

## PLAN YOUR ESTATE NOW

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*Proper estate planning does not necessarily mean an estate will pass tax free, but a thorough understanding of potential costs can help save tax dollars.*

The certainty of death and the severity of taxes levied on property of a person after death are good reasons to stop and think about personal estate planning. The key to having death tax dollars is a thorough understanding of the potential costs these taxes represent.

It is important to plan for conserving and building an estate while you are alive and in good health.

### Reasons for Planning

Why the need for estate planning? One reason is the increased fair market value of land. Many people have wealth they don't recognize. For example, the average value of Texas land per acre in 1940 was \$18.81; in 1972 the average was \$185, and in some areas of the state, land is now selling from \$500 to \$600 per acre. Near major cities it is selling from \$2,000 to \$4,000. Since taxes at death are based on the estate's fair market value, adequate estate liquidity becomes a real problem where substantial land holdings are involved.

In estate planning liquidity is important (i.e., having assets which can be converted into cash, such as savings, insurance or other investments). Cash resources will be needed to pay debts and taxes. The alternative might be a forced sale of land or other business enterprises.

### Steps in Planning

Estate planning is a family decision-making process. One of the first steps for everyone is to inventory all estate assets and liabilities and to discover the costs of taxes and administration. The second step is to evaluate the alternative routes for minimizing taxes and administration cost. This can be done with a tax accountant, tax attorney, or other professional estate planner.

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Having a properly drawn will is an important third step in any estate plan. The family attorney will be able to assist here. Through a will, a person can direct disposition of property at death and have an executor to administer his affairs. Substantial savings in court costs and attorney's fees can be achieved with a well considered will.

### Determining Wealth for Taxes

In determining the wealth for your taxable estate, list:

- (1) the value of all personal effects,
- (2) real estate holdings,
- (3) stocks and bonds,
- (4) cash on hand or in the bank,
- (5) value of business interests,
- (6) proceeds of life insurance policies individually owned, even though payable to a named beneficiary,
- (7) gifts within 3 years prior to death, and
- (8) all other items of value.

Deductions are allowable in computing a taxable estate. Federal estate taxes allow a specific deduction of \$60,000. Texas inheritance tax deductions are smaller, but the rates of taxation are substantially less. Death taxes are to be paid in 9 months. If these taxes are not paid in 9 months, a penalty of 6 percent is charged.

Arrangements can be made, if done properly, for paying taxes over a 10-year period at 4 percent interest. Established hardship cases can be carried for a year's extension at 4 percent when properly cleared. All this must be done at the Internal Revenue Office before the 9 months period ends.

### Fair Market Value

Fair market value is the value upon which estate taxes of real property, stocks and bonds, and other property is calculated at death. It is established on values owned at death or, alternatively, on the value of the property 6 months thereafter. Federal regulations define fair market value as the price at which property will change hands in a reasonable time between a willing buyer and a willing

seller, neither being under compulsion to buy or sell, and both having reasonable knowledge of the facts.

#### **Tax Basis**

Federal estate taxes are based on net estates above \$60,000. For example, tax on a \$100,000 net estate would be reflected as a taxable estate of \$40,000 (\$100,000 less \$60,000). The tax would be \$4,800.

Under Texas law, all property one owns at death or has given away for something less than full value within a 2-year period before death, as well as property over which he maintains control, is taxable for state inheritance taxes. Texas allows a tax exemption on the first \$40,000 of life insurance proceeds. All life insurance proceeds on policies owned at death, however, are taxable by federal authorities. Policy ownership is the deciding factor in taxing these proceeds. Payment to a named beneficiary other than one's estate is not a controlling factor.

Texas inheritance tax is computed on the basis of the value received by a beneficiary. The tax rate on each bequest varies, depending upon the kinship of the beneficiary to the deceased.

Charitable bequests have not always been exempt in Texas from inheritance tax. The law has been changed and charitable gifts now exempt under federal laws qualify for state exemption as well.

It is clear that the impact of inheritance tax can be lessened or even eliminated depending upon how a person distributes property. Good estate planning means distributing property at minimum cost, but planning to avoid taxes entirely can often trap people into arrangements that are undesirable and unsuitable. Good planning does not necessarily imply an estate will pass tax free, but taxes can be lessened.

#### **Lessening Taxes**

Proper estate planning can often lessen or eliminate entirely the impact of state inheritance tax, by dividing a larger estate into smaller bequests to several persons rather than one large bequest to one person. For example, there is no state tax on an estate of \$150,000 if it is divided equally among a surviving spouse and 5 children. As Class A beneficiaries they can each take \$25,000 tax free. Giving it entirely to a surviving spouse would subject \$125,000 to state inheritance tax.

Numerous small bequests as suggested here might defeat taxes, yet they might also defeat the

security that survivors badly need. A person who has a surviving spouse and several descendants can potentially give away a very large estate to them with no tax whatever, but it is still poor tax planning if this plan is not what is really preferred.

Lessening estate taxes is accomplished by channeling it to survivors in ways that do not subject the same property to multiple taxation. Property is taxed when it is earned (income tax), when the first spouse dies (estate tax) and, if the property has all passed to the surviving spouse, it is again taxed (another estate tax) when that spouse dies. Estate taxes are heaviest when the second spouse dies, since that person then owns entirely what was once the community estate, half of which escaped when the first spouse died. When both husband and wife die within a relatively short period, certain provisions exist to prevent inequity.

Since the federal estate tax taxes everything one owns, an estate inventory is essential. People with land may be "land poor." The cash flow may increase slightly from year to year, yet inflation has substantially increased the value of farm land. Since this land is taxed at its fair market value, it could become necessary to sell the family land holdings if there is not sufficient cash to pay these taxes.

Proper planning is just one more part of the good business practices needed in farm or ranch management.

#### **Exempt Bequests**

Texas law divides possible beneficiaries into 5 classes (A through E). Bequests are tax exempt according to the following formula:

*Class A*—Bequests to husband, wife, child, lineal descendants, sons-in-law, daughters-in-law. Exempt to the extent each bequest to each individual does not exceed \$25,000.

*Class B*—Bequests to the United States to be used in Texas. Exempt to the extent such bequest does not exceed \$25,000.

*Class C*—Bequests to brother, sister, or direct lineal descendant of brother or sister. Exempt to the extent each bequest to each individual does not exceed \$10,000.

*Class D*—Bequests to uncle, aunt, or direct lineal descendant of an aunt or uncle. Exempt to the extent each bequest to each individual does not exceed \$10,000.

*Class E*—Other bequests. Exempt to the extent each bequest to each individual or organization does not exceed \$500.

## EXAMPLES OF HOW SOME ESTATES WOULD BE TAXED

### Example A

In an estate of \$100,000 left by one parent to four children:

- a) \$100,000 would be the exemption for Texas inheritance tax because there is a \$25,000 exemption per child. Thus there is no Texas tax when four children are equally involved.
- b) There would be a \$60,000 specific exemption for federal estate tax and assuming \$10,000 as expenses and debts, a federal tax would be paid on only \$30,000.

### Example B

In an estate of \$50,000 left by one parent to one child:

\$25,000 would be exempt under Texas inheritance tax in this case. \$25,000 would be subject to Texas tax but no federal tax would be due on this amount since it does not exceed \$60,000.

### Example C

In an estate of \$37,500 left by one parent to one child with \$5,000 expenses:

\$32,500 would be the taxable estate.

\$25,000 would be the exemption.

\$7,500 would represent the amount on which Texas inheritance tax would be paid. Again there is no federal estate tax liability in this example.

### Example D

An example of how state inheritance tax would be determined from the decedent's estate:

The deceased is survived by his wife and desires his estate be passed to her.

Gross estate assets of husband and wife total.....\$300,000

The decedent's interest is one half in a community estate or.....\$150,000

Deductions:

Funeral Expenses

Attorney Fees

Court Costs

Debts

Total.....\$ 11,800

The taxable inheritance is.....\$138,200

When distributed to the wife, the \$138,200 is taxed in the following manner:

The first \$25,000 is exempt.

The second \$25,000 is taxed at 1 percent. The tax is \$250.

The next \$50,000 is taxed at 2 percent and the tax is \$1,000.

The final \$38,000 is taxed at 3 percent and the tax is \$1,146.

Total inheritance tax on \$138,200 is.....\$2,396

For a federal estate tax with total assets of \$300,000 for husband and wife, the decedent's interest is \$150,000. If expense deductions are \$11,500, with specific exemption of \$60,000, the taxable estate will be \$78,500. Total federal estate tax would be \$14,680. This example does not reflect the tax impact which occurs on the death of the second spouse. The second death tax can be reduced by wise planning.

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Other fact sheets on estate planning: L-774, L-950 through L-956, L-1147.

STATEMENTS OF HOW SOME TYPES OF TAXES

The following are some of the ways in which the various types of taxes are levied and collected. The information is given in a general way and is not intended to be a complete statement of the law. For a complete statement of the law, reference should be made to the appropriate laws and regulations.

Example 1. A person who is engaged in a business or profession is required to pay a tax on the net income derived from such business or profession. The tax is levied on the net income after deducting from the gross income the cost of the goods sold or the cost of the services rendered, and the cost of the depreciation of the property used in the business or profession.

Example 2. A person who is engaged in a business or profession is required to pay a tax on the net income derived from such business or profession. The tax is levied on the net income after deducting from the gross income the cost of the goods sold or the cost of the services rendered, and the cost of the depreciation of the property used in the business or profession.

Example 3. A person who is engaged in a business or profession is required to pay a tax on the net income derived from such business or profession. The tax is levied on the net income after deducting from the gross income the cost of the goods sold or the cost of the services rendered, and the cost of the depreciation of the property used in the business or profession.

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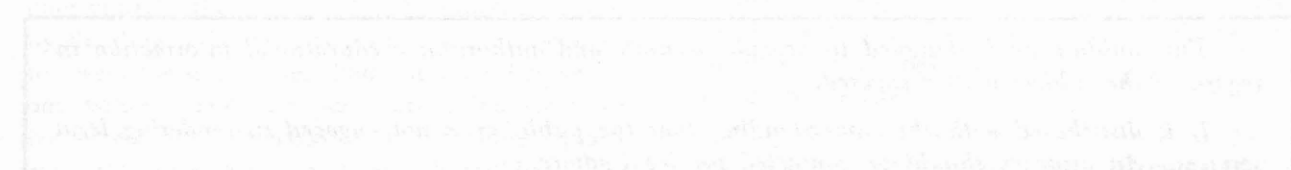
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