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## SPECIAL USE VALUATION AND INSTALLMENT PROVISIONS

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Several of the prior articles in this series have discussed estate and gift tax provisions which have general application. This article will be more specialized. For farmers and owners of other closely held businesses, planning can be important to meet the requirements of some special estate planning provisions, such as, "special use valuation" and "installment payment of federal estate tax". These provisions can substantially reduce the estate tax burden and/or facilitate the liquidity of the estate. As indicated, both of these provisions are available to farmers and owners of other closely held businesses.

The first provision, "**special use valuation**", allows the estate to value real property used in a business on the basis of the property's value in its current use, such as farming, rather than its fair market value. This provision can be used to reduce the gross estate up to a maximum of \$840,000. To qualify for special use valuation, in addition to the decedent being a U.S. citizen or resident, the following are some of the conditions which must be met. First, the value of the business assets (both real and personal property) net of related debts, must be at least 50% of the gross estate net of debts. Second, at least 25% of the adjusted gross estate must be qualified business real property. Third, the real property qualifying for the special use valuation must pass to a qualified heir or heirs. Fourth, the real property must have been used in the business for five of the last eight years prior to the decedent's death. Fifth, the decedent or a member of the decedent's family must have participated materially in the

business for 5 of the last 8 years before the decedent's retirement, disability, or death.

For an individual with substantial non-business assets or situations where major restructuring of assets are being considered, timely planning with the individual's estate planning team can help insure the estate will qualify for the special use valuation. The members of the team might suggest annual gifting or the sale of non-qualifying assets, and/or perhaps the purchase of additional qualifying assets. Early planning and continued monitoring of one's estate can pay substantial dividends with regard to the special-use valuation provision.

For special use valuation, a qualified heir is considered to be a member of the decedent's family, including spouse, parents, brothers, sisters, stepchildren, and spouses or lineal descendants of these individuals. Retiring farmers and surviving spouses interested in qualifying their real estate for special use valuation should review the requirements for "material participation" and "active management" with their tax planners. Another important note is that the step-up in basis of the property for which special-use valuation is elected is limited to the special-use value rather than the fair market value date of death.

The second provision to be reviewed is the **installment payment** provision for the payment of estate taxes. This provision allows the executor, if certain requirements are met, to defer the payment of qualified federal estate taxes for 4 years, and thereafter, paying the tax in 10 annual installments. The basic requirement of this provision is that the closely held farm or other closely held business, makes up more than 35% of the adjusted gross estate. In addition, to the extended payment period, another attractive feature of this provision is that the interest rate on the unpaid estate tax is only 2 percent on the unpaid tax attributable to the first \$1,120,000 of taxable

estate involving farm or other closely held business property. The interest rate charged on the amount of deferred estate tax in excess of the \$1,120,000 described above is defined as 45 percent of the rate applicable to underpayments of federal tax.

This installment provision is available to an estate regardless of size. In order for business property to meet the 35% of adjusted gross estate, annual gifting or use of the unlimited marital deduction for lifetime gifts might be used as means of slimming down the non-business assets of a business owner's estate. Additionally, the sale of non-business assets and purchase of additional business assets might be considered.

Special use valuation and installment payment provisions can offer substantial estate tax savings and provide added liquidity during this period of transition of a family business from one generation to the next. However, if the benefits of these provisions are to be maximized, creative and timely planning will frequently be required to meet and maintain compliance with the requirements of these provisions.