Testimony of

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On Behalf of

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(HARDI)

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Subcommittee on Select Revenue Measures

Hearing on the
Burden of the Estate Tax on Family Businesses and Farms

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Chairman Reichert, Ranking Member Neal and Members of the Subcommittee on Select Revenue Measures, my name is Karen Madonia, and I am the Chief Financial Officer and next generation of Illco, Inc., a Chicago-area distributor of heating, ventilation, air-conditioning and refrigeration equipment, parts and supplies. Thank you for giving me the opportunity to talk about the estate tax and its effect on the many small family businesses that comprise the United States economy. This is an issue that is very close to my heart as my family is in the midst of our own generational transfer.

Let me provide you with some background: Illco was a very small company with only seven employees when my father purchased it back in 1973. At that time, my dad was only 32 years old, with a wife, three daughters and a mortgage, but he knew he wanted something more than just a job. He wanted to use his passion to create something permanent, to be in control of his own destiny. With help from my grandfather, my dad decided to take a risk and go into business for himself. A community bank took my grandfather's assets, my dad's assets and a guarantee from a vendor as collateral for a $340,000 loan to purchase the company.

In those early years, my dad worked every job at Illco. During the day, he went to see customers and secure orders, then went back to the warehouse to pull and package them. The next day, he would make deliveries using my mom's station wagon before visiting more customers and taking more orders. Eventually, he was able to buy a truck and hire a driver, which left the station wagon free for my mom to pick up merchandise from Illco vendors while my sisters and I were at school. After the doors closed at 5:00, my dad would go to his office to perform both the accounts payable and accounts receivable functions. Every bit of profit he made got funneled back into the company so he could hire more people, buy more trucks and expand his inventory. My dad worked seven days a week, and most nights he did not get home until long after most people had finished their dinners. He had to give up any hobbies which took too much time away from his business, and our family vacations were mostly extended weekends because a week was simply too long for him to be away. Many weekends were spent entertaining customers, mostly over home-cooked meals, because that was the only way my parents could afford to wine and dine the people that were so necessary to the success of the business. But my dad's passion for the industry, his commitment to his employees, and his drive to grow his company empowered him to keep pushing even when interest rates hovered in the high teens during the late 1970's and early 1980's and things looked pretty ominous. Forty years later, he has a business with eight branches in three states, 97 employees and $42,000,000 in revenue.

My sisters and I grew up understanding that if we wanted to be successful at anything, we had to work hard and stay focused on our goals. We are all proud to work alongside our dad now, and look forward to making our own mark on the family business in the coming years. There is also a generation behind us that is just beginning to consider career options. Perhaps some of them will join us…that is certainly my hope. But after years of listening to us struggle to figure out how to grow the business while navigating the estate tax waters, I imagine that all of them will think twice before making that leap.

For the last few years, I have come to Washington with our trade association, HARDI, to talk to Members of the House and Senate about the issues that are important to our companies and our industry. Every year, estate tax is on the top of my list of topics to discuss. I personally find it fundamentally wrong to place a tax on death. If a person accumulates wealth through hard work, and if that person pays his fair share of taxes on income as it is earned, I do not understand how the government can justify taking a significant portion of what he has left simply because he opted to save and re-invest rather than consume. The United States has already benefited from that person's success because he has employed people who pay taxes, bought buildings on which he has paid property taxes and bought inventory and supplies from other companies, which can then afford to employ more people who pay taxes. He has created opportunity for the community as a whole while creating prosperity for himself. We all benefit when a small businessperson succeeds. To me, and probably to a large portion of the generation behind me, the estate tax serves as a tremendous entrepreneurial disincentive. Why work hard to build something substantial if it is likely to die when you do? Why not be just another worker, make enough money to live comfortably, and not worry about generating any more wealth than that? If even a small percentage of potential entrepreneurs decide not to turn their dreams into viable businesses because our tax policy discourages them from doing so, haven't we done a great disservice to our economy?

Proponents of the estate tax will tell you tell it prevents the concentrated accumulation of wealth in our country. They'll tell you that our nation needs to increase taxes on the "wealthy" because they need to pay their "fair share". On the surface, that's a pretty safe argument to make. It's easy to say the solution to our fiscal issues is to increase the burden on those who can afford it the most. But what's fair about paying taxes your whole life only to have to pay even more at death simply because you're leaving a business behind? What is always overlooked in these discussions is the effect of the estate tax on the small family business. In most cases, we're not talking about passing on bank accounts with multi-million dollar balances. We're talking about businesses where most of the net worth is tied up in inventory, accounts receivable, equipment and real estate. At Illco, for example, we carry an inventory valued at $12,000,000 and accounts receivable of about $5,000,000. Our inventory has to be high – we provide vital heating, air-conditioning and refrigeration parts and supplies to hospitals, schools, nursing homes and grocery stores. When the refrigeration system in a grocery store goes down, it needs to be repaired within hours or the food is lost. When the air conditioning system in a hospital doesn't work, patients cannot be appropriately cared for until air is circulating again. The parts and supplies that we sell must be on hand in order to facilitate quick repairs and replacements, which means that we must carry a heavy inventory. We also own five buildings and operate a fleet of twenty-four trucks, some of which cost upwards of $250,000. After paying our taxes and making our annual profit sharing contribution to our employees, the income that's left is put right back into the company so we can continue to carry an extensive inventory, extend payment terms to our customers and maintain our fleet and our buildings. If something happened to my dad and we were left with a large estate tax bill, we would literally have to sell parts of the company in order to pay it. That would likely mean shutting down branches, laying off workers or liquidating inventory just to be able to pay a tax bill that only occurred because an owner died. Even worse, our company might have to be sold outright, which would likely mean that instead of our employees being part of our small business family, they would become part of a larger company that is beholden to Wall Street. That would not benefit them, and I would argue that it wouldn't benefit the economy as a whole either. Small businesses employ over half of the nation's private sector workforce and create the vast majority of new jobs. With our economy in a relatively slow recovery, government should be encouraging us to grow and prosper. Instead, worry over the estate tax forces us to spend too much time and money focusing on things that have nothing to do with our businesses.

Over the last few years, my dad has spent countless hours and entirely too much money trying to figure out how his company can outlive him. Instead of focusing on growing his business so he can open more branches and employ more people, he has had to strategize about how to pass his company on to his kids without having to dismantle it. Most of our strategic management decisions, whether they are about day-to-day operations or opportunities to expand, involve consideration of the estate tax in one way or another. We have opted to maintain a large cash reserve as a precaution. Other companies choose to protect themselves by purchasing insurance. Either way, money that could be used to grow and create jobs is sitting on the sidelines. The estate tax is a huge roadblock to successful family businesses undergoing generational transfers. Think about that…perhaps the greatest challenge in transitioning a business from one generation to the next is our own tax code.

The United States has always been the land of opportunity. Small business owners take tremendous risk at great personal sacrifice, and they truly are the backbone of the American economy. No one is asking for it to be easy. In fact, my dad would probably be the first to tell you that working to overcome the challenges is the most rewarding part of owning your own business. But it shouldn't be the case that the thing that keeps you up at night is the worry that you may leave your kids with a huge tax burden when you die. I believe that most people would be proponents of an overhaul to our tax code. There probably are too many exemptions and loopholes that only upper income people can take advantage of, and those topics are worthy of a national conversation. But taxing the estates of successful entrepreneurs is punitive, and that is not the role that our tax code should play.

Two years ago, when Congress last addressed the issue of the estate tax, you gave the small business community some certainty by establishing an exemption and indexing it to inflation. While we still maintained that full repeal was the right answer, we appreciated that you understood that changing the rules on us every year made it impossible for us to properly plan for the future of our businesses. I respectfully ask that you again carefully consider all the ramifications of estate tax policy and then vote, once and for all, to permanently repeal the estate tax. Let's encourage families to create wealth by starting their own businesses, not threaten to take it away from them if the government thinks they have accumulated too much. Let's unleash the potential of those citizens willing to work hard and create something that will benefit all of us, not discourage their ambition through our tax code.

Thank you for the opportunity to share my family story with you. I would be happy to answer any questions that you may have.