



ESTATE TAX DEFERRAL FOR ESTATES INCLUDING A CLOSELY HELD BUSINESS

A special estate tax deferral election is available for Federal estate tax if more than 35% of your estate is comprised of a closely-held business. If your estate qualifies, such tax is deferred for up to five years and is then subsequently paid off over a ten-year period. Interest on the deferred amount, subject to a limitation discussed below, is set at only 2%. As President Barack Obama has already indicated his opposition to estate tax repeal and his desire to retain the current exemption amount and tax rate (\$3,500,000 and 45% in 2009), the estate tax deferral election remains a relevant and useful tool for managing the estates of closely held business owners.

Qualification For Deferral

1. The Business Interest Test.

The business interest must be one of the following:

- If you own the business as a sole proprietor, you satisfy this test;
- If your business was conducted in partnership form, you satisfy this test if either: (i) there were no more than 45 partners; or (ii) you had at least a 20% capital interest; or
- If the business was conducted as a corporation, you satisfy this test if either: (i) there were no more than 45 shareholders; or (ii) your owned at least 20% of the corporation's voting stock.

In applying the 45 partner or shareholder test, above, interests or shares owned by your spouse, siblings, ancestors, and descendants are treated as owned by you. Additionally, any jointly-owned interest by a married couple is counted as one partner or shareholder.

Example (1). John Smith's adjusted gross estate (as defined below) is \$5 million. Included in his estate is a partnership interest valued at \$2,000,000 (i.e., 40% of the estate). However, there are 48 partners in the partnership (unrelated to M), and M held only a 16% interest. Result: M's estate does not qualify for the deferral provisions.

The Closely Held Business Team attorneys at Harrang Long Gary Rudnick are committed to serving the needs of business owners in a responsive and proactive manner. They understand the challenges and the opportunities provided by the law in today's business climate, and are focused on the advancement of each client's success in business.

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Example (2). The facts are same as in Example (1) except that M's wife, brother, sister, father and mother were among the 48 partners in the partnership. These five interests plus M's are treated as a single interest. There are only 42 other partners. Thus, there would be only 43 partners and M's estate would qualify for deferral.

2. The 35% Test.

If your business interest qualifies, its value (if you own more than one business you can combine them to satisfy this test) must exceed 35% of your "adjusted gross estate." (The adjusted gross estate is defined as the gross estate minus deductions for expenses, debts, taxes and losses.)

How much estate tax qualifies for deferral?

If the above two tests are satisfied, the portion of the federal estate tax bill allocable to the qualifying business interest is deferred.

Example. M's estate's tax bill is \$1 million. The amount included for the qualifying business interest was 38% of the total adjusted gross estate. Thus, 38% of \$1 million, or \$380,000, qualifies for deferral.

How much of the tax being deferred qualifies for the 2% interest rate?

The special 2% rate applies to the portion of the deferred estate tax attributable to the first \$1,330,000 (subject to adjustment for inflation) in taxable value of the closely held business. The first \$1,330,000 in "taxable value" is the first \$1,330,000 above the applicable exclusion amount. For example, if the current estate tax exemption amount equals \$3.5 million, the amount of estate tax attributable to the value of the closely held business between \$3.5 million and \$4,830,000 is eligible for the 2% interest rate. Please be aware that the interest paid is not deductible for estate or income tax purposes.

If you have questions concerning whether you qualify for estate tax deferral mechanism, please contact our closely held business members Randall L. Duncan, Douglas S. Chiapuzio or Jonathan D. Mishkin, LL.M. at (503) 242-0000, and we will be glad to assist you.

Nothing in this communication creates or is intended to create an attorney-client relationship with you, constitutes the provision of legal advice, or creates any legal duty to you. If you are seeking legal advice, you should first contact a member of the Closely Held Business Team with the understanding that any attorney-client relationship would be subsequently established by a specific written agreement with Harrang Long Gary Rudnick P.C. To maintain confidentiality, you should not forward any unsolicited information you deem to be confidential until after an attorney-client relationship has been established.

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