Keeping It All In The Family

If you own a family business or form at your death, and your estate qualifies, it may eligible for the qualified family owned business ("QFOB") deduction. Now, effective for estates of individuals dying after December 31, 1997, an estate tax deduction exists for a qualified family-held business. This deduction is designed to help prevent the liquidation of family-held farms and businesses in order to meet the estate taxes due.

The qualified family-owned business deduction will allow a family-owned business or farm to pass estate tax free to heirs if its value does not exceed $1.3 million. This deduction is in addition to the $1 million applicable exclusion amount (previously called the "unified credit") and signifies a potential $1.3 million benefit afforded a taxpayer with a family-owned business or farm.

The qualified family owned business deduction is similar to another IRS provision that was also designed to help keep the family business or farm in the family. This other provision is the special use valuation. Under the special use valuation, if the family owned business or farm qualifies, it will be valued on its actual use, rather than at its highest and best use. The qualified family owned business deduction may be taken in addition to using the applicable exclusion and applying a special use valuation.

A qualified family-owned business interest is any interest in a trade or business, in whatever legal form. This may be a sole proprietorship, partnership or corporation. A corporation, however, may not be eligible if its stock is publicly traded. The principal place of the family-owned business must be in the United States, and the ownership must be held (1) at least 50% by one family, (2) 70% by two families or (3) 90% by three families. If held by more than one family, the decedent's family must own at least 30% of the trade or business. To qualify for the exclusion, the value of the decedent's qualified family-held business interests must be at least 50% of the decedent's estate. The decedent must be a U.S. citizen or resident at the time of death.

Be aware that transfers of nonbusiness assets (such as investment and personal assets) to a spouse made within 10 years of the decedent's death may be included in the decedent's estate for purposes of calculating the 50% limitation. Similarly, transfers to others must have been made more than three years before the decedent's death to escape inclusion. Non-taxable transfers of assets to family members and any other person that qualify for the annual gift tax exclusion (gifts under $11,000) do not count toward this three year test.

Since the purpose of the deduction is to help preserve family businesses, a qualified heir or a member of a qualified heir's family must participate in the business for 10 years after the decedent's death. In addition, the decedent or a family member must have owned and materially participated in the trade or business for at least five of the eight years prior to the decedent's death. The tax benefits allowed may be subject to recapture if the participation requirements are not met or the qualified heir sells the business or a portion of the business.

Of course, this brief article is no substitute for a careful consideration of all of the advantages and disadvantages of this matter in light of your unique personal circumstances. Before implementing an estate planning strategy involving a family-owned business or farm, contact and consult with your Financial Advisor, estate attorney and tax professional.

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