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Second Annual Seminar on Estate Planning

Office of Continuing Legal Education at the University of Kentucky College of Law

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SECOND ANNUAL
SEMINAR ON ESTATE PLANNING

AUGUST 22-23, 1975



Presented by the
OFFICE OF CONTINUING LEGAL EDUCATION
UNIVERSITY OF KENTUCKY COLLEGE OF LAW

In cooperation with the
KENTUCKY BAR ASSOCIATION

SECOND ANNUAL

SEMINAR ON ESTATE PLANNING

FRIDAY-SATURDAY, JULY 18-19, 1975

FRIDAY, JULY 18, 1975

- 8:00 A.M. REGISTRATION, College of Law Building
- 9:00 A.M. WELCOMING REMARKS, John K. Hickey, Director of Continuing Legal Education, College of Law, University of Kentucky
- 9:15 A.M. CHAIRMAN-MODERATOR, Samuel Milner, Partner, Eblen, Howard and Milner, Lexington, Kentucky; Adjunct Professor of Law, College of Law, University of Kentucky
- SPEAKER, John T. Bondurant, Partner, Brown, Todd and Heyburn, Louisville, Kentucky, FREEZING THE FURTHER GROWTH OF THE ESTATE
- 9:45 A.M. SPEAKER, Edward A. Rothschild, Partner, Washer, Kaplan, Rothschild, Aberson, Miller and Dodd, Louisville, Kentucky, SOME USES OF LIFE INSURANCE IN ESTATE PLANNING: Split Dollar, Employee Group Life, Key Man, Funding Buy-Sell Agreements
- 10:30 A.M. COFFEE
- 10:45 A.M. SPEAKER, Edwin H. Perry, Partner, Greenebaum, Doll, Matthews & Boone, Louisville, Kentucky, BUY-SELL AGREEMENTS: (a) Corporate, Partnerships, Sole Proprietorships and Tenants in Common; (b) Problems Created by Income Tax Attribution Rules
- 11:30 A.M. SPEAKER, P. Michael Davis, Professor of Accounting, College of Business and Economics, University of Kentucky, Lexington, Kentucky, USE OF PRIVATE ANNUITIES IN ESTATE PLANNING

- 12:00 NOON LUNCHEON, Student Center Ballroom
- 1:30 P.M. SPEAKER, Philip W. Moss, Esquire, Cargill Incorporated Law Department, Minneapolis, Minnesota, USE OF GIFTS IN ESTATE PLANNING: (a) Gift of Life Insurance Ownership; (b) Gift Tax Annual Exclusion; (c) Present v. Future Interest; (d) Charitable Gifts
- 2:15 P.M. SPEAKER, Frederick W. Whiteside, Jr., Professor of Law, College of Law, University of Kentucky, ALTERNATIVE METHODS FOR GIFTS TO MINORS: (a) Uniform Gifts to Minors Act; (b) Internal Revenue Code Section 2503(c); (c) Outright Gift
- 2:45 P.M. SPEAKER, Robert M. Bath, Attorney, Senior Agent, Estate and Gift Tax Division, Internal Revenue Service, Lexington, Kentucky, SOME PROBLEMS IN VALUATION
- 3:15 P.M. COFFEE
- 3:30 P.M. SPEAKER, William V. Phelan, Partner, Schulman, Phelan, Tucker, Boyle and Mullen, Iowa City, Iowa, ESTATE PLANNING FOR THE FARMER
- 4:30 P.M. SPEAKER, John Peter Frank, CPA, Coopers-Lybrand, Lexington, Kentucky, METHODS OF DEFERRING PAYMENTS OF FEDERAL ESTATE TAX TO COPE WITH LIQUIDITY PROBLEMS
- 5:15 P.M. RECESS

SATURDAY, JULY 19, 1975

- 9:00 A.M. SPEAKER, Gladney Harville, Partner, Stoll, Keenon and Park, Lexington, Kentucky, WHAT TO LOOK FOR IN REVIEWING AN EXISTING ESTATE PLAN
- 9:30 A.M. A SIMULATED ESTATE PLANNING CONFERENCE WITH CLIENT, Participants: ATTORNEY, Samuel Milner, Eblen, Howard and Milner, Lexington, Kentucky; ACCOUNTANT, Kenneth Mayer, Certified Public Accountant, Alexander Grant and Company, Lexington, Kentucky; LIFE UNDERWRITER,

F. Donovan Cooper, C.L.U., Mutual Benefit Life Insurance Company, Lexington, Kentucky; TRUST OFFICER, Charles D. Mitchell, Jr., Bank of Commerce and Trust Company, Lexington, Kentucky; CLIENT, Thomas Ellis Meng, Green and Meng, Lexington, Kentucky

10:30 A.M. COFFEE

10:45 A.M. SPEAKER, William S. Dillon, Vice President, American National Bank and Trust Company of Chicago, Chicago, Illinois, TRUST FLEXIBILITY TECHNIQUES: (a) Spray, Accumulation, Spendthrift; (b) Short Term "Clifford" Trust; (c) Corpus Invasion

11:15 A.M. SPEAKER, Eugene F. Scoles, Professor of Law, School of Law, University of Oregon, POWERS OF APPOINTMENT - A SECOND LOOK FROM THE GRAVE

11:45 A.M. GENERAL DISCUSSION - QUESTIONS AND ANSWERS

12:15 P.M. ADJOURN

OUTLINE

FREEZING THE FURTHER GROWTH OF THE ESTATE

John T. Bondurant
Partner, Brown, Todd and Heyburn
Louisville, Kentucky

- A. Objective - to minimize or eliminate any subsequent increase in the value of a significant portion of an estate without inflicting any overall economic loss on the individual or his beneficiaries.
- B. General Approach - the technique or techniques used will depend upon a number of factors, such as the nature of the assets involved and the personal and economic circumstances of the individual and his beneficiary. Each technique generally has some good news, some bad news.
- D. Specific Techniques - illustrative, not exculsive:
 - 1. Sale to Beneficiaries. Converts asset with capability of growth into asset with fixed value (cash or installment note). Estate possibly then reduced by gift of cash or note. Constitutes present gift, even if in contemplation of death, has same value in estate as at time of gift. Note possible loss of increase in basis if pay any gift tax on gift of cash. Sale may be either for cash, with buyers probably obtaining financing, or at least in part on credit, with seller taking note or notes from purchasers and retaining vendor's lien or equivalent. Areas to be considered:
 - (a) Seller may recognize gain on sale. If has low basis, gain could be substantial. Use of income averaging or installment sale reporting of gain might help.
 - (1) If use income averaging, still might have minimum tax because long-term capital gain deduction is tax preference item.
 - (2) If report gain on installment basis, keep in mind that deferred gain not received prior to death constitutes income in respect of a decedent and gets no step up in basis on death.
 - (3) By same token, value of installment obligation for estate tax purposes does not affect income tax basis, so no disadvantage from using lowest possible valuation.

- (4) Gives rise to need for planning always necessary where have source of income in respect of decedent. Example -- If marital deduction trust holds interest in installment obligation, and spouse has complete inter vivos right of withdrawal, all income in respect of decedent attributable to trust's interest in installment obligation will be taxed to spouse (at least to the extent of distributable net income).
 - (b) May have question of bargain sale - often difficult to substantiate that sales price reflects full fair market value. Should provide for at least minimum interest on notes to avoid imputed interest provisions.
 - (c) Can generate unfavorable tax consequences in addition to realization and/or recognition of capital gain:
 - (1) If involves real estate, may require payment of transfer tax and trigger reassessment of property for ad valorem tax purposes.
 - (2) May cause recapture of depreciation (IRC §1245 and 1250) and of farm loss deduction (IRC §1251).
 - (3) May have denial of capital gain where depreciable property sold to spouse or certain controlled corporations (IRC §1239).
2. Sale of Remainder Interest (Estate of J.W. Kelley, 63 T.C. 321 (1974)). Should be for full value as measured by 6% life interest tables. Most likely for notes with retained lien, possibly on installment basis. Provide for minimum interest to avoid imputed interest. Areas to be considered:
- (a) Primary consideration is whether any part of asset includable in transferor's gross estate for federal estate tax. Kelley dealt only with gift tax, not estate or income tax considerations. Can argue that should not be includable in gross estate in remainder transferred for value. Dictum in Estate of William H. Myers, 27 TCM 975 (1968), seems to support this position. Uncertain area with good chance have to litigate. Under 6% interest tables, relatively high value of life interest reduces value (and price) of remainder interest.
 - (b) Can forgive or give back principal and interest on the notes.
 - (1) Forgiveness of notes characterized in Kelley as gift of present interest qualifying for

annual exclusion. May have adverse income tax effect on transferee-debtor, but probably no income to transferor (notes in Kelley were non-interest bearing).

- (2) Return of payment after made. More clear cut. Interest income and recognition of deferred gain by transferor, interest deduction to transferee-debtor. Clearly gift of present interest.

- (c) Basis for computing gain on sale by transferor apparently would be proportionate part of total basis. Basis of property in hands of transferee would apparently be consideration paid. Not entirely clear.

3. Capitalization or recapitalization of closely-held corporation. If asset to be frozen is stock in existing corporation, can either recapitalize that corporation or create another corporation to hold stock of first corporation. If asset is interest in unincorporated property, would create corporation to own that property.

- (a) Recapitalization - exchange individual's stock interest for new class of preferred stock, with cumulative dividend and preference on liquidation, but with fixed value. If individual owned 100% of stock new preferred stock should have fair market value essentially equivalent to fair market value of original common stock and new common stock should have only a nominal fair market value. New common with growth potential then given to beneficiaries or trusts. Areas to be considered:

- (1) Subjective requirement for tax-free recapitalization is that it have a business purpose. Might make risky to utilize this technique without obtaining a ruling from IRS.
- (2) Must be sure that preferred stock has sufficient value. Would include dividend in line with prevailing rates of return on similar securities.
- (3) New preferred stock probably be §306 stock. Should not present problem if preferred stock held until death or disposed of only after or at same time as disposes of all of his common stock.
- (4) If individual not need cumulative dividends on preferred stock, might let them accumulate so as to have them taxed only at capital gains rates on subsequent disposition of preferred. If died before disposed of preferred, might be possible to avoid any income tax on accumulated dividends.

(b) Creation of new corporation - individual's interest in unincorporated assets or in first corporation exchanged for preferred stock in new corporation. Common stock in new corporation acquired by others for assets or cash. Tax-free exchange. Areas to be considered:

- (1) Probably not have to be concerned about "business purpose" or §306 stock problem.
- (2) New corporation may be personal holding company, have to declare dividends on common stock to avoid personal holding company tax.

OUTLINE

SOME USES OF LIFE INSURANCE IN ESTATE PLANNING

Edward A. Rothschild
Attorney, CPA
Washer, Kaplan, Rothschild,
Aberson, Miller & Dodd
Louisville, Kentucky

A. Gifts and Beneficiary Designations Thereafter

1. Gifts of life insurance policies

a. Advantages

- (1) The full proceeds of the policy will be removed from the donor's gross estate, even though for gift tax purposes the value of the policy will not be the face proceeds but only its replacement value at the date of gift.
- (2) A gift of a life insurance policy ordinarily causes no loss of current income to the donor, whereas a gift of most other assets will involve a loss of current income.
- (3) A gift of many assets may perpetuate a low income tax basis in the hands of the donee; with a gift of life insurance, the beneficiary can take the proceeds and purchase assets at the decedent's death whose basis will be their then fair market value.
- (4) The donee will have no management problems.
- (5) The donee will be psychologically much less likely to squander a life insurance policy than almost any other asset.

b. Disadvantages

- (1) There is no income tax saving to the donor, as contrasted with the income tax situation where productive assets are given away.
- (2) Any gift tax will ordinarily not have a basis effect on the policy, whereas gift taxes paid in connection with gifts of other assets may increase the basis of those assets by the amount of gift tax paid.

- (3) Gifts of life insurance are particularly vulnerable to the contemplation of death problem because to some extent a life insurance policy is inherently testamentary. If the donor lives for three years after the gift, the problem will disappear by virtue of the presumption provided in Section 2035(b).
- (4) A gift of a life insurance policy will not afford the donee any management experience.
- (5) A gift of a life insurance policy may remove liquid funds from the use of the donor's executor. Of course, there is nothing to prevent the donee, upon the donor's death, from lending money to, or buying assets from, the donor's estate, in order that the donor's estate may have the desired liquidity.

2. Gift tax aspects

a. Valuation of the policy

Before the gift is made, the planner should obtain from the insurance company a statement showing the value, for gift tax purposes, of the policy on the proposed date of gift. After the gift is made, the insurance company, upon request, will furnish Treasury Form 938 for each policy which is given away. This form should be attached to the donor's gift tax return (Form 709).

b. Annual exclusion

If the donor wants to be certain that the entire gift will be a "present interest," and thereby qualify for the annual \$3,000 exclusion, he will generally make an outright gift of a policy. A gift in trust of the policy will ordinarily not qualify for the annual exclusion.

Where the policy to be given to a donee has a value in excess of \$3,000, the donor can request the insurance company to split the policy into several smaller policies, and one of the smaller policies can be given away in each year. Another alternative is to have the donor borrow on the security of the policy and then to make a gift of the policy subject to the loan. The loan can be made in such an amount that, when deducted from the unencumbered value of the policy, the value of the gift will be slightly less than \$3,000. In each year thereafter, the donor can make further gifts by paying off \$3,000 of the loan.

c. Marital deduction

Where the donor's spouse is to be the donee, the gift tax marital deduction will be available if the gift is made outright to her. If, however, the gift of the policy is in trust, great care must be taken in drafting the trust instrument to insure the availability of the marital deduction.

d. Split gifts

Where gifts are made by one spouse to a third party, the gift may be considered as having been made one half by each spouse.

If the wife is a donee to any extent, the gift-splitting privilege is not available as to the value of her interest.

e. Subsequent payment of premiums

- (1) If the premiums subsequently are paid by the donor they will generally be treated, for purposes of the annual exclusion and the marital deduction, in the same manner as a gift of the policy.

f. Designation of beneficiary after gift

- (1) Husband gives to wife the ownership of a policy on husband's life. Wife names herself as the beneficiary of the policy. Upon husband's death, wife receives the proceeds; she has not made a gift because she cannot make a gift to herself.
- (2) Husband gives to wife the ownership of a policy of insurance on husband's life. Wife names her children as beneficiaries of the policy. Upon husband's death, the children receive the proceeds. Wife will be deemed to have made a gift, at her husband's death, of the full proceeds of the policy. The theory is that since the wife had the power to receive the proceeds, she constructively received them and then immediately gave the proceeds to her children.

Where the owner names herself as life beneficiary of the proceeds and designates her children to receive the proceeds after her death, she has made a gift, at her husband's death, of the actuarial value of her children's remainder interest. Furthermore, when she subsequently dies, the proceeds will be included in her gross estate under Section 2036 as a transfer with a retained life estate. A credit for any gift tax paid when her husband died will be available.

g. Death of donee before insured

(1) Donee's estate tax

If the donee dies before the insured, the gift tax value of the policy will be included in the donee's gross estate. If the insured dies within six months after the donee, and if the donee's executor elects the alternate valuation method, the full proceeds will be included in the donee's gross estate. It is probably advisable, where a donee owns a policy of insurance on the life of the donor, for the donee's will specifically to bequeath the policy to someone, and for the executors to satisfy the bequest as soon as possible after the donee's death.

(2) Designation of new owner of policy

- (a) Some insurance companies will permit the designation by the donee of contingent owners of the policy, in the event the donee predeceases the insured.
- (b) If a contingent owner is not named in the policy, the ownership of the policy will pass under the donee's will. Where a wife owns a policy of insurance on her husband's life, it will often be desirable for the wife specifically to bequeath the policy to her children, or testamentary trust in her will, rather than back to her husband, in whose estate the full proceeds will be included if he subsequently dies with any of the incidents of ownership.
- (c) If the ownership of the policy passes to a testamentary trust, of which the insured is a trustee, the insured may be considered to have incidents of ownership in the policy. There are three solutions to this problem, if the ownership of the policy is to vest in trustees: (i) the safest one is not to name the insured as a trustee; (ii) another possible solution is to name two or more trustees but to provide that the insured, as co-trustee, shall have no vote or power with regard to any policy of insurance on his life which is an asset of the trust; and (iii) if the insured is not a beneficiary of the trust, recent cases indicate there should be no tax problem when the trustee dies.

(d) Although the Internal Revenue Service has not issued a regulation dealing specifically with an insured acting as an executor of an estate which owns a policy of insurance on his life, the same precaution as in the trustee context should probably be exercised.

h. Complete divestiture of incidents of ownership

If an insured intends to give away all the incidents of ownership of a policy on his life, he should do so both nominally and practically. Nominally, he should be certain that the insurance company's forms are sufficient to divest him of any rights to deal with the policy.

i. Selection of policies to be given away.

Where an insured owns a number of policies and desires to give away some, but not all, of the policies, consideration must be given to the advantages of giving away one type of policy rather than another.

(1) Term policies--individual or group

The chief advantage of giving away the ownership of term policies is that the gift tax value will be nominal or, in some cases, zero. The main disadvantage is that if the donor dies within three years after making the gift, it will be almost impossible to maintain an argument that the policies were not given away in contemplation of death, because the policies will generally have little or no cash value and afford no advantage to the donee immediately after the gift.

(2) Ordinary life policies

If an insured has several ordinary life policies, it is best initially to select the most recently issued ones, because the ratio of the gift tax value of these to the estate tax value will generally be lower than the earlier issued policies.

(3) Endowment and limited pay policies

The gift tax value of these will be higher in proportion to the face amount than in ordinary life policies, conversely, the Service's contemplation of death argument is weaker because the cash value of these policies will be correspondingly higher than in ordinary life policies.

(4) Paid-up policies

Because the gift tax value of paid-up policies will often be very close to the face value, there is little advantage to giving them away if other policies are available.

(5) Policies containing accidental death benefits provision

Policies containing an accidental death benefit provision should be given away in preference to policies without the provision because, if the insured dies in an accident, the additional death benefit will have been removed from his estate at practically no additional gift tax cost.

B. Life Insurance Trusts

1. Revocable trusts

a. Unfunded

An unfunded revocable life insurance trust is created by a trust agreement wherein the trustee is authorized to collect the life insurance proceeds at the death of the insured and to administer them according to the terms of the trust agreement. The trustee may or may not assume active duties until the death of the insured. Generally, premium notices are sent directly to the grantor, and the grantor retains the right, during his lifetime, to revoke, alter, or amend the trust.

b. Funded

A funded revocable life insurance trust is created by transferring cash, securities, or other property to the trust. Generally, the income from the trust will be used to pay the premiums due on the insurance policies, and the balance of the income will be paid to the grantor.

c. Tax consequences

The Tax consequences of a revocable trust, funded or unfunded, are very simple. At the grantor's death, the full value of the trust, including the entire death proceeds of the insurance, will be included in the grantor's gross estate.

2. Irrevocable trusts

a. Unfunded

- (1) An irrevocable unfunded life insurance trust is created by an irrevocable ownership of the insurance policies. Unless the policies are surrendered, exchanged, or converted, the trustees will have no active duties until the death of the insured.
- (2) Premium notices are sent to the trustees, who are the owners. The trustees, of course, have no funds with which to pay the premiums, so that the premiums are usually paid either by the grantor or by one or more of the beneficiaries of the trust.

b. Funded

An irrevocable funded life insurance trust is created by irrevocably transferring cash, securities, or other property to the trust in addition to the insurance policies. The income from the trust is used to pay the premiums due on the insurance policies, and the balance of the income is either accumulated or paid to one or more of the trust beneficiaries, in the manner set forth in the trust agreement.

c. Tax Consequences

- (1) Generally, the major purpose of creating an irrevocable insurance trust is to remove the assets of the trust from the grantor's gross estate.
- (2) The funded irrevocable trust would therefore seem to be free from estate taxation if the grantor lives for at least three years, retains no rights to receive any of the income and does not name himself a trustee.
- (3) The creation of an irrevocable trust is a taxable gift.
- (4) If the trust is unfunded, the gift will probably be a gift of a future interest, unless the beneficiary of the trust can compel the conversion of the insurance policies to income-producing assets or can withdraw some portion of the trust. If the trust is funded, only the value of the right to receive the income after deducting the amount of income necessary to pay the premiums on the policies, would seem to qualify as a gift of a present interest.

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- (4) If the trust is unfunded, the gift will probably be a gift of a future interest, unless the beneficiary of the trust can compel the conversion of the insurance policies to income-producing assets or can withdraw some portion of the trust. If the trust is funded, only the value of the right to receive the income after deducting the amount of income necessary to pay the premiums on the policies, would seem to qualify as a gift of a present interest.

- (5) If the grantor continues to pay the premiums, the premium payments will be considered to be taxable gifts, and if the gift of the policies was considered to be a gift of a future interest, the gift of the premiums will also be considered to be the gift of a future interest.
- (6) No income tax problem exists with respect to an unfunded insurance trust since such a trust will have no income; in a funded trust, the income will be taxed to the trust, if accumulated, or to the beneficiary, if distributed.

3. Testamentary trusts

- (a) Where someone other than the insured owns a policy of insurance on the life of the insured and dies before the insured, the ownership of the policy might, unless bequeathed outright, pass to a trust under the owner's will. If a testamentary trust also has other assets, the income from which is used to pay the premiums on the policy, there will be no gift tax on the premium payments since an irrevocable trust cannot make a taxable gift.
- (b) The major difficulty with the ownership of insurance policies by testamentary trusts is an estate tax problem. If the insured is a trustee, the proceeds of the insurance may be included in the insured's gross estate at his subsequent death; if the insured is a beneficiary of the trust, but not a trustee, it is possible, although not likely, that the Service will argue that the insurance proceeds should be in the gross estate on the basis that one of the incidents of ownership is "the right of the insured or his estate to the economic benefits of the policy."
- (c) The safest procedure is to remove any connection of the insured from the testamentary trust. One method is to provide for two testamentary trusts, one, an unfunded trust owning only life insurance policies and naming persons other than the insured as beneficiaries and trustees, and the other, a trust containing all other assets.

C. Business Purchase Agreements

Business purchase agreements usually are drafted in one of two forms:

1. Stock Retirement Plans, where the corporation agrees to redeem the stock of the deceased shareholder from his estate. Typically, the corporation will own a policy on each of the shareholders and will use the proceeds to help pay the purchase price of the stock.
2. Cross-Purchase Plans, where each stockholder takes out enough insurance on each other stockholder to enable him to purchase a pro rata share of the decedent's stock.
 - (a) Both of these plans can be used for purchasing the interest of a deceased partner in a partnership, as well as a deceased stockholder of corporation.
 - (b) Under a properly executed arrangement, there should be no danger that the value of both the business interest and the insurance proceeds will be included in the decedent's gross estate.

D. "Split-Dollar" Insurance

1. The typical "split-dollar" plan requires that the corporation purchase a "whole" life insurance policy on one of its employees. The corporation is the sole owner and beneficiary of the policy proceeds not in excess of cash value. By a supplemental agreement, the corporation agrees to pay that part of the net premium which equals the annual increase in cash value of the policy, the employee pays the remainder in return for the right to designate the beneficiary of the death benefits in excess of cash value.
2. Regardless of the form in which the split dollar arrangement is cast, the employee has an incident of ownership over that portion of the proceeds which are not to be refunded to the employer, primarily because he has the right to designate the beneficiary thereof. Accordingly, the portion of the proceeds will be included in his gross estate for purposes of estate taxation.

E. Group Life Insurance

1. One of the major problems involving the taxation of life insurance is whether the insured may assign all of his incidents of ownership in a group life insurance plan in order to remove its proceeds from his gross estate at death.
2. In Rev. Rul. 72-307, the Revenue Service announced that the power to cancel a group term life insurance policy solely by terminating employment is not an incident of ownership, such that the proceeds of the policy are not includable in the insured's gross estate under those facts. Rather, the Service characterized such a power as "a Collateral consequence of the power that every employee has to terminate his employment."

3. The proceeds of life insurance have been held includable in the employee's gross estate because he retained the conversion privilege. This right was an incident of ownership.
4. In 41 states, legislation has been passed expressly validating assignments of group life policies, including assignments of the conversion privileges.

F. Qualifying Insurance Proceeds for the Estate Tax Marital Deduction.

1. Inclusion in gross estate.

The first prerequisite is that the proceeds themselves must be includable in the decedent's gross estate in order to qualify for the marital deduction.

2. Manner of payment

(a) Lump-sum distribution

A lump-sum distribution to the surviving spouse will qualify for the marital deduction if the widow's rights vested immediately upon the insured's death, or if they must vest within six months after the insured's death.

3. Payments to spouse and her estate.

An option providing a life annuity, installment payments, interest payments, or even no payments at all during the surviving spouse's lifetime will qualify if:

(a) during the surviving spouse's lifetime, no one else can receive any payments; and

(b) at the surviving spouse's death, any amounts remaining with the insurer are distributed to the estate of the surviving spouse.

There must not be any contingency such as remarriage or failure to submit due proof of death which would permit the proceeds to be paid to any one other than the surviving spouse or the estate of the surviving spouse, if the proceeds are to qualify for the marital deduction under this provision.

4. Payments to spouse and contingent beneficiaries

Section 2056(b) (6) provides as follows:

"(6) LIFE INSURANCE OR ANNUITY PAYMENTS WITH POWER OF APPOINTMENT IN SURVIVING SPOUSE--

In the case of an interest in property passing from the decedent consisting of proceeds under a life insurance, endowment, or annuity contract, if under the terms of the contract such proceeds are payable in installments or are held by the insurer subject to an agreement to pay interest thereon (whether the proceeds, on the termination of any interest payments, are payable in a lump sum or in annual or more frequent installments), and such installment or interest payments are payable annually or at more frequent intervals, commencing not later than 13 months after the decedent's death, and all amounts, or a specific portion of all such amounts, payable during the life of the surviving spouse are payable only to such spouse, and such spouse has the power to appoint all amounts or such specific portion, payable under such contract (exercisable in favor of such surviving spouse, or of the estate of such surviving spouse, or in favor of either, whether or not in each case the power is exercisable in favor of others), with no power in any other person to appoint such amounts to any person other than the surviving spouse.

- (a) such amounts shall, for purposes of subsection (a), be considered as passing to the surviving spouse; and
- (b) no part of such amounts shall, for purposes of paragraph (1)(a), be considered as passing to any person other than the surviving spouse.

This paragraph shall apply only if, under the terms of the contract, such power in the surviving spouse to appoint such amounts, whether exercisable by will or during life, is exercisable by such spouse alone and in all events.

5. Option elected by surviving spouse

If the proceeds are payable in a lump sum to the surviving spouse the deduction is available even though the surviving spouse elects instead to take them under a settlement option which, itself, does not qualify.

G. Qualified Pension and Profit-Sharing Plans

In a noncontributory qualified plan, Section 2039 (c) provides that the entire value of any death benefits will be excluded from the decedent's gross estate unless the benefits are payable to the decedent's executor. In a contributory plan, such a similar exclusion is available, but is limited to a fractional part of the death benefits.

- (a) Example 1: In a noncontributory profit-sharing plan, the employer contributed \$40,000 allocable to the decedent's benefits, the decedent contributed nothing. At decedent's death, his wife received \$80,000 as beneficiary under the plan. The entire \$80,000 will be excluded from the decedent's gross estate.
- (b) Example 2: In a contributory profit-sharing plan, the employer contributed \$30,000 allocable to the decedent's benefits, and the decedent contributed \$10,000. At the decedent's death, his wife receives \$80,000 as his beneficiary under the plan. The exclusion fraction is
- \$30,000 (employer's contribution)
- \$40,000 (employer's and employee's contribution)
- Therefore, the amount excluded from the gross estate will be $\frac{3}{4}$ times \$80,000 or \$60,000; \$20,000 will be included in the decedent's gross estate.
- (c) The above rules apply not only to payments from uninsured trusts or under group annuity plans, but also to the entire amount, including any amount at risk, payable on account of any insurance or other contract, including a group insurance contract, acquired by a qualified plan.
- (d) The above rules apply to any distributions on account of the death of a participant dying after December 31, 1953, if the plan was qualified at the time of death or was qualified at separation from employment or termination of the plan. These rules do not apply, however, and the estate tax advantages of Section 2039(c) will be lost if death occurs after retirement, other separation from employment, or termination of the plan, and the decedent had constructively received the value from which the later death benefit is derived. Presumably, Section 2039(c) would not apply therefore when an insurance contract is distributed at separation from employment or termination of a qualified plan, and is not converted within 60 days to an annuity. Under Section 72 (h) constructive receipt occurs unless the policy is converted within 50 days.
- (e) The rules of Section 2039 (c) will apply only when the death benefit is "receivable by any beneficiary (other than the executor)".

Comment: The wisest course is to make the benefits payable either to named individuals or to a trust which is under no obligation to pay any of the decedent's debts or taxes.

H. Apportionment of Estate Taxes

Section 2206 provides:

"Unless the decedent directs otherwise in his will, if any part of the gross estate on which tax has been paid consists of proceeds of policies of insurance on the life of the decedent receivable by a beneficiary other than the executor, the executor shall be entitled to recover from such beneficiary such portion of the total tax paid as the proceeds of such policies bear to the sum of the taxable estate and the amount of the exemption allowed in computing the taxable estate, determined under Section 2051.

I. State Inheritance Taxes

1. In many states, the proceeds of an insurance policy will be exempt from state inheritance taxes if the proceeds are not payable to the decedent's estate. Incidents of ownership are generally irrelevant. Under Kentucky law you can leave the proceeds to a testamentary trust and still avoid Kentucky Inheritance Tax.
2. The effect of policy loans on the inheritance tax exemption can often be another very important issue for state inheritance taxation. If the loan is made from the insurance company against the cash or loan value of the policy, the general rule is that the loan does not create personal liability or a general obligation of the insured's estate, but merely reduces the face amount of the policy and the proceeds payable to the beneficiary. The loan, therefore, is disallowed as a deductible claim against the estate.
3. On the other hand if the loan is made from a bank on a personal note of the insured and the policies are merely pledged as collateral, it has been held in most jurisdictions that the loan is a valid claim against the estate, and that, depending upon the insured's intent, the beneficiary under the policies has a claim against the estate for the amount of the proceeds used to pay off the debt.

OUTLINE

BUY-SELL AGREEMENTS

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1. Definitions.

- a. Stock Purchase Agreement - Between corporation and shareholders, often with secondary obligations or options in other shareholders concerning stock.
- b. Stock Cross-Purchase Agreement - Between shareholders.
- c. Partnership Purchase Agreement - Between partnership and partners.
- d. Partnership Cross-Purchase Agreement - Between partners.
- e. Buy-Sell Agreement - Generic name for all of the above.
- f. ESOP - Employee Stock Ownership Plan and/or Trust.

2. Advantages and Disadvantages of Stock Purchase Agreement.

a. Advantages:

- (i) Simplicity
- (ii) Usually corporation has greater cash resources for purchase.
- (iii) As often corporation not required to buy, gives it and controlling shareholders greater flexibility.
- (iv) Reduction of earnings and profits.
- (v) Can subject new shareholders to agreement automatically if have Article or By-Law provision on sale to corporation.
- (vi) If insurance acquired to fund purchase, only need one policy for each shareholder.
- (vii) Miscellaneous.

b. Disadvantages:

- (i) State law restrictions on corporate redemptions.
- (ii) Value of corporation may be increased after redemption, but cost basis to shareholders remains the same.
- (iii) Attribution rules can effectively prohibit corporate redemption.
- (iv) Sec. 531 problems on accumulation of cash to fund redemption.
- (v) Miscellaneous.

3. Advantages and Disadvantages of Stock Cross-Purchase Agreements.

- a. These are mainly the correlative of items listed in Paragraph 2.
- b. Serious disadvantage is difficulty of finding source of funds to shareholders to effect purchase.
- c. Insurance policies to fund purchases cause quite a few problems.

4. Advantages and Disadvantages of Partnership Purchase Agreements and Partnership Cross-Purchase Agreements.

- a. In small partnership Cross-Purchase Agreement more feasible because usually capital assets small and thus amounts need to fund purchase small.
- b. As partnership grows in numbers and capital, Partnership Purchase Agreement more feasible.
- c. Problems in Partnership Buy-Sell Agreements are directed more towards the character of amounts received on sale than identity of the purchaser.

5. Sole Proprietorship Buy-Sell Agreements.

- a. These are always between the sole proprietor and purchaser as no entity exists to make purchase.
- b. Experience has been seldom utilized.

6. Valuation.

- a. Fixed-Price method.
- b. Appraisal method.
- c. Book value method and variations thereof.
- d. Capitalization of earnings method.
- e. Combination of above methods.

7. Major Elements of Corporate Buy-Sell Agreements.

- a. Parties affected.
- b. Events causing purchase or offers.
- c. Whether purchase mandatory or optional.
- d. Secondary purchases or options.
- e. Definition of Purchase Price.
- f. Payment of Purchase Price.
- g. Restrictions on transfer of stock.
- h. Agreement termination date.

8. Problem Areas.

- a. Treatment of redemption as capital transaction under Sec. 302.
- b. Funding purchase.
- c. State law restrictions on corporate redemption.
- d. Estate tax value of shares.
- e. Securities law considerations.
- f. Treatment of insurance proceeds in determining Purchase Price.
- g. Valuation in Subchapter S corporations.

9. Use of ESOP to Purchase Stock.

- a. Background of ESOPs.
- b. General outline of ESOPs.
- c. Conversion of existing qualified plans to ESOPs.
- d. Use in special situations.

OUTLINE

USE OF PRIVATE ANNUITIES IN ESTATE PLANNING

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- I. Introduction
- II. Situations Calling for Use of Private Annuities
 - A. Transfer of Stock
 - B. Transfer of Apartment Building
 - C. Transfer of Farm
 - D. Transfer of Cash
- III. Advantages of Private Annuities
 - A. Estate Tax
 - B. Gift Tax
 - C. Contemplation of Death
 - D. Income Tax
 - E. Unavailability of Commercial Annuity
- IV. Limitations Upon the Use of Private Annuities
 - A. Non-payment Risk
 - B. Early Death of Transferor
 - C. Late Death of Transferor
 - D. No Deduction for Interest
 - E. Problems of Inflation
 - F. Economic Burden on Transferee
 - G. Valuation Problems
 - H. Total Tax Cost
- V. Estate Tax Consequences
 - A. General Scheme
 - B. Transfer Intended to Take Effect at Death
- VI. Gift Tax Consequences
- VII. Income Tax Consequences
- VIII. Conclusion

-OUTLINE

USE OF GIFTS IN ESTATE PLANNING

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Cargill Incorporated Law Department
Minneapolis, Minnesota

1. Introductory, General Objectives and Considerations
2. Gift of Life Insurance Ownership
 - A. Gift of Life Insurance versus Gift of Other Property
 - B. Group Term Life
 - C. Incidents of Ownership
 - D. Contemplation of Death Problems
3. Gift Tax Annual Exclusion
 - A. \$3,000 per Donee
 - B. Distinguished from Lifetime Exemption
 - C. Gift-splitting Distinguished from Marital Deduction
4. Present Interest versus Future Interests
 - A. Regulations Definition
 - B. Immediate Right to Possession or Enjoyment
 - C. Examples
5. Charitable Gifts
 - A. Removal from Estate
 - B. Gift Tax Deduction
 - C. Income Tax Deduction

OUTLINE

ALTERNATIVE METHODS FOR GIFTS TO MINORS

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I. Introduction

- A. The main alternative methods of making gifts to minors to be discussed are:
 - 1. Outright transfers to minors
 - 2. Guardianship transfers
 - 3. Gifts under custodianship statutes (Uniform Gifts to Minors Acts)
 - 4. Trusts
- B. In choosing the most suitable method, the following factors should be considered:
 - a) The family situation and general objectives of donor
 - b) The kind of property to be given
 - c) Ease of accomplishment--(mechanical requirements, costs, etc.)
 - d) Non-tax advantages/disadvantages
 - e) Tax results--gift tax, income taxes, estate tax
- C. Basic tax considerations
 - 1. Income tax
 - a) Income earned from donated property is taxed at the minor donee's lower rates, utilizing his separate \$750 exemption (and dividend exclusion of \$100 where applicable).

- b) The additional low income allowance (\$1600 in 1975) is no longer allowed for a dependent donee for investment type income but is still available for his earned income. I.R.C. § 141(e)
- c) Income from donated property actually expended for minor's support may be taxable to person (donor or other) under a duty to support the minor. §§ 677(b), 678

2. Gift tax

- a) The gift tax is applicable to complete and irrevocable transfers
- b) Section 2503(c) may save the annual \$3000 exclusion for each donee. It provides that a gift to a person under 21 is not a gift of a future interest if the property and its income:
 - (1) may be expended for the donee before he becomes 21; and
 - (2) will pass to him when he becomes 21 (or if he dies before reaching 21 will either be paid to his estate or as he may have appointed under a general power of appointment as defined in § 2514)

3. Estate tax

- a) Donated property is not included in grantor's gross estate unless:
 - (1) a gift in contemplation of death, § 2035; or
 - (2) revocable or subject to grantor's power of amendment or control § 2038 (also § 2036(a)(2))

II. Outright Transfers

A. Practical considerations

1. Relatively easy to put property in minor's name
2. But problems arise later
(management, sale, death of minor, e.g.)

B. Usual tax results

1. Income belongs to minor
2. Gift fully qualifies for gift tax exclusion, there being no "future interest" involved
(Rev. Rul. 54-400, 1954-2 C.B. 319)

C. Variations on outright transfers

1. Joint property arrangements
2. U.S. bonds
3. Life insurance
4. Other informal "do-it-yourself" arrangements

III. Guardianship (See K.R.S., Ch. 386)

A. Advantages: management, sale and transfer

B. Drawbacks: court supervision, accountings and costs, usually under antiquated statutes

C. Tax results, same as for outright transfers

IV. Gifts under Uniform Gifts to Minors Acts (K.R.S., Ch. 385)

A. General provisions in custodianship statutes

1. Purpose and scope
2. Kinds of property--money, securities, life insurance, annuity contracts
3. Form of gift--typically "...[name of adult] as custodian for...[name of minor] under Ky. U.G.T.M.A."
4. The custodian--usually any adult member of minor's family

5. Property and income may be expended for minor prior to his reaching 21; and must be paid to him at age 21
6. Minor over 14 can demand that property be used for support

B. Non-tax characteristics

1. Act provides a simple and inexpensive method of giving
2. Custodian has reasonable investment authority
3. Court supervision is not required
4. Custodianship terminates at age 21
5. Is custodianship a "trust"?

C. Tax consequences

1. Gift tax--transfer qualifies as a gift of present interest for purpose of exclusion. Rev. Rul. 59-357, 1959-2 C.B. 212
2. Income tax--income from property is taxed to the minor, but may be taxable to donor, or to another person, to extent the income is actually expended to discharge his obligation of support,

I.R.C. §§ 677(b)
Rev. Rul. 56-434, 1956-2 C.B. 23
Rev. Rul. 59-357, 1959-2 C.B. 212
at 214

a. Extent of support obligation

- (1) Local law determines (See Regs. 1.662(a)-(4))
 - (2) College education after 18 as an obligation?
3. Estate tax--If donor is custodian at his death, I.R.S. views property as taxable to his estate--a "prime issue".

Rev. Rul. 70-348, 1970-2 C.B. 193

V. Trusts

A. A wide variety in kinds of trusts and flexible trust provisions are available for minors, as is true for other trust beneficiaries:

1. Example: The types of trusts possible for minors include:

revocable trusts, irrevocable trusts

short term reversionary trusts

The trust terms may provide for invasion of the principal or for accumulation of income (either discretionary or mandatory).

2. Example of trust flexibility:

a) Not limited as to kinds of property

b) Need not terminate at age 21

c) May include spendthrift clause

d) Few restrictions on selection of trustee

e) Trust not of public record

B. Section 2503(c) trusts

1. Definition. If a trust provides that the property and income may be used for minor donee before he is 21 years old and will pass to him or his estate (or as appointed) upon his attaining 21 years of age, the entire transfer is a present interest for gift tax purposes under § 2503(c)

2. Some guidelines for § 2503(c) trusts:

a) There must be no substantial restriction upon trustee's power to expend for benefit of minor. Reg. 25.2503-4

Example: A substantial restriction exists when the trustee must consider other sources of income before he can expend for minor. Rev. Rul. 69-345, 1969-2 C.B. 226.

- b) Trustee can legitimately accumulate income (under language "may be expended"). Rev. Rul. 67-270, 1970-2 C.B. 349.
- c) The I.R.S. no longer insists that trust automatically terminate at age 21, provided the beneficiary is given the power to secure the property upon his demand. Rev. Rul. 74-43, 1974-1 C.B. 285.

3. Tax consequences:

- a) Gift tax: Exclusion allowable for transfers into trust under a program of gift giving (\$3,000 excluded from tax for each beneficiary each year).
- b) Income tax: Tax is effectively shifted from grantor to beneficiaries or to trust.

Qualification: to extent that income is actually used to discharge support obligation grantor may be taxed, § 677(b) (or sometimes another person under § 678).

- c) Estate tax: Ordinarily no tax.

But caution: watch invasion powers where grantor is trustee. § 2038.

C. Partial Section 2503(c) trusts

- 1. A trust may be so drawn that the entire income interest for the minor is a present interest utilizing both Sections 2503(c) and 2503(b), while the principal is a future interest.

Example: Trust directs that income for minor be either paid or accumulated until age 21; subsequent income from age 21 to 35 to be paid to him annually; principal to be distributed to him at 35. Result:

- (a) Income prior to 21 qualified under Section 2503(c);
- (b) Income from 21 to 35 is a future interest, Section 2503(b);
- (c) Principal is a future interest.

Arlene I. Herr, 35 T.C. 732 (1961)
aff'd. 303 F.2d 780 (3rd Cir. 1962);
Estate of David Levine, 63 T.C. No.
14 (11-23-74).

D. Section 2503(b)--"Mandatory Income Trust"

1. The entire income interest will qualify for gift tax exclusion, though trust continues past age 21, if the income is required to be distributed annually.
2. Main characteristics
 - a) All income must be distributed--but may have spendthrift provision.
 - b) Payment of principal to minor is deferred.
 - c) Cannot invade corpus for one other than beneficiary.
 - d) Possibility of income tax to beneficiary's parents.
3. Calculation of value of income interests. Regs. 25.2512-9(c), (with tables showing present values of lifetime interests and income interests for term of years).

VI. Recommendations

OUTLINE

SOME PROBLEMS IN VALUATION

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- I. Degree of Support Required for Returned Values of the Estate Assets
- II. Explanation of Term "Fair Market Value" as Applied to Valuation of Estate Assets
- III. Valuation of the Typical Kentucky Assets of Estates, such as Farms, Thoroughbreds, Tobacco and Corn Crops; Art Objects¹, Coal Interests², and Family Corporation Stock³.

(The above item 3 will be discussed by illustrative situations which involve points of law and valuation techniques. There will be a follow-up letter with citations of authorities.)

¹David Smith case, Trusts & Estates, June 1975, by Martin S. Ector.

²Kentucky Geological Survey - Special Pub. 18 Series X 1959, Methods and Considerations in Appraising a Coal Property by S.E. Fish.

³Estate of Gregg Maxcy, et. al. v. Comm., (T.C. Memo 1969-158).

ESTATE PLANNING FOR THE FARMER

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I. RECURRING ASPECTS OF ESTATE PLANNING FOR FARMERS

A. The sole proprietorship is the most prevalent form of farm business organization.

1. An integrated economic unit that is functionally indivisible.
2. Low ratio of liquid assets to total value.
3. Commingling of business and nonbusiness assets.

B. High frequency of use of the joint tenancy with right of survivorship form of ownership.

1. Does joint tenancy land produce joint tenancy crops?
2. Do joint tenancy cows produce joint tenancy calves?
3. Modern decisions tend to emphasize the intention of the parties rather than the common law formalities in determining whether a joint tenancy exists.

C. Intensive use of capital.

1. Appreciated land values.
2. Rising equipment costs.
3. Trend to larger farming units and to greater intensity of use.
4. Total reliance on debt financing.
5. Low labor input outside the immediate family.

D. The client's value emphasis.

1. Acceptance of a low rate of return on invested capital.

2. Relatively high values are imputed to unencumbered ownership of assets; independence; and the life style of country living.
3. Preference for uncomplicated transfer techniques such as the "simple" will; the legal life estate; and joint tenancy.
4. Tendency to understate values.
5. Mistrust of outside professional advisors and resistance to loss of control.
6. Apprehension about the adverse effects of inaction and resistance to change.

II. ESTATE PLANNING OBJECTIVES OF FARMERS

- A. The objectives rated most critical are often inherently incompatible.
 1. Retain ownership and control.
 2. Minimize death taxes and probate costs.
 3. Provide income and security for the surviving spouse.
 4. Keep the farm in the family.
 5. Treat all children fairly.
 6. Inability or unwillingness to assign priorities and resolve the conflicts.
- B. Time periods to be considered.
 1. During the joint lifetime of the husband and wife.
 2. During the lifetime of the survivor.
 3. Following the death of the survivor.

C. Techniques available.

- | | |
|-------------------------|-------------------------------------|
| 1. Intestacy | 10. Inter vivos trusts |
| 2. Joint tenancy | 11. Testamentary trusts |
| 3. Will | 12. Powers of appointment |
| 4. Marital deduction | 13. Leases |
| 5. Legal life estate | 14. Options |
| 6. Private annuity | 15. Partnership |
| 7. Installment contract | 16. Corporation |
| 8. Life insurance | 17. Disclaimer |
| 9. Outright gifts | 18. Installment payment
of taxes |

III. APPLYING THE AVAILABLE TECHNIQUES

A. During the joint lifetime of the husband and wife.

1. Identify and sever joint tenancies.
2. Gifts between spouses.
3. Gifts and "non-gifts" to children.
4. Marital deduction.
5. Life insurance.
6. Ownership of life insurance by an irrevocable trust.
7. Funded and/or unfunded revocable trusts.
8. Wills.
9. Installment sale contract.
10. Private annuity.
11. Options to lease and/or purchase.
12. Organization of a partnership and/or a corporation.

B. During the lifetime of the survivor.

1. Total or partial disclaimers by spouse and/or children.
2. Gifts to children.
3. Exercise or nonexercise of powers of appointment.
4. Installment sale contract.
5. Private annuity.
6. Life insurance.
7. Options to lease and/or purchase.
8. Installment payment of Federal Estate tax.
9. Organization of a partnership and/or a corporation.

C. Following the death of the survivor

1. Total or partial disclaimers.
2. Exercise or nonexercise of options.
3. Exercise or nonexercise of powers of appointment.
4. Installment payment of Federal Estate tax.

IV. ILLUSTRATIONS

A. Facts assumed

<u>Asset</u>	<u>(H)</u>	<u>(W)</u>	<u>Joint</u>	<u>Total</u>
(1) Farm land	--	--	\$ 160,000.	\$ 160,000.
(2) Livestock & Grain	\$ 20,000.	--	--	20,000.
(3) Machinery	40,000.	--	--	40,000.
(4) Misc. Assets	10,000.	5,000.	5,000.	20,000.
(5) Totals	\$ 70,000.	\$ 5,000.	\$ 165,000.	\$ 240,000.

Notes

- (a) Wife cannot substantiate contribution to jointly owned property. But read Estate of Everett Otte, 31 TCM 301 (1972) before conceding this point.
- (b) Two adult children.
- (c) Current wills prepared several years ago provide for outright devise of all assets to each other, if living, otherwise in equal shares to the two children. Approximate Federal Estate Tax payable under this arrangement:

(1) If W survives H:

H's estate pays	\$ 6,600.
W's estate pays	33,400.
TOTAL	<u>\$ 40,000.</u>

(2) If H survives W:

W's estate pays	\$ -0-
H's estate pays	38,600.
TOTAL	<u>\$ 38,600.</u>

B. Plan Model I.

- 1. Sever joint tenancies by putting those assets in H's name alone.

(a) Gift tax?

- 2. H signs a Will establishing a marital trust and a nonmarital trust for W with remainders to the two children.

- 3. Approximate Federal Estate tax payable under Model I:

(a) If W survives H:

H's estate pays	\$ 6,600.
W's estate pays	6,600.
TOTAL	<u>\$ 13,200.</u>

(b) If H survives W:

W's estate pays	-0-
H's estate pays	<u>\$ 38,600.</u>
TOTAL	<u>\$ 38,600.</u>

C. Plan Model II

1. Sever the farm joint tenancy into a tenancy in common between H and W.

(a) Gift tax?

2. Line 5 of Section IV, A above would be as follows:

<u>(H)</u>	<u>(W)</u>	<u>Joint</u>	<u>Total</u>
\$150,000.	\$ 85,000.	\$ 5,000.	\$ 240,000.

3. H signs a Will establishing a marital trust and a nonmarital trust for W with remainders to the two children. W signs a Will establishing a nonmarital trust for H with remainder to the two children.

4. Approximate Federal Estate tax payable under Model II:

(a) If W survives H:

H's estate pays	\$ 500.
W's estate pays	<u>15,800.</u>
TOTAL	\$16,300.

(b) If H survives W:

W's estate pays	\$ 1,600.
H's estate pays	<u>14,700.</u>
TOTAL	\$16,300.

D. Plan Model II-A

1. Same as Model II, except that following death of H, W disclaims one-half of the amount of the marital trust.

(a) If W survives H:

H's estate pays	\$ 5,800.
W's estate pays	<u>6,700.</u>
TOTAL	\$12,500.

(b) If H survives W:

(same as Model II)

E. Plan Model III

1. Sever joint tenancies and equalize holdings by gifts from H to W, so that each owns \$120,000.
 - (a) Gift tax?
2. Wills of each establish a nonmarital deduction type trust for the other with remainder to the two children.
3. Approximate Federal Estate tax payable under Model III:

(a) If W survives H:

H's estate pays	\$ 7,600.
W's estate pays	7,600.
TOTAL	<u>\$15,200.</u>

(b) If H survives W:

(same as (a) above)

F. Plan Model III-A

1. Same as Model III, except H and W each have Wills establishing a marital trust and a nonmarital trust for the other with remainders to the two children.
2. Approximate Federal Estate tax payable under Model III-A:

(a) If W survives H:

H's estate pays	-0-
W's estate pays	\$22,600.
TOTAL	<u>\$22,600.</u>

(b) If H survives W:

W's estate pays	-0-
H's estate pays	\$22,600.
TOTAL	<u>\$22,600.</u>

G. Plan Model III-B

1. Same as Model III-A, except following death of one spouse the other disclaims one-half of the marital deduction trust.

(a) If W survives H:

H's estate pays	\$ 2,100.
W's estate pays	<u>14,600.</u>
TOTAL	\$ 16,700.

(b) If H survives W:

(same as (a) above)

V. SUGGESTIONS FOR DRAFTING WILLS AND TRUST AGREEMENTS

- A. The typical farm proprietorship consists of land, buildings, machinery, livestock, feed, grain, growing crops, leases, accounts receivable, bank accounts, insurance policies, contracts, claims, and other tangible and intangible personal property.
 1. Are incumbrances to paid from estate assets or to be assumed by the devisee or legatee?
 2. Are insurance contracts to pass to the recipient of the insured property?
- B. Powers for the executor and trustee.
 1. The usual boiler plate provisions do not specifically include the range of powers necessary for efficient farm management.
 2. If family members are to serve in a fiduciary capacity a specific provision is necessary to free them from the normal restrictions relating to self-dealing.
- C. Consider and provide for the source of funds to be used for the payment of debts, expenses and death taxes.

1. Local law rules relating to abatement or contribution will often distort the intended result.
2. Will life insurance proceeds be available to the personal representative for the payment of debts, expenses and death taxes?

D. Provisions relating to options to lease or buy.

1. Determination of the rent or sales price, interest rate, and terms for payment.
2. Is the option to be personal to the optionee?
 - (a) Is it intended that the optionee may assign the option?
 - (b) Is it intended that the option pass by descent or Will to the heirs or devisees of the optionee?

E. Other matters.

1. It is intended that the Will operate to exercise any power(s) of appointment held by the testator?
2. Provision may be made to authorize a beneficiary to change the trustee and/or the situs of the trust.
3. Anticipate the use of disclaimers.

SELECTED READING LIST OF RECENT ARTICLES RELATING
TO ESTATE PLANNING FOR THE FARMER

- (1) "Use of Inter Vivos Trusts in Agricultural Estate Planning", 55 Iowa Law Rev. 1328 (1970).
- (2) "Contemporary Studies Project: Large Farm Estate Planning and Probate in Iowa", 59 Iowa Law Rev. 794 (1974).
- (3) Hines, "Special Problems in Planning the Agricultural Businessman's Estate", Chapter 73-11, 7 Institute on Estate Planning (University of Miami Law Center, 1973).
- (4) Harl, "Estate and Business Planning for Farmers", 19 Hastings Law J. 271 (1968).
- (5) Fiore, "Analyzing and Planning the Finances and Estate of the Family Engaged in Agricultural Business", 1 Estate Planning No. 2, p. 96 (Winter 1974).
- (6) Kelley, "Estate Planning for Farmers and Ranchers", 20 Practical Lawyer No. 2, p. 13, Feb. 1974.
- (7) Boehlje, "Intergeneration Transfers: Is Agriculture Unique?", 112 Trusts and Estates 172, Mar. 1973.
- (8) Peterson, "Estate Planning for Farmer-Client Now Calls for Special Adaption of Standard Techniques", Taxation for Lawyers, Sept. - Oct. 1973, p. 120.
- (9) Wright, "Estate Planning for Agricultural Interests", 25 Okla. Law Rev. 1 (1972).
- (10) ALI-ABA Course of Study, Tax Planning for Agriculture, held at Denver, Colorado, October 3 and 4, 1974.

OUTLINE

METHODS OF DEFERRING PAYMENTS OF FEDERAL ESTATE
TAX TO COPE WITH LIQUIDITY PROBLEMS

John Peter Frank III, CPA
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- I. Installment Payment Election Under Section 6166
 - A. Availability of Election
 - B. What Assets Qualify
 - C. What Estates Qualify
 - D. Pre-Death Planning
 - E. Timing and Form of Election
 - F. Acceleration of Payments
- II. Interplay of Sections 303 and 6166
- III. "Undue Hardship" Extensions Under Section 6161
- IV. Deferral of Tax Attributable to Reversionary or
Remainder Interests

OUTLINE

WHAT TO LOOK FOR IN REVIEWING AN EXISTING ESTATE PLAN

Gladney Harville
Partner, Stoll, Keenon and Park
Lexington, Kentucky

1. Changes in beneficiaries that have occurred such as births, deaths, health (both mental and physical), wealth or lack thereof, and client's relationship with beneficiaries.
2. Changes that have occurred in the law affecting:
 - a) Income or death taxation;
 - b) Descent and distribution;
 - c) Wills and trusts.
3. Liquidity requirements - changes in needs and availability.
4. Identify, locate and evaluate the assets.
5. Current addresses of beneficiaries.
6. Marital deduction - is it advisable?
7. Flower bonds - are they needed?
8. Stock in closely held corporations - examine corporate records if there is such stock.
9. Are inter vivos gifts or trusts advisable?
10. Are there Section 2036 problems?
11. Are there likely to be any Section 691 problems that can be removed?
12. Any powers of appointment created or being exercised - Section 2041.
13. Inflation and recession - effect on pecuniary versus fractional or percentage marital trust.
14. Mobility of client.
15. Smaller estates - marital trust - don't overpay to save taxes to the point where a surviving spouse is left to either beg or go destitute.

ESTATE PLANNING SEMINAR
Simulated Client Conference

The Facts

Harry Brown is 53 years old. His wife, Frances, is 50. They have a daughter, Helen, who is 17, and is mentally retarded. They also have a son, George, who is 19, and who is presently a freshman in college and has intentions of going to medical college.

Frances is not suited to handling assets or business matters, and does not wish to do so. Harry owns 50 percent of the capital stock of the X Corporation. The remaining 50 percent is owned by Frank Smith, who is 40 years of age. They do not have a buy-sell agreement.

There is in effect ordinary life insurance insuring the life of Harry with a face amount of \$73,000. All of the policies are owned by Harry. Harry has an after income tax income of \$40,000 per year.

There follows a financial statement of Harry. All of the assets are owned by him, and none are owned by Frances, and none are in joint ownership.

Financial Statement

Assets

Fifty percent of the capital stock of X Corporation	\$250,000
Miscellaneous investment properties (non-liquid)	150,000
Residence	90,000
Furniture and household goods	20,000

Automobiles	7,000
Art collection	<u>10,000</u>
TOTAL ASSETS	\$527,000

Liabilities

Promissory note payable on demand	<u>\$ 40,000</u>
TOTAL LIABILITIES	<u>\$ 40,000</u>
NET WORTH (Not including cash value of life insurance)	<u>\$487,000</u>

In the simulated client conference the participants are as follows:

Harry Brown, The Client	Thomas E. Meng
Life Underwriter	F. Donovan Cooper
Certified Public Accountant	Kenneth Mayer
Trust Officer	Charles D. Mitchell, Jr.
Attorney	Samuel Milner

OUTLINE

TRUST FLEXIBILITY TECHNIQUES

William S. Dillon
Vice President
American National Bank and Trust Company of Chicago
Chicago, Illinois

- I. Trust Flexibility Techniques
 - A. "Spray" or "Sprinkle" Provisions
 - B. Income Accumulations
 - C. Spendthrift Clauses
- II. Principal Invasion
- III. Short Term Trusts (Clifford Trusts)
- IV. Miscellaneous

OUTLINE

POWERS OF APPOINTMENT

Eugene F. Scoles
Professor of Law
School of Law
University of Oregon

1. Definitions and Terminology

A power of appointment is a power created or reserved by a person (the donor) having property subject to his disposition enabling the donee of the power to designate, within such limits as the donor may prescribe, the transferees of the property or the shares in which it shall be received.

Donor	Donee	Takers in Default Objects of the Power Appointees
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2. Classifications of Powers

- A. General Power - nearly complete ownership
- B. Special Power - nonbeneficial disposition
- C. Tax Classifications - general - non-general
- D. Method and Time of Exercise - by will or deed

3. Creation of Power

Inter vivos or testamentary - and why.

4. Exercise and Non-Exercise of Power

- A. Capacity - of donee as required by method of exercise
- B. Intent - when is the necessary intent shown?
- C. Lapse statutes
- D. Special powers have special problems
- E. Failure to exercise - where does it go now?

5. Renunciation, Release and Contracts

- A. Renunciation or disclaimer - I won't take it
- B. Release - I'll give it up
- C. Contracts to appoint - I'll promise to appoint

6. Rights of Creditors and Spouses

- A. Donor's Creditors and Spouse - as any other transfer
- B. Donee's Creditors and Spouse - is it property?

7. Rule Against Perpetuities

A reminder or two

8. A Few Tax Considerations (time permitting)

A. Federal Income Estate and Gift Tax

B. Apportionment of Federal Estate Taxes by Federal Statute