

Closely-Held Businesses and Farming Property: Opportunities for Deduction and Deferral of Washington State Estate Tax

By William Friedman

With the passage of the Tax Cuts and Jobs Act of 2017, the threshold at which individuals must pay federal gift or estate tax increased to \$11,180,000 (\$22,360,000 for married couples) for 2018. While this increase is scheduled to phase out in 2026, during the next eight years very few people who die will pay federal estate tax.

However, the Washington estate tax still applies to individuals living in Washington and to those who own Washington property at death. With the threshold at which individuals must pay Washington estate tax set at a relatively low \$2,193,000 for 2018, deductions and deferral of Washington estate tax become even more important. Here are three opportunities to note:

Washington Farm Deduction

An unlimited deduction is available to Washington estates for the value of farms (defined broadly to include vineyards, timberland, nurseries, ranches, etc.) and related personal property meeting certain requirements. Very generally, qualifying property must (1) make up at least 50 percent of the estate of the person who has died, (2) have been used for farming by that person or a family member at death, and (3) pass to a qualified heir (including spouses and descendants). Special rules apply to real property, which generally must make up at least 25 percent of the estate and have been owned and used for farming for at least five of the eight years prior to death, with material participation by the deceased person or a family member during that time. Farm property may qualify for the deduction even if owned in a corporation, partnership, or LLC.

Qualified Family-Owned Business Interest Deduction

A deduction of up to \$2.5 million is available for Washington estates owning qualified family-owned business interests that meet certain ownership requirements. To qualify for the deduction, such businesses must also exceed 50 percent of the estate of the person who has died. In addition, the deceased person or a family member must have owned and materially participated in the operation of the business for five of the eight years prior to death. The value of the deceased person's interest in the business generally cannot exceed \$6 million; however, with proper pre-death planning it may be possible to take advantage of the deduction even if the deceased person owns more than \$6 million of family-owned business interests. The business must be acquired from the deceased person by a qualified heir (including spouses, descendants, and key employees). Qualified heirs must meet certain requirements for the three-year period following the deceased person's death, or risk being liable for a portion of the business's deduction-related tax savings.

Washington Estate Tax Deferral

The portion of Washington estate tax attributable to an interest in one or more closely held businesses can be deferred for up to 14 years at relatively favorable interest rates. Very generally, interests in sole proprietorships, partnerships, and corporations may qualify if the entity carries on a trade or business and the business interests make up at least 35 percent of the estate of the person who has died. Partnerships and corporations must have 45 or fewer partners or shareholders, and at least 20 percent of the capital interest or value of the voting stock, respectively, must be included in the estate. Qualification for this estate tax deferral can be complex, and thought should be given during life to how best to structure holdings in a trade or business, and whether and to what extent an individual should make lifetime transfers of business interests, to avoid unintentionally undermining estate tax deferral.

With proper planning, it may be possible to significantly reduce the amount of Washington estate tax due at death, and to defer payment of that tax for several years after death.

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