

MARCH 2014 NEWSLETTER

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PENNSYLVANIA INHERITANCE TAX EXEMPTION FOR QUALIFIED FAMILY OWNED BUSINESSES

NEWS ALERT:

UPCOMING SEMINARS:

A. Joseph R. Pozzuolo, Esquire and Jeffrey S. Pozzuolo, Esquire will be presenting a CPE/CLE at *Penn State Doylestown Campus* on **Thursday May 22, 2014** from **12:30pm-4:30pm.**

The Topic will be *“Retirement Planning for Middle Income Families”*.

B. Judith P. Rodden, Esquire and Lesley M. Ibanez, Esquire will be presenting a CPE/CLE at *Penn State Doylestown Campus* on **Thursday June 19, 2014** from **12:30pm-4:30pm**.

The Topic will be *“Commercial and Residential Real Estate Practice Today: From Agreement of Sale to Closing, with Ethics”*.

Please contact Theresa M. Bloom, Education Program Manager to sign up.

Call 215-881-7402 or email: tmb17@psu.edu

QUESTION OF THE MONTH:

Do I Have to Support My Spouse During the Pendency of our Divorce if He or She Cheated on Me?

Answer-See Page 4 of this Newsletter

Pennsylvania Inheritance Tax Exemption for Qualified Family Owned Businesses

Beginning July 1, 2013, the transfer at death of certain family owned business interests will be protected from the Pennsylvania inheritance tax. While the Pennsylvania inheritance tax is not nearly as burdensome as the federal estate tax, the tax may still be substantial and its payment may cause certain family business interests to otherwise be sold off to make payment of the tax.

The rate of the Pennsylvania inheritance tax is based off of the relationship between the beneficiary, or heir, and the decedent with rates ranging from 0% to 15%. For example, transfers to a surviving spouse are entirely exempted from Pennsylvania Inheritance Tax. However, a rate of 4.5% applies to interests transferred to lineal descendants and ascendants, such as children or grandchildren, parents or grandparents. A rate of 12% applies to transfers to siblings and a rate of 15% applies to transfers to all other beneficiaries. If the main family asset is the family business, then its transfer at death of the business owner can create liquidity problems for paying the tax.

Accordingly, in an effort to help protect certain Pennsylvania family owned businesses, the Pennsylvania legislature created a new exemption from the inheritance tax for the transfer of qualifying family owned business interests. The potential tax savings may be significant.

I. **Statutory Requirements**

In order for a death time transfer of a qualified family owned business interest to be

exempt from the inheritance tax, certain requirements must be met. There are two main requirements, which are: (1) the interest being transferred at death must be a qualified family owned business interest; and, (2) the person receiving the interest must be a qualified transferee. Other requirements apply as well.

A. Qualified Family Owned Business Interest

In order to be a qualified family owned business interest, the business must either be a qualifying sole proprietorship where the decedent was the owner and manager, or the interest transferred is a qualifying interest. To qualify, the business or business interest must be in an entity carrying on a trade or business that:

1. Has fewer than 50 employees;
2. Has a net book value of less than \$5 million;
3. Has been in existence for five years prior to the decedent's death;
4. Is wholly owned by the decedent or the decedent and members of the decedents family that are qualified transferees; and
5. Is engaged in a trade or business, the principal purpose of which is not the management of investments or income producing assets.

All of the above requirements must be in existence as of the date of death. While some of the requirements are straightforward, such as the 50 employee limitation, others are not. For example, \$5 million book value requirement applies to the business as a whole, and not just the decedent's interest. Furthermore, the statutory requirement requires the value be measured as book value and not fair market value. The difference is important in that, for example, the book value of a business may be significantly less than its fair market value because business assets have depreciated over time. Thus, as long as the business' book value is less than \$5 million, even if the fair market value is significantly greater than \$5 million, the transfer of the business may still qualify for the exemption.

Meanwhile, the business must be wholly owned by the decedent and qualified transferees. If the decedent had transferred even nominal interest to someone who is not a qualified transferee, the transfer of the business at the decedent's death may not qualify for the exemption. For example, if a son- or daughter-in-law was an owner, the death time transfer would not qualify because spouses of descendants are not qualified transferees. It is also important to remember that a trust is not a qualified transferee. Thus, if a parent placed the business in trust for the children, the transfer would be outside the scope of the exemption and not qualify.

B. Qualified Transferee

A qualified transferee generally is any member of the decedent's family. Specifically, the definition includes husband and wife, lineal descendants, siblings and siblings' lineal descendants, and ancestors and ancestors' siblings.

C. Other Requirements

There are several other qualifications that apply in order for the transfer to be exempt

from the inheritance tax. They include:

1. The interest must be reported on the Pennsylvania inheritance tax return;
2. The business, or interest, must continue to be owned by the qualified transferee for seven years after the decedent's death;
3. A certification must be filed annually by the qualified transferee for the seven year period; and
4. Any property transferred to the qualified family owned business within one year of the decedent's death is not eligible for the exemption unless it was transferred for a legitimate business purpose.

If the certification is not filed, the exemption will be lost and inheritance tax will be due. If a qualified transferee no longer owns the qualified family owned business interest during the seven year period, the inheritance tax will be due, plus interest. It is not necessary, however, that the same qualified transferee holds the interest during the entire seven year period.

In the event that loss of the exemption is triggered, the Pennsylvania Department of Revenue may place a lien on the business in the amount of taxed owed if necessary.

II. Planning Opportunities

The new exemption will benefit business owners who want to keep the business within the family after death. Planning opportunities exist. For example, if the decedent has a low basis in the business, there are opportunities to transfer the business tax free based on the low book value as compared to the fair market value. However, placing the business interests in trust is not an option. Thus, the business owner must feel comfortable transferring the business to one of the qualified transferees so that this new exemption may be incorporated into the owner's business succession planning.

Ultimately, there are opportunities here and it is best to contact your estate and business succession planning attorney or professional to determine whether and how you should take advantage of this new law.

QUESTION OF THE MONTH:

Do I Have to Support My Spouse During the Pendency of our Divorce if He or She Cheated on Me?

In Pennsylvania marital misconduct is a factor considered by the Courts in denying alimony or spousal support, but it does not limit a party's ability to collect alimony pendente lite. Alimony pendente lite ("APL") refers to court ordered payments from one spouse to the other spouse during the parties' separation period and the pendency of the divorce and equitable distribution proceedings, whereas alimony refers a court ordered support payments from one former spouse to the other former spouse after their marriage has ended and a divorce decree has been entered.

APL is generally paid by the primary bread winner to a dependent spouse with less or no earnings and limited financial resources. Pennsylvania has a statute that allows for a court to grant APL, counsel fees and expenses to either spouse during the pendency of the action, but unlike the statute allowing for alimony, marital misconduct is not a factor that the courts may consider when awarding APL to a spouse.

Courts in Pennsylvania have consistently found that APL is not barred by marital misconduct, because the purpose of APL is to place spouses on equal economic footing during the divorce proceedings. In Schenk v. Schenk, the Superior Court of Pennsylvania stated, “APL is based on the need of one party to have equal financial resources to pursue a divorce proceeding when, in theory, the other party has major assets.” This illustrates that APL is dependent on the state of the litigation and that it aims to place both spouses on equal footing in litigating the divorce proceeding. In Schenk, the Court found that APL could even be awarded to a spouse who is cohabitating with her boyfriend during the divorce proceedings, if she could “demonstrate the need for maintenance and professional services during the pendency of the proceedings.”

Accordingly, if your spouse cheated on you, you may still be required to provide APL to your spouse during the pendency of any divorce proceedings, but your spouse’s marital misconduct could preclude any claims of alimony or spousal support that your spouse may attempt to assert. If you are contemplating divorce and have any questions or concerns regarding possible divorce proceedings and their financial implications, please do not hesitate to contact us and set up an appointment.

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- If there are any legal questions you would like this office to answer in the future, please email the question to us at info@pozzuolo.com. Each month, the question with the most relevance to our privately held business clients, advisors, and friends will be answered in our monthly newsletter. The questions can relate to any of the areas practiced by this office including business planning and transactions, corporate law, commercial litigation, employment law and litigation, commercial real estate and development, construction law and litigation, estate planning, estate administration, tax and pension law, family law litigation.
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PUBLICATIONS

All of the following professional publications and past newsletters written by attorneys of this office are available by clicking here: <http://pozzuolo.com/Pubs Articles.shtml>

- **Corporate/Tax Articles**
- Bankruptcy - How To Prevent It And How To Cope With It Should It Happen To Your Business
- Deferred Compensation Rewards And Retains Key Employees
- Design Buy-Sell Agreements For Maximum Utility

- How An S Corporation Avoids The Double Taxation Incurred When Excessive Compensation Is Treated As A Dividend
- How Mortgage Lenders Should Draft Broker Agreements To Avoid RESPA Violations
- How To Look, Act And Sound Like A Professional Corporation
- How to Structure a Suitable Buy-Sell Agreement
- How To Use Non-Qualified Deferred Compensation Arrangements As A Business, Retirement And Tax Planning Tool
- Money Purchase Pension Plan Falls Out Of Favor
- Protecting A Client's Business From Unfair Competition Using Restrictive Covenants
- Structuring Loans From Qualified Plans - How To Handle The Strict Tax Rules
- What Type of Qualified Corporate Retirement Plan Best Serves Your Business, Tax And Retirement Needs
- Why An Employment Contract Is Mandatory
- **Estate Planning Articles**
- Adapt Estate Planning Strategies to Fit the Needs of Same-Sex Couples
- College Funding Tool Offers Estate Planning Advantage
- Diversify Strategies For An Effective Estate Plan
- Divorce and Estate Planning
- Divorce Raises The Need For Performing An Estate Planning Review
- Drafting The Durable Power Of Attorney For Wealth Protection Purposes
- Estate Planning For Pet Owners
- Remarriage Situations Can Raise Special Estate Planning Considerations
- Six Proven Estate Planning Techniques
- Special Needs Trust - An Estate Planning Tool For The Disabled
- The Limited Liability Company -A Sophisticated Tool For Estate Planning
- Using Trusts To Maximize Family Protection And Minimize Estate Tax
- Why Living Wills- Advance Directives Are An Essential Part Of Estate Planning

Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects. It is to provide insight into legal developments and issues. You should always consult with legal counsel before taking any action on matters covered in our updates.

This newsletter is courtesy of Pozzuolo Rodden, P.C.

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