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INTRODUCTION TO PROBATE AND ESTATE PLANNING

GARRY A. PEARSON* AND CHAD E. PEARSON**

Not everyone has a deep and abiding interest in the probate-estate planning process. Still, both those who practice law and those who have a significant degree of wealth should have a nodding acquaintance with the subject so that they will know when they should seek further advice. This article is not written solely for the Probate Bar, or for lawyers alone. It is our hope that this article will be clear and direct enough to provide some assistance to a layperson in determining whether his or her situation warrants estate and probate planning.

We also hope to be intensely practical. There are thousands of factual situations that could implicate several approaches to the estate planning process. We will focus on two. First, we will examine the probate and estate planning needs of those that have a non-taxable estate. Second, we will address those with a taxable estate. The dividing line between taxable and non-taxable estates is an amount which will exempt an estate with $625,000 of taxable value.[1] To arrive at the taxable estate, we subtract the debts of the decedent,[2] the expenses of administration,[3] the amount passing to a surviving spouse,[4] and the amount given to charity[5] from the value of the assets owned. The amount that is exempt from estate taxes, referred to as the amount of applicable credit, is presently scheduled to increase to $1 million by the year 2006.[6]

The first concern of most people with a non-taxable estate is whether they need a will. If the client is young, middle class, and unmarried, it may well be that a will is not needed since the laws of succession will normally suffice.[7] All the person's assets would descend to his parents or his siblings, depending upon whether the parents or the siblings

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1. 26 U.S.C. § 2010(a) (1994 & West Supp. 1998).
2. *Id.* § 2053(a)(3) (1994 & West Supp. 1998).
3. *Id.* § 2053(a)(2).
4. *Id.* § 2056 (1994 & West Supp. 1998).
5. *Id.* § 2055 (1994 & West Supp. 1998).
6. *Id.* § 2010(c) (1994 & West Supp. 1998).
7. N.D. CENT. CODE § 30.1-04 (1996 & Supp. 1997).

survived the decedent. These directions are most likely what the client would provide for in a will. For a married, middle class couple who owns a home, most likely subject to mortgage, some life insurance, one or two vehicles, furniture, and a small amount of savings, the decision to draft a will can be handled similarly. The laws of succession will most likely provide the same result as in the case of the typical will. Should the primary income producer die, all the assets will pass to the surviving spouse pursuant to North Dakota Century Code § 30.1-04-02. If the spouse does not survive, the property will pass to the children. However, the laws of succession deal exclusively with probate assets and therefore, much of the property owned by this imaginary couple would likely be what is called a non-probate asset.

A probate asset is one which would pass, by laws of intestacy, to heirs in the event that somebody died without a will.[8] An example of property which may not be a probate asset is real estate. Accordingly, the home that the imaginary couple lives in is commonly referred to as a joint tenancy property since, in the experience of your authors, homes are usually owned in joint tenancy between husbands and wives. This means that the survivor automatically succeeds to the ownership of the property upon the death of the first joint tenant.

Life insurance policies also possess a similar self-executing feature since the owner of the policy names the beneficiary. Life insurance proceeds do not pass "through the estate," but rather go directly to the beneficiaries named in the policy. An identical rule applies to pension benefits. Moreover, bank accounts are often joint party or multiple party accounts governed by North Dakota Century Code Chapter 30.1-31. Generally speaking, bank accounts involve survivorship features in that the other party named on the joint bank account typically inherits the balance in that account automatically.[9] In a joint account owned by a married couple, the survivor succeeds to the account upon death without further directions to the contrary.[10]

In the case of our imaginary family, the remaining probate assets probably include furniture, sporting equipment, and miscellaneous household goods. In a stable family, there is no question that the surviving spouse will succeed to ownership of this property even though there is no title associated with the dining room table, for example. Even if one spouses dies with a will leaving everything to the surviving spouse, it still may not be necessary to actually "probate" the will. This is

8. *Id.* §30.1-31-01 (1996).
9. *Id.* § 30.1-31 (1996).
10. *Id.* § 30.1-31-09 (1996).

because in a stable family no one usually challenges the surviving spouse's ownership of the property.[11]

Much has been written and advertised about whether one should attempt to avoid probate. Those individuals who have practiced law for some years will remember the controversy stirred by the book *How to Avoid Probate,* written by Norman F. Dacey, which enjoyed considerable popularity in the 1960s.[12] Mr. Dacey's method for avoiding probate was to transfer a client's property into a revocable trust, thereby placing a title on each and every item. The trust then identified the person who would succeed to the property at the time of death.[13] At death, the trust would become irrevocable and the property owned by the trust would be transferred by the appropriate documents to the person named as the heir in the revocable trust.[14] To accomplish this objective, the parties described above must transfer their home, automobiles, and bank accounts from joint tenancy into the revocable trust.[15] Although insurance policies could be transferred into trust by naming the revocable trust as the beneficiary of the insurance policy, generally, they would not be transferred. Title to personal property would also need to be transferred to the revocable trust. In addition, all assets acquired in the future would be in the name of the revocable trust. It is fairly apparent that this strategy does not simplify the lives of the parties who use revocable trusts to avoid probate.

In our example, when a spouse dies, the trustee would then distribute the property to the named survivors. For example, the home may be deeded to the surviving spouse. The bank accounts are also transferred to the surviving spouse. The insurance proceeds and pension funds will be paid to the survivor either directly or through the trust. The revocable trust could transfer the dining room table, for example, by way of a bill of sale. We have certainly avoided probate, but we do not seem to have accomplished much. As such, without a revocable trust, it is often unnecessary to probate an estate because the assets pass by beneficiary designation, as with insurance, or joint tenancy, or other joint ownership.

Assume, however, that a probate is necessary since the husband owns the home and the bank accounts are in his name alone. The probate process is simple under existing law and the Uniform Probate Code and renders a revocable trust unnecessary.[16] When one party owns the

11. *See generally* § 30.1-20-01 (1996 & Supp. 1998).
12. NORMAN F. DACEY, HOW TO AVOID PROBATE 13 (1965)
13. *Id.* at 13-15.
14. *Id.*
15. *Id.*
16. *Id.*

home and bank accounts individually and where the insurance policy and pension is payable to the spouse, the probate process can be best described as follows:

1. A petition is filed with the district court asking that the surviving spouse be appointed as the decedent's personal representative.[17] If the decedent left a will, she or he probably would have appointed their spouse as the personal representative. If she or he died without a will, the spouse would probably apply to be appointed as the personal representative. The filing of the "application to be appointed as personal representative and for admission of the will," is usually a single two-sided sheet of paper.

2. The court will consider the petition and almost invariably appoint the spouse as the personal representative. This requires an order admitting the will to probate, if a will exists, or recognizing intestacy, if there is no will, which appoints the spouse as the personal representative.[18] The judge also signs Letters Testamentary which authorizes the personal representative to act on behalf of the decedent.[19]

3. The next step is to publish the notice to creditors so as to terminate the rights of any unknown creditors.[20] Termination generally occurs nine months after the publication of such a notice.[21] It is a special process available only through probate, and not through any of the probate avoidance methods such as a revocable trust.

Once appointed, the personal representative will transfer the property from the estate to the heirs. A deed is drawn up transferring the home to the surviving spouse. The bank accounts are transferred from the decedent's account to the survivor's account by a check. A bill of sale will transfer the dining room table, and all other untitled personal property to the surviving spouse. The insurance policy will be paid by the insurance company to the named beneficiary, as will the pension plan proceeds. The transfer of property from the dead to the living is almost an identical process, whether one uses a revocable trust or goes through the probate process itself.

The revocable trust, which was the subject of the book *How to Avoid Probate*, enjoyed a relatively brief life, and seemed to disappear from the scene by the late 1970s. However, it has been resurrected in the past ten years and is now referred to as a "living trust." A living trust has nothing to do with living, nor is it a trust in the true sense of the word

17. N.D. CENT. CODE § 30.1-14-01 (1996 & Supp. 1997).
18. *Id.* § 30.1-14-08 (1996).
19. *Id.* § 30.1-01-06(29) (1996).
20. *Id.* § 30.1-19-01 (1996).
21. *Id.*

since it is revocable. A revocable trust does not generate any tax consequences by itself and there are no gift tax consequences for the transfer of property to a revocable trust.[22] The income of the revocable trust remains taxable to the grantor, and the full value of all property in the revocable trust is taxable to the decedent's estate at his death.[23]

The living trust is often marketed in ways which are not befitting to members of the Bar. Seminars are scheduled extolling the alleged virtues of the living trust. The living trust is often promoted on the basis that it will save the client time, publicity, and attorney's fees that they would otherwise incur by using the probate process. We have seen advertisements claiming that up to twelve percent of a decedent's estate may be consumed by probate costs. Practically speaking, however, the probate costs for filing the four sheets of paper required for probate and the drawing of a deed and a bill of sale are modest, especially when compared to the cost of a living will. The price of a living will can be in the $3,000 to $4,000 range for a combination living trust and the very simple will that accompanies it.[24] Your writers submit that a $3,000 fee for a living trust for a non-taxable estate is not what the client actually needs and is five to ten times more expensive than a relatively simple will which might cost around $300.

There are disadvantages to the revocable trust as well. As stated above, the revocable trust does not allow a notice to creditors to eliminate unknown claims.[25] Should one's will leave property to a spouse, and thereafter the parties divorce, the probate code automatically eliminates the divorced spouse.[26] This is not true in a revocable trust since it is not a probate asset. Another advantage of probate is that losses during administration are deductible against an estate's income.[27] In the event that losses exceed the estate's income during probate, the accumulated loss is ultimately deductible by the heirs at the conclusion of probate.[28]

A living trust will avoid probate and should not be totally dismissed. However, it is a more complicated process than necessary to accomplish the transfer of assets from the dead to the living. In contrast, the probate process for the average estate is quick, cheap, and simple. In addition, it provides clarity since it names the person who will raise the minor

22. *See generally* 26 C.F.R. § 20.2031 (1997).

23. 26 U.S.C. § 2038(a)(1) (1994).

24. A "pour over" will often accompany a living will. Such a will provides that in the event that the decedent failed to include all of his assets in the living trust, the short, two page will takes over and any probate property is "poured" into the living trust. Still, it is a will and necessitates the filing of those four sheets of paper needed for probate.

25. N.D. CENT. CODE § 30.1-10-02 (1996).

26. *Id.*

27. 26 U.S.C. 642(d) (1994 & West Supp. 1998).

28. *Id.* § 642(h).

children in the event of the death of both the husband and the wife. Due to the relatively modest cost of a sweetheart will and the advantages of probated over non-probated wills, there appears to be little, if any, incentive to avoid probate.

Often people are concerned about the effect an inheritance may have on their children. Usually, a young family has so little property that should the children inherit, the concern over unwise spending would have little practical merit. Children cannot come into an inheritance until they attain the age of majority at eighteen. However, there is always the possibility that successful parents will leave trusts preventing the children's possession of the property until they reach maturity, say age thirty-five. In these wills, the surviving spouse will receive all the property, unless one spouse predeceases the other, in which case the property will pass into a trust for the benefit of the children. The trustee will be directed to pay a portion of the income necessary for the care, comfort, support, and education of the children and to pay the principle at some appropriate time. For example, a common provision of such a trust is that half of the property is paid at age twenty-five and the balance at age thirty, with the income paid to the child throughout the trust period after age twenty-one or upon graduation from college.

The concerns underlying a taxable estate can best be illustrated by the following example. In this situation we assume a taxable estate, with a prospering business, owned by the husband and wife, age fifty, where the children have completed or are in their college years. Assume that the total assets owned by the husband and the wife are valued at $5 million. A home worth $300,000, investments of $600,000, life insurance having a face value of $1 million, miscellaneous property, such as cars and personal property of $100,000, and the business with a value of $3 million.

Few families are even hit by the federal estate tax. However, those families who are targeted and subsequently hire estate planners, are primarily concerned with the preservation of their wealth. There are, perhaps, no limits to the number of schemes and plans used to avoid estate taxes. They range from the simple plan of leaving everything to a charity or to the surviving spouse, both which produce non-taxable estates, to more complex and far reaching schemes, which include expatriation for the purpose of fleeing to some tax haven country that has no estate tax.[29] However, this article is about fundamentals and we shall discuss only basic planning for estate taxation.

29. *See id.* § 877(a)(1) (1994 & West Supp. 1998).

There is also a tax on gifts since it would be a simple matter to give everything away and avoid estate taxes. However, the gift tax has closed this loophole. The exemption for gifts and the exemption for estates is identical. For 1998, $625,000 in gifts or $625,000 of an estate is exempt from tax. But when a part of that exemption is used by a gift, it is forever gone and cannot be used again when the donor dies. For example, if the donor uses up his entire exemption of $625,000 by making gifts in 1998 and then immediately dies, there is no exemption to offset the estate tax. Consequently, the first dollar of the estate and every dollar thereafter will be taxed. Until the 1997 Act, the amount of the exemption was referred to as the unified credit, unified in the sense that it applied to both the gift tax and the estate tax.[30] In addition, individuals may each give up to $10,000 per year per donee free from a gift tax.[31] Accordingly, a common estate tax planning device is to establish a gifting program between the parents and their children or other objects of their bounty.[32]

Gifts within the amount of the annual exclusion can be made up until the time of death.[33] A donor can give away his entire estate on his death bed and pay no estate tax, as long as his property was given to a sufficient number of donees. For example, with a $5 million estate, 500 recipients must be identified, each receiving $10,000, in order to totally exhaust the estate and avoid paying any estate tax.

Perhaps the most fundamental approach to estate taxation is marital deduction estate planning. All transfers between spouses, including gifts and property passing at the time of death, will qualify for marital deductions as long as the spouse receives an interest which is not terminable.[34] An example of a terminable interest is a gift to a surviving spouse of a life estate, with the remainder to a child. The life estate will terminate when the spouse dies, and therefore would not be included in the surviving spouse's estate.[35] One of the reasons for the marital deduction is that while there will be a deduction in the estate of the first to die, the property will inevitably be taxed in the estate of the second spouse to die

30. *Id.* §§ 2001, -2501, -2502 (1994 & West Supp. 1998).

31. *Id.* § 2503(b) (1994 & West Supp. 1998).

32. The annual exemption does not apply to gifts of so-called future interests, that is, a gift for which the enjoyment is delayed until sometime in the future. 26 U.S.C. § 2503(b). An example of a future interest is a gift, in trust, to a child which pays the child the income as it is deemed necessary by the trustee, but with the principle not paid to the child until age 30. However it is possible to salvage the annual exemption of $10,000 even on such gifts if we give the child the right to demand the amount contributed in that year, up to the amount of the annual exemption, which converts the future interest into a present interest. Crummey v. Comm'r of Internal Revenue, 397 F.2d 82, 87-88 (9th Cir. 1968).

33. 26 U.S.C. § 2503(h).

34. *Id.* § 2056(d)(1) (1994 & West Supp. 1998). This does not apply to a non-citizen spouse. *Id.*

35. *See id.* § 2056.

even though there is a deduction. Even with the terminable interest, that is, a life estate to the wife and a remainder to the children, the estate can still qualify for the marital deduction if the husband's estate elects the so-called "Q-Tip," or Qualified Terminable Interest Property Election.[36] This simply provides that the Q-Tip property can be included in the surviving spouse's estate.

Martial deduction planning today essentially involves what is known as a "reduce to zero" strategy which reduces the taxes in the estate of the first deceased spouse to zero. This reduction occurs by providing that a calculated amount passes to the surviving spouse which causes the estate of the first spouse to be exempt from taxation. Assume a husband has a taxable estate worth $925,000 at the time of his death. He dies in 1998, when the applicable credit is $625,000 worth of property. To reduce his estate to zero, it would be necessary for $300,000 to pass to his widow. At the time the $300,000 is deducted from the estate the tax is zero.

Assume the widow also has $925,000 in her own name. The $300,000 she receives from her husband will increase her estate to $1,225,000. The widow dies ten years after his death in 2008. If the widow survives the decedent by a decade or more, $1 million of her estate is exempt from taxation due to the scheduled increase in the applicable credit.[37] If the widow's property has the same value it had when her husband died, her estate tax would be $92,250.[38] Had the husband's estate not claimed the marital deduction, the taxes in 1998 would have been $114,500.[39] The savings with the reduce to zero clause comes from the use of the money during the wife's remaining lifetime, money that was not paid in taxes when the husband died.

The use of marital deduction planning is by no means the only method to reduce estate taxes. In 1976, Congress responded to complaints by farmers seeking to preserve the family farm from what they thought to be high federal estate tax rates.[40] Congress responded to the complaints by providing for a method of valuing qualifying farm property in a manner which would normally produce a smaller estate tax than normal valuation.[41] This method of taxation is known as special use value and basically permits the valuation of property on an income

36. *Id.* § 2056(b)(7).

37. *Id.* § 2010 (a)-(d)(1994 & West Supp. 1998).

38. *See generally id.* §§ 2001-2010 (1994 & West Supp. 1998).

39. *See id.* §2001.

40. *See generally* The Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified as amended in scattered sections of 26 U.S.C.).

41. Pub. L. No. 94-455, § 2003(a), 90 Stat. 1856 (codified as amended at 26 U.S.C. § 2032A (1994 & West Supp. 1998)).

approach, rather than the standard fair market value approach.[42] If a farm qualifies for special use valuation, the value of the farmland is determined by initially establishing an average cash rental rate for similar land for the five years prior to death.[43] Once the average cash rental rate is established, the average real estate taxes on a similar property are then subtracted from that amount and the resulting number is divided by the average farm credit services interest rate for the preceding five years. For example, assume that the average cash rental rate for similar land was $100 per acre, that the average real estate tax on similar land was five dollars per acre, and that the average farm credit services interest rate for the past five years was ten percent. The resulting value of the farmland would be $950 per acre.[44] That same land might have an actual fair market value in the normal real estate market of $1,500 per acre.

To qualify for special use valuation, the decedent or a member of his immediate family must have actually operated the farm for at least five of the eight years prior to his death.[45] Renting the land out under a material participation crop share lease qualifies for the five of eight year test. If the decedent retired or became disabled, his material participation for five of the last eight years before his death can be satisfied at the time of disability or retirement.[46] In addition to the above requirements, the farm must be an actual working farm. The test for this determination is whether fifty percent or more of the total assets in the gross estate are comprised of farm property.[47] Similarly, twenty-five percent of the farm assets must be farm real estate.[48]

Special use valuation requires the family to operate the farm after the death of the decedent.[49] Otherwise, there is a recapture of the tax savings in the event that the farm no longer qualifies for a ten year period following death.[50] The land must also pass to a qualified heir, including a child, a spouse, the spouse of a child, a grandchild, or an ancestor, and the land must actually be farmed by that person.[51] The qualified heir could avoid recapture by leasing the property under a material participation crop share lease in the post death period.[52] Up

42. 26 U.S.C. § 2032A(a)(1), (2).
43. For a cash rent we simply mean rent paid in cash as opposed to a crop share rental basis.
44. ($100-$5) + .10 = $950.
45. 26 U.S.C. § 2032A(b)(1)(C)(ii).
46. *Id.* § 2032A(b)(4)(A)(I), (ii).
47. *Id.* § 2032A(b)(1)(A)(i).
48. *Id.* § 2032A(b)(1)(B).
49. *Id.* § 2032A(b)(1).
50. *Id.* § 2032A(c)(1).
51. *Id.* § 2032A(e)(1),(2).
52. *Id.* § 2032A(e)(b).

until the 1997 Taxpayer Relief Act,[53] only a surviving spouse could rent the property for cash to another qualified heir in the post-death period and still avoid the recapture of the tax savings. A major change in the statute occurred under that Act which permitted all lineal descendants of the decedent to rent the property for cash to other qualified heirs without triggering the recapture of the tax.[54] Another substantial change that occurred in the 1997 Taxpayer Relief Act ensured that certain technical failures do not disqualify the election, unless the disqualifying act may be remedied. For example, the failure to obtain a signature is not remedied within ninety days following the receipt of written notice of the failure from the Internal Revenue Service.[55] The maximum tax reduction per estate is $750,000.[56] The death of an heir terminates the potential for recapture, as does the passage of ten years from the time of death.[57] When there is succession of a qualified use the heirs are required to file tax return form 706A.[58]

The Taxpayer Relief Act of 1997 also established an exclusion for the value of a closely held business.[59] This is not a special method of valuation but rather a complete exclusion of the value of certain qualifying property.[60] Thus, an estate which can utilize special use valuation is also entitled to exclude the value of farm property if it otherwise qualifies as a closely held business. The amount of the exclusion is $1.3 million but this exclusion is reduced by the amount of the applicable credit.[61] In 1998, $625,000 in value will be effectively exempted from the estate tax due to the applicable credit. Accordingly, the amount of the exclusion for closely held businesses is limited to the difference, for example, $675,000.[62]

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53. Pub. L. No. 105-34, 111 Stat. 788 (codified as amended in scattered sections of 26 U.S.C.).

54. *See* Pub. L. No. 105-34, § 504, 111 Stat. at 853-54 (codified at 26 U.S.C. § 2032A(c)(7)(E) (West Supp. 1998).

55. 26 U.S.C. § 2032A(d)(3)(B). For example, the failure of an heir to sign the agreement which promises to repay the tax in the event that the land no longer qualifies for special use. *Id.*

56. *Id.* § 2032A(a)(2).

57. *Id.* § 2032A(c).

58. This is a requirement of the recapture agreement of § 2032A(d)(2).

59. Pub. L. No. 105-34, § 502(a), 111 Stat. 847 (codified at 26 U.S.C. § 2033A (West Supp. 1998)).

60. *Id.*

61. 26 U.S.C. § 2033A(a)(2).

62. *Id.* § 2033A(a)(1)(A)-(D). There are a number of requirements for the above exclusion. The decedent must be a U.S. citizen or resident, the personal representative must elect the exclusion and obtain a signature of all the individuals who have an interest for recapture, the value of the closely held business must exceed 50% of the adjusted gross estate, and it must be an active trade or a business. If it is a sole proprietorship, 50% of the business must be owned by the decedent and members of his family. If it is a corporation or a partnership then the decedent and his family must own 30%, and members of two other families must own 70%, or 90% must be owned by three other families. The business must have been operated for five of the past eight years, but the decedent or members of his family and the business interest must pass to a qualified heir. *See id.*

The net effect of the combination of the applicable credit, special use valuation, and the exclusion for a family owned business is the potential exclusion from federal estate taxation of up to $4.1 million of value for a family who owns a farm. A husband and wife who own a farm can reduce their estates by up to $750,000 each, indexed to inflation, starting in 1998, by the special use election, or $1.5 million. To reach the final figure of $4.1 million, the $1.5 million must be added to the estate and doubled by the sum of exemptions for the applicable credit and the family owned business; $1.3 million each.

Estate planning in the above situation is necessarily indirect. The client should be apprised of the opportunities for tax savings and informed that it is necessary to maintain eligibility by the ownership of qualified property for special use value and for the exemption of family owned businesses. Awareness of the existence of the tax strategy is the key. In addition to the amounts that are excluded from taxation or covered by the applicable credit, the Internal Revenue Code also allows the deferral of taxes that are due. Section 6166 of the United States Code permits installment payments of the estate tax, but not the gift tax, if thirty-five percent of the value of the estate is comprised of the assets of a business.[63] The deferral is only for the value of that business.[64] The business can be a corporation or a partnership, or several businesses can be combined to meet the thirty-five percent test.[65] The interest rate on the deferral of tax before 1998 was four percent on the first $153,000 of tax,[66] but for decedents dying after 1997, the interest rate is only two percent on the first $1 million of a taxable estate.[67] There is no principle payment for the first four years following death because only interest is paid until the fifth year, at which time ten percent of the principle is paid each year.[68] For example, assume an estate with an exclusion for family owned businesses with a taxable estate of $3 million. The two percent rate would apply on the $1 million of tax, that is, the amount between the first $1.3 million and $2.3 million.[69] The other $700,000 of the taxable estate would be subject to an interest rate of forty-five percent of the normal Internal Revenue Service interest rate.[70]

63. *Id.* § 6166(a)(1) (1994 & West Supp. 1998).
64. *Id.* § 6166(a)(2)(A), (B).
65. *Id.* § 6166(c). The only applies if the decedent has 20% equity interest in each entity. *Id.*
66. *See id.* § 6601(j) (1994 & West Supp. 1998).
67. *Id.* § 6601(j).
68. *Id.* §§ 6601(f)-(j)(2).
69. *Id.* § 6601(j)(a)(A)(I).
70. *Id.* § 6601(j)(1).

Property is valued for estate tax purposes at fair market value, with the exception of special use value property as described above.[71] Fair market value is the amount that a willing buyer would pay to a willing seller, who is fully advised concerning the subject matter of the sale and is not under a compulsion to buy or sell.[72] A less than majority interest in a closely held business, or jointly owned property, is particularly difficult to value since prospective buyers are usually unwilling to pay the same amount per share for a minority interest as they would pay for a controlling share. For example, assume a decedent owned a minority interest, less than fifty percent, in a small, closely held corporation. A prospective buyer would insist upon a substantial discount before he would purchase a forty-nine percent interest in the corporation. The same is true of a minority interest in a partnership, limited liability company, limited liability partnership, or limited partnership. The courts, and the Internal Revenue Service, recognize such discounts, and also recognize that there is a further discount allowed for lack of marketability.[73]

Lack of marketability is a separate and distinct doctrine from minority discounts. A stock traded on a stock exchange obviously has a market. Non-traded stock in a closely held corporation has no ready market and the determination of fair market value is complicated by the lack of a ready pool of prospective buyers. The range of the discounts allowed by the courts has varied between twenty percent and eighty-five percent. In *Estate of Watts*,[74] the decedent owned an interest in a partnership which was subject to state law limitations on its ability to dissolve.[75] The court recognized that the partnership interest should be discounted for lack of marketability and for its minority position, and reduced its value by eighty-five percent from the amount claimed by the Internal Revenue Service.[76]

Proper planning for minority discounts and lack of marketability discounts involves arranging the ownership of a family owned business enterprise so that minority situations exist. For example, a father and a mother might each own thirty percent of a business while the children own the other forty percent. The shares owned by everybody are thus eligible for the minority discount. Similar discounts are also available for co-ownership of real property. In *Propstra v. United States*,[77] a hus-

71. *Id.* §§ 2032A-2033A (1994 & West Supp. 1998).

72. *See, e.g.*, U.S. v. Simmons, 346 F.2d 213, 217 (5th Cir. 1965).

73. Estate of Berg v. U.S., 687 F.2d 377 (Ct. Cl. 1982).

74. 823 F.2d 483 (11th Cir. 1987).

75. Estate of Watts v. Comm'r of Internal Revenue, 823 F.2d 483, 484, 486 (9th Cir. 1987).

76. *Id.* at 488.

77. 680 F.2d 1248 (9th Cir. 1982).

band and wife owned real estate as joint tenants.[78] The husband died and the wife claimed and was allowed a fifteen percent discount in the value of the property passing to her from her husband, through joint tenancy, because his half share was subject to the co-ownership rules of state law.[79] Discounts for co-ownership of real property are allowed by the Internal Revenue Service and the only question in most estates is how significant a discount should be claimed.[80]

This completes our introductory list of fundamental estate planning principles and objectives. There are scores of other planning strategies including the sophisticated use of pension plans combined with life insurance, annuities, trusts that last beyond the normal rule of perpetuities, charitable gifts through the use of unitrusts, charitable remainder trusts (GRITS), grantor retained income trusts (GRATS), grantor retained annuity trusts, and grantor retained unitrusts (GRUTS). However, in our experience, most estates encountered in North Dakota will utilize the fundamental principles described in this article.

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78. Propstra v. United States, 680 F.2d 1248, 1250 (9th Cir. 1982).

79. *Id.*

80. *See, e.g.*, Estate of Pillsbury v. Commissioner, 64 T.C.M. (CCH) 284 (1992).