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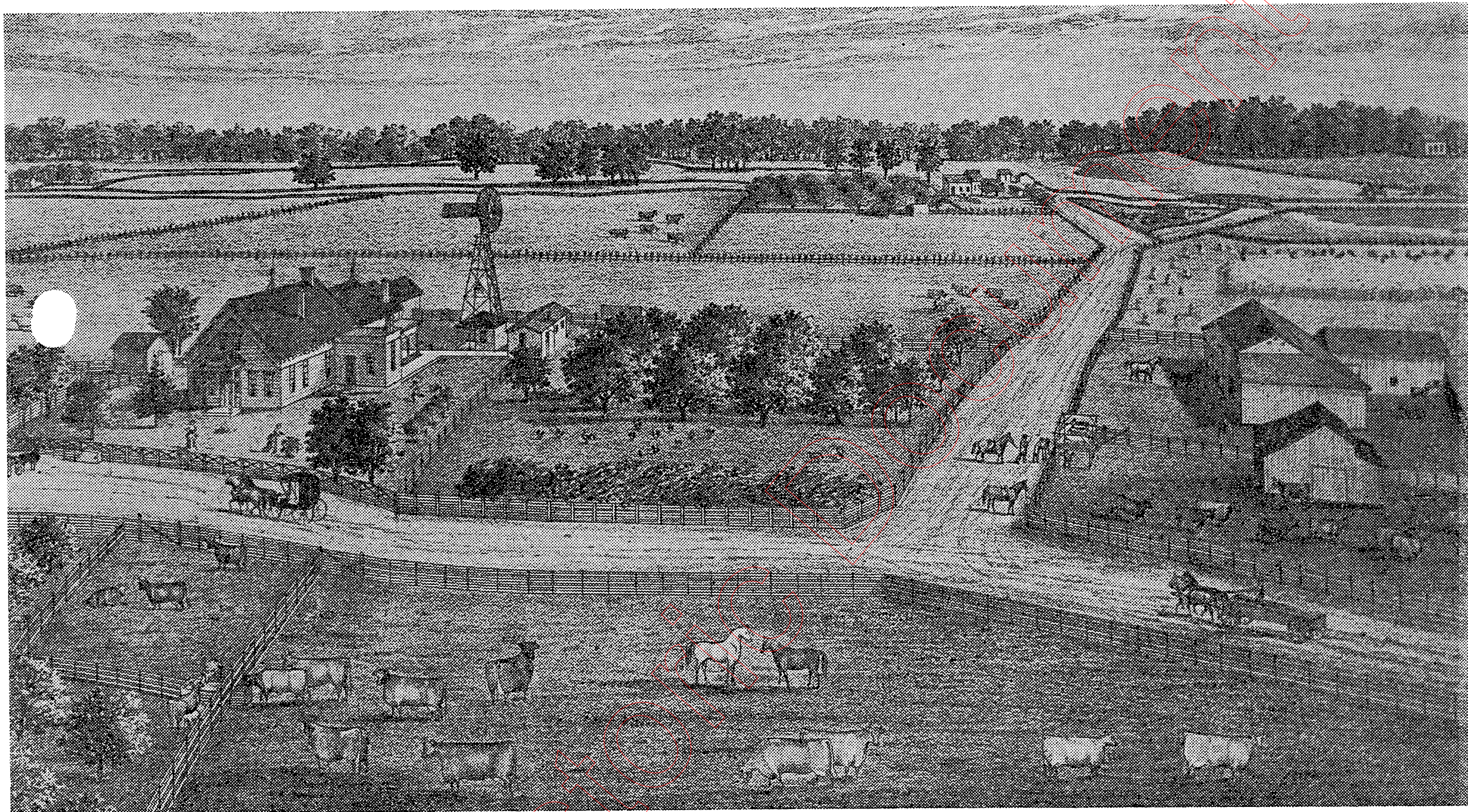
ESTATE MANAGEMENT FOR INDIANA FARM FAMILIES



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The purpose of this publication is to acquaint farm families (and others) with basic concepts of and the need for estate management. Particular emphasis is given to economic consequences of various practices. But estate management is a complex problem and a highly specialized area. Therefore, under no circumstances should you consider this publication a substitute for legal assistance. Estate planning requires the knowledge and expertise of a competent attorney. It might also require the expertise of a competent accountant, trust officer, insurance representative, and others.

ESTATE MANAGEMENT FOR INDIANA FARM FAMILIES

M. D. Boehlje and L. M. Eisgruber
Department of Agricultural Economics

I. Introduction

Suppose you are a successful Indiana farmer in your mid fifties. Through hard work, good management and wise spending you and your wife have accumulated considerable wealth. Although there is still a substantial mortgage on the farm, your net worth does amount to something in excess of $500,000. Your family consists of two children, a son and a daughter both in their mid-thirties. Your son is farming with you, and because there have been no major disagreements, you don't feel that a written contractual arrangement is necessary. Your daughter is married to an engineer who has no interest in farming. They live in a neighboring state. Since you have been in excellent health, neither you nor your wife have felt the need to draw up a will.

But suppose something *would* happen to you—a car accident or a tractor accident on the farm. Even after claiming all deductions and exemptions, your family would have to face estate taxes, inheritance taxes and legal fees of about $75,000. In addition, according to the Indiana Laws of Descent, your wife, your son and your daughter would each receive one third of the farm. Does this provide the security you wanted for your wife? Will your family be able to come up with $75,000 on such short notice? Will your daughter and her husband want to get "their money out of the farm?" What will all this do to your family and the farm?

Unfortunately, too few farmers ask themselves these questions. It seems so much easier and so much more urgent to the farm manager that he spend his time and effort planning and implementing the production and investment decisions which increase farm and estate size. Little consideration is given to the problems of transferring the farm estate to future generations. However, unless adequate plans are made for estate transfer, significant economic losses can occur—in effect reducing the value of the property received by the heirs and offsetting the growth in firm and estate size achieved by profitable production and investment decisions. In addition, family arguments and other non-economic problems may arise unless adequate estate plans have been developed. Thus, it is difficult to overemphasize the need for proper estate planning. After a lifetime devoted to accumulating property, you should be able to have some control over the distribution of your property. Such control can be obtained only through proper planning. In all fairness to you and your family, you should acquire some knowledge about transferring property between generations.

The following discussion is designed to provide you with basic knowledge about estate planning. To be sure, there is no "one-best" plan which suits every farm family. Nevertheless, the basic principles discussed below should enable you to delineate and evaluate alternative plans which are consistent with your family's goals and circumstances, and to overcome apathy with respect to estate planning. Finally, we wish to emphasize again that any plan needs to be developed with the aid of competent professional service, including that of an attorney.

II. Estate Planning

1. What Is It All About?

Estate planning is the development of a plan:

(1) to insure economic management of the estate property during and after the lifetime of the estate owner, and

(2) to create the desired legal consequences in the disposition of the property.

A plan to manage and transfer an estate is difficult to design for at least two reasons. First, multiple and often conflicting goals must be satisfied by the estate plan. In the development of the farm estate plan, such goals as reducing the death taxes, reducing the estate settlement costs, assisting one of the heirs to get established in farming, keeping the farm or business property in the family, providing adequate lifetime income for the parents, and/or reducing the personal conflicts by treating all the heirs equitably but not necessarily equally must be considered.[1]

Conflicts of interest provide the second source of difficulty in the development of estate management plans. These conflicts can exist not only among their heirs but also between the heirs and

[1] Nichter, A. M., 1965. *"Inheritance and Transfer of Property in Indiana,"* Extension Circular 490, Cooperative Extension Service, Purdue University.

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the parents. Thus, if the father has provided the major amount of labor and management during the growth and expansion of the farm, he may not be willing to give this responsibility to the heirs during his lifetime. Or, the father may give complete management responsibility to the heirs but maintain sufficient control over the financial assets of the firm so that the heirs cannot exercise this responsibility.

2. Why Estate Planning Is Important in Agriculture

Particular characteristics of the agricultural firm and agricultural assets not only increase the need for adequate estate planning, but also increase the complexity of the estate management problem.

(a) *The Capital Input and Costs of Transfer:* Substantial economic losses can occur if the proper strategy is not used to transfer the estate which contains large amounts of highly specialized capital assets. The most obvious source of economic loss is a result of the state and federal estate, inheritance and gift taxes. Although these taxes may not be applicable to small estates (for example, estates less than $120,000 if the marital deduction is used), the tax rates increase progressively at the federal level and in most states. Thus, the federal estate tax rate for a $500,000 taxable estate is about 30% and, along with an Indiana inheritance tax rate of about 3% for this size estate, a total tax liability of $160,000 would be incurred at death.[2]

A second source of economic loss occurs when the transfer taxes are so large that they cannot be paid from liquid assets (cash, insurance proceeds, inventories), and capital assets of the firm must be liquidated. Frequently, a forced liquidation does not allow the seller to take advantage of seasonality in asset prices or the traditional bargaining power of a seller to hold the asset if the bid price is too low. Liquidation prices are typically 75-80% of market values. Thus, a forced sale may result in the receipt of a lower price for the asset than its fair market value and an economic loss to the firm.

The splitting of assets because of a forced sale or a disagreement among the heirs is the third sources of economic loss. The sale of some of the assets of the firm to provide liquid funds for one of the heirs or the physical splitting of assets among the heirs may eliminate the opportunities to exploit economies of size. As a result, the per unit returns of these assets which remain intact in the firm are reduced. Not only may the production efficiency be reduced, but marketing advantages such as quantity discounts and financial opportunities such as a line of credit may be sacrificed when a large firm is forced to liquidate some of its assets to pay transfer taxes or to provide liquid funds for one of the heirs.

The final source of cost or loss is attributable to the process of estate planning *per se*. Legal and management fees are incurred in any transfer plan and must be considered in the evaluation of the plan. If no estate plan is made, the legal and management fees of planning will be minimal. But the litigation costs and losses from discontinuity in managing the estate assets may be substantial.

(b) *Ownership, Control and Financing of Agricultural Assets:* The typical "family farm" is organized as a sole proprietorship. In addition, the production management function and the financial management function are usually performed by the same individual. Thus, in contrast to the public corporation, the farm firm is closely tied to the life of the owner. Unless a plan is made to transfer not only ownership but also managerial and financial responsibility, the farm as a firm often disintegrates when the farmer dies because of the lack of a competent manager and entrepreneur to take his place.

Even if plans are made to transfer ownership and managerial and financial responsibility, conflicts will occur if certain responsibilities are not transferred together. For example, transferring the management function but not the financial responsibility from the father to a son can result in the father undermining his son's management decisions by not providing funds to implement those decisions.

Usually, not all of the heirs have the interest or the opportunity to be directly involved in the farming operation, and when the estate is transferred to the heirs they rightfully want their share. Financial arrangements can be made which will keep the physical assets intact on the farm firm and still provide liquid funds to compensate the off-farm heirs. However, these arrangements may force the farm heir to acquire a much higher debt position than is desirable. Thus, the farm firm is frequently refinanced at the end of each generation.

(c) *Age of Farmers:* Census data indicate that the median age of farm operators has increased

[2] Internal Revenue Code of 1954 (I.R.C.), July 1, 1970, edition, Prentice-Hall, Englewood Cliffs, N. J., Sec. 2001. In 1964, 24,364 U.S. farms had a value of land and buildings greater than $500,000. However, in the same year, almost 347,000 farms had a land and building value greater than $100,000 and thus would be vulnerable to transfer taxes. Bureau of Census, "Size of Farms," *1964 Census of Agriculture,* U. S. Dept. of Commerce, Vol. II, Chapter 3, p. 242.

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from 48.7 to 51.3 during the last 20 years.[3] Thus, the number of farms that will be going through the intergeneration transfer process during the next decade could be quite large. In addition, farms are larger now than in the past, increasing the opportunity for large intergeneration transfer costs.

3. Estate Creation and Estate Transfer

Creation of the farm estate (i.e. accumulation of net worth) and transfer of that estate are interrelated processes that must be coordinated for efficient estate planning. To understand the estate creation process, the farm firm may be viewed as consisting of specific quantities of productive assets such as land, hog and cattle facilities, cropping machinery, inventories of livestock and crops, off-farm investments and insurance. These assets are utilized through either production, sale or lease along with borrowed assets to produce earnings which can be either consumed or reinvested in larger quantities of the different productive assets. This reinvestment results in growth, or net worth accumulation, of the firm.

For estate transfer purposes, the assets can be aggregated into the four classes, namely, farm real estate and improvements, farm personal property, off-farm investments and insurance.[4] Various methods of transferring the estate such as joint ownership, trusts or gifts can be utilized, but the method chosen will be influenced by the farm family goals, family characteristics, tax laws and the laws of descent as well as the total size and ownership composition of the estate. Once the transfer decisions have been made, the resulting tax and management fees must be paid. In addition, the non-farm heirs may desire to separate their assets from the firm. Thus, the asset composition of the firm may be substantially different and the growth may be significantly influenced by the transfer decisions.

Although the estate planning and intergeneration transfer decisions are difficult during all stages of growth, the problems are usually different during the early stages of firm expansion when the estate is small compared to the latter stages when a substantial size estate has been acquired. The problems which arise with a large estate usually center around the desire to minimize transfer costs or losses and death taxes and still maintain the large size farm unit which is able to exploit economies of size and capital intensive technologies. In contrast, taxes are of minor importance in the transfer of a small estate. The major problem is to assure a minimal level of income to support the heirs, particularly the surviving spouse. Thus, growth of the farm firm (or creation of the farm estate) and the transfer of this estate to future generations are inseparable problems. The optimal growth path of the firm over more than one generation may be substantially influenced by the differential treatment given different classes of assets such as farm real estate, insurance or outside investments by the income and death tax regulations. Moreover, any change in the size of the firm may require a completely different strategy and set of objectives for the intergeneration transfer process.

III. Goals and Estate Planning

Various goals must be identified and considered in evaluating the various transfer and creation tools and techniques. All of the major goals that are to be achieved by estate management plans can be categorized into the three following classes:

1. Transfer the largest possible amount of property to the heirs.
2. Provide income and capital security for the parents.
3. Direct the distribution of the estate assets.

1. Transfer the Largest Amount of Property to the Heirs

One of the major objectives of any estate creation-transfer plan is to reduce the economic losses of the firm during transfer, or to maximize the aggregate value of the estate transferred from the parents to the heirs. Rather than maximize net worth over a period of years which includes only his lifetime, a farmer is frequently interested in the welfare of his heirs and the continuity of the farming operation after his death. He desires to maximize the net value of the estate after it is transferred to the heirs rather than before this transfer. Consequently, the plan should be developed to reduce the estate planning and administration expenses, death and income tax obligations, losses due to liquidation at less than market value and losses because of inability to exploit economies of scale. The plan which can best satisfy this goal will involve judicious concern for the creation of the estate as well as the actual transfer of that estate.

[3] Bureau of Census, "Characteristics of Farm Operators and Persons Living on Farms," *1964 U.S. Census of Agriculture*, U. S. Dept. of Commerce, Vol. II, Chapter 5, p. 513.

[4] A fifth type of asset which does not fit into any of these classes would be the patronage dividends from cooperative input supply and marketing firms. Frequently, these dividends can be liquidated only upon death of the owner.

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2. Provide Income and Capital Security for the Parents

An estate plan should guarantee that the individuals who have accumulated an estate have the opportunity to use that wealth for their enjoyment and security. For some individuals this enjoyment might involve the liquidation and consumption of firm assets with little concern for the amount of the estate left to transfer. For others, an adequate level of income and assets to meet normal living expenses and unexpected contingencies during the retirement years would be acceptable. In either case the parents should specify the level of income and capital assets which they feel is necessary to provide security throughout their life. Because of changes in the living standard and income requirements as parents grow older, the minimum amount of property that should remain in the parent's estate may change during the retirement years.

3. Directed Distribution of Property

One of the explicit purposes of any estate creation-transfer plan is to guarantee that the property is divided and transferred exactly as the parents desire. Directed distribution might include arrangements that will treat all children equitably, help one or more children begin farming, provide financial support for a charity or educational institution or keep the property within the immediate family. In addition, a parent may desire to reward certain children for special favors or improvements in the farm through specifying what assets they should receive from the estate. In some cases, parents may desire to transfer property to their grandchildren rather than their children. This process of skipping a generation may not only provide the financial base for the grandchildren to obtain an education or start farming, but it may also reduce the tax liability and estate planning problems of children who may already have a sizable estate of their own. In general, directed distribution insures that the property is transferred to those heirs or organizations who the parents feel (for whatever reason) should receive the property. In some cases, the goal of directed distribution dominates all other goals of estate planning. However, even in these cases there are alternative methods, some of them more costly than others, which can be used to guarantee that certain heirs receive certain property. Subject to the imposed limitations on transfer, these alternatives must still be evaluated.

IV. Alternatives in Estate Planning

Numerous alternatives are available to farm families who plan the creation and transfer of their estates. Included are the various production and investment alternatives employed to create the estate as well as the alternative legal and financial methods that can be used to transfer the estate.

1. Creation Alternatives

The creation decisions of the estate creation-transfer process include the determination of the level, amount and timing of the production and investment alternatives. Funds which can be used in the creation of the farm estate may come from many different sources including past earnings, credit, gifts, and inheritances. Because a recent publication[5] from this Experiment Station indicates rather specifically the alternatives and relationships that must be considered in the farm firm growth or creation process, that information will not be duplicated here.

2. Transfer Alternatives

As with creation of an estate, there are a number of methods which can be used to transfer an estate. Thus, a farmer must decide not only what method or methods to use in transferring the estate, but also how much of each type of property to transfer to each heir with the different methods. The following discussion will summarize some of the legal characteristics and economic consequences of the various transfer alternatives.

(a) *Types of Property Ownership:* Four types of property ownership are common in Indiana.[6] *Sole or fee simple* ownership refers to the ownership of property by one person with all legal rights to dispose of the property in any way he desires. Ownership of property as *tenants-in-common* exists when two or more individuals have undivided interests in the property. Each tenant-in-common has the right to sell, mortgage, assign or convey by any legal means, including a will, his interest in the property. *Joint tenancy* is a type of property ownership between two or more individuals which includes the right of survivorship. Thus, if one joint tenant dies, his interest in the property is immediately and automatically conveyed equally to the other joint tenants. A joint tenant *does* have the right to sell, mortgage, or assign his in-

[5] See Boehlje, M. D. and T. K. White, 1969. *Analysis of the Impact of Selected Factors on the Process of Farm Firm Growth,* Research Bulletin 854, Purdue Exp. Sta.

[6] Casner, A. J. and W. B. Leach, *Cases and Text on Property,* First Standard Edition with 1959 Supp., Little, Brown & Co., Boston, 1951, pp. 267, 270-275, 304-309. The life estate type of property ownership is discussed later.

terest in jointly-held property during his lifetime, but the will is ineffective with respect to jointly-held property. In Indiana, real estate owned by a husband and wife is usually owned by them as *tenants-by-the-entireties* and the survivorship rights apply upon the death of either spouse. Property held in tenancy-by-the-entirety cannot be sold, mortgaged, assigned or conveyed by one co-owner alone, except upon divorce.[7] However, it is possible for a husband and wife to own real estate as tenants-in-common.

Ownership of property either in fee simple or as tenants-in-common rather than as joint tenants or tenants-by-the-entirety may have a substantial influence on the death tax liability as well as the freedom to transfer the property as one desires. When a person dies, the total value of all jointly-held property with the *right of survivorship* is included in the decedent's estate for federal estate tax purposes, except that portion for which positive proof exists that the property did not originate with the decedent.[8] In most cases this positive proof is difficult to obtain. In addition, at the death of the surviving joint tenant or tenant-by-the-entirety, the total value of the property is again included in the estate and another tax liability is incurred.[9] Thus, jointly-held property with the right of survivorship may be taxed twice whereas, if the same property had been held in tenancy-in-common or split between the individuals involved as sole owners, it would have been taxed only once (only the ownership portion of property held in tenancy-in-common is included in the estate).[10] Because of the automatic nature of the transfer of property held in joint ownership, the decision to register property in joint tenancy or tenancy-by-the-entireties is in essence an estate transfer decision.

(b) *Wills:* A will is a legal instrument used to make testamentary transfers or transfers after death. Frequently, a will is used as the instrument to implement other aspects of the estate transfer plan such as setting up a trust or transferring a life estate to the surviving spouse. The few restrictions on how property can be transferred by a will make it a very flexible transfer instrument in terms of guaranteeing that the property goes to the desired heirs. However, it must be combined with other transfer methods to effectively reduce the economic losses which might occur during the transfer process.

Only two important restrictions exist with respect to transferring property by will. First, a surviving spouse is entitled to her statutory share, irrespective of what is transferred to her by the will. Thus, a spouse may elect to take against the will and receive her statutory interest in the property. In Indiana this statutory share is one-third of the deceased's estate, irrespective of the number of children or heirs.[11]

The second restriction on property transfers by will relates to the type of property ownership. As indicated earlier, if property is held by two or more persons as joint tenants or tenants-by-the-entireties, the rights of survivorship are created and the property does not pass to the heirs as specified in the will. Instead it passes to the surviving joint tenant or tenants in the case of joint tenancy and the surviving spouse in the case of tenancy-by-the-entireties.

If both the husband and wife are still alive when a will is written, the decisions of whether to utilize the marital deduction must be made. Under federal estate tax law, the deceased can transfer up to one-half of his real and personal property to a surviving spouse without incurring any tax liability. However, property in which the decedent transfers a life estate to his wife with a remainder to the children, property in which the spouse receives a conditional interest from the decedent (providing the conditional event must occur after 6 months from the time of death), and annuities or property which is under contract to benefit a third party does not qualify for the marital deduction.

If the taxable estate is valued at more than $60,000, it is usually advisable to take advantage of the marital deduction. However, if the spouse who will receive the property through the marital deduction already possesses a substantial amount of property, the progressive estate tax rates will result in a higher total tax liability on both transfers (the decedent to the spouse and the children,

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7 Burns, Harrison, *Burns Annotated Indiana Statutes,* Bobbs-Merrill, Indianapolis, 1954 (revised 1969), Sec. 56-112; Casner, A. and W. Leach, *Cases and Text on Property,* First Standard Edition with 1959 Supp., Little, Brown & Co., Boston, 1951, p. 309.

8 *Internal Revenue Code of 1954* (I.R.C.), July 1, 1970, edition, Prentice-Hall, Englewood Cliffs, N. J., Sec. 2040.

9 Gromley, C. R., J. A. Hiller, D. R. Hoeppner, *Workbook for Indiana Estate Planners,* Bobbs-Merrill Co., Indpls., revised 1969, Sec. F07.1-F07.8.

10 Krausz, N. G. P. and H. R. Allen, 1968. *Family Planning of Titles and Taxes in the Transfer of Farm Property,* Circular 885, Un. of Illinois, Coop. Extension Service, pp. 18-19.

11 Burns, Harrison, *Burns Annotated Indiana Statutes,* Bobbs-Merrill, Indianapolis, 1954 (Revised 1969), Sec. 6-301. The right of a surviving spouse to receive a statutory interest is frequently varied by an antenuptial contract entered into before marriage. If the decedent is survived by a child or children or descendents thereof from his first spouse, a surviving second or other subsequent childless spouse is entitled to one-third of the personal property of the testator plus a life estate in one-third of the real esate.

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and the spouse to the children) when the marital deduction is fully utilized than when it is only partially utilized. Thus, the greatest tax saving from using the marital deduction will occur when property equal to half the value of the combined estate of the husband and wife minus the value of the wife's estate is qualified for the deduction.

(c) *Sales:* The use of a contract or mortgage sale is a common method of inter vivos or lifetime transfer. The sale can be used in two very different ways to assist in transferring property. If there is no interest in keeping the farm intact or transferring it as a unit to the heirs, it can be sold to a buyer outside the family. Then the liquid proceeds from the sale plus the mortgage or contract, if one exists, can be transferred to the heirs by gift or through the decedent's estate at his death. The advantage of the sale in this situation is that the proceeds of a sale may be easier to divide among the heirs than the specific farm assets.

However, a more common desire is to transfer the actual property to the heirs rather than an equivalent cash value. This can easily be accomplished by a contract or mortgage sale to the heir or heirs that desire to own and operate the farm. A mortgage sale would involve the transfer of title from the seller (the parents) to the buyer (a son or son-in-law) with the buyer making a downpayment and using a mortgage to guarantee payment of the balance. A contract sale would require the buyer to make a downpayment to the seller and also to sign a contract to pay the remainder. However, the title would remain in the possession of the seller until the contract is fulfilled. The contract sale is used frequently when the buyer has a limited amount of capital and cannot qualify for a mortgage. In the case of either a contract or mortgage sale, a downpayment of less than 30% of the total sale price is beneficial to the seller; he can then treat the sale as an installment sale, and the capital gain subject to tax can be spread over the contract period and taxed at a lower rate rather than the higher rate applicable to concentrated lump sum payments.

In one respect, a sale does not transfer the estate from one generation to another. Although a sale transfers the *property* between generations, it does not reduce the size or value of the estate held by the parents. A sale only converts non-liquid assets into the more liquid form of cash and a contract or mortgage. Thus, although specific property has been transferred, the estate transfer has not been accomplished and a decision must still be made as to how to transfer the proceeds received from the sale. However, the sale may facilitate this estate transfer in that cash and an interest in a contract or mortgage can be transferred to the heirs rather than specific assets, thus reducing the losses caused by liquidation, splitting of assets or diseconomies of size.

(d) *Gifts:* Another type of inter vivos or lifetime transfer alternative available to the farm owner is that of gifts. A gift of real or personal property can be given by a signed, acknowledged and delivered deed. Personal property can also be given from one person to another simply by transferring possession. Although the gift is subject to gift taxes, it is no longer part of the estate nor subject to estate taxes. However, to qualify as a gift for tax purposes, no conditions or restrictions can be placed on the gift by the donor (giver). The donee (recipient) must receive complete ownership and powers of disposition and use. Thus, in addition to the tax implications, the loss to the donor of income from gifted property is an important determinant of the amount of an estate which should be given to the heirs as gifts.

Because of the federal and state tax regulations, the timing of gifts is also an important decision. Federal gift tax rules specify that any property given within 3 years of the date of death is considered to be in contemplation of death and is not a gift, but is part of the estate of the deceased. Indiana inheritance tax rules consider property given within 2 years of death in contemplation of death and part of the deceased's estate. Thus, to qualify gifts for gift tax treatment, not only must control be completely transferred to another individual, but the property must be given to the donee a specified time before death.

(e) *Life Estates:* The purpose of a life estate is to divide the ownership interest in property between two parties, one party possessing a current interest and the other party a remainder interest. The party possessing the remainder interest can exercise the rights of ownership and take possession of the property only after the death of the party that has the current interest. Thus, title in property can be held as a life estate in one or both parents with the heirs having a remainder interest. The effect of this type of title division is that the parents have the right to use the property and receive the income from it during their lifetime, but the heirs will receive the property at the death of the parents. The heirs also have a present interest in the property that can be sold, mortgaged or conveyed in any way to anyone.

The use of a life estate may not save death taxes, but it can accomplish other estate planning

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goals. A remainder interest held by a son or son-in-law who is operating the farm guarantees him eventual ownership of the property. Thus, he may be willing to make necessary improvements and maintenance as well as needed additions to the real estate and buildings without fear of these improvements going to another heir at the death of the parents. In addition, a life estate held by the parents or a surviving spouse provides lifetime income security for the parents. However, if an heir who has a remainder interest in property dies, leaving this interest to his minor children, it may become difficult for the parents to mortgage or convey the property because of the restrictions on the transfer of property by minors.[12]

(f) *Trusts:* A trust is a legal arrangement between three parties, a grantor, a trustee and beneficiaries. A trust is created when the grantor transfers by will (testamentary) or during his lifetime (inter vivos) legal title of property to a trustee whose fiduciary obligation is to manage the property for the benefit of the beneficiaries. Because the trust arrangement is very flexible, a number of different goals can be satisfied through the use of this legal instrument. In addition to transferring ownership of property, transferring managerial responsibility and guaranteeing continuity of management is one of the major objectives of most trust arrangements. Thus, the choice of a qualified trustee who has training and experience in the operation of a farm firm is probably the most important decision in developing a trust.

Although any type of trust can be used to maintain the efficiency of the farm or reduce the economic loss from asset splitting or liquidation, not all forms of the trust arrangement will reduce the estate size and death tax liability. A testamentary trust comes into existence only at the time of death and is subject to inheritance and estate taxes. With an inter vivos trust, the death tax liability depends on the amount of control maintained over the trust by the grantor. If the grantor has the power to amend, revoke or alter the agreement and specify who should receive the property or the income thereof or enjoy the income thereof himself, the trust is revocable and the property will be considered part of his estate at the time of his death. Only when the grantor has no powers of control over the property or no ownership interests in the property (an irrevocable trust) is the estate diminished by the value of the property in trust. Thus, an irrevocable inter vivos trust may substantially reduce the size of the estate and the death tax liability. However, the creation of an irrevocable inter vivos trust may result in a gift tax liability on the value of the property put in the trust.

(g) *Business Organizations:* The reorganization of the farm business in terms of ownership structure rather than enterprise structure can have a substantial impact on the creation and transfer of the farm estate. It should be noted that business organization refers to the ownership and management of a business entity rather than the particular assets controlled by this entity. Most farm firms are organized as sole proprietorships. Although this type of organization does not necessarily hinder the development of estate plans, other types of business organizations may actually help accomplish some of the estate planning goals.

The partnership arrangement between a father and son or son-in-law can encourage the heir to become involved in the farm business and can assist in the transfer of managerial responsibility as well as the transfer of specific assets. Thus, the heir can participate in management decisions and reinvest his earnings in the farm operation without the fear of a nonfarm heir receiving control of the property purchased with those earnings. However, the reorganization of a firm as a partnership rather than a sole proprietorship does *not* result in the actual transfer of any property. Although the partnership arrangement will facilitate the transfer, specific property transfer arrangements such as periodic gifts, a mortgage or contract sale, or a testamentary transfer must be used to actually convey the assets from the parents to the heirs. The use of these property transfer arrangements would have the same income tax, death tax and other economic implications in the partnership type of organization as in the sole proprietorship.

As in the case of the partnership arrangement, the process of incorporating a family farm will not accomplish the property transfer objective of estate planning, but it may facilitate this objective. In particular, because corporate stock is more easily divided into the desired units, gifts and even testamentary transfer of stock may be much easier than the transfer of particular assets. In addition, the closed corporate structure allows the parents to give property to their heirs without losing the services of that property or control of its disposition. Unless the heirs have a controlling interest, they cannot manage or sell the property, nor can they force dissolution of the firm which

[12] For a brief review of other problems associated with life estates, see Harl, N., 1967. *Estate and Business Planning for the Farmer as a Sole Proprietor,* Iowa State Un., Coop. Ext. Serv., Law-Econ. 31, pp. 21-24.

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is using the property.[13] In addition, restrictions on the transfer of corporate stock can frequently be used to keep the donee from selling the stock outside the family.[14] Thus, the concern for economic losses caused by inability to exploit economies of scale may not be as important in the corporate business organization as compared to the sole proprietorship and the partnership. However, as in the partnership, and sole proprietorship, actual property transfer arrangements with their respective tax and economic implications must be developed within the corporate structure to perform the estate transfer function.

V. Taxes and Estate Planning

As has been indicated earlier, federal and state taxes are important considerations in estate planning. Summarized below are some of the key elements of the state and federal tax regulations.[15]

1. Federal Gift Tax

A federal tax is levied on the value of all gifts given during the lifetime of the donor to all donees, except those gifts which qualify for the marital deduction, the annual exclusion, the lifetime exemption, or as charitable contributions. The marital deduction specifies that only one-half of all property given to a spouse is subject to gift tax. The annual exclusion allows an individual to give away $3,000 annually to each of any number of donees tax free. In addition, the lifetime exemption permits a total of $30,000 of tax-free gifts to all donees during the lifetime of the donor. If the donee's spouse joins in the gift, the annual exclusion and lifetime exemption are doubled to $6,000 per year *and* $60,000 lifetime, respectively.

Table 1 summarizes the federal gift tax schedule. The tax is cumulative in that the taxable gifts of the current year are added to all taxable gifts made in previous years. Then the amount of tax payable in the current year is calculated as the tax liability on the accumulated amount of taxable gifts minus the gift taxes paid in previous years. Thus, the gift tax, like the estate and income tax, is progressive.

Table 1. Federal gift tax schedule (I.R.C. § 2502(a))*

Taxable gifts From	Taxable gifts To	Tax on amount in column 1	Tax rate (%) on excess of amount in column 1
(1)	(2)	(3)	(4)
$ 0	$ 5,000	$ 0	2.25
5,000	10,000	112.50	5.25
10,000	20,000	375.00	8.25
20,000	30,000	1,200.00	10.50
30,000	40,000	2,250.00	13.50
40,000	50,000	3,600.00	16.50
50,000	60,000	5,250.00	18.75
60,000	100,000	7,125.00	21.00
100,000	250,000	15,525.00	22.50
250,000	500,000	49,275.00	24.00
500,000	750,000	109,275.00	26.25

* Only part of the schedule has been reproduced here.

2. Federal Estate Tax

A federal estate tax is levied on the total value of the gross estate less credits, exemptions and deductions of a deceased individual. The gross estate is defined as the "value at the time of his death of all property, real or personal, tangible or intangible, wherever situated." This gross estate includes dower interests,[16] retained life estates,[17] revocable trusts, the total value of property held in joint tenancy, proceeds of life insurance owned by the deceased, and the value of all property transferred other than by bona fide sale within 3 years of the date of death, as well as all property in which the deceased maintained simple ownership. The taxable estate is defined as the gross estate minus funeral and medical expenses associated with the death, estate administration expenses, debts and other claims against the estate, casuality or theft losses if not compensated for by insurance, charitable contributions, a marital de-

Table 2. Federal estate tax schedule applicable to the taxable estate (I.R.C. § 2001)*

Taxable estate From	Taxable estate To	Tax on amount in column 1	Tax rate (%) on excess of amount in column 1
(1)	(2)	(3)	(4)
$ 0	$ 5,000	$ 0.00	3.00
5,000	10,000	150.00	7.00
10,000	20,000	500.00	11.00
20,000	30,000	1,600.00	14.00
30,000	40,000	3,000.00	18.00
40,000	50,000	4,800.00	22.00
50,000	60,000	7,000.00	25.00
60,000	100,000	9,500.00	28.00
100,000	250,000	20,700.00	30.00
250,000	500,000	65,700.00	32.00
500,000	750,000	145,700.00	35.00
750,000	1,000,000	233,200.00	37.00

* Only part of the schedule has been duplicated here.

13 Schrampfer, W., 1957. *Law in Its Application to Business*, Rinehard & Co., New York, p. 962.

14 Harl, Neil, 1968. "Farm Corporation Organization and Operation," Law-Econ. 3 (Rev.), Iowa State Un., Coop. Extension Service, p. 3.

15 The following discussion of the tax regulations relies heavily upon: *Internal Revenue Code of 1954, I.R.C.*, July 1, 1970, edition, Prentice-Hall, Englewood Cliffs, N. J.; Burns, Harrison, *Burns Annotated Indiana Statutes*, Bobbs-Merrill, Indianapolis, 1954 (revised 1969).

16 A dower interest is the spouses' statutory interest in all real property owned by the deceased. It is a one-third interest in Indiana.

17 A retained life estate is a type of property transfer whereby the decedent retains for life the right to use the property's income for the enjoyment of himself or anyone he designates.

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Table 3. Credit for tax paid on prior transfers (I.R.C. § 2013)

Time of prior transfer	Credit on estate tax as a (%) of tax paid on prior transfer
1 or 2 years ago	100.00
3 or 4 years ago	80.00
5 or 6 years ago	60.00
7 or 8 years ago	40.00
9 or 10 years ago	20.00
11 or more years ago	0.00

duction of no more than 50% of the adjusted gross estate (gross estate minus losses, debts and medical and administrative expenses), and a $60,000 exemption. Tax rates as summarized in Table 2 are applied to this taxable estate to calculate the tax liability. Finally, credits against this tax liability are allowed for the amount of gift tax paid on gifts which are in contemplation of death, a percentage as shown by Table 3, of the amount of estate tax paid on property received from an individual who preceded the decedent in death by no more than 10 years, and an amount as specified by Table 4, of the state death tax which must be paid.

3. Federal Income Tax

The income from a business enterprise, whether ordinary or capital gains, is taxed by the federal government at a progressive rate. The different methods of transferring property between generations has definite implications with respect to the size of the income tax liability.

In general, gross income for tax purposes is defined as all income from whatever source including compensation for services, income derived from business, gains from dealings in property, interest, rent, dividends, annuities, income from life insurance, etc. However, gross income does not include proceeds of life insurance payable by reason of death. Neither is property acquired by gift, bequest, devise, or inheritance included as gross income. Adjusted gross income is defined as gross income minus trade and business deductions, 50% of net long-term capital gains, losses from sale or exchange of property, deductions attributable to property held for the production of rents and royalties (depreciation) and certain deductions of life tenants and income beneficiaries of property. Taxable income is defined as adjusted gross income minus itemized personal deductions or the standard deduction and the deductions for personal exemptions.[18] The tax rate as summarized in Table 5 is applied to this taxable income to obtain the tax liability. Finally certain credits for retirement income, partially tax-exempt interest, etc. are allowed against this tax liability.

The impact of the income tax provisions on the creation or growth of the farm estate is clear. Not only is the amount of earnings available for reinvestment reduced by the amount of the tax liability, but the preferential treatment of capital gains encourages the production of that form of income rather than ordinary income. In contrast, the impact of the income tax provisions on estate

Table 4. Credit for payment of state death taxes (I.R.C. § 2011)*

Taxable estate From	Taxable estate To	Credit on estate tax on amount in column 1	Credit rate (%) on excess of amount in column 1
(1)	(2)	(3)	(4)
$ 0	$ 40,000	$ 0.00	.00
40,000	90,000	0.00	.80
90,000	140,000	400.00	1.60
140,000	240,000	1,200.00	2.40
240,000	440,000	3,600.00	3.20
440,000	640,000	10,000.00	4.00
640,000	840,000	18,000.00	4.80
840,000	1,040,000	27,600.00	5.60

* Only part of the schedule has been duplicated here.

Table 5. Federal income tax schedule on individuals (I.R.C. § 1(a)(2))*[a]

Taxable income From	Taxable income To	Tax on amount in column 1	Tax rate (%) on excess of amount in column 1[b]
(1)	(2)	(3)	(4)
$ 0	$ 500	$ 0.00	14.00
500	1,000	70.00	15.00
1,000	1,500	145.00	16.00
1,500	2,000	225.00	17.00
2,000	4,000	310.00	19.00
4,000	6,000	690.00	21.00
6,000	8,000	1,110.00	24.00
8,000	10,000	1,590.00	25.00
10,000	12,000	2,090.00	27.00
12,000	14,000	2,630.00	29.00
14,000	16,000	3,210.00	31.00
16,000	18,000	3,830.00	34.00
18,000	20,000	4,510.00	36.00
20,000	22,000	5,230.00	38.00
22,000	26,000	5,990.00	40.00
26,000	32,000	7,590.00	45.00

* Only part of the schedule has been duplicated here.
[a] This tax schedule is applicable to individual taxpayers. If a husband and wife file a joint return, the tax is computed by dividing the taxable income by two and taking the tax liability on this income times two (I.R.C. § 2(a)).
[b] These rates apply to ordinary income only. Rates on capital gains income are effectively one-half of the rates in this column up to a maximum of 25%.

[18] The standard deduction is the larger of the percentage standard deduction (percentage of the adjusted gross income) or the low income allowance. The percentage standard deduction in each of the future calendar years is:

Year	*Percentage*	*Maximum amount*
1971	13%	$1,500
1972	14%	$2,000
1973 and thereafter	15%	$2,000

The maximum low income allowance in each future year is $1,100 for 1973 and thereafter. The personal exemption for the taxpayer and each dependent is $650 in 1971, $700 in 1972 and $750 in 1973 and thereafter.

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transfer decisions is subtle, but may be quite important. As indicated by O'Byrne, et.al., "it is important to include in any estate plan an analysis of the effect of the income tax upon the family unit during the lives of all parties and upon spouse, children and heirs after the farm owner's death . . . successful tax analysis must integrate income, gift and death taxes."[19]

One method of reducing the income tax liability when an estate is passed or gifts are given to the heirs is to spread the property among the family members. Because the income tax rates are progressive, the spreading of property and the income thereof tends to keep the incomes of the family members in lower tax brackets so that the total tax burden is lower than when all property (and income) is concentrated in the hands of one heir.

Unless proper planning occurs, the capital gains provisions may also result in a substantial income tax liability when property is transferred to the heirs. When property is transferred by sale or other disposition, the gain subject to tax is the difference between the "basis" of the property in the hands of the seller and the amount received for the property from the buyer. If the property is acquired through a bona fide purchase, the "basis" is the taxpayer's cost less depreciation. However, if property is received as a gift, the "basis" for the donee is the same as the "basis" of the donor plus gift tax minus depreciation in the hands of the donor. Thus, if the property appreciates between the time it is received and the time of a subsequent sale, a larger gain must be recognized and is taxable if the property has been acquired by gift rather than a bona fide purchase.

In contrast to the treatment of property transferred by sale or gift, the "basis" of property that is part of an estate is the fair market value of the property at the date of death. Thus, the heir receives the property with a "stepped-up basis," and if the property appreciates, the taxable gain and tax liability at the time of a subsequent sale will be lower than if the property had been received through purchase or gift. In addition, the "basis" of property determines the amount of depreciation allowed. Depreciation cannot be taken in excess of the "basis" of the property in the hands of the taxpayer. Since depreciation reduces the amount of taxable income, property with a higher "basis" will also reduce the income tax liability through higher depreciation allowances.

4. Indiana Inheritance Tax

In addition to the federal tax, Indiana levies a state inheritance tax on the property of a decedent. This tax differs from the federal tax in that the rates are much lower, the tax is computed separately for each heir (not on the entire estate) with each heir responsible for paying his inheritance tax, and real property held in tenancy by-the-entireties is not subject to taxation. Property subject to Indiana inheritance tax includes all personal property and all real property not held by the entireties in the state plus all intangible personal property wherever title is held. In addition, property transferred by gift within 2 years prior to death is assumed to be transferred in contemplation of death and is part of the gross estate for Indiana inheritance tax purposes. However, life insurance benefits payable to a named beneficiary are not included in the gross estate. Deductions from this gross estate to obtain the taxable estate include debts and claims against the decedent's estate, charitable and public contributions, property and income taxes, mortgages, funeral expenses, and closing and administration fees. The tax rates summarized in Table 6 are then levied against the amount of the estate received by each heir. As indicated in Table 6, exemptions depend upon the relationship of the heir to the decedent.

VI. Other Family Firm and Legal Considerations in Estate Planning

1. Indiana Laws of Descent

If a person dies without a will specifying how his property should be divided, the property is distributed according to the state "laws of descent." All personal property and all real property in the state of residence of the deceased is divided by the descent rules of the state of residence. The Indiana laws of descent can be summarized as follows:[20]

A. Decedent leaves a surviving spouse and two or more children or issue thereof—
   1. The surviving spouse receives one-third of the estate and the children receive two-thirds divided equally among them (a surviving widow, but not a widower, gets a $2,000 allowance before division is made).

[19] O'Byrne, J., J. F. Timmons, and N. W. Hines, 1966. *Planning Farm Property Transfers Within Families in Iowa,* Bulletin P-125, Iowa State Un., Ag. Experiment Station, pp. 41 and 43.

[20] Burns, Harrison, *Burns Annotated Indiana Statutes,* Sec. 6-201 to 6-258, Bobbs-Merrill, Indianapolis, 1954 (revised 1969).

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Table 6. Indiana inheritance tax schedule (Burns Annotated Indiana Statutes, Vol. 3, § 7-2402, § 7-2403, 1963)*

Beneficiary	Exemptions**		Schedule of rates			
	From first $25,000 an exemption of	On remainder of first $25,000 above exemption	$25,000 to $50,000	$50,000 to $100,000	$100,000 to $200,000	$200,000 to $300,000
Class A						
Wife	$15,000.00					
Husband	15,000.00					
Decedent's children under 18	5,000.00					
Other lineal issue	2,000.00	1%	2%	3%	3%	4%
Lineal ancestors	2,000.00					
Foster child (defined by statute) under 18	5,000.00					
Lineal issue of same	2,000.00					
Class B						
Brother, sister, descendant of brother or sister, wife or widow of son, huband of daughter	500.00	5%	5%	5%	8%	10%
Class C						
All Others	100.00	7%	7%	7%	10%	12%

* Only part of the schedule has been duplicated here.
** Exemptions—Transfers to the following are entirely exempt: Any municipal corporation within the state, public institutions, charitable corporations, etc. for use within the state.

2. If the children are not alive, the grandchildren take their deceased parents' share.

B. Decedent leaves a surviving spouse and one child or issue thereof—
1. The surviving spouse receives one-half and the child receives one-half (a surviving widow, but not a widower, gets a $2,000 allowance before division is made).
2. If the child is not alive, grandchildren take their deceased parents' share.

C. Decedent leaves a surviving spouse and no children—
1. If decedent's parent or parents survive, they get one-fourth and spouse gets three-fourths.
2. If no parent survives, spouse gets all.
3. If spouse is second or subsequent spouse without children from that union, but decedent has descendants from a previous spouse, the surviving spouse takes one-third of the personal property and a one-third life estate in the real property and the children from the previous spouse receive the remainder.

D. Decedent leaves no surviving spouse and two or more children or issue thereof—
1. The children receive equal shares.
2. If the children are not alive, the grandchildren take their deceased parents' share.

E. Decedent leaves no surviving spouse and one child or issue thereof—
1. The child receives the entire estate.
2. If the child is not alive, the grandchildren take equally their deceased parents' share.

F. Decedent leaves no descendants—
1. If parents and brothers and sisters survive, they all share equally (each parent's share shall not be less than one-fourth).
2. If only brothers and sisters survive or issue thereof, they share equally and the issue of deceased brothers and sisters receive their parents' share.
3. If neither parents nor brothers and sisters survive, surviving grandparents or their issue share equally.
4. If no heirs, the estate goes to the State of Indiana.

There may be cases where the laws of descent provide exactly the divisions desired by the parents, particularly where there is only one possible heir. However, even in such situations, a will is needed to make provision for disposition of the estate if the sole heir fails to survive or to select a particular person as executor.

2. Age of Parents

The probability of dying in any particular year increases as the farm owner grows older. In addition, the interest and motivation of most farmers to be fully involved in the expansion and management of the farm firm decreases during the later years of life. Thus, as a person ages, it is usually desirable to make plans for the transfer of his property and the associated management responsibility to his heirs.

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There are important economic advantages to inter vivos or lifetime rather than testamentary (at the time of death) transfers. If an heir is interested in managing the farm business, the gradual transfer of property and managerial responsibilities during the parent's lifetime will enable the heir to obtain valuable management experience under the guidance of the parent. Thus, the economic losses which might occur from an abrupt transfer of responsibility to an inexperienced manager at the time of the parent's death will be avoided. The federal tax regulations also encourage lifetime transfers through larger exemptions on property transferred as gifts rather than through probate proceedings. In addition, the federal gift tax rates are about three-fourths of the federal estate tax rates, resulting in a lower tax liability on property transferred as gifts. Finally, in contrast to a testamentary transfer, a lifetime transfer guarantees that specific property will go to designated heirs and reduces the possibility of litigation among the heirs. A contested will or other legal complications can occur with testamentary transfers. Not only do these complications result in additional legal fees and litigation costs, but the heirs may receive the property with complete disregard for the parents' desires or intent.

However, it is not possible to make all bona fide lifetime transfers until the point of death. The contemplation of death regulations of both the federal and state tax code rule out the making of bona fide gifts (i.e., gifts subject to gift tax rather than estate tax) within 3 years and 2 years respectively of the date of death. Thus, a farmer cannot wait until he is on his deathbed to make a bona fide gift of the farm to his children.

3. Number, Occupational Interests, and Health of Children

The number of children in the family will significantly influence the division of property if a will is not filed and the property of a decedent must pass under the Indiana laws of descent. In addition, because the exemption structure of the Indiana inheritance tax is based on lineal relationship to the deceased, the death tax liability will be influenced by the number of children and the amount of property passing to each child. The opportunity to split property ownership and the income thereof to minimize the income tax burden of property transfers is also affected by the number of children in the family.

Irrespective of the tax impact of the number of children, a very crucial determinant of the best estate plan is the occupational interests of the children. If one of the children is interested in farming, the parents may desire to transfer the farm real estate, personal property and inventories to this child so that he may continue the farming operation. It is frequently desirable to transfer some interest in the property to the on-farm heir during the lifetime of the parents so that he can be operating the farm during the prime of his economic life. However, if the family includes more than one child, the transfer of all the farm property to one heir presents a problem of treating the off-farm heir(s) equitably. Liquidation of farm assets to compensate off-farm heirs may result in substantial liquidation losses and a loss of efficiency because of decreased farm size and inability to exploit economies of size. Thus, the advantages of acquiring off-farm assets or insurance which can be given to the off-farm heir(s) to maintain equitable distribution without decreasing the efficiency of the farming operation must be evaluated.

The health of children or grandchildren may also influence the division of property. If one of the heirs has serious health problems which require extensive medical attention, the parents may desire to give a substantial amount of the property to his heir to help defray medical expenses. A similar desire may exist if one of the heirs is employed in a hazardous occupation or for health reasons cannot adequately support his family.

4. Size and Composition of the Estate

The total size of the farm estate will change from year to year as new assets are acquired through investment of earnings and borrowed funds, and as assets are transferred through gifts, sale, etc. Thus, in each year a different estate creation-transfer plan would be expected, depending in part upon the total size of the estate. For example, if the estate is small, gifts might not be the best estate transfer method to use because the farm unit might be uneconomical if some of the assets were no longer part of the firm. In addition, because the estate may be small enough to not incur any death tax liability at the time of testamentary transfer, lifetime transfers would not reduce the tax liability. However, as the farm grows over time, the use of gifts even in excess of the exemptions may be a logical method of estate transfer. With a large estate, gifts may reduce the tax liability without a substantial loss in economic efficiency of the firm as an entity.

For estate transfer purposes, the productive assets of the farm firm can be aggregated into the four classes of farm real estate and improvements (includes land and livestock buildings and facili-

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ties), farm personal property (includes machinery and crop and livestock inventories), insurance and off-farm assets. The relative amounts of these different types of property in the estate will have an impact on the best estate planning decisions. For example, lower liquidation losses may occur if some insurance or liquid off-farm assets or inventories are included in the farm estate to pay death taxes or to transfer to off-farm heirs at the time of death of the parents. Thus, the type of transfer desired may substantially influence the most desirable asset composition. Conversely, a farm estate that contains a large proportion of marketable securities or stock can make more efficient use of tax-free gifts than a sole proprietorship that has all of its funds invested in farm assets and must make gifts of specific assets rather than marketable stock. In this situation the asset composition can be a major determinant of the best transfer method to use.

5. Planning, Management and Administration Fee Schedules

One of the major cost components of estate planning is the plan development and implementation costs. Legal fee schedules indicate that estate planning costs *per se* are quite reasonable. An estate plan that includes only a simple will (no lifetime gifts, trusts, etc.) can be obtained for about $25.00.[21] A more complex estate plan involving a trust or a life estate will require substantially more hours to prepare and thus, a higher cost. It is difficult to estimate the cost of a complex estate plan without some knowledge of the size and composition of the estate and the methods being used in the plan. However, suggested minimum legal fee schedules for many counties in Indiana specify that the minimum fee per hour of time spent in developing the estate plan should be $25.00.[22]

Estate administration and management fees can result in substantial plan implementation costs. County minimum fee schedules in Indiana indicate that the attorney's fee for administering or closing an estate should be a minimum of $250.00 plus 4% of the value of the gross estate (all personal property and all real estate except that held in tenancy-by-the-entireties or life insurance where the insurance is payable to a designated beneficiary other than the estate) above $2,500.00. In addition, the executor or administrator usually receives a fee equal to 50% of the total legal fees unless the will specifies differently. Finally, court costs, newspaper notices, bond costs and appraisal costs would probably total a minimum of $50.00 plus .5% of the value of the gross estate.[23]

An additional management fee is incurred if property is put in trust with a bank or other financial institution as a trustee. Although trust management fees are not uniform and depend upon the type of property in the trust, a typical rate in Indiana is .5% on the first $50,000 of corpus (value of property in the trust), .25% on the next $450,000 and .2% on any amount above $500,000.[24]

VII. Estate Management and Planning Examples

The following two illustrations, one for two 60-year-old parents and the other for a 75-year-old widow,[25] indicate the type of estate and family information required and the type of estate planning budgets that should be developed to evaluate an estate plan. These examples also summarize estate creation and transfer decisions that might be applicable to farm cases similar to the specified family and estate situation.

1. Example 1: Two 60-year-old Parents

The family for the first example consists of two 60-year-old parents with two grown children—a married son who is involved in the farming operation and a married daughter. The son owns some land and most of the farm machinery. He also has interest in the livestock that is on the farm. The size, asset composition, and ownership structure of the estate and farm in 1970 is given in Table 7.

To find a good estate management plan, 50 different plans were analyzed with the aid of an electronic computer. Each plan consists of a set of annual creation plans (what products to produce and resources to acquire) and a set of annual transfer plans for the years 1970 through 1974. The annual transfer plans indicate the type of property division and the tax and cost implications if the husband or wife would die in each year. Then the creation and transfer plans for the sub-

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21 Gromley, C. R., J. A. Hiller, D. R. Hoeppner, *Workbook for Indiana Estate Planners*, Bobbs-Merrill Co., Indianapolis (revised 1969), Sec. 3A0.3.

22 "Suggested Local Bar Rate Schedule," Carroll County, Indiana 1965; see also footnote 21.

23 O'Byrne, Timmons, and Hines, op. cit.

24 "Trustee Fee Schedule," First Nat. Bank of Goshen, Goshen, Ind., 1969; personal correspondence from Purdue Nat. Bank, Lafayette, Ind., 1969.

25 Although some modifications in the data were made for purposes of this publication, the examples are based on actual Indiana farm situations.

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Table 7. Size and composition of the estate for two 60-year-old parents with two children, 1970

Item	Amount, size or capacity	Value owned by husband	Value owned by wife	Value owned jointly
Real estate and improvements				
Farm real estate	506 acres	—	—	$202,400
Sow main. fac.	50 sows	—	—	$ 1,200
Sow farrowing fac.	50 sows	—	—	$ 15,660
Pig nursery fac.	25 litters	—	—	$ 1,860
Pig finishing fac.	40 litters	—	—	$ 14,208
Cattle finishing fac.	250 cattle	—	—	$ 17,000
Urban real estate	—	—	$27,000	—
Farm personal property				
Crop and livestock inventory	—	$21,454	—	—
Cash	—	$22,550	—	—
Outside investments				
Checking and savings account	—	—	$30,200	—
Certificates of deposit	—	—	$ 8,500	—
Stocks and bonds	—	—	$18,000	—
Home furnishings and auto	—	—	$ 4,300	—
Insurance				
Whole life policy	—	$ 1,000	—	—
Total values (by ownership)*	—	$45,004	$88,000	$252,328
Total value both parents*	—	—	—	$385,332

* In addition, the children owned land (140 acres) and equipment, valued at $79,956. These assets were inputs to the total farming operation. The children also participated in the farm operation with livestock and supplies equivalent in value to that of their parents.

sequent year indicate the types of production, investment, ownership, gift and will decisions that could be made and the implications of these decisions assuming both parents live to that subsequent year.

Table 8 summarizes the best management plan of the 50 investigated.[26] The annual transfer plans result in significant changes in the ownership structure of the firm during the 5-year period. In 1970, over half ($267,334) of the $482,221 of the net worth of the firm is owned jointly by the parents. However, because gifts are given to the children and new farm assets are purchased solely by the husband or wife (not in joint ownership), the amount of jointly held property has been significantly reduced by 1974. In addition, the husband and wife have adjusted their sole ownership of property during the 5 years so that by 1974 they own about equal amounts of property.

Gifts are an important part of the annual transfer plans. In 1971, $56,500 of property is transferred by gift from both parents to the children. More than $160,000 of property is transferred to the children as gifts from 1970 through 1974, resulting in a total gift tax liability of $1,437 for the husband and $5,297 for the wife. By 1974, the children own almost one-third of the net worth of the firm compared to one sixth in 1970.

[26] Although the computer provides detailed information on production decisions, this information is not presented here in order to focus on the transfer aspects of estate management.

In most cases, the will policy results in most of the deceased's property being transferred to the surviving spouse. The survivorship rights on jointly owned property provide the main explanation for this type of property division. Thus, for example, if the wife has a simple will (a will that only implements the state laws of descent and *does not* name an executor) and dies in 1970, $85,078 of property would be transferred from her to the children and the husband would receive $42,669 of property under the will and $258,834 of property through the survivorship rights on jointly owned property. These will transfers would result in a federal estate tax liability of $30,533 an Indiana inheritance tax of $3,271 and administration and closing costs of $14,640.

2. Example 2: A 75-year-old Widow

The family, farm and estate situation for this example is very similar to Example 1 except most of the property is owned by a widow rather than a husband and wife. The widow has two grown children, a married son who is operating the farm and a married daughter. The size, asset composition and ownership structure of the estate and farm in 1970 is summarized in Table 9. As indicated in the footnote to this table, the children own land worth $56,000. They received $30,000 of this land as a gift from the widow, so the widow has completely used her lifetime exemption for gifts.

Fifty estate management plans were analyzed

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Table 8. Annual estate management plans for two 60-year-old parents with two children and a $385,000 estate, 1970-1974*

	Years				
	1970	1971	1972	1973	1974
A. Income, assets, and net worth					
Net returns[a]	$ 16,931	$ 21,400	$ 35,800	$ 56,500	$ 51,300
Ending net worth[b]	$482,221	$489,751	$506,753	$529,714	$555,523
Ending total assets[c]	$519,353	$515,064	$519,409	$645,474	$683,883
Value husband prop.[d]	—	$ 21,200	$ 45,262	$ 69,178	$102,096
Value wife prop.[d]	$144,745	$137,500	$ 97,788	$104,621	$ 93,422
Value joint prop.[d]	$267,334	$253,401	$230,163	$204,273	$189,359
B. Transfer plans					
1. **Gift policy** (if both parents live)					
Husband to wife[e]	—	—	$ 6,000	$ 11,500	—
Wife to husband[e]	$ 14,500	$ 18,000	—	—	$ 16,000
Joint to children[e]	$ 8,500	$ 22,000	$ 22,000	$ 11,000	$ 6,000
Husband to children[e]	—	$ 16,500	$ 1,500	—	$ 18,000
Wife to children	$ 2,500	$ 18,000	$ 2,500	$ 6,500	$ 27,000
Gift tax—husband	—	—	$ 68	$ 163	$ 1,206
Gift tax—wife	—	$ 152	$ 656	$ 523	$ 3,966
2. **Will policy** (implemented if the husband or wife would die in that particular year)					
a. **Husband** (dies)					
Type of will[f]	Simple	Simple	Simple	Simple	Complex
Amount to wife[g]	$ 4,843	$ 7,582	$ 12,613	$ 19,264	$ 75,072
Joint to wife[h]	$258,834	$231,401	$208,163	$193,273	$183,359
Amount to children[i]	$ 9,657	$ 15,118	$ 25,149	$ 38,413	$ 25,024
Federal estate tax	$ 13,612	$ 14,663	$ 17,180	$ 20,383	$ 22,794
Indiana inheritance tax	$ 815	$ 604	$ 830	—	$ 333
Admin. costs[j]	$ 6,174	$ 6,711	$ 8,032	$ 3,623	$ 4,147
b. **Wife** (dies)					
Type of will[f]	Simple	Simple	Complex	Complex	Complex
Amount to husband[g]	$ 42,669	$ 33,901	$101,288	$109,621	$ 25,211
Joint to husband[h]	$258,834	$231,401	$208,163	$193,273	$183,359
Amount to children[i]	$ 85,078	$ 67,599	—	—	$ 25,211
Federal estate tax	$ 30,533	$ 29,494	$ 29,420	$ 27,705	$ 14,427
Indiana inheritance tax	$ 3,271	$ 3,077	$ 3,220	$ 123	—
Admin. costs[j]	$ 14,640	$ 14,206	$ 10,158	$ 5,142	$ 2,587

* The farm involved grew between 640 and 810 acres of corn and raised up to 1300 hogs from farrowing through finishing.

[a] Net returns are calculated as the change in net worth of the farming operation (including the parents' and children's interests in the operation) during the year (or gross income minus all costs of production, income taxes, and consumption).

[b] Net worth of the firm at the end of the year.

[c] Value of the total assets controlled by the firm (parents and children) at the end of the year.

[d] Value of the assets of the firm at the end of each year (before gift and will transfers are made) that are owned solely by the husband, solely by the wife, jointly by the husband and wife, and by the children. Because the husband solely owns only cash and inventories at the beginning of year one (Table 7) and these assets are used during the year, he owns no assets at the end of the year.

[e] Indicates the amount of property transferred between the parents or from the parents to the heirs by gift.

[f] Simple indicates a simple will that implements the Indiana laws of descent and does not name an executor for the will. Complex indicates a complex will which enables the division of property among the heirs in a different proportion than that specified by the laws of descent. It is assumed that an executor with no fee is named with a complex will, thus eliminating the executor fee and reducing the administration and closing costs.

[g] The amount of property owned solely by the husband or wife and transferred by the will to the surviving spouse.

[h] The amount of property owned jointly by the husband and wife and transferred to the surviving spouse by the rights of survivorship.

[i] The amount of property owned solely by the husband or wife and transferred by the will to the children.

[j] The administration, legal and court costs incurred in administering or executing the will and closing the estate.

with the aid of an electronic computer. Each plan consisted of a set of annual creation plans and annual transfer plans for the years 1970 through 1979. Table 10 summarizes the best estate management plan of the 50 investigated.

As in the case of the two-parent example, gifts are again an important part of the annual transfer plans for the widow. Almost $125,000 of property is transferred by gift from the widow to the children from 1970 to 1979. In most years the annual gifts exceed the allowable deductions and exemptions, so a total of $7,966 of gift tax must be paid during the 10-year period. However, the farm firm is profitable enough that even though these gifts are made, the value of the widow's property increases from $397,072 in 1970 to $530,505 in 1979.

The widow uses a complex will (allows for the appointment of an executor at no fee and the division of property different than that specified by the laws of descent) during most of the 10-year period. If she would die in 1970, $379,072 of property would be transferred to the children, resulting in a federal estate tax liability of $80,955,

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an Indiana inheritance tax of $9,770 and administration and closing costs of $18,068. After the children have paid these costs, they would only receive $270,279 of property tax free. If the widow would die in 1979, the children would receive $348,129 of property tax free from the estate *plus* the $124,000 of property given to the children during the previous 10 years.

An important observation which cannot be made from Tables 8 and 10 but which is apparent from the much more detailed computer answers should be made. This observation relates to the fact that all estate management plans called for investment of net returns *outside* the farming business (savings, securities, insurance, etc.) Up to $20,000 were invested outside the farm in some years. This outside investment not only diversifies the asset holdings of the firm, but it also provides the liquidity that is frequently needed at the time of death. Outside investments were an important aspect of good estate management in the case of both examples.

Table 9. Size and composition of the estate of a 75-year-old widow with two children, 1970

Item	Value owned by widow
Real estate and improvements	
Farm real estate	$202,400
Sow main. fac.	1,200
Sow farrowing fac.	15,660
Pig nursery fac.	1,860
Pig finishing fac.	14,208
Cattle finishing fac.	17,000
Urban real estate	27,000
Farm personal property	
Crop and livestock inventory	21,454
Cash	22,550
Outside investments	
Checking and savings account	30,200
Certificates of deposit	8,500
Stocks and bonds	18,000
Home furnishings and auto	4,300
Insurance	
Whole life policy	1,000
Total value*	$385,332

* In addition, the children owned land (140 acres) and equipment, valued at $79,956. These assets were inputs to the total farming operation. The children also participated in the farm operation with livestock and supplies equivalent in value to that of their parents.

Table 10. Annual estate management plans for a 75-year-old widow with two children and a $385,000 estate, 1970-1979*

	1970	1971	1972	1973	1974	1975	1976	1977	1978	1979
A. Income, assets, and net worth										
Net returns[a]	$ 5,538	$ 6,588	$ 20,412	$ 20,816	$ 24,676	$ 23,581	$ 26,459	$ 22,072	$ 28,019	$ 27,895
Ending net worth[b]	$470,826	$458,769	$463,177	$482,436	$506,995	$530,456	$556,797	$577,783	$604,599	$631,130
Ending total assets[c]	$493,083	$492,978	$571,219	$614,532	$607,872	$640,533	$666,562	$679,351	$678,631	$684,211
Value widow's property[d]	$397,072	$395,162	$399,892	$425,902	$445,058	$473,857	$497,860	$507,333	$519,498	$530,505
B. Transfer plans										
1. **Gift policy**										
Widow to children[e]	$ 18,000	$ 18,000	$ 18,000	$ 6,000	$ 6,000	$ 6,000	$ 13,000	$ 13,000	$ 13,000	$ 13,000
Widow's gift tax	$ 540	$ 1,080	$ 1,440	—	—	—	$ 1,035	$ 1,155	$ 1,313	$ 1,403
2. **Will policy** (implemented if the widow would die in respective year)										
Type of will[f]	Complex	Complex	Complex	Complex	Complex	Complex	Simple	Simple	Simple	Simple
Amount to children[g]	$379,072	$377,162	$381,892	$419,902	$439,058	$467,857	$484,860	$494,333	$506,498	$517,505
Fed. est. tax	$ 80,955	$ 84,270	$ 89,038	$ 96,682	$ 99,717	$105,745	$108,328	$111,578	$115,732	$118,246
Ind. inheri. tax	$ 9,770	$ 10,231	$ 10,342	$ 11,317	$ 11,590	$ 12,712	$ 13,218	$ 13,834	$ 14,271	$ 14,682
Admin. costs[h]	$ 18,068	$ 18,792	$ 19,815	$ 20,986	$ 21,308	$ 22,064	$ 33,416	$ 34,487	$ 35,732	$ 36,448

* The farm involved grew between 520 to 800 acres of corn and raised between 650 and 1,000 head of cattle (feeding of 700 pound yearlings). The low net returns in 1970 and 1971 are due to high first-year depreciations of new equipment and buildings.

[a] Net returns are calculated as the change in net worth of the farming operation (including the parent's and children's interests in the operation) during the year (or gross income minus all costs of production, income taxes, and consumption).

[b] Net worth of the firm at the end of the year.

[c] Value of the total assets controlled by the firm at the end of the year.

[d] Value of the property included in the firm that is owned by the widow.

[e] Indicates the amount of property transferred from the widow to the children as gifts.

[f] Simple indicates a simple will that implements the state laws of descent and does not name an executor for the will. Complex indicates a complex will which enables the division of property among the heirs in a different proportion than that specified by the laws of descent. It is also assumed that an executor with no fee is named with a complex will, thus eliminating the executor fee and reducing the administration and closing costs.

[g] The amount of property transferred by the will from the widow to the children.

[h] The administration, legal and court costs incurred in administering or executing the will and closing the estate.

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VIII. Some Important Conclusions

1. Estate Planning Is Important

Most farmers concentrate their time and energy on making production and investment decisions that will create a larger farm and estate. Although one of the major goals of a farmer's life work is to have a large estate to give to his heirs, estate transfer plans are frequently not made. The foregoing discussion and examples clearly show that serious economic and emotional problems can be avoided with timely and proper estate planning.

2. Estate Planning Should be Done Early

There is a tendency for all people to postpone estate planning until that time when "they are older." Unfortunately, transfer costs and problems generally increase as the parents get older because the time available to accomplish the transfer is shorter and the estate is usually larger. In addition, when one parent dies, the number of transfer options available to the other parent are reduced considerably. Therefore, farmers should plan the transfer of their estate *before* they actually plan to retire, and then periodically revise it as their estate and family situation changes.

3. Estate Creation and Transfer Are Interrelated

In the foregoing discussion we have indicated that certain types of transfer decisions can decrease the productive capacity and growth potential of the farm business. While the use of these transfer methods may decrease total transfer costs, they *may not* result in the transfer of the most wealth to the heirs or provide the greatest security for the parents. The interrelationship between business growth and business transfer may be such that for economic and emotional reasons, higher transfer costs and taxes should be tolerated to maintain the productive potential of the farm business. The interdependencies between estate creation and estate transfer are complex, but must be carefully evaluated.

4. Estate Planning Is Not Easy

After reading this publication, you will agree with us that estate planning is a complex undertaking. Estate planning cannot and must not be a "do-it-yourself" project for the farmer. Only after consulting with the family lawyer, an accountant, a farm management specialist and perhaps others to evaluate how well alternative plans satisfy certain family goals should estate management plans be finalized and implemented.

Glossary

Administrator—A person appointed by the probate court to collect the assets, pay the debts and distribute the residue of an estate.

Annuity—A yearly payment of a specified sum of money for life or a definite period of years.

Antenuptial—Determined or made before a marriage.

Beneficiaries—One for whose benefit a trust is created.

Bequest—A transfer by will of personal property.

Bona Fide—In or with good faith; honestly, openly and sincerely; without deceit or fraud.

Conditional Interest—An interest or right in property that is not settled or does not accrue until a particular condition is satisfied or a particular event occurs.

Contemplation of Death—The expectation of death provides the primary motive to make a gift.

Contested will—A will that is disputed or questioned by an interested party.

Contingency—An event which may occur, but comes without foresight or design.

Decedent—A deceased or dead person.

Deed—The legal instrument used to transfer title in real property from one person to another.

Descendant—One who has descended or is the off-spring of another.

Dissolution—The cancellation, revoking or termination of a particular organization or entity.

Donee—The person to whom a gift is made; the recipient.

Donor—The person who makes a gift; the giver.

Estate—The total value of the interest a person has in all property, real and personal.

Executor—A person appointed by a will to carry out the directions and requests and dispose of the property in accordance with the will.

Fiduciary obligation—A duty or obligation of one party to act and make decisions primarily for the benefit of another party.

Gift—A voluntary, gratuitous transfer of property from one person to another.

Grantee—The person who receives a grant or property from another.

Grantor—The person who makes a grant or transfers property to another.

Heir—A person who inherits property or receives property because of and at the death of another.

Intangible Property—Property that has no intrinsic value but is merely the evidence of value such as certificates of stock, bonds, promisory notes and francises.

Intergeneration—Between members of different generations as between a father and his son.

Inter Vivos—Transferring of property from one living person to another living person.

Irrevocable Trust—A trust arrangement that *cannot* be cancelled, rescinded or repealed by the maker (grantor).

Issue—Depending upon the context, a disputed question or fact or all of the persons who have descended from a common ancestor.

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Joint Tenancy—Co-ownership of property by two or more individuals each with the right of survivorship.

Laws of Descent—The state statutes that specify how a deceased's property is to be divided among his heirs if he does not have a will.

Life Estate—A property interest that is limited in duration to the life of the individual holding the interest; the holder of this type of interest is called a life tenant.

Lineal—Proceeding in a direct or unbroken line from a common source; Hereditary as from father to son.

Litigation—A lawsuit; a judicial contest to enforce a law or right.

Marital Deduction—The deduction(s) that can be taken in the determination of gift and estate tax liabilities because of the existence of a marriage or marital relationship.

Mortgage—A lien or encumbrance on real property to secure the payment of a debt.

Personal Property—Property that is not permanently in place but is temporary or movable; in general, all property that is not real property.

Probate—The judicial act or process of establishing the validity of a will and administering or settling an estate.

Proprietorship—Having the legal right or exclusive title to property; owner.

Real Property—Land and all immovable fixtures erected, growing or affixed to land.

Remainder—An interest in property that takes effect in the future at a specified time or after the occurrence of some event such as death of a life tenant.

Retained Life Estate—A property transfer whereby the transferor retains for life the right to the use of the property's income for the enjoyment of himself or anyone he designates.

Revocable Trust—A trust agreement that can be cancelled, rescinded or repealed by the maker (grantor).

Right of Survivorship—The ownership rights that result in the acquisition of title to property by reason of having survived other co-owners; usually refers to the rights that exist in property held as joint tenants or tenants by the entirety.

Royalty—A payment which is made for the right of mining for natural resources or the use of an author's or inventor's name.

Statutory—Created or defined by a statute (a legislative act or law) or conforming to a statute.

Tangible Property—Property (real or personal) that can be felt or touched.

Tenancy by the Entirety—Co-ownership of property between husband and wife with the right of survivorship.

Tenancy in Common—Co-ownership of property by two or more individuals where at death the interest owned by each co-owner passes to his heirs under his will.

Testamentary—A document or event that is not to take place until after the death of the person who arranged it; refers in most cases to a will.

Trust—The legal relationship created by virtue of one party holding legal title to property for the benefit of another.

Trustee—The person or entity appointed or chosen to administer or carry out the terms of a trust for the benefit of the beneficiary.

Will—The legal instrument used to declare a person's wishes as to the distribution of his property after his death.

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