

# Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

by Martha Eller Gangi and Brian G. Raub

**W**ith the enactment of several legislative provisions, the U.S. Congress has sought to protect family-owned farms and closely held businesses by lessening the burden of the Federal estate tax, a progressive tax on the transfer of wealth at death. These provisions have included: special use valuation--the valuation of property at its actual, rather than its potential, use in a family enterprise; the qualified family-owned business deduction; and the deferral of Federal estate tax liabilities [1]. Special use valuation and the qualified family-owned business deduction each reduce the taxable estate, the amount to which graduated estate tax rates are applied, and, ultimately, an estate's tax liability. The deferral provision allows an estate to defer the portion of estate tax that is attributable to the decedent's closely held business and pay the balance in installments.

For decedents who died in 2001, the population to be examined in this article, about 1,800 estates, or 1.7 percent of the estate tax decedent population, elected to use at least one of the three special business provisions. A total of 831 estates elected special use valuation, alone or in combination with the business deduction or deferral of estate taxes; 1,114 estates claimed the qualified family-owned business deduction, alone or in combination with special use or deferral of taxes; and 382 estates elected to defer estate taxes, alone or in combination with the other two business provisions.

Figure A shows the elections and combinations of elections employed by estates of 2001 decedents. Of the estates that elected at least one provision, the most predominant election was the qualified family-owned business deduction alone, with 656 estates that claimed the deduction. The second largest election was special use valuation alone, with 425 estates that elected the provision. Estates elected both special use and the qualified family-owned business deduction in 332 cases. Rarely, estates elected all three provisions, only in 21 cases. Some differences by size of gross estate are notable. Of those estates that utilized a special business provision, smaller estates tended to elect only the qualified

family-owned business deduction, while larger estates tended to elect only the deferral of taxes.

This article presents a description of Federal estate tax law in effect for the estates of 2001 decedents, a brief overview of the estate tax decedent population, and an examination of each of the three business provisions available to estates of 2001 decedents. The subpopulations of estates that utilize each of the provisions will be compared to the subpopulations that do not utilize the provisions in an effort to identify possible differences between the groups.

In most of the figures included in this article, coefficients of variation (CVs) are provided [2]. A CV is a statistical measure that shows the magnitude of potential sampling error for an estimate. Generally, only those comparisons for which a statistically significant difference can be demonstrated between subpopulations are highlighted.

## Background: Federal Tax Law and the Estate Tax Decedent Population

The estate of a decedent who, at death, owns assets valued in excess of the estate tax applicable exclusion amount, or filing threshold, must file a Federal estate tax return, Form 706, *U.S. Estate (and Generation-Skipping Transfer) Tax Return*. For decedents who died in 2001, the exclusion amount was \$675,000. For estate tax purposes, the value of property included in gross estate is fair market value (FMV), defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of all relevant facts," according to Regulation 20.2031-1(b) of the Internal Revenue Code (IRC) [3]. The gross estate consists of all property, whether real or personal, tangible or intangible, including "all property in which the decedent had an interest at the time of his death and certain property transferred during the lifetime of the decedent without adequate consideration; certain property held jointly by the decedent with others; property over which the decedent had a general power of appointment; proceeds of certain insurance policies on the decedent's life; dower or curtesy of a surviving spouse; and certain life estate property for which the marital deduction was previously allowed" [4]. Specific items of gross estate include real estate, cash, stocks, bonds, businesses, and decedent-owned

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**Figure A**

**Election of Special Business Provisions, by Size of Total Gross Estate**

Size of total gross estate	Total number of estates	Election of business provisions <sup>1</sup>							
		No elections	SUV only	QFOBI only	DOT only	SUV and QFOBI	SUV and DOT	QFOBI and DOT	SUV, QFOBI, and DOT
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
<b>All estates.....</b>	<b>108,330</b>	<b>106,519</b>	<b>425</b>	<b>656</b>	<b>221</b>	<b>332</b>	<b>52</b>	<b>105</b>	<b>21</b>
Small (\$675,000 under \$2.5 million).....	93,322	91,892	385	578	99	303	28	25	12
Medium (\$2.5 million under \$5.0 million).....	9,977	9,769	28	52	39	25	14	44	6
Large (\$5.0 million under \$10.0 million).....	3,454	3,329	**12	21	55	**4	**10	20	**3
Very large (\$10.0 million or more).....	1,578	1,529	**	5	28	**	**	16	**

\*\*Data combined to prevent disclosure of individual taxpayer data.

<sup>1</sup> Special use valuation is abbreviated as "SUV," the qualified family-owned business interest deduction is abbreviated as "QFOBI," and the deferral of taxes is abbreviated as "DOT."

NOTES: Detail may not add to totals due to rounding.

life insurance policies, among others. Assets of gross estate are valued at a decedent's date of death, unless the estate's executor or administrator elects to value assets at an alternate valuation date, 6 months from the date of death, described in IRC section 2032. Alternate valuation may be elected only if the value of the estate, as well as the estate tax, is reduced between the date of death and the alternate date. The estate tax return is due 9 months from the date of the decedent's death, although a 6-month filing extension is allowed.

In 2001, some 108,330 individuals died with gross estates above the estate tax exclusion amount of \$675,000 in assets. These decedents owned more than \$198.8 billion in total assets and reported almost \$20.8 billion in net estate tax liability. Decedents for whom an estate tax return was filed represented 4.6 percent of all deaths that occurred for Americans during 2001, according to vital statistics data collected by the U.S. National Center for Health Statistics. Estate tax decedents for whom a tax liability was reported, 49,845, represented 2.1 percent of the American decedent population for 2001[5].

## Liquidity

The special use valuation, qualified family-owned business deduction, and deferral provisions place constraints on the use of property by heirs, in exchange for reduced or deferred estate tax liabilities. The desire and ability of heirs to continue in the family enterprise is an important determinant of an estate's use of these special provisions. In addition, the value of a closely held business or farm must constitute a significant percentage of the estate to be eligible for the provisions. Thus, the availability of liquid assets

may also be an important factor in an estate's decision to elect any of the three business provisions discussed in this article. Liquid assets are defined as cash and assets that can be quickly converted into cash at low cost. In this article, liquid assets include cash, State and local bonds, Federal Government bonds, publicly traded stock, and insurance on the life of the decedent owned by the decedent and included in the total gross estate. As the following sections of the article will show, estates that claimed any of the three business provisions had, on average, significantly less liquidity than estates that did not claim a provision.

In several sections, this paper uses a measure called the "liquidity ratio" to compare estates that claimed an estate tax business provision to those that did not. This ratio is calculated by dividing the total value of liquid assets by the combined value of reported net estate tax liability and other debts, including mortgages and liens, owed by the estate [6].

Individuals who own a family farm or closely held business may have an incentive to decrease their holdings of liquid assets through *inter vivos* giving, so that their estates may qualify for one or more of the available business provisions. Consider a simple, hypothetical example. An individual has personal holdings worth \$5.0 million in adjusted gross estate [7]. His or her ownership of a closely held business is worth \$1.5 million, or 30 percent of the total. Upon death, his or her estate could not qualify for the deferral of tax provision because it does not meet the requirement that the value of the closely held business constitute 35 percent or more of the adjusted gross estate. However, suppose that, prior to death, he or she gives a total of \$1.0 million in

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stocks and bonds to various family members. In this case, upon death, the closely held business would make up 37.5 percent of the value of the adjusted gross estate (\$1.5 million/\$4.0 million). If this estate meets the other requirements for claiming the deferral of tax provision, it would now qualify for the deferral of tax provision.

### Special Use Valuation

With the Tax Reform Act of 1976, Congress protected U.S. farms and closely held businesses by providing for special use valuation of decedents' interests in real property devoted to such businesses. For estate tax purposes, the value of property included in gross estate, including real property, is generally the fair market value based on property's potential "highest and best use." However, for real property that is used by a decedent or family member in a farm or other business as of the decedent's date of death, as well as in 5 of 8 years preceding death, the executor may elect to value such property at its "qualified," or actual, use in the business, if certain requirements are met. According to the Internal Revenue Code, the term "family member" may include any ancestor of the decedent; the spouse of the decedent; a lineal descendant of the decedent, decedent's spouse, or parent; or the spouse of any lineal descendant.

In order for an estate to elect special use valuation, several other conditions must be met: real property must be transferred from the decedent to a qualified family member of the decedent; at least 25

percent of the adjusted value of the gross estate must consist of the real property, where adjusted value is defined as fair market value of real property less any debts against the property; at least 50 percent of the adjusted value of the gross estate must consist of real and other business property; and the estate must consent to payment of additional estate tax--"recapture tax"--if within 10 years of death the property is sold to an unqualified heir, if the property is no longer used for qualified purpose, or if the qualified heir ceases to fully participate for more than 3 years in any 8-year period. For estates of decedents who died in 2001, the allowed maximum reduction in value between fair market value and special use value was \$800,000 [8].

For 2001, some 831 estates elected special use valuation (SUV) for real property (see Figure B). Although this accounted for only 0.8 percent of all estates, it represented about 6.6 percent of estates that reported farm real estate. Of those 831 estates, about half--405 estates--made protective elections of special use. An estate's executor may make a protective election if he or she must file a Federal estate tax return prior to final determination of real property's qualification as special use property. As such, the election is contingent upon property's value as finally determined. Estates with protective elections do not separately report fair market and qualified use values for real property.

Smaller estates were more likely to claim this provision than their larger counterparts. As shown in Figure B, about 0.8 percent of small estates (those

**Figure B**

**Number of Estates, Number That Held Farm Real Estate, and Number That Elected SUV, by Size of Total Gross Estate**

Size of total gross estate	Total number of estates	Estates with farm real estate	Estates that elected SUV	CV <sup>1</sup>
	(1)	(2)	(3)	(4)
<b>All estates.....</b>	<b>108,330</b>	<b>12,683</b>	<b>831</b>	<b>12.6</b>
Small (\$675,000 under \$2.5 million).....	93,321	10,925	728	14.1
Medium (\$2.5 million under \$5 million).....	9,977	1,102	74	27.1
Large (\$5 million under \$10 million).....	3,449	442	23	28.1
Very Large (\$10 million or more).....	1,583	214	5	8.3

<sup>1</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. The CVs shown refer to the number of estates that elected "SUV," shown in Column 3.

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with less than \$2.5 million in total gross estate) claimed SUV, while only 0.3 percent of their very large counterparts used the provision. Reported fair market value for qualifying property was \$377.2 million, and the property value decreased to \$189.0 million for qualifying purposes.

The demographic characteristics of decedents whose estates claimed SUV differed from the characteristics of decedents whose estates did not claim SUV. Decedents whose estates claimed SUV lived, on average, almost 83 years, while decedents whose estates did not claim SUV lived, on average, only 79 years. Similarly, decedents from SUV estates differed in marital status from decedents from non-SUV estates, as shown in Figure C. While 43.5 percent of non-SUV estate tax decedents were married and 42.3 percent were widowed, SUV decedents with these statuses were 27.6 percent and 58.7 percent, respectively. The balance of the decedents in both groups were single, separated, or divorced.

The distribution of SUV and non-SUV estates by marital status looks somewhat different when the estates of male decedents are considered separately from the estates of female decedents. Widowed decedents made up the majority of SUV-estate decedents for both men and women. And, while a

similar percentage of female decedents from SUV estates and non-SUV estates were widowed, 70.0 percent and 61.1 percent, respectively, male decedents from SUV estates were widowed nearly twice as often as their counterparts from non-SUV estates, 48.1 percent and 24.7 percent, respectively.

Taken together, the demographic differences between SUV decedents and estate tax decedents who did not use this provision are unsurprising. The higher average age of decedents whose estates claimed SUV corresponds to the higher proportion of widowed decedents in this subpopulation. The difference in marital status composition between the two groups is expected due to the availability of the unlimited marital deduction. With this deduction, the first spouse to die may leave an unlimited amount of property to the surviving spouse and thereby minimize or postpone estate tax liability until the death of the second spouse. It is reasonable to assume that the estate of the second spouse to die would be more likely to elect special use valuation for real property, since, for the first spouse to die, the marital deduction eliminates most, if not all, potential estate tax liability.

In terms of liquidity, estates that claimed SUV differ significantly from estates that did not claim SUV. Figure D presents estates' financial capacity

**Figure C**

**Number of Estates that Elected SUV, by Sex and Marital Status**

Sex	Marital status	SUV estates			Non-SUV estates		
		Number (1)	Percent of total (2)	CV <sup>1</sup> (3)	Number (4)	Percent of total (5)	CV <sup>1</sup> (6)
<b>All</b>	All.....	<b>831</b>	<b>100.0</b>	<b>12.6</b>	<b>107,498</b>	<b>100.0</b>	<b>0.1</b>
	Married.....	229	27.6	22.3	46,805	43.5	1.2
	Widowed.....	488	58.7	17.0	45,443	42.3	1.3
	Single.....	65	7.8	46.2	10,038	9.3	3.3
	Other <sup>2</sup> .....	48	5.8	54.5	5,212	4.8	4.3
<b>Females</b>	All.....	<b>406</b>	<b>48.9</b>	<b>18.4</b>	<b>51,874</b>	<b>48.3</b>	<b>1.1</b>
	Married.....	55	6.6	49.5	12,606	11.7	2.9
	Widowed.....	284	34.2	21.5	31,709	29.5	1.7
	Single.....	29	3.5	72.0	5,030	4.7	5.0
	Other <sup>2</sup> .....	38	4.6	68.8	2,529	2.4	6.6
<b>Males</b>	All.....	<b>424</b>	<b>51.0</b>	<b>17.4</b>	<b>55,624</b>	<b>51.7</b>	<b>1.0</b>
	Married.....	174	20.9	24.8	34,199	31.8	1.5
	Widowed.....	204	24.5	27.3	13,734	12.8	3.0
	Single.....	36	4.3	60.0	5,008	4.7	4.6
	Other <sup>2</sup> .....	10	1.2	29.2	2,683	2.5	5.6

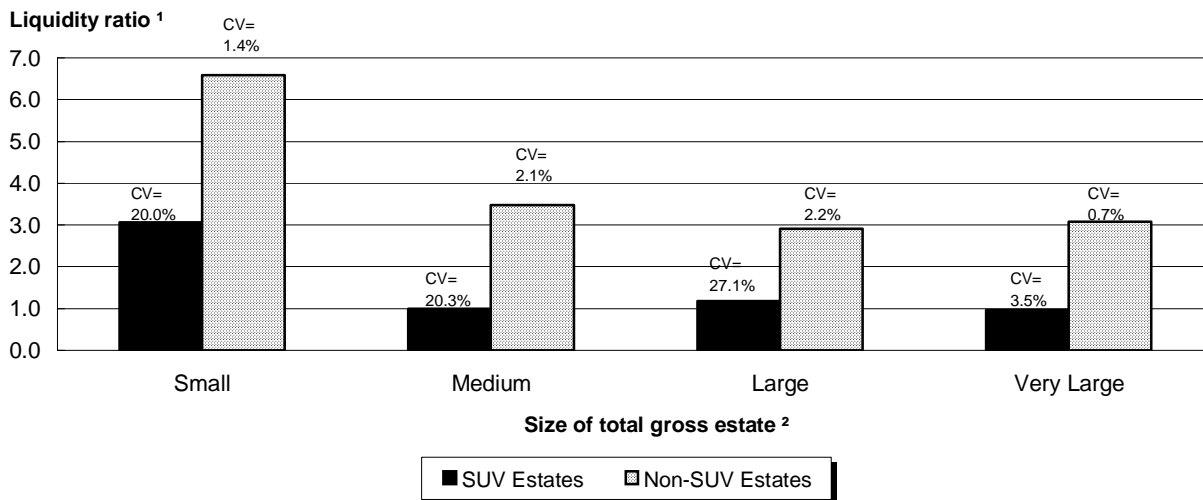
<sup>1</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. The CVs shown in Columns 3 and 6 refer to the number of estates shown in Columns 1 and 4, respectively.

<sup>2</sup> Decedents who were divorced or separated, or whose marital status could not be determined, were assigned a marital status of Other.

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**Figure D**

**Liquidity Ratio of SUV and Non-SUV Estates, by Size of Total Gross Estate**



\* Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error.  
<sup>1</sup> Liquidity ratio is defined as liquid assets (cash and cash management accounts, State and local bonds, Federal government bonds, publicly traded stock, and life insurance) divided by net estate tax plus mortgages and liens.  
<sup>2</sup> Estate size classes are defined as follows: Small--\$675,000 under \$2.5 million, Medium--\$2.5 million under \$5 million, Large--\$5 million under \$10 million, and Very Large--\$10 million or more.

to meet Federal estate tax responsibilities and other debts, including mortgages and liens, with only accumulated liquid assets. Overall, estates that did not claim special use valuation had greater liquid resources with which to meet financial obligations compared to estates that claimed special use, as the ratio of liquid assets to debts was 4.3 for all estates that did not claim SUV and 1.8 for all estates that claimed SUV. This was true across all size of gross estate categories. The greatest proportionate difference between liquidity for non-SUV estates and SUV estates existed for medium-sized estates, for which the liquidity ratio was 3.5 and 1.0, respectively.

Figure E presents the overall asset composition for estates that claimed SUV compared to those that did not. As expected, given the requirements for claiming this provision, farm assets, including farm real estate and agri-business assets, made up a much larger portion of SUV estates, 42.8 percent, than non-SUV estates, 2.9 percent. Other significant differences exist for personal residences, 3.3 percent for claimant estates versus 9.3 percent for nonclaimant estates, and liquid assets, 26.9 percent

for claimant estates versus 58.2 percent for nonclaimant estates [9]. In contrast, there was relatively little difference in the overall importance of closely held businesses in claimant estates and nonclaimant estates. Closely held business assets represented only 4.6 percent of the total gross estate for estates that claimed SUV, similar to the 3.6 percent for those estates that did not claim the provision. Since special use valuation can be applied only to real property, this suggests that real property made up a relatively small part of the total value of closely held businesses held in SUV estates [10].

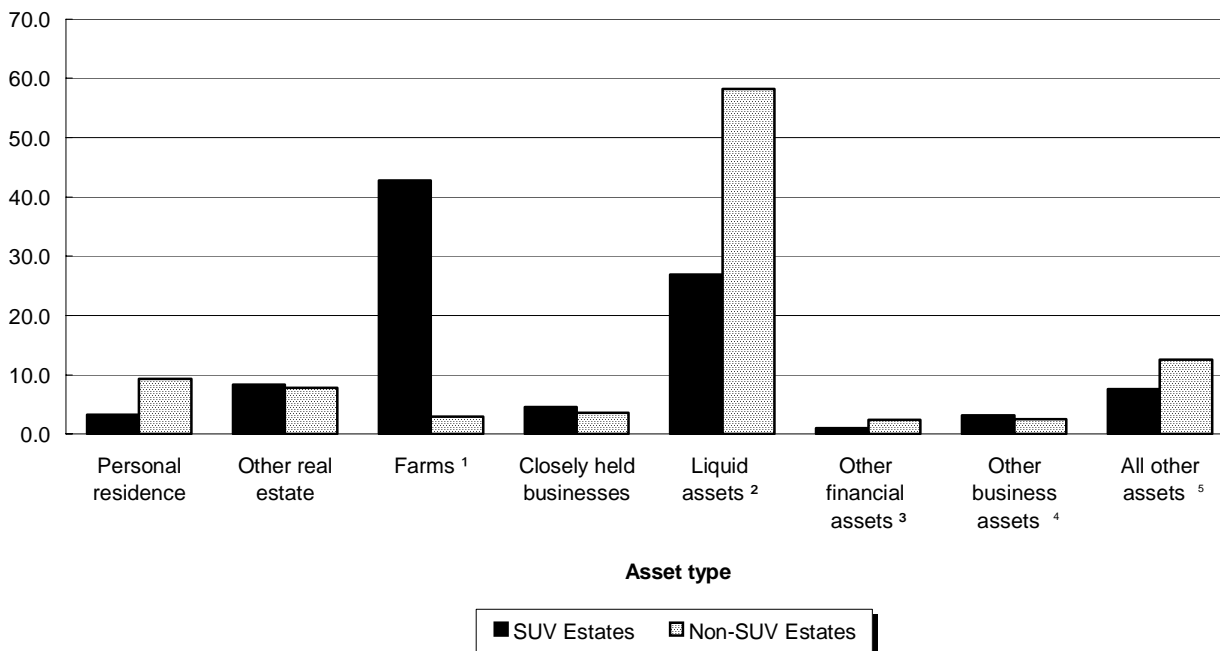
Another way to compare the asset holdings of SUV estates to holdings of non-SUV estates is by examining the mean dollar values of each asset type. Across size of gross estate categories, the mean value of farm assets for SUV estates that reported farm assets was between 2.0 and 3.8 times greater than the mean value of farm assets in non-SUV estates that reported farm assets (Figure F) [11]. The disparity between the mean values for estates that reported farm assets was greatest in very large estates, with SUV estates reporting a mean value of

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**Figure E**

## Composition of Estates, by SUV Status

Percent of total gross estate



<sup>1</sup> The value of farms includes farm real estate and agri-business assets.

<sup>2</sup> Liquid assets are defined as the combination of cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock and insurance on the life of the decedent.

<sup>3</sup> Other financial assets are defined as the combination of corporate and foreign bonds, bond funds, diversified mutual funds, and real estate investment trusts.

<sup>4</sup> Other business assets are defined as the combination of limited partnerships, real estate partnerships, and miscellaneous business assets.

<sup>5</sup> All other assets are comprised of retirement assets, mortgages and notes owed to the estate, depletable and intangible assets, art, and other miscellaneous assets.

\$6.1 million in farm assets, compared with a mean value of \$1.6 million for non-SUV estates. The majority of SUV estates, 85.9 percent, reported farm assets, while only 12.8 percent of non-SUV estates reported farm assets.

The mean values of liquid assets and personal residences were substantially lower for SUV estates that reported these assets compared to non-SUV estates in each size of gross estate category. Across size of gross estate categories, the mean values for liquid assets in SUV estates that reported liquid assets ranged from 1.7 to 2.8 times less than the means for non-SUV estates that reported liquid

assets, while the mean values of personal residences for those SUV estates that reported personal residences ranged from 1.5 to 3.0 times less than the means for non-SUV estates that reported personal residences. Almost all estates reported liquid assets, as 100.0 percent of SUV estates reported liquid assets and 99.7 percent of non-SUV estates reported liquid assets. A little less than a third, 31.5 percent, of SUV estates reported personal residences, while 61.7 percent of non-SUV estates reported personal residences.

Figure F also suggests that estates that claimed SUV differed from those that did not in the mean

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**Figure F**

**Mean Values of Selected Assets and Deductions, by SUV Status and Size of Total Gross Estate**

Selected items and SUV status		Size of total gross estate <sup>1</sup>							
		Small estates		Medium estates		Large estates		Very large estates	
		Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<b>Selected assets</b>									
Closely held businesses	Non-SUV .....	289,669	4.6	676,286	4.7	1,385,615	4.2	4,984,053	1.9
	SUV.....	394,946	32.7	233,973	78.6	1,716,277	36.8	**	**
Farms <sup>4</sup>	Non-SUV .....	338,971	3.0	663,601	7.0	927,822	9.3	1,618,629	1.9
	SUV.....	682,544	8.7	1,792,871	13.3	2,253,072	33.0	6,122,625	9.0
Other financial assets <sup>5</sup>	Non-SUV .....	84,501	2.5	154,816	5.5	227,028	5.3	682,706	2.0
	SUV.....	73,400	39.1	**	**	209,136	37.9	339,245	5.5
Personal residences	Non-SUV .....	230,963	1.3	396,752	2.5	664,907	3.6	1,116,852	1.0
	SUV.....	154,206	22.0	134,375	32.1	396,209	7.1	513,669	7.8
Liquid assets <sup>6</sup>	Non-SUV.....	650,775	0.7	2,011,873	1.1	4,063,267	1.3	13,340,150	0.6
	SUV.....	320,825	13.2	728,457	18.0	2,384,936	27.6	6,372,164	3.9
<b>Selected deductions</b>									
Mortgages & liens	Non-SUV .....	45,067	2.6	141,647	4.6	268,377	4.9	747,731	1.4
	SUV.....	63,478	24.5	294,874	28.7	847,149	35.5	1,530,169	12.6
Charitable bequest	Non-SUV .....	294,407	4.5	852,132	6.2	1,864,744	5.7	6,651,402	1.9
	SUV.....	19,657	58.4	**	**	2,077,187	29.8	73,542	3.0

\*\*Data deleted to prevent disclosure of individual taxpayer data.

<sup>1</sup> Estate size classes are defined as follows: Small--\$675,000 under \$2.5 million, Medium--\$2.5 million under \$5 million, Large--\$5 million under \$10 million, and Very Large--\$10 million or more.

<sup>2</sup> The mean values shown are the means only for those returns which report the relevant asset type.

<sup>3</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. Each CV shown refers to the number in the column preceding it.

<sup>4</sup> The value of farms includes farm real estate and agri-business assets.

<sup>5</sup> Other financial assets are defined as the combination of corporate and foreign bonds, bond funds, diversified mutual funds, and real estate investment trusts.

<sup>6</sup> Liquid assets are defined as the combination of cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and insurance on the life of the decedent.

value of selected deductions. In all but the smallest gross estate category, SUV estates that reported deductions for mortgages and liens had significantly higher mean values for the deduction than their non-SUV counterparts that reported the deduction. The difference between the means was greatest for large estates, as estates that claimed SUV averaged \$847,149, nearly 3.2 times greater than the \$268,377 average for estates that did not claim SUV. Very large SUV estates reported an average of \$1,530,169 in mortgages and liens compared to \$747,731 for very large non-SUV estates. The difference in the mean value of mortgages and liens may be related to the predominant role of farms in SUV estates, as research suggests that, in recent years, farm debt has

averaged about 15.0 percent of the value of farm assets [12]. The majority of both SUV and non-SUV estates reported mortgages and liens, 81.2 percent and 71.2 percent, respectively.

For estates in the smallest and largest gross estate categories that claimed a deduction for charitable bequests, SUV estates, on average, claimed a significantly smaller amount than non-SUV estates. This is not surprising, since the relative paucity of nonfarm assets in SUV estates compared to non-SUV estates may make charitable giving more difficult or less desirable. Among SUV estates, 11.1 percent claimed a deduction for charitable bequests, while 17.2 percent of non-SUV estates claimed a charitable deduction.

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### Qualified Family-Owned Business Interest Deduction

With the Taxpayer Relief Act (TRA) of 1997, Congress sought to safeguard family-run businesses and provided an estate tax deduction for “qualifying” family-owned business interests included in gross estate and transferred to qualified heirs. Requirements for utilizing the deduction are, with a few exceptions, similar to those for electing special use valuation. The principal place of business must be the United States, and the business entity must not have debt or equity that is tradable on an established securities market or secondary market. In addition, at least 50 percent of the business entity must be owned by the decedent and members of the decedent’s family; or 70 percent must be owned by members of two families (and 30 percent owned by the decedent and members of the decedent’s family); or 90 percent must be owned by three families (and 30 percent owned by the decedent and members of the decedent’s family).

Several other requirements must be met, including: the value of the business interest must constitute at least 50 percent of a decedent’s total gross estate less deductible debt, expenses, and taxes; the decedent or family member must have been actively engaged in the business; and additional estate tax is imposed if, within a period of 10 years after the decedent’s death and before the qualified heir’s death,

the heir fails to actively participate in the business for a total of 3 years in any 8-year period [13].

The qualified family-owned business interest deduction (QFOBI), initially set at \$675,000 in TRA of 1997, could not exceed \$1.3 million when combined with the applicable exclusion. Therefore, as the exclusion increased from \$625,000 in 1998 to \$1.5 million in 2004, the maximum allowable deduction decreased and finally disappeared in 2004 [14]. For decedents who died in 2001, the available deduction for qualified family-owned business was \$625,000.

Only a small fraction of estates utilized the qualified family-owned business deduction in calculating taxable estate and estate tax liability. For year-of-death 2001, only 1,114 estates, or 1.0 percent of the total, claimed the deduction, while small estates made up the majority, 82.3 percent, of those that used the deduction (Figure G). These 1,114 estates comprised about 7.1 percent of estates that reported closely held or agri-business assets. The likelihood that an estate would claim the deduction was greater for larger estates. Among all very large estates, 1.5 percent claimed the deduction, while only 1.0 percent of all small estates claimed the deduction. For all estates, the deduction reduced taxable estate by \$626.8 million.

While the largest percentage of decedents were married at death in the 2001 decedent population as a whole, the majority of decedents whose estates claimed the qualified family-owned business deduc-

**Figure G**

**Number of Estates, Number That Held Closely Held Businesses or Agri-Business Assets, and Number That Elected QFOBI, by Size of Total Gross Estate**

Size of total gross estate	Total number of estates	Estates with closely held businesses or agri-business assets	Estates that claimed QFOBI deduction	CV <sup>1</sup>
	(1)	(2)	(3)	(4)
<b>All estates.....</b>	<b>108,330</b>	<b>15,612</b>	<b>1,114</b>	<b>10.3</b>
Small (\$675,000 under \$2.5 million).....	93,321	11,711	917	12.2
Medium (\$2.5 million under \$5 million).....	9,977	2,219	127	18.2
Large (\$5 million under \$10 million).....	3,449	1,056	47	17.6
Very Large (\$10 million or more).....	1,583	626	23	0.4

<sup>1</sup> Coefficient of variation (CV), the ratio of an estimate’s standard error to the estimate, is used to measure the magnitude of potential sampling error. The CVs shown refer to the number of estates that elected QFOBI, shown in Column 3.



## Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

tion, 63.5 percent, were widowed (Figure H). Non-QFOBI estates looked much like the estate tax decedent population as a whole, with 43.6 percent of decedents married at death and 42.2 percent of decedents widowed at death.

The sex composition of the QFOBI subpopulation is similar to the composition of the non-QFOBI subpopulation. Both subpopulations included a slight majority of males, as 53.4 percent of the QFOBI population was male and 51.7 percent of the non-QFOBI population was male (Figure H). This composition--a slight male majority--is unexpected, given the large majority of widowed decedents in the QFOBI subpopulation and the high likelihood that widowed decedents are female.

In terms of age, the mean age of decedents whose estates claimed the deduction was essentially the same as that of decedents whose estates did not claim the deduction, 79.6 years compared to 79.4 years, respectively.

A comparison of estates that claimed QFOBI to estates that did not claim the provision suggests that the two groups vary significantly in terms of liquidity. In fact, across all size of gross estate categories,

liquidity was much lower for estates that claimed the deduction (Figure I). Among those estates that claimed the deduction, the overall ratio of liquid assets to debts was 1.0, while the overall ratio for estates that did not claim the deduction was 4.4. The largest difference in liquidity between QFOBI and non-QFOBI estates existed for very large estates, for which the liquidity ratio was 0.5 and 3.1, respectively.

The asset composition of estates that claimed the qualified family-owned business deduction looked quite different than the composition of estates that did not claim the deduction. Figure J shows the asset composition of estates by QFOBI status. Estates that claimed the QFOBI deduction held higher percentages of closely held businesses and farms, compared to estates that did not claim the deduction. In the aggregate, closely held businesses made up 26.8 percent of QFOBI estates and only 3.3 percent of non-QFOBI estates. Farm assets represented 22.6 percent of QFOBI estates and only 2.9 percent of non-QFOBI estates.

Compared to QFOBI estates, non-QFOBI estates held greater concentrations of other assets, such as liquid assets and personal residences. Liquid assets made up a large percentage of non-QFOBI

**Figure H**

**Number of Estates That Elected QFOBI, by Sex and Marital Status**

Sex	Marital status	QFOBI estates			Non-QFOBI estates		
		Number (1)	Percent of total (2)	CV <sup>1</sup> (3)	Number (4)	Percent of total (5)	CV <sup>1</sup> (6)
<b>All</b>	<b>All</b> .....	<b>1,113</b>	<b>100.0</b>	<b>10.3</b>	<b>107,217</b>	<b>100.0</b>	<b>0.1</b>
	Married.....	245	22.0	17.7	46,789	43.6	1.2
	Widowed.....	707	63.5	14.1	45,225	42.2	1.3
	Single.....	62	5.6	36.4	10,041	9.4	3.3
	Other <sup>2</sup> .....	100	9.0	29.1	5,162	4.8	4.3
<b>Females</b>	<b>All</b> .....	<b>520</b>	<b>46.7</b>	<b>15.7</b>	<b>51,760</b>	<b>48.3</b>	<b>1.1</b>
	Married.....	38	3.4	50.0	12,623	11.8	2.9
	Widowed.....	410	36.8	17.8	31,584	29.5	1.7
	Single.....	29	2.6	65.2	5,030	4.7	5.0
	Other <sup>2</sup> .....	44	4.0	56.6	2,523	2.4	6.6
<b>Males</b>	<b>All</b> .....	<b>594</b>	<b>53.4</b>	<b>13.6</b>	<b>55,456</b>	<b>51.7</b>	<b>1.0</b>
	Married.....	207	18.6	18.9	34,166	31.9	1.5
	Widowed.....	297	26.7	22.9	13,640	12.7	3.0
	Single.....	33	3.0	37.8	5,011	4.7	4.6
	Other <sup>2</sup> .....	56	5.0	27.1	2,638	2.5	5.6

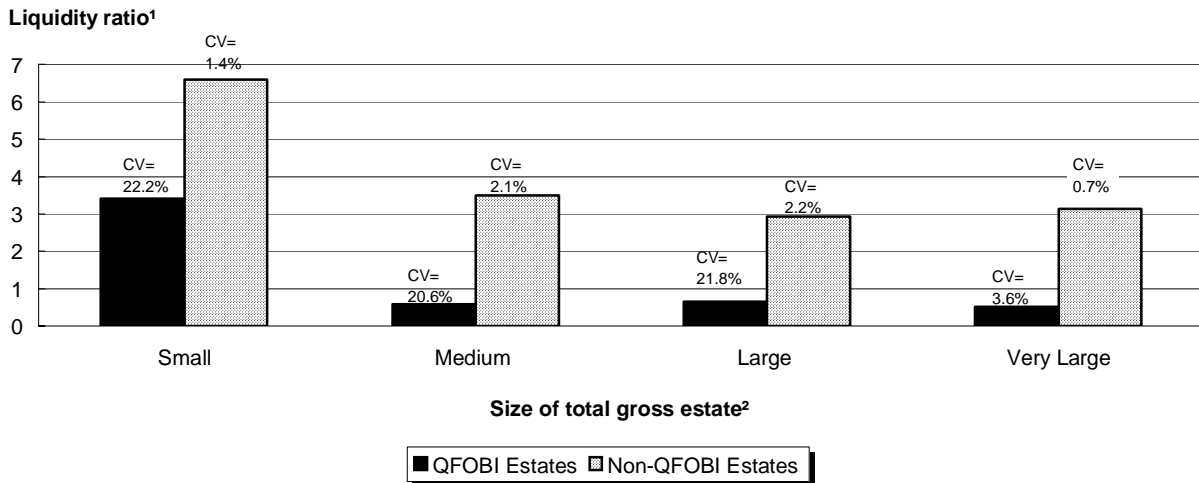
<sup>1</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. The CVs shown in Columns 3 and 6 refer to the number of estates shown in Columns 1 and 4, respectively.

<sup>2</sup> Decedents who were divorced or separated, or whose marital status could not be determined, were assigned a marital status of Other.

# Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

**Figure I**

## Liquidity Ratio of QFOBI and Non-QFOBI Estates, by Size of Total Gross Estate



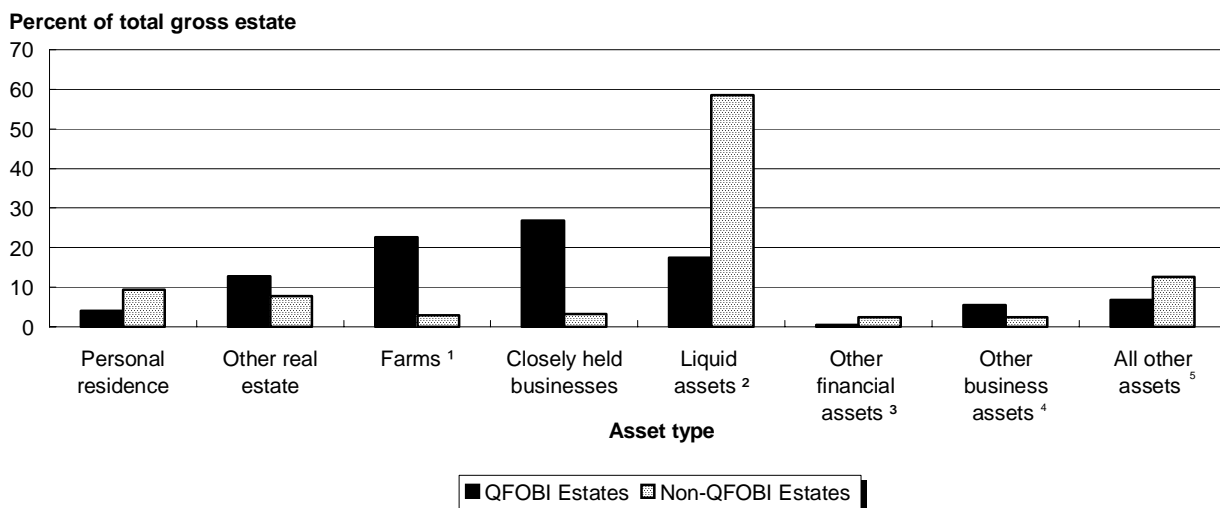
\* Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error.

<sup>1</sup> Liquidity ratio is defined as liquid assets (cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and life insurance) divided by net estate tax plus mortgages and liens.

<sup>2</sup> Estate size classes are defined as follows: Small--\$675,000 under \$2.5 million, Medium--\$2.5 million under \$5 million, Large--\$5 million under \$10 million, and Very Large--\$10 million or more.

**Figure J**

## Composition of Estates, by QFOBI Status



<sup>1</sup> The value of farms includes farm real estate and agri-business assets.

<sup>2</sup> Liquid assets are defined as the combination of cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and insurance on the life of the decedent.

<sup>3</sup> Other financial assets are defined as the combination of corporate and foreign bonds, bond funds, diversified mutual funds, and real estate investment trusts.

<sup>4</sup> Other business assets are defined as the combination of limited partnerships, real estate partnerships, and miscellaneous business assets.

<sup>5</sup> All other assets are comprised of retirement assets, mortgages and notes owed to the estate, depletable and intangible assets, art, and other miscellaneous assets.

## Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

estates, 58.5 percent, but a small percentage, 17.4 percent, of QFOBI estates. Non-QFOBI estates held 9.4 percent of total gross estate in personal residences, while QFOBI estates held 4.1 percent of total gross estate in personal residences.

Comparing mean values for certain asset and deduction categories again highlights some differences between estates that claimed the qualified family-owned business deduction and those that did not claim the deduction. As expected, given the requirements for claiming the deduction, the mean values for closely held businesses are much higher for estates that used the deduction, across all gross estate categories. The mean values for those that

used the deduction and reported closely held business assets ranged from 2.0 to 3.4 times higher than the mean values for those estates that did not use the deduction but reported closely held business assets (Figure K). For the largest estates that claimed the deduction and reported these business assets, the mean value for closely held businesses was \$15.8 million, while the mean value for estates that did not claim the deduction was \$4.7 million. Among QFOBI estates, 31.6 percent reported closely held business assets, while only 8.5 percent of non-QFOBI estates reported such assets.

Similarly, the mean values for farm assets, including real property used in an agri-business, were

**Figure K**

**Mean Values of Selected Assets and Deductions, by QFOBI Status and Size of Total Gross Estate**

Selected items and QFOBI status		Size of total gross estate <sup>1</sup>							
		Small estates		Medium estates		Large estates		Very large estates	
		Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<b>Selected assets</b>									
Closely held businesses	Non-QFOBI .....	269,856	4.6	634,147	4.7	1,338,654	4.2	4,658,051	1.9
	QFOBI.....	821,217	12.0	1,783,551	12.0	2,663,195	20.0	15,846,954	6.7
Farms <sup>4</sup>	Non-QFOBI .....	338,791	3.0	678,738	6.9	952,727	9.2	1,652,884	1.9
	QFOBI.....	679,742	8.6	1,766,018	14.9	1,553,339	52.5	2,396,241	13.2
Other financial assets <sup>5</sup>	Non-QFOBI .....	84,759	2.5	155,060	5.6	228,690	5.3	686,356	2.0
	QFOBI.....	38,887	18.9	91,486	32.4	86,884	38.3	135,639	4.8
Personal residences	Non-QFOBI .....	231,152	1.3	396,704	2.6	665,457	3.6	1,123,219	1.0
	QFOBI.....	158,772	15.0	290,051	11.1	446,287	19.8	495,760	3.4
Liquid assets <sup>6</sup>	Non-QFOBI.....	652,100	0.7	2,020,127	1.1	4,092,388	1.3	13,458,858	0.6
	QFOBI.....	250,707	10.6	557,953	18.2	1,106,688	10.7	3,631,478	4.2
Mortgages & liens	Non-QFOBI .....	45,037	2.6	137,873	4.6	268,898	4.8	742,713	1.5
	QFOBI.....	61,052	23.8	474,952	19.9	463,342	41.3	1,365,966	6.5
Marital deduction	Non-QFOBI .....	657,657	1.1	2,463,972	1.0	5,208,811	1.3	15,583,216	0.9
	QFOBI.....	432,618	22.1	1,333,016	16.2	5,575,118	13.9	8,952,926	3.0

<sup>1</sup> Estate size classes are defined as follows: Small--\$675,000 under \$2.5 million, Medium--\$2.5 million under \$5 million, Large--\$5 million under \$10 million, and Very Large--\$10 million or more.

<sup>2</sup> The mean values shown are the means only for those returns which report the relevant asset type.

<sup>3</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. Each CV shown refers to the number in the column preceding it.

<sup>4</sup> The value of farms includes farm real estate and agri-business assets.

<sup>5</sup> Other financial assets are defined as the combination of corporate and foreign bonds, bond funds, diversified mutual funds, and real estate investment trusts.

<sup>6</sup> Liquid assets are defined as the combination of cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and insurance on the life of the decedent.

## Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

substantially higher for those estates that reported farm assets and elected the business deduction [15]. The smallest difference between the means existed for the largest estates. The mean farm value for the largest estates that elected the deduction and reported farm assets, almost \$2.4 million, was 1.4 times the mean value for estates that did not elect the provision but reported farm assets, almost \$1.7 million. The largest difference between the means existed for the medium-sized estates. Those that claimed the deduction had mean farm values that were 2.6 times higher than the mean for estates that did not claim the deduction. Among QFOBI estates, 64.2 percent reported farm assets, while only 12.9 percent of non-QFOBI estates reported farm assets.

For a few asset categories, estates that did not claim the QFOBI deduction exhibited higher mean values than estates that did claim the deduction. Non-QFOBI estates reported between 2.6 and 3.7 times the value of liquid assets reported by QFOBI estates. Similarly, the values of personal residences were higher for those estates that did not use the deduction, although the differences between the means are less substantial. Estates that did not use the deduction reported between 1.4 and 2.3 times higher values for personal residences. Virtually all estates reported liquid assets, as 99.7 percent of non-QFOBI estates reported liquid assets and 98.4 percent of QFOBI estates reported liquid assets. Among non-QFOBI estates, 61.6 percent reported personal residences, while 43.6 percent of QFOBI estates reported personal residences.

Differences between QFOBI estates and non-QFOBI estates are also observed in the reporting of deductions. For medium-sized and very large estates, QFOBI estates that reported deductions for mortgages and liens had higher mean values for the deduction than non-QFOBI estates that reported the mortgages and liens deduction. The largest difference between the means existed for medium-sized estates. The mean value of the deduction for QFOBI estates that reported the deduction was 3.4 times the mean value of the deduction for non-QFOBI estates that reported the deduction.

In all but one gross estate category, non-QFOBI estates reported higher mean values for the marital deduction than did their QFOBI-estate counterparts. Again, the largest difference between the means

existed for medium-sized estates. The mean value of the marital deduction for non-QFOBI estates that reported the deduction was 1.8 times the mean value of the deduction for QFOBI estates that reported the deduction.

### **Deferral of Tax and Installment Payments**

Congress has also enacted legislation that lessens the burden of certain estate tax payments for estates comprised largely of closely held businesses. The legislation provides estates with an alternative to selling closely held interests in order to meet Federal tax responsibilities. Initially, in 1958, Congress introduced installment payments for these estates, and then, in 1976, Congress established rules for deferral of payments. Under the law, an estate's executor can elect to pay estate tax attributable to the business interest in two or more, but not exceeding ten, equal payments and defer tax payments for 5 years, paying only interest on the tax liability during the deferral period.

In order to qualify for deferral of tax and installment payments, at least 35 percent of the value of adjusted gross estate must consist of an interest in a closely held business. Under the law in effect for 2001, the definition of closely held business included three types of entities: (1) sole proprietorships, (2) partnerships, if the estate included 20 percent of more of the partnership interest or if the partnership had 15 or fewer partners, and (3) corporations, if the estate included 20 percent or more of the voting stock of the corporation or if the corporation had 15 or fewer shareholders. An executor's decision to use these payment options is not contingent on the election of special use valuation. However, if the executor elects special use valuation, the same, lower value must be used for determining the deferred tax payments [16].

Relatively few estates for 2001 decedents chose to elect deferral of tax (DOT) due to ownership interests in closely held businesses. As shown in Figure L, only 382 estates, or 0.4 percent of all estates and 2.4 percent of estates that reported closely held and agri-business assets, elected to use this provision. Larger estates were much more likely to use the provision than their smaller counterparts. About 0.2 percent of small estates (those with less than \$2.5 million in total gross estate) used DOT.

# Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

**Figure L**

**Number of Estates, Number That Held Closely Held Businesses or Agri-Business Assets, and Number That Elected DOT, by Size of Total Gross Estate**

Size of total gross estate	Total number of estates	Estates with closely held businesses or agri-business assets	Estates that elected DOT	CV <sup>1</sup>
	(1)	(2)	(3)	(4)
<b>All estates.....</b>	<b>108,330</b>	<b>15,612</b>	<b>382</b>	<b>11.8</b>
Small (\$675,000 under \$2.5 million).....	93,321	11,711	147	26.5
Medium (\$2.5 million under \$5 million).....	9,977	2,219	103	18.7
Large (\$5 million under \$10 million).....	3,449	1,056	86	13.7
Very Large (\$10 million or more).....	1,583	626	46	2.7

<sup>1</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. The CVs shown refer to the number of estates that elected "DOT," shown in Column 3.

This percentage increased dramatically as size of gross estate increased, as 2.9 percent of the largest estates (those with \$10 million or more in total gross estate) used the provision. Estates deferred more than \$365.6 million in estate tax, or 58.9 percent of reported tax liabilities for those estates; closely held business assets for which tax was deferred totaled \$1.3 billion.

The mean age of decedents whose estates elected to defer tax was essentially the same as that

of decedents whose estates did not elect deferral, 79.7 years compared to 79.4 years, respectively. In contrast, decedents from DOT estates differed in marital status compared to decedents from non-DOT estates, as shown in Figure M. While 43.5 percent of decedents from non-DOT estates were married at death and 42.4 percent were widowed, the percentages of DOT decedents with these statuses were 16.2 and 57.6, respectively.

An examination of marital status by sex for DOT estates shows differences between male and female

**Figure M**

**Number of Estates That Elected DOT, by Sex and Marital Status**

Sex	Marital status	DOT estates			Non-DOT estates		
		Number	Percent of total	CV <sup>1</sup>	Number	Percent of total	CV <sup>1</sup>
		(1)	(2)	(3)	(4)	(5)	(6)
<b>All</b>	<b>All.....</b>	<b>382</b>	<b>100.0</b>	<b>11.8</b>	<b>107,949</b>	<b>100.0</b>	<b>0.1</b>
	Married.....	62	16.2	17.4	46,972	43.5	1.2
	Widowed.....	220	57.6	16.3	45,712	42.3	1.3
	Single.....	21	5.5	54.4	10,083	9.3	3.3
	Other <sup>2</sup> .....	80	20.9	28.5	5,182	4.8	4.3
<b>Females</b>	<b>All.....</b>	<b>183</b>	<b>47.9</b>	<b>18.6</b>	<b>52,097</b>	<b>48.3</b>	<b>1.1</b>
	Married.....	3	0.8	10.0	12,658	11.7	2.9
	Widowed.....	166	43.5	19.7	31,827	29.5	1.7
	Single.....	--	--	--	5,059	4.7	5.0
	Other <sup>2</sup> .....	14	3.7	69.0	2,554	2.4	6.6
<b>Males</b>	<b>All.....</b>	<b>199</b>	<b>52.1</b>	<b>14.8</b>	<b>55,852</b>	<b>51.7</b>	<b>1.0</b>
	Married.....	58	15.2	18.3	34,315	31.8	1.5
	Widowed.....	53	13.9	26.7	13,885	12.9	2.9
	Single.....	21	5.5	54.4	5,024	4.7	4.6
	Other <sup>2</sup> .....	66	17.3	31.3	2,628	2.4	5.6

<sup>1</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. The CVs shown in Columns 3 and 6 refer to the number of estates shown in Columns 1 and 4, respectively.

<sup>2</sup> Decedents who were divorced or separated, or whose marital status could not be determined, were assigned a marital status of Other.

## Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

decedents in this subpopulation. The largest percentage of male decedents from DOT estates, 33.2 percent, were separated, divorced, or marital status unknown, while only 7.7 percent of female decedents from DOT estates were separated, divorced, or marital status unknown. The predominant marital status among female DOT decedents was widowed, at 90.7 percent. Only 1.6 percent of females in the DOT sub-population were married, and none were single. In contrast, 26.6 percent of male DOT decedents were widowed, 29.1 percent were married, and 10.6 percent were single.

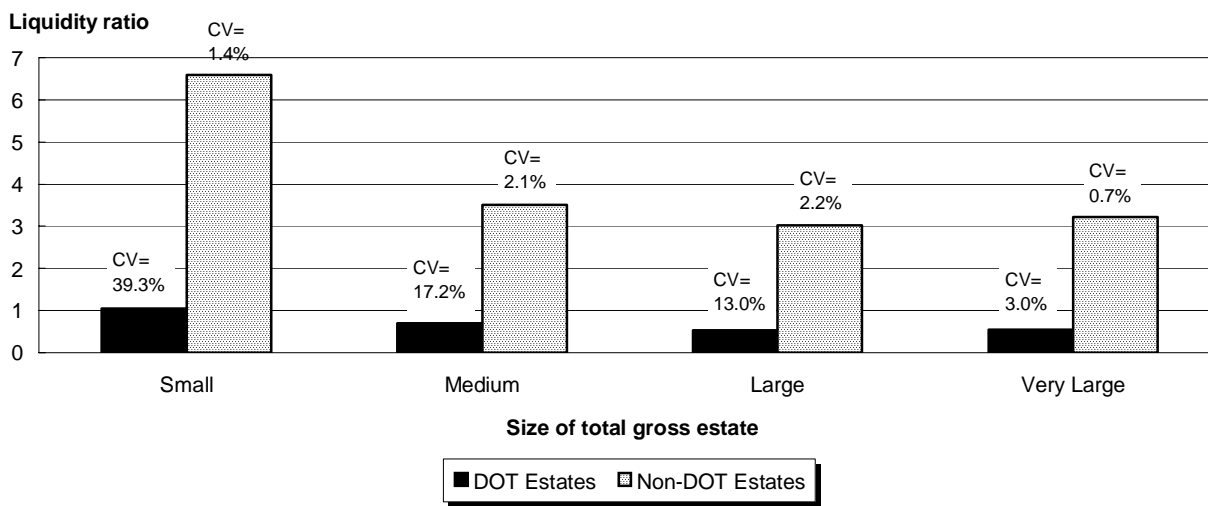
A comparison of estates that elected DOT to estates that did not elect DOT suggests that the two groups vary significantly in terms of liquidity. Liquidity, the ratio of liquid assets to debts, including reported net estate tax and mortgages and liens, was much lower for estates that elected to defer taxes, and the disparity was present across all size of gross estate categories. Overall, the liquidity ratio for estates that elected DOT was 0.6, while the ratio for non-DOT estates was 4.4. As shown in Figure N, the largest difference between liquidity for DOT and non-DOT estates was present for small estates.

Figure O presents the overall asset composition of estates that claimed DOT compared to those that did not claim the provision. As expected, given the requirements for claiming this provision, closely held businesses made up a much larger portion of DOT estates, 28.8 percent, compared to non-DOT estates, at 3.3 percent. DOT estates also contained significantly higher proportions of other real estate, farms, and other business assets than non-DOT estates. In contrast, DOT estates held substantially smaller proportions of total gross estate in personal residences and liquid assets.

The differences in asset holdings between DOT and non-DOT estates are also observable by examining the mean dollar values of asset types for similar size estates that hold those assets. As shown in Figure P, across size of gross estate categories, the mean value of closely held businesses for those estates that reported closely held businesses was between 1.9 and 3.0 times greater in estates that claimed DOT than in non-DOT estates. The difference between the means was greatest in very large estates, as DOT estates reported a mean value of \$13.6 million in closely held businesses, compared to

**Figure N**

### Liquidity Ratio of DOT and Non-DOT Estates, by Size of Total Gross Estate



\* Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error.

<sup>1</sup> Liquidity ratio is defined as liquid assets (cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and life insurance) divided by net estate tax plus mortgages and liens.

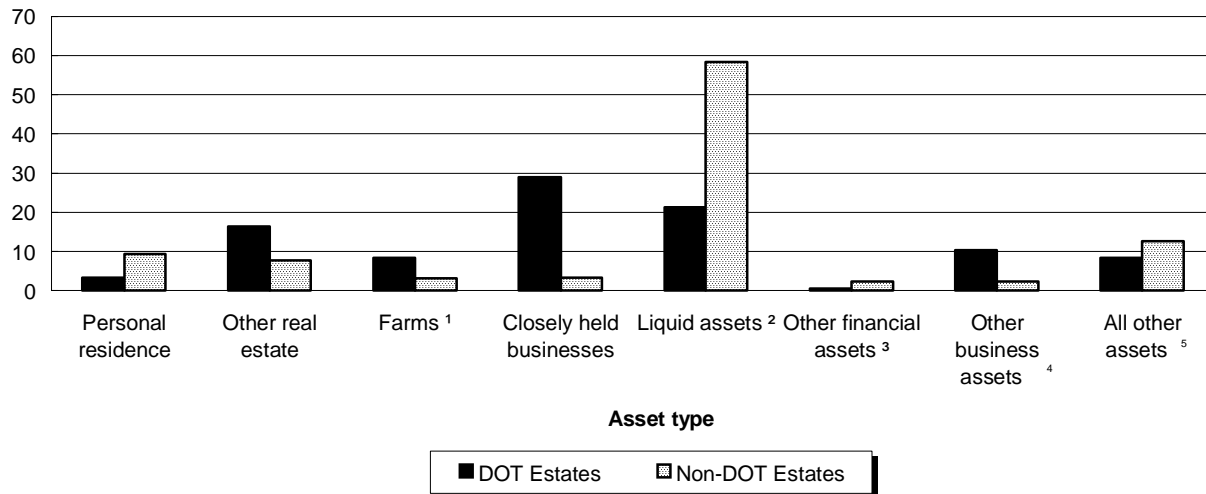
<sup>2</sup> Estate size classes are defined as follows: Small--\$675,000 under \$2.5 million, Medium--\$2.5 million under \$5 million, Large--\$5 million under \$10 million, and Very Large--\$10 million or more.

# Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

**Figure 0**

## Composition of Estates, by DOT Status

Percent of total gross estate



<sup>1</sup> The value of farms includes farm real estate and agri-business assets.

<sup>2</sup> Liquid assets are defined as the combination of cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and insurance on the life of the decedent.

<sup>3</sup> Other financial assets are defined as the combination of corporate and foreign bonds, bond funds, diversified mutual funds, and real estate investment trusts.

<sup>4</sup> Other business assets are defined as the combination of limited partnerships, real estate partnerships, and miscellaneous business assets.

<sup>5</sup> All other assets are comprised of retirement assets, mortgages and notes owed to the estate, depletable and intangible assets, art, and other miscellaneous assets.

a mean value of \$4.5 million for non-DOT estates. Among DOT estates, 43.5 percent reported closely held business assets, while only 8.6 percent of non-DOT estates reported such assets.

For other asset types, non-DOT estates exhibited higher mean values than DOT estates. The mean value of liquid assets was between 1.7 and 2.8 times greater in non-DOT estates than in DOT estates. Among estates that elected DOT, 95.3 percent reported liquid assets, while 99.7 percent of non-DOT estates reported liquid assets.

Estates that claimed DOT differed from those that did not claim DOT in the reporting of deductions, as seen in Figure P. In each gross estate category, DOT estates that reported a deduction for mortgages and liens held a significantly higher value of mortgages and liens than their non-DOT counterparts. The disparity between the means was relatively small for small estates, as DOT estates had a mean value of \$94,571 in mortgages and liens, 2.1 times greater than the mean of \$45,146 reported by non-DOT

estates. The disparity between the means was greatest for large estates, where estates that claimed DOT and held mortgages and liens reported a mean value of \$832,122, nearly 3.3 times greater than the mean value of \$255,586 reported by non-DOT estates. Very large DOT estates that had mortgages and liens reported a mean of \$1,847,852, compared to \$715,820 for their non-DOT counterparts.

DOT estates with a marital deduction reported, on average, a lower value than their non-DOT counterparts. This is consistent with the demographic differences between the two subpopulations, as DOT decedents were more often widowed than non-DOT decedents.

### Summary

At various points in legislative history, the U.S. Congress has sought to protect family-owned farms and closely held businesses by lessening the burden of the Federal estate tax. Three estate tax provisions were available to decedents who died in 2001, if

# Utilization of Special Estate Tax Provisions for Family-Owned Farms and Closely Held Businesses

**Figure P**

**Mean Values of Selected Assets and Deductions, by DOT Status and Size of Total Gross Estate**

Selected items and DOT status		Size of total gross estate <sup>1</sup>							
		Small estates		Medium estates		Large estates		Very large estates	
		Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>	Mean <sup>2</sup>	CV <sup>3</sup>
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<b>Selected assets</b>									
Closely held businesses	Non-DOT .....	287,205	4.5	650,442	4.8	1,332,778	4.3	4,468,959	2.0
	DOT.....	798,097	29.9	1,615,862	17.8	2,534,708	14.8	13,609,587	4.6
Farms <sup>4</sup>	Non-DOT .....	354,657	2.9	708,906	6.7	939,734	9.5	1,541,979	1.9
	DOT.....	628,065	26.5	1,111,339	29.4	1,596,856	29.7	4,464,228	6.1
Other financial assets <sup>5</sup>	Non-DOT .....	84,473	2.5	154,934	5.6	229,317	5.2	685,590	2.1
	DOT.....	66,303	30.5	109,276	33.4	56,079	56.0	456,247	6.8
Personal residences	Non-DOT .....	230,573	1.3	395,824	2.6	664,707	3.6	1,129,834	1.0
	DOT.....	379,922	21.6	350,826	18.2	557,013	15.0	573,234	2.3
Liquid assets <sup>6</sup>	Non-DOT.....	648,597	0.7	2,014,012	1.2	4,117,594	1.2	13,569,040	0.6
	DOT.....	371,083	34.3	815,709	15.7	1,491,181	13.7	4,824,375	3.9
<b>Selected deductions</b>									
Mortgages & liens	Non-DOT .....	45,146	2.6	140,486	4.6	255,586	5.0	715,820	1.5
	DOT.....	94,571	29.7	328,344	16.6	832,122	17.1	1,847,852	5.3
Marital deduction	Non-DOT .....	656,866	1.1	2,459,639	1.0	5,257,686	1.2	15,676,052	0.9
	DOT.....	**	**	702,221	8.4	1,579,094	40.9	5,153,984	3.6

\*\*Data deleted to prevent disclosure of individual taxpayer data.

<sup>1</sup> Estate size classes are defined as follows: Small--\$675,000 under \$2.5 million, Medium--\$2.5 million under \$5 million, Large--\$5 million under \$10 million, and Very Large--\$10 million or more.

<sup>2</sup> The mean values shown are the means only for those returns which report the relevant asset type.

<sup>3</sup> Coefficient of variation (CV), the ratio of an estimate's standard error to the estimate, is used to measure the magnitude of potential sampling error. Each CV shown refers to the number in the column preceding it.

<sup>4</sup> The value of farms includes farm real estate and agri-business assets.

<sup>5</sup> Other financial assets are defined as the combination of corporate and foreign bonds, bond funds, diversified mutual funds, and real estate investment trusts.

<sup>6</sup> Liquid assets are defined as the combination of cash and cash management accounts, State and local bonds, Federal Government bonds, publicly traded stock, and insurance on the life of the decedent.

estates met certain requirements: special use valuation, the qualified family-owned business deduction, and the deferral of Federal estate tax liabilities. For 2001, about 1,800 estates, or 1.7 percent of the estate tax decedent population, elected to use at least one of the three provisions. A total of 831 estates elected special use valuation, alone or in combination with the business deduction or deferral of estate taxes; 1,114 estates claimed the qualified family-owned business deduction, alone or in combination with special use or deferral of taxes; and 382 estates elected to defer estate taxes, alone or in combination with the other two business provisions.

The likelihood that an estate would utilize one of the three provisions varied by provision and size of gross estate. Smaller estates were more likely than their larger counterparts to utilize special use valuation, while larger estates were more likely to utilize

the qualified family-owned business deduction and deferral of taxes.

In terms of liquidity, defined as the ratio of liquid assets to debts (reported net estate tax and mortgages and liens), smaller estates were more liquid than their larger counterparts. This was true across all subpopulations, i.e., those estates that utilized a business provision and those that did not utilize a provision.

The asset composition and mean values for selected assets varied considerably by provision status--utilization or nonutilization of a provision. Those estates that elected special use valuation held a larger percentage of total gross estate in farm assets, compared to estates that did not elect special use. The mean farm value was also higher for estates that elected special use. Estates that did not elect special use held larger percentages of total gross



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estate in liquid assets and personal residences. Again, mean values for these assets were higher for nonelectors of special use compared to electors.

Turning to the qualified family-owned business deduction, estates that utilized the deduction held larger percentages of total gross estate in closely held businesses and farm assets, compared to estates that did not utilize the deduction. The mean values for these assets were also higher for estates that utilized the deduction. Those estates that did not use the deduction held larger percentages of gross estate in liquid assets and personal residences. Mean values for these assets were also higher for estates that did not use the deduction.

Those estates that deferred estate tax liabilities held larger percentages of gross estate in closely held businesses, real estate, farm assets, and other business assets and had a higher mean value for closely held businesses than estates that did not defer tax liabilities. Estates that did not defer tax held larger percentages of gross estate in liquid assets and personal residences, and those estates had a higher mean value for liquid assets, compared to estates that elected deferral.

### Data Sources and Limitations

Analysts in the Special Projects Section of SOI's Special Studies Branch, with SOI staff in the Cincinnati Submission Processing Center, conduct the Estate Tax Study, which extracts demographic, financial and asset data from Form 706, the Federal estate tax return. The Estate Tax Study is conducted on an annual basis, which allows production of filing year data on estate taxation. By focusing on a single year of death for a period of 3 years, the study also allows production of periodic year-of-death estimates. A single year of death is examined for 3 years in order to sample estate tax returns filed in years subsequent to the year of death, as 99 percent of all returns for decedents who die in a given year are filed by the end of the second calendar year following the year of death. The Estate Tax Study for the period 2001-2003 concentrates on year-of-death 2001, the latest year-of-death estimates available. Study years 2004-2006 will concentrate on year-of-death 2004.

For each study year, 2001-2003, a sample was selected from returns filed. Samples were limited to

returns filed for decedents who died after 1981. The sample for the 2001 filing year included 10,838 returns out of a total population of 108,071. In 2002, the year in which most returns for 2001 decedents were filed, 13,415 returns were sampled out of a total of 99,604. There were 11,962 returns out of 73,127 sampled during Filing Year 2003. Of the 36,215 returns sampled during 2001-2003, there were 18,740 returns filed for 2001 decedents.

Estate tax returns were sampled while the returns were being processed for administrative purposes, but before any examination. Returns were selected on a flow basis, using a stratified random probability sampling method, whereby the sample rates were preset based on the desired sample size and an estimate of the population. The design had three stratification variables: year of death, age at death, and size of total gross estate plus adjusted taxable gifts. For the 2001-2003 filing years, the year of death variable was separated into two categories: 2001 year of death and non-2001 year of death. Age was disaggregated into four categories: under 40, 40 under 50, 50 under 65, and 65 and older (including age unknown). Total gross estate plus adjusted taxable gifts was limited to seven categories: under \$1 million, \$1 million under \$1.5 million, \$1.5 million under \$2.0 million, \$2.0 million under \$3.0 million, \$3.0 million under \$5.0 million, \$5.0 million under \$10.0 million, and \$10.0 million or more. Sampling rates ranged from 1 percent to 100 percent. Returns for over half of the strata were selected at the 100-percent rate.

Because almost 99 percent of all returns for decedents who die in a given year are filed by the end of the second calendar year following the year of death and because the decedent's age at death and the length of time between the decedent's date of death and the filing of an estate tax return are related, it was possible to predict the percentage of unfiled returns within age strata. The sample weights were adjusted accordingly, in order to account for returns for 2001 decedents not filed by the end of the 2003 filing year.

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### Notes and References

- [1] Special use valuation and deferral of estate tax liability are available to estates for current deaths. However, the qualified family-owned business deduction was repealed for deaths after 2003.
- [2] A coefficient of variation (CV) is calculated by dividing the standard error of the estimate (SE) by the value of the estimate and multiplying by 100. For example, an estimate of 50 with a SE of 4 would have a CV of 8 percent ( $(4/50) * 100$ ).
- [3] United States Tax Reporter, Estate and Gift Taxes, Volumes I and II, Research Institute of America, 1996. This publication provides an overview of tax law, Internal Revenue Code text, House and Senate committee reports, U.S. Treasury regulations, and a general explanation of the tax code.
- [4] Ibid.
- [5] Total adult deaths represent those of individuals age 20 and over, plus deaths for which age was unavailable. Death statistics are from Volume 52, Number 3, Table 3, Centers for Disease Control and Prevention, National Center for Health Statistics, U.S. Department of Health and Human Services, September 2003.
- [6] The value for net estate tax liability used in calculating the liquidity ratio is the tax value reported on the estate tax return after the application of special business provisions. The election and application of one or more of these provisions reduce the value of the tax base to which estate tax rates are applied, as well as the value of reported estate tax liability. As such, the ratios presented here may be larger than the ratios that would exist in the absence of special use valuation, the family-owned business deduction and deferral of tax.
- [7] According to Internal Revenue Code 2057(c), most gifts given within 3 years of a decedent's death are included in adjusted gross estate.
- [8] For more information on special use valuation, see Code section 2032A in The Complete Internal Revenue Code, Research Institute of America, July 2001, p. 6,016.
- [9] For some estates, the value of farm assets may also include the value of personal residences, as such residences may not be reported separately from the value of the farm businesses on Federal estate tax returns.
- [10] For a small number of estates, the value of closely held businesses may be included in the value of farm assets. Similarly, for a small number of estates, the value of farm assets may be included in the value of closely held businesses.
- [11] Farm real estate included in the value of farm assets presented here and in Figure F is valued at special use, not fair market, value.
- [12] See the U.S. Department of Agriculture, Economic Research Service Web site at [http://www.ers.usda.gov/briefing/FarmIncome/Data/Bs\\_t6.htm](http://www.ers.usda.gov/briefing/FarmIncome/Data/Bs_t6.htm).
- [13] For more information on the qualified family-owned business deduction, see Code section 2057 in The Complete Internal Revenue Code, Research Institute of America, July 2001, p. 6,047.
- [14] In the 1997 Act, Congress provided for gradual increase in the lifetime exemption from \$625,000 in 1998 to \$850,000 in 2004. However, in 2001, Congress enacted legislation in the Economic Growth and Tax Relief Reconciliation Act that completely changed the landscape of estate tax law. As a result, the lifetime exemption, \$675,000 in 2000 and 2001, is set to increase to \$3.5 million in 2009, and the estate tax disappears entirely for deaths in 2010.
- [15] See footnote [9].
- [16] For more information on the deferral of taxes and installment payments, see Code section 6166 in The Complete Internal Revenue Code, Research Institute of America, July 2001, p. 9,125.