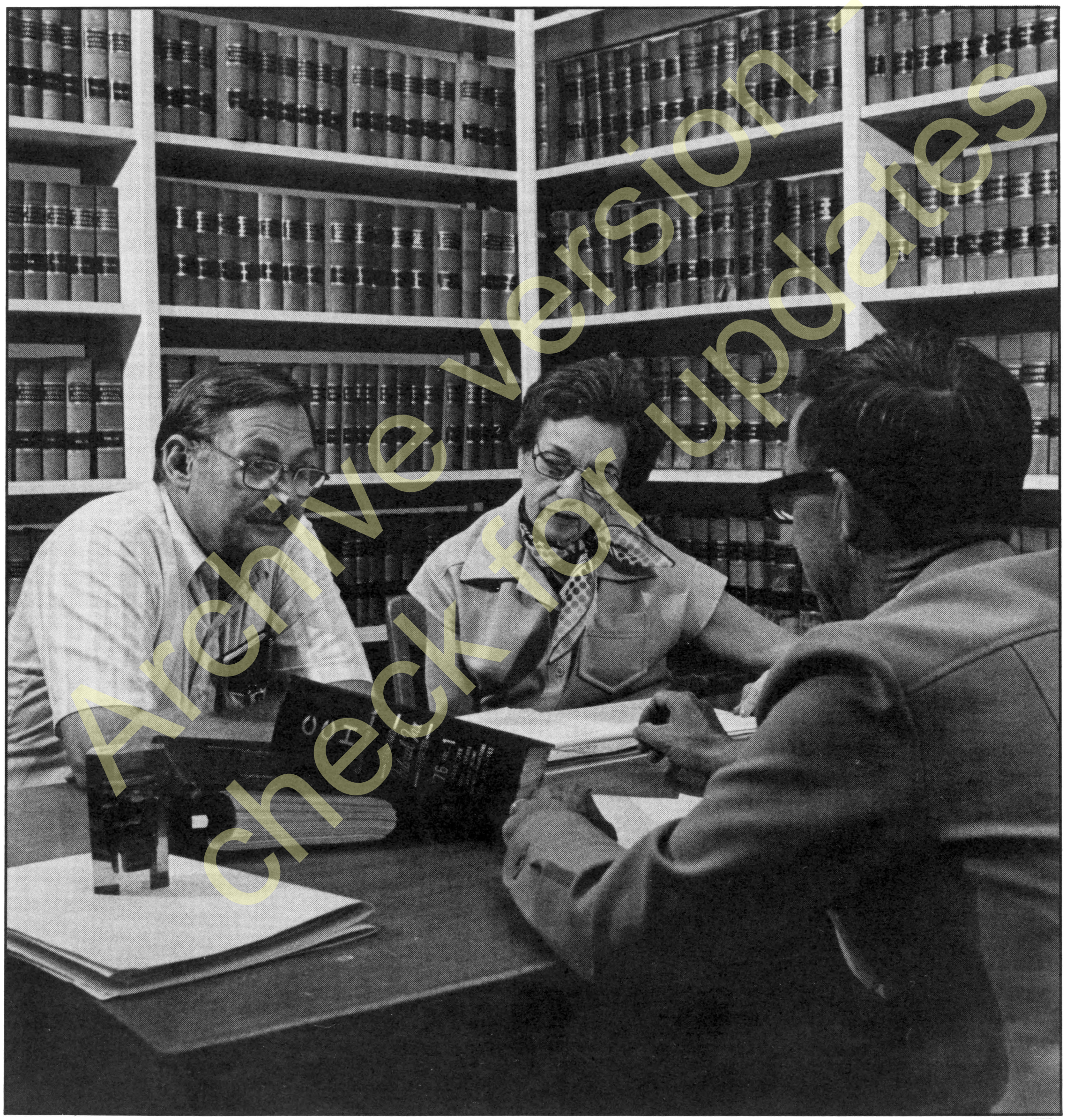
Estate Planning for Missouri Families



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Warning

Estate Planning For Missouri Families represents an attempt to inform you of the basic changes made by the Tax Reform Act of 1976, the Revenue Act of 1978, and the Economic Recovery Tax Act of 1981. You are urged to consult with your attorney and other professional advisors when you consider making decisions about your own situation.

This publication is not to be relied upon as an authoritative basis for interpreting estate planning laws. You should consult with your attorney when legal problems arise.

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Estate Planning For Missouri Families

by
Ronald L. Plain & Stephen F. Matthews

It has been said that one of the blessings of life is that people never know how long it will last. Most people were better prepared for birth, about which they could do nothing, than for death or taxes, about which they can do a great deal. While death is an unpleasant subject, it is inevitable.

An estate plan will not enable you to avoid death or taxes—but it does allow preparation for them and lessens their impact on surviving family members. When a person dies, his estate does not disappear with him. It remains behind to be distributed by someone. If a person does not provide a workable transfer plan for the courts to follow upon his death, the estate will be distributed according to state statutes.

What Is Estate Planning?

Estate planning involves more than the execution of a simple will. It is a comprehensive plan designed to create the desired economic and legal results in the disposition of your estate. It is the arrangement of affairs in such a manner as to provide adequate resources to care for you during retirement, to transfer property to the next generation with a minimal loss of assets, and to preserve your business operation for your chosen heirs.

Who Needs An Estate Plan?

Every property owner needs an estate plan. A proper one ensures the economic and legal consequences you desire. An estate plan may save thousands of dollars if your estate is large enough to be subject to federal estate taxes. There is also a need to plan a small estate. Careful planning for the small estate is essential to give you adequate income during retirement and care for your surviving spouse and minor children. It is also necessary to assure the desired distribution of your property and minimization of probate costs. In this publication, *large estate* refers to an estate which is subject to federal estate taxes; *small estate* refers to one which is not. A glossary of terms is provided at the end of this manual to aid the reader. Since deductions vary significantly from estate to estate (e.g., funeral expenses, expenses of administration), it is difficult to assign estate sizes above which federal estate taxes will always apply.

The size of estate which is small enough to be free of federal estate taxes is largely a function of two items - the marital deduction and the unified tax credit. These will be discussed in greater detail later. Beginning in 1982, no estate is subject to federal estate taxes on that portion of the estate left to the surviving spouse. If the maximum unified tax credit is available, the amount which can be left, tax-free, to persons other than the spouse is $175,000 in 1981, $225,000 in 1982, $275,000 in 1983, $325,000 in 1984, $400,000 in 1985, $500,000 in 1986 and $600,000 in 1987 and later. If the value of the property left to persons other than the spouse is less than these limits and if the maximum unified tax credit is available, the estate will be free of federal estate taxes.

Many property owners do not realize they have accumulated sufficient assets to place them in the large estate category. Other people, who are not currently in this category may someday find that inflation has made their estates large enough to be subject to estate taxes. Property which is considered a part of your estate for federal estate tax purposes includes not only property owned at death but also certain other property in which you have some interest or control. Since different legal considerations exist in the planning of small and large estates you should inventory your assets to determine which category your estate falls within. You should use present fair market value. Do not value assets at your cost for estate tax purposes. Special valuation alternatives for farms and closely held businesses should not be ignored.

The section on "Valuable Records" is included to aid you in making this inventory. After making the inventory, you should consult with an attorney to determine what estate planning alternatives would be best in your situation.

Who Should Plan the Estate?

Formal, written *legal* documents are used as tools in estate planning. Because the interpretation of these legal documents is controlled by the meaning which statute and courts have given the language used, you should never attempt to plan your estate by yourself.

A "homemade" plan can lead to an unnecessary wasting of assets because lawsuits are often required to determine the legal effect of each of the documents used to carry out the plan. Remember, when these documents are being interpreted, you will not be there to explain what you intended the language to mean.

To plan your estate you should contact your lawyer and explain your objectives to him. He* may find it necessary to consult with your accountant, life insurance agent, the representative of a bank or trust company, and other persons with a special knowledge of your estate. Your attorney will then draft all legal documents needed to implement your plan. The cost of securing an attorney's services will generally be much less than the wasting of assets which could occur in the absence of planning or with a homemade plan.

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*For simplicity this bulletin will refer to his or her situations in the male gender.

Objectives of Estate Planning

There are at least three general objectives in every estate plan:

1. To reserve sufficient resources to care for yourself during retirement;
2. To transfer property from one generation to the next in such a manner as to assure distribution of your assets to the person(s) of your choice; and
3. To conserve as much of your estate as possible for your survivors by minimizing death taxes.

Regardless of the size of your estate, the *first objective* of your plan is *to take care of yourself during retirement*. Since you are the person who has accumulated the assets which make up your present estate, it is only logical and fair that provisions be made to care for yourself first. The retention of control over a sufficient quantity of assets to assure you of an adequate retirement income also has the practical function of avoiding family disagreements.

The *second objective* of an estate plan is *to transfer your property to the persons of your choice*. For example, if you own your farm property, you may prefer that the farm be transferred to a son who has decided to remain on the farm and that other assets be distributed among the other children. One way of doing this is by the use of a properly executed will.

If you should die without having made a will, any property subject to probate will pass to your survivors in accordance with the Missouri statutes of intestate descent. A brief summary of these statutes is given on page 10. Rarely do these laws function to distribute assets in the manner desired by the decedent. They may transfer title to your heirs as tenants in common, with each receiving an undivided interest in the whole rather than giving each heir absolute title to specific assets.

The difficulties involved in dividing a business without destroying its efficiency as a productive economic unit might dictate that the only reasonable solution would be to sell the business and divide the proceeds among the heirs. Thus, your business might be sold to a non-family member. To help avoid this situation and assure that your assets will be distributed according to your wishes, planning is required.

The *third objective* of estate planning, *the conservation of a maximum amount of your estate for your heirs,* suggests that you may want to:

1. Keep the expenses of probate administration at a minimum; and
2. Keep federal and Missouri estate taxes at a minimum.

When a person dies, the distribution of much of the property of the estate will have to be administered by the probate court whether he leaves a will or not. The individuals who share in that distribution are determined by referring to the will or to the intestate statutes where there is no will.

Probate

The probate court serves to protect the rights of the heirs and to assure the orderly transfer of the property in accordance with the wishes of the deceased. The probate court also acts to protect the rights of creditors and at the same time to allow the estate to collect any debts that were owed to the decedent at the time of death. The probate court also has the duty to make certain that the rights of the surviving spouse are protected and that he or she is aware of the existence of those rights. In addition, the probate court has jurisdiction over the estates of minors and those found to be mentally incompetent and may appoint a guardian to handle the affairs of those who are incapable of managing their property. Finally, the probate court has the function of ensuring the collection of any taxes which might be due from the estate.

The administration of any estate involves certain expenditures which are generally governed by statute. For example, the compensation of an administrator or executor handling an estate in probate is set by statute. The Missouri rates of compensation for executors and attorneys, based on a sliding scale, are set out in *Table 1*. Only the value of personal property in the probate estate and the proceeds of real property sold under order of the probate court are subject to these rates.

An attorney should be employed to handle all legal work necessary in probating your estate. The law directs that he shall also be paid in accordance with the statutory scheme set out in *Table 1*.

Table 1

Probate Administration Fee Rates Set By Missouri Statute for Executors, Administrators and Attorneys

First	$ 5,000	5 %
Next	$ 20,000	4 %
Next	$ 75,000	3 %
Next	$ 300,000	2¾%
Next	$ 600,000	2½%
All Over	$1,000,000	2 %

SOURCE: Chapter 473.153, Revised Statutes of Missouri-1969, as amended.

Since both the executor (or administrator) and attorney are entitled by law to this compensation, doubling the percentage figure and multiplying it by the value of property which is subject to these costs will yield a fair approximation of the total expenses of administration in probate. The court may allow additional compensation to these individuals when reasonable and adequate for the work done.

The obvious way to avoid expenses of probate administration is to plan your estate so that your property is not part of the estate when it is admitted to probate. The cost of legal advice for this purpose is usually more than offset by the reduction in probate expenses.

Tax Considerations

Minimizing taxes will usually maximize the value of assets transferred to the next generation. Taxes which should be considered include the Missouri estate, federal estate, and federal gift taxes. There is no state gift tax in Missouri.

Missouri Estate Tax

Effective Jan. 1, 1981 the *Missouri estate tax* replaced the Missouri inheritance tax. This estate tax is related to the federal estate tax and places the responsibility for payment of the tax on the estate and its personal representative, not the property heirs.

Property taxed under the federal estate tax system is also subject to the Missouri estate tax. Property which previously avoided inheritance taxation, such as jointly held property, is now subject to the estate tax whether the property is probated or not.

The Missouri estate tax due is dependent upon the value of the federal estate tax due. The Missouri estate tax is the greater of either the credit allowed or the credit allowable as state death tax credits under the federal tax system. The tax credit allowable is calculated using *Table 2*. The credit is progressive in nature and is a function of the "adjusted taxable estate." The adjusted taxable estate is the taxable estate less $60,000.

The Missouri estate tax has eliminated the penalty for not bequeathing assets to close relatives and like the federal tax, does not recognize a difference in an heir's relationship with the decedent except in the case of the marital deduction.

Implementation of the Missouri Estate Tax has altered the approach toward estate planning some families should take. Some people who previously had no potential state death tax liabilities may now face substantial tax bills. Conversely, others that were subject to inheritance taxes may now escape taxation. To determine how the new tax system affects you, consult your estate planner. In general, strategies which minimize federal estate taxes will also minimize Missouri estate taxes.

Table 2
Missouri Estate Tax Rates

If the adjusted taxable estate is:		*The maximum tax credit shall be:*			
Not over	$90,000	8/10ths of 1% of the amount by which the adjusted taxable estate exceeds $46,000			
Over $90,000 but not over	$140,000	$400 +	1.6%	of excess over	$90,000
Over $140,000 but not over	$240,000	$1,200 +	2.4%	of excess over	$140,000
Over $240,000 but not over	$440,000	$3,600 +	3.2%	of excess over	$240,000
Over $440,000 but not over	$640,000	$10,000 +	4.0%	of excess over	$440,000
Over $640,000 but not over	$840,000	$18,000 +	4.8%	of excess over	$640,000
Over $840,000 but not over	$1,040,000	$27,600 +	5.6%	of excess over	$840,000
Over $1,040,000 but not over	$1,540,000	$38,800 +	6.4%	of excess over	$1,040,000
Over $1,540,000 but not over	$2,040,000	$70,800 +	7.2%	of excess over	$1,540,000
Over $2,040,000 but not over	$2,540,000	$106,800 +	8.0%	of excess over	$2,040,000
Over $2,540,000 but not over	$3,040,000	$146,800 +	8.8%	of excess over	$2,540,000
Over $3,040,000 but not over	$3,540,000	$190,800 +	9.6%	of excess over	$3,040,000
Over $3,540,000 but not over	$4,040,000	$238,800 +	10.4%	of excess over	$3,540,000
Over $4,040,000 but not over	$5,040,000	$290,800 +	11.2%	of excess over	$4,040,000
Over $5,040,000 but not over	$6,040,000	$402,800 +	12.0%	of excess over	$5,040,000
Over $6,040,000 but not over	$7,040,000	$522,800 +	12.8%	of excess over	$6,040,000
Over $7,040,000 but not over	$8,040,000	$650,800 +	13.6%	of excess over	$7,040,000
Over $8,040,000 but not over	$9,040,000	$786,800 +	14.4%	of excess over	$8,040,000
Over $9,040,000 but not over	$10,040,000	$930,800 +	15.2%	of excess over	$9,040,000
Over	$10,040,000	$1,082,800 +	16.0%	of excess over	$10,040,000

Source: Internal Revenue Code Section 2011.

Economic Recovery Tax Act of 1981

The Economic Recovery Tax Act of 1981 (hereafter referred to as the "ERTA") made major changes in the federal estate tax system. The system had been completely redesigned several years ago under the Tax Reform Act of 1976. It will be helpful to highlight the major changes in the federal estate tax laws made by the Economic Recovery Tax Act of 1981. Most changes take effect Jan. 1, 1982. A more detailed discussion will follow:

- **Lower Maximum Tax Rates**

Table 3, shows the unified tax rates for estate and gift taxation for decedents dying and gifts made prior to Dec. 31, 1981. The rates range from 18 to 70 percent. Beginning in 1982 the ERTA begins a phased-in reduction of the maximum tax rates. For gifts made or estates of decedents who die in 1982 the maximum tax is 65 percent of the excess over $4,000,000. For 1983, the maximum tax is 60 percent of the amount over $3,500,000. The maximum tax bracket in 1984 is 55 percent of the amount in excess of $3,000,000. The maximum tax rate for gifts made or decedents who die after Dec. 31, 1984 is 50 percent of the amount over $2,500,000. Tax rates for estates under $2,500,000 are not affected by this change.

Table 3.

Unified Estate and Gift Tax Rates*

If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Not over $10,000	18% of such amount.
Over $10,000 but not over $20,000	$1,800, plus 20 percent of the excess of such amount over 10,000.
Over $20,000 but not over $40,000	$3,800, plus 22 percent of the excess of such amount over $20,000.
Over $40,000 but not over $60,000	$8,200, plus 24 percent of the excess of such amount over $40,000.
Over $60,000 but not over $80,000	$13,000, plus 26 percent of the excess of such amount over $60,000.
Over $80,000 but not over $100,000	$18,200, plus 28 percent of the excess of such amount over $80,000.
Over $100,000 but not over $150,000	$23,800, plus 30 percent of the excess of such amount over $100,000.
Over $150,000 but not over $250,000	$38,800, plus 32 percent of the excess of such amount over $150,000.
Over $250,000 but not over $500,000	$70,800, plus 34 percent of the excess of such amount over $250,000.
Over $500,000 but not over $750,000	$155,800, plus 37 percent of the excess of such amount over $500,000.
Over $750,000 but not over $1,000,000	$248,300, plus 39 percent of the excess of such amount over $750,000.
Over $1,000,000 but not over $1,250,000	$345,800, plus 41 percent of the excess of such amount over $1,000,000.
Over $1,250,000 but not over $1,500,000	$448,300, plus 43 percent of the excess of such amount over $1,250,000.
Over $1,500,000 but not over $2,000,000	$555,800, plus 45 percent of the excess of such amount over $1,500,000.
Over $2,000,000 but not over $2,500,000	$780,800, plus 49 percent of the excess of such amount over $2,000,000.
Over $2,500,000 but not over $3,000,000**	$1,025,800, plus 53 percent of the excess of such amount over $2,500,000.
Over $3,000,000 but not over $3,500,000**	$1,290,800, plus 57 percent of the excess of such amount over $3,000,000.
Over $3,500,000 but not over $4,000,000**	$1,575,800, plus 61 percent of the excess of such amount over $3,500,000.
Over $4,000,000 but not over $4,500,000**	$1,880,800, plus 65 percent of the excess of such amount over $4,000,000.
Over $4,500,000 but not over $5,000,000**	$2,205,800, plus 69 percent of the excess of such amount over $4,500,000.
Over $5,000,000**	$2,550,800, plus 70 percent of the excess of such amount over $5,000,000.

*Source: Internal Revenue Code of 1954, as amended, Section 2001.

**A phased-in reduction of tax brackets over $2,500,000 begins in 1982.

• **Unified Credit**

The Act increases the value of the unified credit from its 1981 level of $47,000 to $192,800. This increase will be phased in over the next six years according to *Table 4*.

Table 4: Estate Tax Credits

Dying in Year	Credit	Maximum Exemption "Equivalent
1981	$ 47,000	$175,625
1982	62,800	225,000
1983	79,300	275,000
1984	96,300	325,000
1985	121,800	400,000
1986	155,800	500,000
1987 & later	192,800	600,000

• **Unlimited Marital Deduction**

The Economic Recovery Tax Act lifts the ceiling on the marital deduction of 250,000 or one-half the adjusted gross estate, whichever is greater. After 1981, there is no limit on the amount of property which can be transferred tax-free via estates or gifts to a spouse.

• **Gifts Within Three Years of Death**

For estates of decendents dying after 1981, most gifts made within three years of death are no longer included in the estate. This is a reversal of the position taken in the Tax Reform Act of 1976. The gifts are included, however, for purposes of determining qualifications for tax deferrals, stock redemptions and special use valuations.

• **Farm Realty Valuation: Section 2032A**

Qualification requirements for "actual use" valuation of real estate were clarified and eased for qualified farms and closely held businesses. In addition the maximum reduction in value was raised to $750,000. Special use valuation is discussed in more detail later in this publication. Additional information is available in MU Guide 505—*Farmland Valuation for Federal Estate Tax Purposes*.

• **Estate Tax Payment-Extension Rules**

If more than 35 percent of a decedent's adjusted gross estate is an interest in a farm or closely held business, the executor may elect to defer payment for up to 15 years, with the estate making an annual interest payment for the first five years and thereafter paying the tax and interest in ten annual installments. A special reduced 4 percent interest rate is available on the estate tax attributable to the first $1 million of farm or other closely held property.

• **Jointly Owned Property Between Husband and Wife**

The surviving spouse no longer needs to prove contribution to exclude half of jointly owned property from a decendent's estate. After 1981 the Act provides that, in the case of property jointly owned with the right of survivorship by spouses, the estate of the first spouse to die will include one-half of the value of the property regardless of which spouse furnished the consideration for the property.

• **Orphan's Exclusion**

The orphan's exclusion introduced in the 1976 Tax Reform Act is repealed by the Economic Recovery Tax Act for estates of decedents dying after 1981. It had allowed an additional exclusion for transfers to children under 21 years of age with no known surviving parent. The maximum deduction per child was $5000 multiplied by the difference between 21 and the child's age.

• **Annual Gift Tax Exclusion**

The annual gift tax exclusion is increased from $3,000 to $10,000 for gifts made after 1981. Married couples who elect gift-splitting can transfer annually a total of $20,000 per donee without incurring any gift tax liability.

Beginning in 1982, payments for school tuition or medical expenses made on behalf of an individual will not be subject to gift tax. Payments must be made directly to the institution or person that provides the services. Payments made to donees as reimbursements for such services do not qualify for this exclusion.

• **Property Basis**

The method of determining basis of inherited property was greatly simplified by the ERTA. The 1976 Tax Reform Act had established a complicated and confusing method of determining basis. The 1976 Act included a "fresh start" rule which allowed inherited property a stepped-up basis to reflect its value as of Dec. 31, 1976. In addition, each estate was allowed a minimum aggregate carryover basis of $60,000. The "fresh start" rule had been delayed for the period Jan. 1, 1977 to Jan. 1, 1980 by the Revenue Act of 1978. During this period, inherited property received a stepped-up basis as under the pre-1977 rule.

Under the 1981 ERTA the basis of inherited property is equal to the value placed on the property by the estate, which is usually the fair market value at the time of the decedent's death or six months thereafter, at the executor's election. An exception is made for situations where the decedent received the property within one year of death and upon death returned the property to the donor or the donor's spouse. Another situation where the heir's basis may be less than fair market value is when land has received a reduced valuation under the special farmland valuation rules (Section 2032A).

Federal Estate Tax

An understanding of the basic mechanics of the federal estate tax is essential to a proper interpretation of the material presented in this publication. The first step in determining whether your estate is subject to this tax is to calculate the value of your *gross estate*. Your gross estate includes all property owned by you at death and certain other property over which you may have retained some interest or control. Remember to value property at *current fair market values* at the time of death (or six months thereafter) and *not* at your cost.

The gross estate less deductions for funeral expenses, administrative and probate expenses, debts of the estate and losses incurred in estate settlement give the adjusted gross estate. From the adjusted gross estate are subtracted qualifying deductions such as the marital deduction. This calculation gives the net taxable estate. The tentative tax is calculated on the value of the net taxable estate using the federal estate tax rates set out in *Table 3*.

Step One: The Gross Estate

It is impossible to set out an exhaustive list of property subject to federal estate tax. An attorney can advise you on whether particular assets are subject to this tax. The following summary discusses some of the more common assets which are included as part of your gross estate.

1. Property which you own at death. Examples include land held in your name, as well as stocks, trucks, livestock and machinery. To remove these assets from your gross estate, you must completely divorce yourself of ownership and control.

2. Life insurance policies on your life over which you hold any incidents of ownership or which are payable to your estate. Policies of life insurance on your life over which you hold any incidents of ownership are a part of your gross estate. The incidents of ownership include the right to (1) name the beneficiary, (2) surrender the policy for cash, (3) borrow against the policy, (4) pledge it as security for a loan, and (5) assign the policy and revoke such assignments.

If you have any of these rights, you can effect a change in the disposition of the proceeds. Hence, the proceeds will be included in your gross estate, whether or not you exercise such rights. You must be willing to divorce yourself of these rights if you desire to remove the proceeds from your gross estate for federal estate tax purposes.

Since all policies of life insurance payable to your estate are includible in your gross estate, this may serve as an inducement to change the beneficiary from your estate to intended heirs. This, along with divorcing yourself from the incidents of ownership, may ultimately decrease the size of your net taxable estate and thereby put you in a lower tax bracket.

However, it may be desirable to make your life insurance payable to your estate even though this will increase the size of your estate and the tax which will be due. For example, assume you own a 1000-acre farm and a large herd of cattle. Also, assume that you have little cash available and rely rather heavily upon operating credit. If, after your death, no liquid funds exist to pay the federal estate tax, it may be necessary to sell part of your cattle herd to satisfy the tax liability. Such a sale can impair the efficiency of the farming operation. Under these circumstances, you may prefer to make life insurance policies payable to your estate, even though doing so increases taxes, because it furnishes liquid assets from which the tax may be paid. This might yield the most desirable economic consequences over the long run for your survivors.

An alternative to making the policy payable to the estate may be a life insurance trust. See the trusts section under "Tools Used To Implement The Estate Plan" for more information.

3. Property transferred at death by means of a right of survivorship. In Missouri, two types of co-ownership interests, the joint tenancy and tenancy by entirety, are characterized by a right of survivorship. The usual co-ownership by a husband and wife is called a tenancy by entirety. Joint tenancy is co-ownership of property by two or more persons, not necessarily husband and wife, with a right of survivorship. Under a right of survivorship, when a co-owner dies, title to the property passes automatically to the surviving co-owner(s). Thus, the property is *not* subject to probate.

For joint interests created between husbands and wives before 1977, the "rule of contribution" determined what portion of the co-owned property was to be in the decedent's gross estate for federal estate tax purposes. Under this rule, a surviving spouse could not exclude any portion of jointly-owned property from the deceased's estate unless she(he) could prove by adequate records that she(he) provided part of the consideration for the property. This rule worked a hardship in many situations, especially where the surviving spouse was a housewife with no substantial income apart from her husband's income.

The Economic Recovery Tax Act eliminates the need for proof of spousal contribution in joint interests. One-half of property held under joint tenancy or tenancy by entirety is includable in the estate of the first spouse to die, regardless of the consideration given by the decedent. For example, if a farmer and his wife own all of their property jointly, and he dies, only one-half the property value will be included in his estate. While beneficial, this provision will not solve all estate planning problems concerning joint property. It does not address the problem of how to minimize estate taxes on the death of the survivor, which is where most estate tax problems occur.

This change, when coupled with the unlimited marital deduction, provides a strong argument for holding land as tenants in common. With an unlimited marital deduction, the decedent can bequeath as much property as he would like to his spouse and the rest can go to whom he desires. This will allow more flexibility in estate planning. This argument is compounded by the fact that joint property is no longer immune from the Missouri death tax.

4. Gifts made within three years of death. The Economic Recovery Act has made major changes. The pre-1982 rule was all gifts made within the three-year period ending with the decedent's death will be automatically included in the decedent's estate, except to the extent of the annual gift exclusion.

Before the 1976 TRA, any gifts made within three years of death were *presumed* to have been made in contemplation of death for federal estate tax purposes, and their value was includable in the gross estate. A gift made in "contemplation of death" refers to one induced by a belief that the donor did not have long to live. Such gifts were included in the gross estate on the theory that they were made in lieu of a testamentary disposition of property (which would have been subject to the federal estate tax).

The ERTA has reversed this. Most gifts will *not* be included in the estate of a decedent dying after Dec. 31, 1981, even if made shortly prior to his death. An exception is made in the case of certain property, most notably life insurance.

5. The value of property previously transferred to another if there has been a reservation of:

a. The right of use, enjoyment, or income from the property; or

b. The power to alter, amend, revoke, or terminate the transfer.

Property you have disposed of during your lifetime but in which you have reserved certain rights may be includible in your gross estate. For example, suppose you give your son a farm but retain the right to its sole use during your lifetime.

Here, you are in essentially the same position as if you had kept complete ownership of the property until death and then disposed of it by your will, the only difference being that you no longer have the power to convey absolute ownership.

The degree of control which you can safely retain and yet legally remove a given asset from your gross estate is governed by complicated provisions of the federal estate tax law. Consequently, you should consult with an attorney for more complete information.

Step Two: Adding Up the Deduction

If you are to minimize federal estate taxes and conserve the estate for your survivors, it is essential that you take full advantage of all deductions available by law. The principal deductions include the following:

1. Funeral expenses, expenses of administration in probate, claims against the estate (debts), and casualty losses suffered during the settlement of the estate;
2. An unlimited marital deduction for all property passing to the surviving spouse;
3. The amount of money or value of property left to charities and other organizations approved by the Internal Revenue Service.

Casualty losses refer to losses caused by fire, storm, and theft. They are deductible only to the extent that insurance or some other type of recoupment does not compensate the estate for the loss.

Certain transfers of money or other property for public, charitable or religious uses are deductible. If you contemplate making such transfers, you should consult with your attorney to ascertain whether they will qualify as deductions.

The marital deduction is one of the greatest single tax savers in the federal estate tax area. Wills, *inter vivos* (lifetime) trusts, life insurance options, the use of jointly-owned property, and other dispositive arrangements should be planned with a view to taking advantage of the marital deduction.

Many individuals leave the majority or all of their assets to their surviving spouse simply to assure themselves that she or he will be adequately cared for after their death. But the estate of a surviving spouse has no marital deduction unless remarriage occurs. This may result in large estate taxes when the surviving spouse dies. Your attorney can help you plan to keep property available for use by the surviving spouse yet out of her (or his) estate.

Estate Exemption: Eliminated by the 1976 Tax Reform Act

The $60,000 estate exemption has been eliminated after Dec. 31, 1976, and replaced by a unified credit. The substituted credit *(Table 4)* represents a larger estate tax reduction than the former $60,000 estate exemption. However, a credit works to offset the tentative estate tax due, not the size of the gross estate. Because the estate tax rates are progressive, a credit of a given size does not give large estates a larger estate tax reduction.

Step Three: Calculating the Tentative Tax

The tentative federal estate tax is calculated by cumulating the items in the gross estate minus the various deductions. The unified estate and gift tax rates *(Table 3)* are then applied to determine the tentative federal estate tax due.

Step Four: Estate Tax Credits

The estate tax *credit* ($47,000 for 1981) is subtracted from the tentative estate tax to give the net tax due. After 1981 the credit will increase annually according to the scale in *Table 4*. A credit is subtracted directly from the tax due while exemptions reduce the size of the taxable estate before the tax is calculated.

A prior transfer credit is an additional credit available if property is subject to estate tax more than once in ten years. For example, a father leaves property to his son upon which federal estate tax is paid and the son dies within ten years, the son's estate will be entitled to a credit for tax paid on the same property in the father's estate. Prior transfer credit allowed decreases as the period by which the son survives his father increases, with no credit being allowed after ten years have elapsed.

The amount of Missouri estate tax actually paid is another credit available. The credit allowed will increase as the size of your gross estate increases.

Applying the New Rules: An Illustration

Any illustration suggesting potential impacts of the federal estate tax laws can be misleading if the reader ignores the underlying assumptions. Therefore, you should always seek professional advice when considering your own unique situation.

In this illustration, let's assume that Mr. and Mrs. Estate Planner have not made any lifetime transfers (gifts) and therefore have an estate tax credit available of $62,800 in 1982. (Refer to *Table 4* for the applicable credit for 1982 and later years). Assume Mr. Planner has all the property legally in his name and that there are no debts. Obviously, real life situations are more complicated and require the expertise of attorneys, accountants, and other professional advisors.

Now assume Mr. Planner dies first in 1982 and leaves Mrs. Planner as the sole heir. *Situations A and B*, in *Table 5*, summarize the basic estate tax impact, with an additional assumption that Mrs. Planner neither increases nor decreases the value of her inheritance which is transferred to their children upon her death five years later. These two situations in *Table 5*, indicate the potential estate tax impact for estates of different sizes under the above assumptions.

Situation C assumes a different distribution of the estate upon the death of Mr. Planner. Half the estate is left to Mrs. Planner and half to their children. It is still assumed that Mrs. Planner dies in 1987 and leaves all of her estate to the children.

Each situation shows the potential federal estate tax liability for both estates under the above assumptions. Three key things should be noted from these examples. *First,* the marriage deduction allows tax-free transfer of property to the surviving spouse. *Second,* the higher estate tax credit *(Table 4)* which will be available in future years will be very beneficial in reducing estate taxes. *Third,* the primary expense in all three of these situations was not estate taxes but rather administrative expenses.

Special Valuation of Real Property Used for Farming (Section 2032A)

Under certain conditions, real property used for farming or closely-held business may be valued on the basis of its "actual use" rather than the usual fair market value standard of "highest and best" use. The maximum reduction of the gross estate allowed under this special election will be $600,000 for 1981, $700,000 for 1982 and $750,000 for 1983 and thereafter.

The conditions for eligibility include the following:

1. The decedent must have been a U.S. resident or a U.S. citizen;
2. The property must be located in the United States;
3. The property must pass to a member of the decedent's family, to include the spouse, the parents, grandparents, lineal descendants (including adopted children) of the decedent, the decedent's spouse, or the decedent's parents, as well as the spouse of any lineal descendant;
4. An agreement signed by the heir to abide by the stipulations of Section 2032A must be filed by the executor;

   The heir has a two-year grace period after the decedent's death in which to employ the real property in a qualified use before the recapture tax is implemented. The heir must have "material participation" in the management of the property.

5. The decedent must have owned the qualifying property and either the decedent or a member of the family must have substantially participated in the operation of the business in five of the eight years preceding the earliest of: (a) the date of the decedent's death; (b) the date the decedent became disabled; or (c) the date the decedent retired;
6. The adjusted value of real and personal property used in the trade or business must make up at least 50 percent of the adjusted value of the decedent's gross estate, and at least 25 percent of the adjusted value of the gross estate must consist of the adjusted value of real property.

Farms, in general, are valued according to a formula. The "actual value" is calculated using one of two methods.

The first method is the net rental method. This method takes the five-year average annual gross cash rental less the five-year average annual state and local real estate taxes for comparable land and divides the difference by the five-year average annual effective interest rate for all new Federal Land Bank loans. If there is no comparable land from which average cash rentals can be obtained, then average annual net share rental may be obtained if available. This formula cannot be used where it is established that there is no comparable land for determining average gross cash or net share rental.

The second method allows the executor to elect to have valuation made on the basis of factors applied to other closely held business interests rather than based on the formula.

Table 5

	Situation A	Situation B	Situation C
Mr. Planner's Estate 1982			
Gross Estate	$1,000,000	$500,000	$500,000
Less Administrative Expense[1]	(80,000)	(40,000)	(40,000)
Adjusted Gross Estate	920,000	460,000	460,000
Less Marital Deduction	(920,000)	(460,000)	(230,000)
Taxable Estate	0	0	230,000
Tentative Estate Tax	0	0	64,400
Less 1982 Estate Tax Credit	(0)	(0)	(62,800)
Estate Tax Due	0	0	1,600
Mrs. Planner's Estate 1987	920,000	460,000	230,000
Less Administrative Expense[1]	(73,600)	(36,800)	(18,400)
Adjusted Gross Estate	846,400	423,200	211,600
Less Marital Deduction	(0)	(0)	(0)
Taxable Estate	846,400	423,200	211,600
Tentative Estate Tax	285,896	129,688	58,512
Less 1987 Estate Tax Credit	(192,800)	(129,688)	(58,512)
Estate Tax Due	93,096	0	0
Total Estate Tax	93,096	0	1,600

[1]Administrative expense was estimated as 8 percent of the gross estate. It includes executor and attorney fees, probate court costs, management fee during probate, and funeral expenses.

The property must be kept in a qualified use for ten years or it is subject to a recapture tax. Another change in the law is in the treatment of the property's basis for income tax purposes. If recapture occurs the heir has the option to elect to increase the basis to fair market value at the date of death. If elected the heir must pay interest on the amount of recapture tax.

Since the special valuation rules have several legal prerequisites, you should consult with an attorney to determine the appropriateness of the election in your own situation. For more general information, see UMC Guide Number 505—*Farmland Valuation for Federal Estate Tax Purposes,* available at your Extension Center.

Generation-Skipping Transfers

The *Tax Reform Act of 1976* included new rules for "generation-skipping" transfers. The basic concept in a generation-skipping transfer is for a member of *Generation A* to pass wealth to a member of *Generation B* who will pass the wealth on to a member of *Generation C*. The "skipping" refers to the exclusion of the property from the gross estate of *Generation B* assuming that legal requirements were satisfied as to the amount of control that *Generation B* could exercise over the property. Typically, a generation-skipping transfer involves a trust.

The possibility of skipping the estate tax has been reduced by the 1976 TRA. Under the 1976 law, splitting of the benefits of property between two or more generations that are junior to that of the grantor-originator will not "skip" federal estate taxation. However, there remains a limited exception for transfers to grandchildren.

These rules are complicated. The generation-skipping transfer rules are generally applicable to transfers made after April 30, 1976, but limited exceptions are available for a transitional period. You are encouraged to discuss generation-skipping trusts and the transition rule with your attorney and other professional advisors.

Postponing Estate Tax Payment

Economic Recovery Tax Act consolidated the two previous sections which had deferral periods of 10 to 15 years. For decedents dying after 1981, if the value of a closely held business interest exceeds 35 percent of the adjusted gross estate, or 50 percent of the taxable estate, the estate taxes attributable to that interest may be deferred for up to 15 years. Interest is charged at 4 percent on the first $1,000,000 of the business taxed. The estate makes an annual interest payment for the first five years and thereafter pays the tax and interest in ten annual installments.

Disposition of one-half of the qualifying property will accelerate the due date of the estate tax. Delinquent payment of the tax will cause acceleration if payment is not made within six months of the due date.

Federal Gift Tax

Since ownership at the date of death is the critical factor in determining whether a particular asset will be within your estate for federal estate tax purposes, one obvious way of attempting to avoid this tax is to give property away prior to death. The federal gift tax prevents one from avoiding taxation by disposing of all property through lifetime gifts. However, unlimited tax-free gifts can be made to a spouse and tax-free gifts can be made to others on a limited annual basis. The impact of the federal gift tax falls upon the doner (giver).

Beginning in 1982 the first $10,000 (annual exclusion) of gifts to each person each year is gift tax-free if it is a gift of a present interest. Basically, a present interest gift is one by which the donee (receiver of the gift) immediately obtains possession and enjoyment of the asset being given to him. If possession and enjoyment are postponed for a period of time, or if possession and enjoyment are subject to conditions or the will of another, this will be a gift of a future interest rather than a present one. If you have questions, your attorney can advise you as to whether a contemplated gift will create a present or a future interest.

Your spouse can elect to join in the gift and double the amount of the annual exclusion. This applies even though you are giving away property which you hold in sole ownership. With the spouse joining in the first $20,000 of gifts to each donee would be non-taxable under the annual exclusion. This joining-in election is made by showing the consent of both spouses on their respective gift tax returns (Form 709).

There are other deductions available under the gift tax law. Gifts to certain charitable organizations are exempt from the federal gift tax, as are gifts to governmental entities for public purposes. The Economic Recovery Tax Act eliminated the gift tax on transfers between spouses made after Dec. 31, 1981. Thus, unlimited amounts of property can transfer tax-free between spouses via gifts.

The federal gift tax is assessed on the fair market value of the property being transferred at the date of the gift. The value of your original investment in the property being given away is not used in calculating the gift tax liability.

In calculating the tentative federal gift tax, you must cumulate all taxable gifts which are in excess of the annual exclusion for the present year and all previous years. Next subtract the amount of gift taxes previously paid, yielding the tentative gift tax. This amount is reduced by the "unified credit" not previously used. Because of the unified approach between gift and estate taxes, sizeable lifetime transfers can reduce the credit available against later estate taxes. The unified federal gift tax rates are given in *Table 4*.

To illustrate the computation of the federal gift tax, assume in 1982 that Mr. Giver transferred property valued at $250,000 to his son. An annual exclusion of $10,000 would reduce the taxable gift to $240,000. (If Giver is married and his wife joins in the gift, the exclusion could be doubled to $20,000.) Turning to *Table 3* for the "Unified Gift and Estate Tax Rates," the tentative gift tax is $67,600. If no previous lifetime transfers had been made, the full $62,800 credit (for 1982) is available to credit against the tentative gift tax. This leaves a gift tax due of $4,800 (see *Table 6)*. The unified credit will increase on an annual basis according to the schedule on page 5 until 1987.

For more information on the federal gift tax, see UMC Guide 503, *Lifetime Gifts*.

Table 6

Gift from father to son	$250,000
Less 10,000 annual exclusion	(10,000)
Taxable gift	240,000
Tentative gift tax	67,600
Less unified credit	62,800
Gift Tax Due	4,800

Filing Gift Tax Returns

Quarterly returns are not required on pre-1982 gifts unless taxable gifts for the quarter plus all other taxable gifts for the calendar year for which no return has been filed exceed $25,000.

Effective for gifts made after 1981, the Act provides that gift tax returns are to be filed, and any gift tax paid, on an annual basis. In general, the due date for filing the annual gift tax return will be the 15th day of the fourth month following the close of a calendar year. However, for a calendar year in which a donor dies, the gift tax return is required to be filed no later than the due date for filing the donor's estate tax return, including extensions.

Tools Used to Implement the Estate Plan

The manner of property distribution is very important if optimal results are to be achieved by estate planning. A will, trust, gift, annuity, sale, or joint tenancy may be used individually or in various combinations to fit your particular situation. The form of business organization is also an important factor to consider in estate planning. Again, it is your particular circumstances which determine whether you can operate most advantageously as a sole proprietorship, a partnership, or a corporation.

- **WILLS**
- **TRUSTS**
- **GIFTS**
- **CO-OWNERSHIP**
- **SALE**
- **FAMILY ANNUITIES**
- **PARTNERSHIPS**
- **CORPORATIONS**

Wills

Most persons do not dispose of all their property by lifetime gifts but retain ownership and control over enough property to support themselves during retirement. If you do not leave a will directing distribution of your property, the State of Missouri has intestate statues of descent which determine how and to whom property will be distributed. Seldom will these inflexible laws of descent provide for the desired property distribution. You may prefer that specific heirs receive specific items of your property, ranging from family heirlooms to substantial holdings of land. Such desired distribution can be achieved by the execution of a will.

When there is no valid will, the Missouri laws of intestate descent provide that the estate of the decedent will be divided in the following general manner. How the property is divided depends upon the potential surviving heirs.

- Sole survivor is the spouse (no children or parents) -All property goes to the surviving spouse.
- Survivors are the spouse and children - Household goods, an allowance for a year's support, $20,000, and half of the remaining property goes to the surviving spouse. Remaining property is divided equally among the children.
- Survivors are the spouse and parents (no children) - Household goods, an allowance for a year's support, $20,000, and half the remaining property goes to the surviving spouse. Remaining property is divided equally among the decedent's parents and their descendants.
- Survivors are children (no spouse) - All property goes to the children in equal shares.
- Survivors are parents (no spouse or children) - All property is divided equally among the parents and the parent's descendants.
- Survivors are siblings (no spouse, children, or parents) - All property is divided equally among the surviving brothers and sisters, with descendants of deceased siblings receiving their parent's share.
- Survivors are distant relatives (no spouse, children, parents, brothers or sisters) - All property goes to grandparents, aunts, uncles and their descendants.
- No known surviving relatives - The entire estate passes to the relatives of the deceased spouse, as though the spouse had survived the decedent and then died.
- No person entitled to inherit - The property passes to the state.

A will is a legally recognized document by which a person can distribute his property as he sees fit, can appoint an executor to handle the settlement of his estate, and can provide for a guardian for his minor children.

Every estate must have an executor or administrator to handle the settlement of the estate. By use of a will a person may designate the person he wishes to serve as executor. Otherwise, the probate court must appoint an administrator to carry out these duties and responsibilities.

Where both parents are deceased but leave minor children as survivors, a guardian must be appointed to care for the children and manage the financial assets for the minors. The court will face a difficult task in selecting the guardian unless guided by the wishes of the parents. In their wills the parents can designate the person(s) they prefer to raise the children.

If a change in circumstances dictates a change in provisions of the will, you should not hesitate to see your attorney. The provisions can be changed by executing a *codicil* (addition to a will) or a completely new will which revokes the old one. Technical legal rules govern the execution, validity, and interpretation of both wills and codicils; consequently, you should always have your attorney prepare them. A publication on wills entitled, *A Will of Your Own,* C-863, is available from your local University Extension Center.

Trusts

A trust is created by transferring legal title of the trust property (corpus) to a trustee who manages the property for the benefit of chosen beneficiaries. A fiduciary relationship exists between the trustee and the beneficiaries. This relationship is defined in terms of trust and confidence and requires the trustee to act in the best interests of the beneficiaries in following the directions of the trust agreement.

Planning an estate for maximum long-run tax savings requires consideration of federal estate, gift and income tax consequences which result from the creation of a trust. The tax consequences are dependent upon the type of trust that is used. Both an *inter vivos* (lifetime) and a *testamentary* (after death) trust can be employed to advantage in estate planning under the proper circumstances. *Inter vivos* trusts can be broken down into two general categories, revocable and irrevocable.

Inter Vivos Trust

An *inter vivos* trust involves the transfer of property from you (the settlor) to the trustee during your life. A revocable trust is one which gives you the power to revoke, amend, or alter the trust during your lifetime. An irrevocable trust arises whenever you completely dispose of your power to control the trust property or the income from it. The tax consequences of an *inter vivos* trust depend primarily upon the degree of control that you retain over the trust property.

(a) *Federal Estate Tax:* If you retain the possession or enjoyment, the right to the income, or the right to designate the persons who shall possess or enjoy the property, then the trust property is included in your gross estate. If you retain the right to alter, amend, revoke, or terminate the trust at any time before your death, the trust property will also be included in your gross estate. However, if you divorce yourself of these rights, it is possible to remove the value of the trust property from your estate for federal estate tax purposes.

(b) *Federal Income Tax:* If you are treated as the owner of the trust or any portion, you must report all income that comes from your portion in your personal income tax return.

As a general rule, you will be treated as the owner of the trust any time you can control the disposition of the trust property or its income without the approval or consent of any party who has a substantial beneficial interest in the trust. The theory of taxation here is much like that set forth in the estate tax situation above. As long as you retain control over the trust property, the income from it will be taxed to you.

(c) *Federal Gift Tax:* Gift tax liability often results from the creation of an irrevocable trust. If you retain no right to alter, amend, or revoke the trust, you have in effect given up all control over the property and have no interest which requires you to pay estate or income tax. When you have given up all control, the gift is deemed complete and the gift tax possibility must be faced.

As a general rule, property subject to gift taxes will not be subject to estate or income taxes.

Exceptions—It is possible that even though a federal gift tax has been paid on property, the property may later be included in the decedent's estate for federal estate tax purposes. These exceptions include:

1. Gifts made within three years of decedent's death, if death occurs before 1982.
2. Gifts by which you retain a reversionary interest if the value of this interest exceeds 5 percent of the value of the property immediately before your death; and
3. The retention by you of the right to designate who may receive the income or corpus from the trust, or the retention of the right to alter, amend, or revoke the trust.

If you pay gift tax on property which later becomes a part of your gross estate for federal estate tax purposes, the gift tax previously paid is credited against the federal estate tax due.

Testamentary Trust

A *testamentary* trust is created by provisions in the will and does not take effect until after the death of the property owner. Since the property remains under his direction and control until death, it will be in his estate for federal estate tax purposes. Hence, a *testamentary* trust does not avoid the federal estate tax for the property owner. However, *testamentary* trusts may serve several purposes such as providing property management for a surviving spouse or possibly keeping property out of the estate of a survivor. You should explore these possibilities with your attorney.

Life Insurance Trust

A life insurance trust can be used in estate planning. By divorcing yourself of all incidents of ownership and making the policies payable to the trustee, the value of such policies can be effectively removed from your gross estate. This will help minimize the impact of the federal estate tax.

If the trustee is given discretion to pay estate taxes, assurance is given that liquid funds will be available for their payment. However, since the trustee is under a fiduciary duty to act in the best interests of the beneficiary, life insurance proceeds might not be used to pay estate taxes if the beneficiaries under the trust are not ones who will inherit the remainder of the estate. That is, payment of estate taxes by the trustee might not be in the best interests of the beneficiaries.

Trusts in General

Other types of trusts for either real or personal property may be desirable in your estate plan. A trustee should be selected for them who is adept at handling the particular type of property involved. The income from such property can be distributed to your heirs in the manner and proportions which you direct by the trust agreement terms. This may be done to relieve your heirs of the obligations of managing the trust property. It might be used, for example, when your heirs are minor children.

You may want to use either an irrevocable or a revocable *inter vivos* trust or a *testamentary* trust. Your selection depends on which will most advantageously meet your needs. Study of the gift, income, and estate tax consequences of each trust type is highly relevant in the selection process.

For more information on the use of marital trusts, see UMC Guide 504.

Gifts

A planned system of giving can save a significant number of tax and probate dollars, if the exclusions and deductions previously discussed are effectively used.

Although disposing of property through gifts eliminates the problem of estate taxes on that property there may be factors other than estate and gift taxes which should be considered before making gifts of large amounts of property.

Basis Considerations

Some knowledge of income tax consequences is also helpful in determining the relative merits of making lifetime gifts. When you sell property, not all of the sale price is income because the law specifically allows you to recover your investment first. More properly stated, a taxpayer is entitled to recover his "basis" in the property before any income is subject to tax. In its simplest form, the term basis means the original cost of the property plus the cost of improvements less the amount of depreciation claimed or allowable.

For example, suppose you purchased a farm for $300,000 and claimed $15,000 depreciation on the buildings. Your basis in this farm for tax purposes would be the original cost ($300,000) less the depreciation claimed ($15,000) or $285,000. If you sell the farm for $400,000, your capital gains will be $115,000, the difference between the sale price and your tax basis (see *Table 7)*.

Table 7

Purchase Price	$300,000
Less Depreciation	(15,000)
Basis	285,000
Selling Price	400,000
Capital Gains	115,000

If instead of selling the farm you make a gift of this property, the recipient of the farm will have a basis equal to your basis in the property at the time of the gift (in this example 285,000). Should the recipient then sell the farm for $400,000, there will be a taxable capital gain of $115,000.

Upon the decedent's death the basis of an asset is "stepped up" to fair market value at the date of death. In the above example, if you die and leave the farm to your son, his basis in the property will be $400,000. He could then sell the property for $400,000 and not incur any capital gains taxes.

Election of special use valuation restricts the change in basis, however. Real property valued according to special use valuation has a basis equal to the special use value. If recapture occurs basis can be reverted to the property's value as of the date of death. Such an election should be made if the objectives of the heirs can be satisfied. Consult UMC Guide Number 505, *Farmland Valuation for Federal Estate Tax Purposes*.

A primary objective of estate planning is to transfer the most property possible to the succeeding generation. The income tax factors stated above must be considered if the sale of the family farm by your heirs can be foreseen. The nature and extent of your assets and the projected taxable income of your intended heirs may affect your decision whether to make a lifetime gift of the farm or other property.

Expert advice focused on your particular situation, coupled with long range planning, is essential if maximum tax savings are to be achieved.

Co-Ownership of Property

The three principal types of co-ownership are *tenancy in common, tenancy by entirety* and *joint tenancy*. They may be created in either real or personal property and are characterized by an undivided interest in the whole asset. Other differing characteristics dictate which will accomplish your desired distribution of property.

Under the proper circumstances, co-owning property with your intended heirs in either joint tenancy or tenancy by entirety will maximize the value of assets transferred to the succeeding generation. A joint tenancy can exist between two or more persons, regardless of relationship, while a tenancy by entirety can exist only between husband and wife. Both are characterized by a right of survivorship; that is, when one co-owner dies, title passes automatically to the surviving co-owner(s).

Since title passes at the moment of death, property held in this fashion will not go through probate. Therefore, it will not be subject to the administrative expenses of probate. Property held in tenancy in common does not pass by right of survivorship. Instead, tenants in common can pass their portion by their will or by the intestate laws.

However, there are circumstances under which the right of survivorship characteristic produces undesirable results. Suppose your farm is held in tenancy by entirety. Will holding property in this manner ultimately achieve the distribution of property which you desire? Assume that you die first. Your spouse automatically becomes sole owner of the farm. In the absence of a premarital agreement, if your surviving spouse remarries, her (or his) new partner will be entitled to the entire property if your spouse dies first and they hold the land jointly.

Obviously, there are many contingencies which should be discussed with your attorney before using this or any other type of co-ownership in your estate plan.

Any member of a *joint tenancy* can force the partition (Physical division) of the asset among co-owners. If it is not economically feasible to divide the property, one co-owner can force its sale with the proceeds being divided among the co-owners. This may be the very thing which you want to avoid. In any event the *legal result* of creating a joint tenancy is a co-ordinate loss of both control and the exclusive right to rents and profits.

For example, assume you own a farm which provides an adequate living and you decide to create a joint tenancy with two heirs. This transfer may be subject to gift taxation, depending upon the consideration furnished by the parties and their relationship to you. If one of your heirs has an immediate need for cash because of personal family circumstances, he can obtain it (and destroy the joint tenancy) in one of three ways.

1. The heir can convey his undivided one-third interest to a third party (who in turn may force partition);
2. He can force the division of the farm into three tracts of equal value and sell his tract; or
3. If such division substantially impairs the efficiency of each tract as a productive unit, he may be able to force the sale of the entire farm, with the proceeds being divided among the three joint tenants.

At any rate, the property or the cash you wind up with may not be sufficient to provide you with income adequate to meet retirement expenses. If any of the circumstances above can be foreseen, the use of a joint tenancy in your estate plan may be risky.

Many property owners have created joint tenancies and tenancies by entirety as a part of a homemade estate plan simply because these types of co-ownership pass title automatically at death by operation of law. However, since these types of co-ownership may result in adverse federal estate and gift tax consequences, they should be used in large estates only upon the advice of your attorney.

If you are a co-owner of property with non-relative business associates, you may prefer to own such property as *tenants in common*. Here again, all owners have an undivided interest in the whole asset, but this type of tenancy does not have a right of survivorship. Rather than your interest passing to the surviving co-owners at death, it passes to your heirs. The use of a tenancy in common here will help to keep your property in the family.

Sale

Another tool which may be used to transfer property to the next generation is the simple sale. For example, after you retire, you could sell your farm to your son under terms which make it possible for him to grow with the farming operation. This assures that your son will get started in farming. It also provides cash to meet retirement expenses. However, you should be aware of the potential income tax consequences.

Family Annuities

A family annuity is very similar to an annuity purchased from a life insurance company. In the latter, you pay the life insurance company a lump sum in exchange for their promise to make specified monthly payments to you for the rest of your life. The total of these payments may be either more or less than the sum which you paid them, depending on how long you live after purchasing the annuity.

With a family annuity, you need not make an immediate cash outlay. Rather, you can use a specific asset, such as your farm, to "purchase" the annuity. You can deed the farm to a family member in exchange for his promise to make monthly payments. Professional counsel should be obtained before establishing a family annuity as there are complicated income, gift and estate tax aspects.

Partnerships

A parent-child relationship can be used in estate planning to accomplish desired results. It permits and encourages your child to remain on the farm. Participation in management allows your child to develop farm managerial ability under your guidance.

This form of business organization allows gradual withdrawal from the responsibilities of ownership and management as you approach retirement. It also permits the younger generation to assume a more active role in operating the farm business.

More comprehensive information on partnerships is available at your local extension center. Ask for UMC Guides 510, 511, and 512, dealing with the farm partnership.

Corporations

In recent years, more and more consideration has been given to incorporating the farm business. There are cases in which creating a farm corporation can be used effectively as a tool in estate planning. For example, suppose essentially all of your assets are tied up in a large farming operation. Here it may be impractical to make lifetime gifts to remove property from your estate in an attempt to avoid federal estate taxes because gifts of assets essential to the farming operation can destroy its efficiency.

However, if you should incorporate and give away shares, you can decrease the size of your taxable estate while continuing to operate the farm at maximum efficiency. If the annual exclusion available under federal gift law is fully utilized in a planned system of giving, a large tax savings can be accomplished without affecting the income-producing capacity of your basic economic unit.

Using the corporation as a tool in your estate plan has the additional advantage of allowing you to retain control over the operation. As long as you own 51 percent of the shares, you can elect a majority of the board of directors which is the governing body of a corporation.

There are some costs involved in incorporating the farm business. They may be more than off-set by derived benefits, however. For further information about incorporation see UMC Guide 400, *Should You Incorporate Your Farm?* and North Central Regional Publication No. 11—*The Farm Corporation*.

Planning the Small Estate

Since, by definition, small estates are those which are not subject to federal estate taxes, tax considerations are of minimal importance in planning this type of estate. But this does not mean that estate planning is not beneficial in small estates. Proper planning can reduce probate and administrative costs. In addition, a properly executed will is essential to achieving the desired distribution of the estate.

Co-ownership of property, family annuities, and life insurance trusts are tools frequently employed in implementing small estate plans. They are usually complemented by a will which accomplishes the desired distribution of the remainder of the estate. However, it is emphasized that these are not the only tools which can or should be used in planning your estate. Under the proper circumstances, various other tools can be advantageously employed.

Since one of the primary objectives of estate planning is to care for yourself during retirement, projected benefits from social security should not be overlooked. The extent of benefits you may expect to receive can materially influence the plan for disposition of the remainder of your assets.

Planning the Large Estate

The primary objectives of planning the large estate should be minimization of estate taxes and transfer costs and achieving the desired distribution of your property. Expert advice is essential in long range planning in order to achieve the appropriate intergenerational transfer of assets.

Wills, trusts, family annuities, and corporations are used frequently to implement large estate plans. Since the nature and extent of your assets, together with your particular objectives, often dictate the method of implementing an estate plan, the possibility of using the various other tools described should not be overlooked.

Valuable Records

As soon as someone dies, there will be someone else called upon to settle the decedent's estate. This will require the making of business decisions, along with locating important business and family records. Both husband and wife should keep a convenient inventory of these records and their location. Survivors are already burdened by the loss felt when a close friend or relative dies. You can greatly assist them by providing a complete and up-to-date inventory of the following financial records:

- Wills, deeds, leases, insurance policies, military service records, marriage certificate, birth certificates, and social security records.
- Stocks, bonds, and other investments.
- Outstanding debts, notes, and mortgages.
- Banks with your savings and checking accounts.
- Names and addresses of professional advisors, including attorneys, bankers, accountants, life insurance salesmen.

In addition to merely describing the above important records, be sure to indicate where they can be located. University of Missouri Extension Circular 863, *Our Valuable Papers,* contains an inventory form for valuable records. Probably no form or listing, no matter how long and complicated, will suit your estate exactly. However, your efforts to organize your valuable records now can help considerably those you leave behind.

Additional References

(Available Through Your University Extension Center)

MU GUIDE 400—Should You Incorporate Your Farm?
MU GUIDE 502—Probate of Missouri Estates
MU GUIDE 503—Lifetime Gifts
MU GUIDE 504—Marital Trusts
MU GUIDE 505—Farmland Valuation for Federal Estate Tax Purposes
MU GUIDE 506—Subchapter S: Tax Option for Small Corporations
MU GUIDE 507—Low-Equity Land Transfer: The Installment Sale
MU GUIDE 510—Farm Partnerships - Part I
MU GUIDE 511—Farm Partnerships - Part II
MU GUIDE 512—Farm Partnerships - Part III
North Central Regional Publication No. 11—The Farm Corporation
North Central Regional Publication No. 49—Retirement Planning for Farm Families
North Central Regional Publication No. 50—Farm Business Arrangements: Which One for You?
MU Extension Circular 705—Our Valuable Papers
MU Extension Circular 863—A Will of Your Own

Glossary of Useful Estate Planning Terms

Adjusted Gross Estate—For federal estate tax purposes, this refers to the gross estate less funeral expenses, expenses of administration in probate, debts of the estate, and casualty losses suffered during the settlement of the estate.

Administrator—A male person appointed by the probate court to administer the estate of a decedent. His duties include the collection of the assets of the estate, the payment of its debts, and the distribution of the residue.

Administratrix—A female person appointed by the probate court to administer the estate of a decedent, similar to the role of an executor.

Annuity—The periodical payment of a definite sum of money, with such payments to continue for life or for a definite number of years.

Beneficiary—The person who derives the primary benefit from the creation of a trust.

Bequeath—To leave to another by will.

Bequest—A transfer of personal property by will.

Codicil—A supplement or an addition to a will; it may explain, modify, add to, subtract from, qualify, alter, restrain or revoke provisions in a will.

Contemplation of Death—The situation where property transfer is motivated primarily by the expectation of death.

Contingency—The possibility of coming to pass; an event which may occur.

Corpus—Trust property; the principal sum or capital, as distinguished from interest or income.

Decedent—A dead person.

Deed—The legal instrument used to transfer title to real property.

Donee—The recipient of a gift.

Donor—A person making a gift.

Estate—The interest which one has in both real and personal property; the dollar value of this interest.

Executor—A male person named in the will to carry out the directions and requests of the will, and to dispose of property in accordance with the provisions of the will.

Executrix—A female person named in the will to perform the duties of an executor.

Fiduciary Obligation—A relationship between two or more persons in regard to business or property, or in regard to the general business or estate of one of them, of such a character that one must repose trust or confidence in the other. In return, the law raises the rule that the fiduciary must exercise a corresponding degree of fairness and good faith, and in no way take selfish advantage of the relationship.

Gift—A voluntary transfer of real or property with no consideration.

Gross Estate—For federal estate tax purposes, the total value of all property, real or personal, tangible or intangible, that a decedent had beneficial ownership of at the time of death.

Guardian—A person legally approved by the probate judge to care for a minor or incompetent and/or his property.

Heir—A survivor who inherits property belonging to a decedent.

Inter Vivos—Transfer during the transferor's lifetime.

Intestate—To die without making a will is to die intestate.

Intestate Descent, Statutes of—Laws which specify the method and manner of distributing and disposing of the estate of a person who dies without a will.

Irrevocable Trust—A trust over which the maker (trustor) has no power of cancellation.

Joint Tenancy—Co-ownership of property, either real or personal, by two or more people. One of the major characteristics of this type of co-ownership is the right of survivorship.

Legacy—A disposition of personal property by will. Modern usage sometimes extends legacy to include the disposition of interests in real property by will.

Life Estate—A property interest lasting only for the lifetime of the holder of the life estate (life tenant).

Lineal Descendant—One who is, by blood relationship, in the direct line of descent from an ancestor. By statute, the term now includes adopted children in some states, including Missouri.

Litigation—Lawsuit; a judicial content or controversy.

Marital Deduction—The deduction allowed in determining federal gift and estate tax liabilities if property is transferred to a spouse.

Mortgage—The legal instrument typically used to attach a claim to property in order to secure payment of a debt.

Non-Terminable Interest—For purposes of the marital deduction, this refers to an interest in property which will be taxable in the estate of the surviving spouse.

Personal Property—Property that is movable such as cars, machinery, stocks and bonds.

Probate—A general term used to include all matters over which the probate courts have jurisdiction. It refers to the judicial process of administering the estates of all decedents, whether they died with or without a will.

Real Property—Land, buildings, and other permanently placed property.

Revocable Trust—A trust which can be cancelled by the maker (trustor).

Right of Survivorship—This right is present in both a joint tenancy and tenancy by entireties. With these types of co-ownership, by virtue of simple survivorship, the surviving co-owner(s) accede to the decedent's ownership interest.

Settlor—One who creates a trust by transferring property to the trustee.

Tenancy by Entirety—A type of co-ownership which can exist between two persons who are husband and wife. Here the interest of the deceased co-owner passes to the surviving spouse under a right of survivorship.

Tenancy in Common—Co-ownership of property, either real or personal, by two or more people. There is no right of survivorship.

Testamentary—Pertaining to a will; any instrument is testamentary if drafted so as not to take effect until death.

Testate—Refers to a person who dies leaving a valid will.

Trustee—The legal relationship created by virtue of one party holding legal title to property, whether real or personal, for the benefit of another.

NOTES