

PENNSYLVANIA EXEMPTS FAMILY-OWNED BUSINESSES FROM INHERITANCE TAX

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In 2013, Pennsylvania amended its tax laws to provide an exemption from Pennsylvania inheritance tax for transfers of qualified family-owned businesses if certain conditions are met. The old rule taxed such a transfer at a percentage of the fair market value of the business ranging from no tax on transfers to a spouse, 4.5% to children, and 12% to siblings, nieces and nephews. Under the new rules, certain family-owned businesses may now be transferred to spouses, children, siblings, nieces and nephews, inheritance tax free.

In order to qualify for the tax exemption, it must be a transfer of a “qualified family-owned business interest”, a transfer to one or more “qualified transferees”, and held by the qualified transferee for at least 7 years after the decedent’s death. A proper and timely inheritance tax return must be filed for the decedent and certifications must be filed by the transferees for each of the 7 years.

To qualify as a “qualified family-owned business” the business must:

- Have no more than 50 full-time equivalent employees
- Have a net book value (not market value) of less than \$5 million
- Have been established at least 5 years prior to owner’s death
- Be wholly owned by decedent or by decedent and “qualified transferees”
- Not have management of investments or income-producing assets as its principal purpose

A “qualified transferee” is:

- Husband or wife
- Children, grandchildren, and great-grandchildren
- Siblings and/or sibling’s children, grandchildren, and great-grandchildren
- Ancestors and ancestor’s siblings

If within 7 years from the date of the decedent’s death the qualified transferee re-transfers his or her interest in the business to someone other than another qualified transferee, then the Pennsylvania Department of Revenue will impose inheritance tax on the market value of the interest transferred plus interest from the time the tax would have been due.

Book value is usually substantially less than market value. This allows for an inheritance tax free transfer of a business whose fair market value may be significantly greater than \$5,000,000.



In order to use this exemption, careful and timely business planning is a must. Business owners must strictly comply with all conditions required by the tax code. For example, all interests in the business must be owned by the decedent or by the decedent and qualified transferees. So if the owners are not related, this exclusion is not available. In other words, this exemption is not available if two un-related business partners own a business or if an un-related key business partner owns even the smallest of interests in the business. Also of significant note is that an in-law is not a “qualified transferee” so a transfer of any interest to a son-in-law, daughter-in-law, brother-in-law or sister-in-law is not exempt.

The new rules also do not limit the number of qualified family-owned businesses that may be transferred inheritance tax free. With proper planning, assets with a total book value in excess of \$5,000,000 may be transferred tax free.

A similar exemption exists for family farms.

ROBERT A. ALPERT's principal areas of practice include corporate law, where he provides general counsel to businesses, as well as real estate law, commercial litigation, and estate planning and administration. He advises his corporate clients on day-to-day legal issues including commercial, operational, employment, transactional, and regulatory issues.

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