

## Estate tax special use valuation election

Dear Reader:

For estate tax purposes, property must generally be valued at its value for its "highest and best" use. This means, for example, that if real estate could be sold for \$1 million to developers who will build a shopping mall on it, that's the value for estate tax purposes, even if the decedent and his family were using it as farmland or in a family business, and its value as farmland (or as business property) was only \$600,000.

In an attempt to save families from having to sell farms or closely-held (family) businesses to meet estate tax obligations, the estate tax law allows a decedent's executor to elect "special use" valuation for estate tax purposes. If a series of tests are passed, the real estate described above can be valued at just \$600,000 in the gross estate. Here are the tests:

1. The real estate in question must pass from the decedent to a "qualified heir." This heir can either inherit it or buy it from the estate. Qualified heirs include the decedent's ancestors (parents, grandparents), spouse, and lineal descendants (children, grandchildren). They also include the lineal descendants of the decedent's spouse or parents, and the spouses of the lineal descendants.
2. For five of the eight years leading up to the decedent's death, the realty must have been used in a farm or family business on or in which the decedent or a family member worked ("materially participated").
3. (i) The real and personal property in the business or farm included in the decedent's estate has to comprise at least 50% of the gross estate, and (ii) the real property in the business or farm included in the decedent's estate has to comprise at least 25% of the gross estate. (For these purposes, the realty is valued at its "high" value, e.g., \$1 million in the example given in the first paragraph above.) In meeting these tests, two or more qualifying businesses can be combined as long as they all have real estate included in the decedent's estate.
4. The qualified heir must consent (with IRS) to be liable for all of the estate taxes saved if, within ten years, the property is transferred to anyone other than a qualified heir (of the first qualified heir) or if the property stops being used for the qualified purpose (for example, if it's sold to an outsider or is developed by the family as a shopping mall).
5. Even if the property qualifies for special use valuation, the property's value can't be reduced by more than \$1 million (for estates of decedents dying in 2009).

*Example (1).* Land with a highest and best use value of \$3 million qualifies for special use valuation as farmland, and has a value as farmland of \$2.5 million. If the election is made, the land is valued in the gross estate at \$2.5 million, its value as farmland.

*Example (2).* Land with a highest and best use value of \$3 million qualifies for special use valuation as farmland, and has a value as farmland of \$1.8 million. If the election is made, the land is valued in the gross estate at \$2 million (\$3 million - 1 million). You can't bring it all the way down to its farmland value of \$1.8 million, because you can't reduce its highest and best use value by more than \$1 million.

If you are involved with an estate that may qualify for the election, or are interested in undertaking estate planning with the goal of making a future estate qualify, please call and I will be happy to assist you.

