4-28-2017

Testimony in Absentia Before The Committee on Agriculture United States House of Representatives Washington, D.C. March 15, 2017 (Part 2)

Neil E. Harl
Iowa State University

Follow this and additional works at: https://lib.dr.iastate.edu/aglawdigest

Part of the Agricultural and Resource Economics Commons, Agricultural Economics Commons, Agriculture Law Commons, and the Public Economics Commons

Recommended Citation
Available at: https://lib.dr.iastate.edu/aglawdigest/vol28/iss9/1

This Article is brought to you for free and open access by the Journals at Iowa State University Digital Repository. It has been accepted for inclusion in Agricultural Law Digest by an authorized editor of Iowa State University Digital Repository. For more information, please contact digrep@iastate.edu.
Testimony in Absentia Before The Committee on Agriculture United States House of Representatives Washington, D.C. March 15, 2017 (Part 2)

-by Neil E. Harl

Note from the Editor: In early March, the Committee on Agriculture of the United States House of Representatives asked Dr. Harl to testify at a hearing then scheduled for March 15 in Washington, D.C. on Tax Policy. An expected severe snow storm that week caused the Hearing to be postponed to April 5. Because of the health of Dr. Harl’s wife, necessitating intensive care, the Committee agreed to receive his testimony in writing rather than in person. The first four topics covered by Dr. Harl were published in the previous issue; the last three topics are covered in this issue of the Digest. Robert P. Achenbach, Jr., Editor

The “small partnership” exception

In my opinion, one of the key issues in the taxation arena is whether we are capable of simplifying the tax system. In 1967, I was asked to join a small group which was convened by the Department of the Treasury to advise the Department of how to address “tax sheltering” which was sweeping the agricultural sector. The lure of investment tax credit, fast depreciation and other more subtle practices were coming to influence economic practices, especially in livestock. Our group made several recommendations which were mostly enacted in 1969, 1976, 1981 and 1986. However, the tax committees (and IRS) in the 1970s reached the conclusion that the villain was partnerships, principally limited partnerships. Those organizational structures were present in many of the tax shelters. The outcome was that Congress became convinced that it was necessary to “get tough” with partnership taxation and weed out the unacceptable behaviors. However, a group of Senators and Members of the House of Representatives concluded that the “get tough” policy with partnerships would make life very difficult for small partnerships. That group convinced the Congress to accept an amendment to simplify tax filing for small businesses.

The amendment passed and was part of the Tax Equity and Fiscal Responsibility Act of 1982. The nine-line amendment stated, in I.R.C. § 6231(a)(1)(B)(i) –

“The term ‘partnership’ shall not include any partnership having 10 or fewer partners each of whom is an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner.”

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
Essentially, it meant that a “small partnership” did not have to file a Form 1065 and the income, losses and credits simply flowed through to the taxpayers’ Form 1040s. Moreover, the resulting entity avoided the highly complicated restrictions imposed on regular partnerships. It turned out that it was undoubtedly the most significant tax simplification move in decades.

Over the years, I covered the subject in what eventually became my 669 page seminar manual in about 3,400 seminars. I detected rumbles of resistance among some practitioners, mainly CPAs, often citing that it adversely affected “their bottom line.” My response often was “a professional in practice should focus attention on what is in the best interests of the client, not on what is in the best interests of the practitioner.”

However, a group of unhappy tax practitioners – principally in the Pacific Northwest and Midwest—managed to convince a Member of the House of Representatives to push through an amendment to the Bipartisan Budget Act of 2015, carefully camouflaged, repealing the “small partnership” exception effective after December 31, 2017. There were no hearings, no warnings of what was being plotted and no hint of the fact that it would eliminate the most significant tax simplification move in decades.

The Joint Committee on Taxation proved to be the barrier to getting the 2015 amendment eliminated. The staff insisted all last year that “there is no such thing as a small partnership.” We set out to prove that there was such a thing with an article in Tax Notes, page 1015 of the August 15, 2016 issue; the fact that IRS has embraced the small partnership with IRS Publication 541, January 2016, which details the opportunities to make use of the “small partnership” exception, at page 13; by publishing Revenue Procedure 1984-35, 1984-1 C.B. 509; by reproducing the content of that Revenue Procedure in the IR Manual, IRM 20.1.2.3.3.1, and by litigating in more than 20 cases involving various issues with the “small partnership.”

It is our belief that if the “small partnership” is reinstated, it will become the dominant entity for eligible small partnerships. Reinstatement would not affect federal revenues (the tax rates are the same to file a Form 1065 with the information as to file a complex Form 1065). At a time when many farm and ranch operations are struggling financially because of the low market prices for many of the commodities, the savings would be welcomed. The going rate for filing a complete Form 1065 varies but runs in the vicinity of $2,000 to $2,500 or more.

**What about a “flat tax”**?

The idea of a “flat tax” has been around for nearly 30 years. A colleague and I wrote an article evaluating that possibility. Our conclusions were that the revenue would fall well short of the revenue needed to maintain programs at the level the public has been accustomed, it would impose a heavy tax burden on lower tax bracket taxpayers and it would distort economic decision making with full deductibility of expenditures, at least for many investments. Our conclusion was that the idea did not deserve serious attention.

**Repealing the Rule Against Perpetuities**

Finally . . . a word or two about an ancient concept (that is, it is ancient to many of us) that has its origins in the Duke of Norfolk’s Case in the late 17th Century in England. The case involved disagreements among the heirs of the Duke of Norfolk over the propriety of leaving property in successive life estates. The court agreed that it was wrong to tie up property beyond the lives of persons living at the time the property was last conveyed, although the exact time beyond which conveyances were nullified was not determined until roughly 150 years later. As a practical matter, the Rule Against Perpetuities (as it is known) places limits on how long property can be held in trust. Stated simply, property generally could not be held in trust beyond the lifetimes of a designated class of individuals plus 21 more years. As a practical matter, the Rule allows property ownership to be tied up for 100 to 125 years.

Until about 40 years ago, each of the states in this country had enacted language embodying the Rule. After South Dakota, under the leadership of their then Governor Janklow broke ranks and repealed the Rule in that state, 30 more states have acted to repeal or modify the Rule. However, 19 states have held out with those states believing that it is not in the public interest to eliminate the Rule and allow property ownership to be tied up forever.

Professor Lewis Simes, a well-known legal scholar articulated two reasons for the Rule in contemporary society – (1) first, the Rule strikes a fair balance between the desires of the present generation, and similar desires of succeeding generations, to do what they wish with the property which they enjoy; and (2) a second and even more important reason for the Rule is that it is socially desirable that the wealth of the world be controlled by its living members and not by the dead. To those two I have added a third – it is an article of faith that economic growth is maximized if resources at our disposal are subject to the forces and pressures of the market. Prices emanating from free, open and competitive markets are the best way to allocate resources and distribute income.

However, it is a bit sobering to envision a world economy in a couple of hundred years where the ownership of property that is held by a bunch of trusts physically located half a world away with those not benefitting from ancestors who left property in trust forever unable to acquire land to farm, houses in which to live or real estate for other ventures except as tenants.

Fortunately, my wife and I live in a state that has three times since 1999 voted to retain the Rule. In my view, our generation inherited the best economic system and the best legal system in the world. To repeal the Rule would be a step backward. The Administration in 2011 took steps to place a limit on how long property can be held in trust. We would be wise to review carefully whether that limit should be imposed everywhere. Thank you!