Ask The Lawyer

by Daniel N. DeFio
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THE DEATH TAX: A Plague on Small Business?

Just over a year ago, the President signed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) into law. While this legislation encompassed large tax reforms in several areas, one of the most debated and heavily focused portions of the measure dealt with the relief from the death tax.

Prior to its passage, I watched CNN, MSNBC and other media sources to get my fill of the arguments people made both for and against the “elimination of the death tax.” I never fully understood what the fighting was about, since more than 200 years ago, Poor Richard prophesied that you can always count on death and taxes, and to me the two together just seemed to be a natural fit. But one of the most impassioned arguments that I found was made for the elimination of the death tax is that it destroys small businesses. I heard horror stories of poor widows who had to liquidate (at rock bottom prices, of course) their husband’s life work in order to pay Uncle Sam.

Well, the death tax is now on death row, scheduled for termination in 2010. Small- business owners can now breath easy that if they unfortunately pass away, their life’s work will not be liquidated. Or will it? Let me give you a little information which may help to sort out some of these arguments.

First, the federal death tax is still very much alive. Second, when the death tax is eliminated in 2010 (if it actually happens), it will be replaced with a capital gains tax that will apply when assets over a certain value are sold. Third, EGTRRA is scheduled to “sunset” or terminate in the year 2011, unless Congress takes action to reenact its provisions.

When I say the federal death tax is very much alive, I mean that the provisions of the act are designed to give relief over a period of years. Government officials need a few years to figure out how to pay for the relief that was so generously granted.

Since the federal government has not yet relieved the American people of the federal estate tax, there is still relief that is allowed under the current tax code for small-business owners, with proper planning. Here’s a quick primer on some of the techniques still available to the estates of small-business owners.

The “unlimited martial deduction” allows an individual to pass to their spouse an unlimited amount of assets during life or upon death. If the main concern is the welfare of the surviving spouse, then this is an invaluable provision. Second, the unified credit, which allows up to $1 million to pass to children and other beneficiaries without incurring an estate tax is generous enough to shelter many small businesses from this tax. When these simple forms fail, there are other provisions in the tax code that provide relief solely to small businesses, but they are more complicated.

A “qualified family owned business” of up to $1.3 million may be passed upon death to family members who are involved in the business and continue to be involved for a period of 10 years after death. The provisions of this section are very complicated, and only available to estates where the business interest comprises more than 50% of the gross estate. If family members of a younger generation are involved in the business, do not overlook this potentially beneficial section.

Another provision of the tax code allows for real property used in farming or other business ventures to be given what is know as “special use value.” For instance, if 100 acres of real property is being used in the operation of a farm, but would have a higher fair market value as subdivided residential real property, the IRS will allow the lower value to be allocated to the land for estate tax purposes, provided that land is continued to be used for farming.

Even, if with the aforementioned provisions, your estate will still be subject to a tax, the federal law does allow an estate, of which more than 35% of its value is comprised of a closely held business, to pay the tax over time (up to 14 years) rather than forcing heirs to liquidate the business.

Rumors of the death of the estate tax have been greatly exaggerated, but with proper planning and sound advice, there are ways to inoculate the estate of a small-business owner from the plague of death taxes. ❑

Small-Biz Snapshot

Small-business owners in Central and Western New York were asked to cite the two most important reasons for their current business location:

54% Owner/family reside in community
38% Proximity of market and clientele
25% Quality of life/standard of living
24% Low rent or property costs
12% Potential for market growth
9% Lack of competitors
3% Availability of quality suppliers and vendors
3% Transportation costs/infrastructure
2% Low labor costs
2% Quality labor pool

Source: Buffalo branch — Federal Reserve Bank of New York and Center for Governmental Research, Inc.