash resources to pay the estate tax, based on current valuation, would force my family to sell the store to pay the IRS…Our yearly earnings would not cover the payment of such a tax,” Mr. Harris explains. But the loss extends far beyond his family – what about the next generation of kids who will not be able to get jobs at the Chatham Food Center or the loyal customers who will have to travel further to get their groceries? They are victims of this tax as well.

Schnuck Markets, Inc. (St. Louis, MO) **–** Schnuck Markets was founded in 1939 and stands today as one of the industry’s estate tax survivors. The Schnuck family understood early on that in order to preserve the company they needed to make the significant investment required in estate and tax planning to try and weather the passing of the business from one generation to the next. Their Chairman and CEO Craig Schnuck explains that, “if we hadn’t begun estate tax planning in the 1970s, we probably would have had to sell our business in the 1990s” when the company’s surviving co-founder Donald Schnuck passed away. The company not only survived, but continued to grow, in spite of the burden placed on the family by the estate tax. But you can’t help but wonder how many jobs were never created and how many customers never served all because Schnuck Markets’ very success was penalized by the U.S. government. Today, the family continues to invest in extensive estate tax planning and is determined to pass the company down to future generations. But the uncertainty remains. “We think we’re covered now, but who knows for sure,” Craig Schnuck wonders.

Proponents of the estate tax often argue that it helps increase productivity and innovation by protecting against the creation of a leisured class. But the stories of these five companies illustrate the fallacy behind this argument. These are not aristocrats fighting to preserve the right of their children to live off of inherited family money. These are business people who want to preserve the companies they have spent a lifetime building and to see their children have the opportunity to take the business to new heights. The estate tax penalizes their success and makes a mockery of these dreams.

The estate tax, however, does not just hit owners; employees also feel its impact. Every store that does not get built – or worse, has to be sold - to pay an estate tax bill means lost jobs and less income security for the millions of employees in the grocery industry. For many of these workers, grocery stores represent their first real job and first real responsibility. According to the Bureau of Labor Statistics, 32 percent of all the jobs in the industry are held by people between the ages of 16 and 24. Where are these jobs and opportunities going to come from when stores are sold to pay the estate tax? Proponents of the tax often completely ignore the effect it has on employment, but for communities that are struggling to create good jobs, especially for young people, it looms as a very real threat.

Conclusion

For family-owned grocery stores and supermarkets, the estate tax is a constant threat that has a real impact on the day-to-day operations of their business. No matter how much these companies spend and plan to prepare for it, it is clear they are plagued by one constant doubt – "Have I done enough?" These business owners do not have the cash or liquid assets on hand to simply write a check and pay the government. Their companies and their lives are tied up in stores, inventories and hundreds of employees. For them, the estate tax often leads to painful and unfair trade-offs for their families, their suppliers and their employees. In the most extreme cases, when companies are sold to pay the tax bill, entire communities can be forced to bear the brunt of the estate tax.

The victims of the estate tax extend far beyond the next generation of owners and its impact ripples throughout the entire economy. Despite its relatively small contribution to the U.S. treasury, the tax looms disproportionately large in the operations of family-owned businesses. Congress needs to act now to end the estate tax to preserve family businesses, create strong communities and foster growth and innovation.

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