

## **Navigating the Estate Tax Deduction for Family-Owned Business Interests**

### **Abstract**

Under 1997 legislation, substantially revised and renumbered as Internal Revenue Code sec. 2057 in 1998, a special estate tax benefit is now available to some estates containing a qualified family-owned business interest (QFOBI). Although often described as providing a \$1.3 million estate tax exclusion for family-owned business interests, sec. 2057 is actually far more modest in scope. The actual benefit is only the amount by which \$1.3 million exceeds the applicable exclusion amount otherwise available. Stated differently, the combined estate tax exclusion provided by the applicable exclusion amount and the section 2057 deduction will equal up to \$1.3 million.

Sec. 2057 has numerous requirements that must be met in order for an estate to benefit. These include requirements that the decedent must be a U.S. citizen, the business must be principally located in the United States, and the business entity cannot have been readily tradable on an established securities market within three years of the decedent's death. Additionally, there is a minimum portion of the business that must be family-owned. Transfers to non-family members and other failures to meet the requirements of sec. 2057 after the decedent's death may trigger recapture of the sec. 2057 benefits. Importantly, the law contains a "liquidity test," that states that the value of the QFOBI must exceed 50 percent of the decedent's adjusted gross estate. With all its restrictions, however, sec. 2057 and the QFOBI deduction should still be taken into account when doing estate planning for the owner of a predominantly family-owned business. This includes incorporating sec. 2057 considerations into decisions related to lifetime gifts, both of family-owned business interests and other assets. In particular special attention needs to be given to estate planning for a married couple, both as to drafting of testamentary documents and allocation of assets.

For all the complexity that sec. 2057 involves, a tax advisor needs to be aware of these rules, and learn how to optimize their effects. There are many variables that must be weighed before the client and the planner can definitively decide whether sec. 2057 is reasonably feasible given the circumstances of the particular estate. When applicable a family-owned business owner with proper planning can maximize long-term tax savings from sec. 2057, both at the death of the business owner himself or herself, and at the subsequent death of the business owner's spouse.