University of Nebraska - Lincoln
DigitalCommons@University of Nebraska - Lincoln

Historical Materials from University of Nebraska-Lincoln Extension

Extension

1993

NF93-146 Delayed Payment of Federal Estate Taxes

Ray Massey

Gary Bredensteiner
University of Nebraska--Lincoln, gbredensteiner1@unl.edu

Follow this and additional works at: https://digitalcommons.unl.edu/extensionhist

Part of the Agriculture Commons, and the Curriculum and Instruction Commons

Massey, Ray and Bredensteiner, Gary, "NF93-146 Delayed Payment of Federal Estate Taxes" (1993). *Historical Materials from University of Nebraska-Lincoln Extension*. 401.
https://digitalcommons.unl.edu/extensionhist/401

This Article is brought to you for free and open access by the Extension at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Historical Materials from University of Nebraska-Lincoln Extension by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.

Nebraska Cooperative Extension NF93-146

NebFact

Published by Cooperative Extension, Institute of Agriculture and Natural Resources,
University of Nebraska-Lincoln

Delayed Payment of Federal Estate Taxes

Ray Massey, Extension Economist
Gary Bredensteiner, Director Farm Management Operations

Persons whose estates are valued at more than $600,000 will generally have to pay federal estate taxes. Payment of federal estate tax is typically due nine months after death, at the same time as the estate tax return is due.

If the decedent's assets are not easily convertible to cash (i.e. consist of real estate or a business), paying the tax liability may pose a problem to the heirs. The inability to pay the tax liability when it is due can endanger the value and use of the estate by forcing the premature sale of productive assets which may be essential for carrying on a business. This strain can be particularly troublesome for family businesses which are being passed on to the spouse or children.

The Internal Revenue Service allows the delayed payment of the estate tax in order to more efficiently manage the estate. This NebFact details the installment payment of estate taxes and deals with filing for an extension of time to pay taxes. Some additional factors to consider before making a decision are also given.

Installment Payment of Estate Taxes

Eligibility For Paying Estate Taxes In Installment.

Installment payment of federal estate taxes can occur only if the estate of the decedent contained interest in a closely held business such as a farm or family business. Installment payment of taxes is permissible only on the part of the estate tax liability attributable to the closely held business.

Test 1. Did the decedent have interest in a closely held business? A person is said to have a closely held business if he or she:

1. owns a trade or business carried on as a proprietorship;
2. owns 20 percent or more of the total capital interest in a partnership or is a partner in a partnership

having no more than 15 partners;
3. owns 20 percent or more of the voting stock of a corporation or owns stock in a corporation having no more than 15 stockholders.

Test 2. Is the value of the interest in a closely held business large enough to qualify? The value of an interest in the closely held business must be at least 35 percent of the value of the decedent's adjusted gross estate. The decedent's adjusted gross estate is the gross estate less expenses, indebtedness, taxes and losses (see NebFact 93-143, *Federal Estate and Gift Taxes*, for further definition of the adjusted gross estate).

If the decedent owned part of two or more closely held businesses, the interest in them is combined if at least 20 percent of the total value of each business in included in the gross estate.

The interest in a closely held farm business includes the interest in the residential buildings and related improvements occupied regularly by the owners, lessees, or employees running the farm.

The maximum amount that can be paid in installments is equal to the part of the estate tax that is attributable to the closely held business. For example, if 50 percent of the taxable estate of the decedent is closely held business property, only 50 percent of the federal estate taxes due can be paid through the installment method.

Restrictions. If any part of an interest in a closely held business that qualifies for installment payments is disposed of in any manner, the extension of time for payment of the tax ends. Payment of all remaining installments must be made immediately.

Disposition of property does not end installment tax payments if:

1. property is transferred, because of the death of the original heir, to a family member; or
2. a redemption of stock to pay death taxes.

Payment of Principal and Interest

Under the installment method, interest payments on the deferred tax must be made every year, beginning one year after the estate tax would normally be due. The payment of principal (the estate tax), but not interest, can be deferred for up to five years from the original due date for paying the tax. Payment of the principal must be made annually after the first installment of tax is paid. There can be no more than 10 installment payments. The final payment can be made as late as 15 years after the original due date. Interest on the unpaid portion of the tax is not deferred and must be paid annually. Interest must be paid at the same time as each installment of tax is paid.

Installment Payment of Estate Taxes

First Payment Due
    Interest: 1 year after normal due date
    Principal: 5 years after normal due date
Frequency of Payments: annual
Maximum number of principal payments: 10
Interest Rate: 4% (with limitations)

Interest on Installment Payments.

The interest rate charged by the IRS on installment payment of estate taxes is 4 percent of the first $1 million worth of closely held business property. The maximum amount of the estate tax that may be subject to the lower 4 percent interest rate is the lesser of

1. $345,800 (the estate tax on $1 million) reduced by the amount of the allowable (unused) unified credit (See NebFact 93-143, *Federal Estate and Gift Taxes*), or
2. the amount of the estate tax that is attributable to the closely held business and that is payable in installments.

If the estate tax due is greater than the maximum amount to which the 4 percent interest rate applies, the remainder is subject to the regular interest rate, published monthly by the IRS in the Internal Revenue Bulletin. In such cases, each installment payment is composed of some of the principal subject to the 4 percent rate and some of the principal subject to the regular interest rate.

The interest accruing on installment payment of estate tax is an administrative expense to the estate and, therefore, deductible from the gross estate. The deduction can be claimed only after the interest has accrued and been paid. A supplemental Form 706 needs to be filed with each annual installment payment to claim the deduction.

Penalties. If any payment of principal or interest is not paid within six months of the due date, the unpaid part of the tax payable in installments must be paid upon notice from the IRS. There is a penalty of 5 percent per month on the amount of the late payment.

Electing to Pay Taxes on Installment.

Installment payment of taxes is chosen and implemented by attaching a notice of electing to pay in installments to a timely filed estate tax return (IRS Form 706). The notice must contain:

1. the decedent's name and taxpayer identification number,
2. the total amount of tax to be paid in installments,
3. the date chosen for paying the first installment,
4. the properties shown on the estate tax return that make up the closely held business, and
5. the reasons you think the estate qualifies for installment payments.

Factors to Consider

Installment payments of federal estate taxes is available only for closely held businesses and the closely held business must remain closely held (in the family) for the duration of the payment time. If for any reason the business ceases to be closely held, the remainder of the estate taxes would become due immediately. Installment payments can become difficult if the closely held business is passed on to more than one heir. Breakup of the business could endanger the installment payment schedule of all the owners. Consider leaving the closely held business to heirs who are likely to continue to manage the business. Perhaps some of the heirs should receive the business and other heirs should receive other assets not tied to the installment payment of taxes.

The interest rate of only 4 percent on installment loans is an attractive method of gaining access to capital. Consider using the installment method of paying estate tax on qualified businesses even if the cash to pay the tax is available. Use the cash which could have been used for paying the estate tax to pay existing debt which is at a higher interest rate. Remember that the delay of estate taxes is a liability and may affect your ability to borrow money for other purposes.

Extension of Time to Pay Estate Taxes

An extension of time to pay (as opposed to installment payment of taxes) may be obtained if an estate consists of property which does not qualify for installment payment of taxes. The extension is obtained by filing Form 4768, *Application for Extension of Time to File U.S. Estate Tax Return and/or Pay Estate Tax*. Extensions are granted only if reasonable cause for not being able to pay the tax when due can be shown. Reasonable causes include:

1. liquid assets to pay the tax are located in several jurisdictions and not within the executor's immediate control;
2. most of the estate's assets consist of rights to receive payment in the future;
3. an estate includes a claim to substantial assets that cannot be collected without a lawsuit; and
4. the estate would have to borrow at an interest rate higher than normally available to have enough funds to pay the taxes, provide for the decedent's surviving spouse and dependents, and satisfy the claims against the estate.

The information contained in this NebFact is for educational purposes only. Tax is complicated and the information presented here has necessarily been simplified. See a tax consultant for specific questions.

File NF146 under FARM MANAGEMENT
F-5, Estate Planning
Issued September 1993

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Elbert C. Dickey, Director of Cooperative Extension, University of Nebraska, Institute of Agriculture and Natural Resources.

University of Nebraska Cooperative Extension educational programs abide with the non-discrimination policies of the University of Nebraska-Lincoln and the United States Department of Agriculture.