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Estate Planning

Wills

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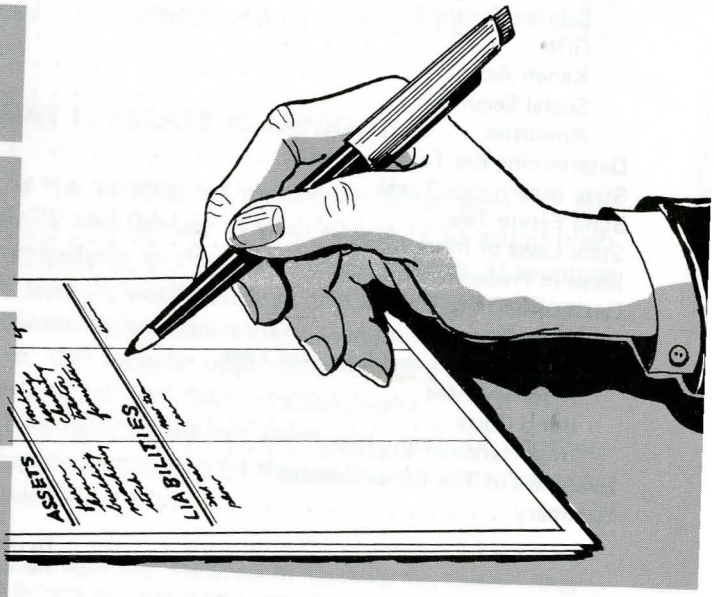

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Leo E. Lucas, Director

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ESTATE PLANNING

Philip A. Henderson[1]

INTRODUCTION

Most people are reluctant to talk about death or any of its consequences as it relates to themselves. Nevertheless, it is a reality from which no one escapes and sooner or later its consequences must be reckoned with. By the same token, any property acquired by an individual during his lifetime will eventually pass into the hands of other people.

This publication explains what is meant by estate planning, what it involves, why it is important, and some of the tools which can be used to develop a good plan.

(The discussion is necessarily simplified since estate planning requires detailed knowledge of federal and state laws pertaining to inheritance, gifts, and taxes. It is not a do-it-yourself type of job. Anyone thinking of developing an estate plan should seek the counsel of an attorney, trust officer of a bank, or someone skilled in estate planning.)

WHAT IS ESTATE PLANNING?

Estate planning is the process of making arrangements for the well-being of your family and the use of your property to accomplish desired objectives, particularly in the event of your death. It involves property owned, the way property is held, life insurance programs, social security provisions, other retirement programs, concern for your children's future, the various objectives which a husband and wife may have in mind, as well as other considerations.

A plan that fits one family will not meet the needs of another. Each plan needs to be tailor-made to fit the particular circumstances surrounding each individual family.

[1] Extension Economist (farm management), University of Nebraska. The author wishes to express appreciation to Curt Bromm, who was largely responsible for earlier editions of this publication and to law student John Uhrich, who provided technical assistance in preparing this edition.

Three Time Periods Involved

An estate plan should provide for three different periods of time: (1) during your lifetime; (2) during the critical period immediately after your death; and (3) the longer run period of adjustment which follows.

The first of these three time periods could actually be divided into two parts, i.e., the years when property is being accumulated and the years during which you may draw on your estate for retirement purposes or start distributing part of it to heirs.

During the period immediately following your death, there will be financial demands on your estate to cover things such as costs of a last illness, funeral expenses, claims of creditors, estate administration costs, and state and federal taxes. Careful planning is needed to be reasonably certain there will be liquid assets available to meet these demands. Too often the estate is forced to sell some of its assets at a sacrifice to meet expenses.

During the third period, the surviving spouse needs financial security. You may want to regulate the amount of property going to the wife and children or the time at which property is actually placed under their control.

OBJECTIVES OF ESTATE PLANNING

Objectives of families vary but some of the more common ones are:

1. Provide for surviving spouse.
2. Provide adequate income for the parents during retirement years.
3. Transfer property to children or other heirs with maximum savings of taxes, legal fees, and court costs.
4. Equitable (but not necessarily equal) treatment of heirs.
5. Keep the farm (or other property) in the family.
6. Help a son, daughter, or son-in-law get started in business.
7. Make sure property goes where you want it to go.
8. Provide for the education of minor children.
9. Make arrangements for guardians for children.
10. Provide enough readily available money to meet costs associated with estate settlement.

If one child plans to carry on the business, your plan should be designed to help him do so with a minimum of financial hardship consistent with equitable treatment of other heirs. If more than one of the heirs is to be directly and jointly involved in the farming operation, consideration should be given to where responsibility for management will rest. This need not be incorporated in the written plan unless desired.

Insofar as possible, splintering off parcels of land should be avoided if the farm is to be kept in the family and operated by one of the heirs. However, you may want **all** of the children or other heirs to share in the mineral rights.

WHO SHOULD MAKE AN ESTATE PLAN?

Nearly everyone should make an estate plan.

Far too often people take the attitude that there's no point in worrying about transferring property until death is imminent or at least not until one is about ready to retire. This is unfortunate. Suppose death occurred before you had made any kind of an estate plan—not even a will. Would you want your property distributed the way Nebraska state laws provide? Figure 1 summarizes the provisions of Nebraska state laws governing the distribution of property in the absence of a valid will.

Unfortunately, many people associate estate planning with old age. This kind of thinking causes young people to shrug off any thought of developing an estate plan. They're young; they don't have much property; so why should they be concerned with estate planning? Especially when it costs money to have a will made or to carry insurance?

Actually, however, there are several reasons why young couples need to be thinking about estate planning.

In its broadest sense, estate planning includes the planning, decision-making, and implementation of ideas which affect the amount of property accumulated. For this reason, young couples could well afford to think about how property accumulates. Why is it that some people become wealthy and others never seem to be able to accumulate anything? Luck? Yes, but not entirely so by any means. The accumulation of property depends a great deal on good management in the home as well as in business.

Figure 1. Laws of Intestate Succession.

	Spouse	*Children and/or their issue*	*Parents*	*Brothers, Sisters, and/ or their issue*	*Grandparents and/or their issue*	*Next of Kin*	*State*
Situation I: Survived by spouse and children (or their issue),[a] children are all issue of deceased parents and surviving spouse.	First 35,000 + ½ the balance b	Remainder of the estate b					
Situation II: Survived by spouse and children (or their issue); one or more of children not the issue of surviving spouse.	50% b	50% b					
Situation III: Survived by spouse and parents. No surviving children or issue thereof.	First 35,000 + ½ the balance b		Remainder of the estate				
Situation IV: Survived only by spouse i.e., no parents, no children, or issue of children.	100% b						
Situation V: Survived by children and/or issue of children. No surviving spouse.		100% b					
Situation VI: Survived by parents. No surviving spouse, children, or issue of children.			100%				
Situation VII: Survived by brothers and/or sisters and issue thereof. No surviving parents, spouse, children, or issue of children.				100%			
Situation VIII: Survived by maternal and paternal grandparents and their issue. No surviving parents, brothers and sisters (or issue thereof), spouse, children, or issue of children.					50% Maternal GP, 50% Paternal GP or their issue c		
Situation IX: Survived by next of kin. No surviving parents, grandparents or their issue, brothers and sisters or their issue, children or their issue.						100%	
Situation X: No surviving relatives.							100%

[a] *Issue—means lineal descendants, i.e., children, grandchildren, great-grandchildren, etc.*

[b] *The surviving spouse or children are entitled to a homestead allowance of $5,000, exempt property allowance in household furniture, autos, furnishings, appliances and personal effects of $3,500, and family allowance for one year. These allowances are in addition to the intestate share.*

[c] *If there is no surviving maternal grandparent(s) or issue thereof, the entire estate passes to the living paternal grandparents or issue thereof. Similarly, if there is no surviving paternal grandparent(s) or issue thereof, the entire estate passes to the living maternal grandparent(s) or issue thereof.*

There is a saying: "It takes money to make money." And whether we like it or not, there is a large element of truth in these words, particularly for farmers and ranchers. Figures 2 and 3 illustrate how capital invested at various rates of interest accumulates.

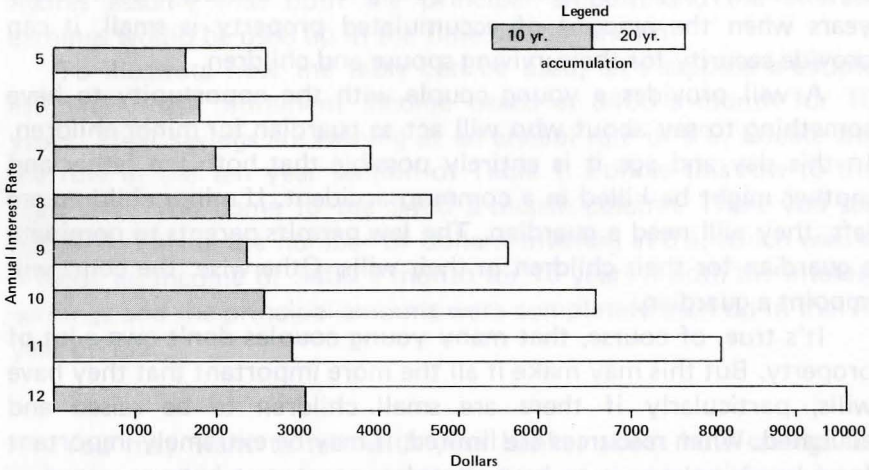

Figure 2. Accumulated value of $1000 invested at different rates of interest if compounded annually.

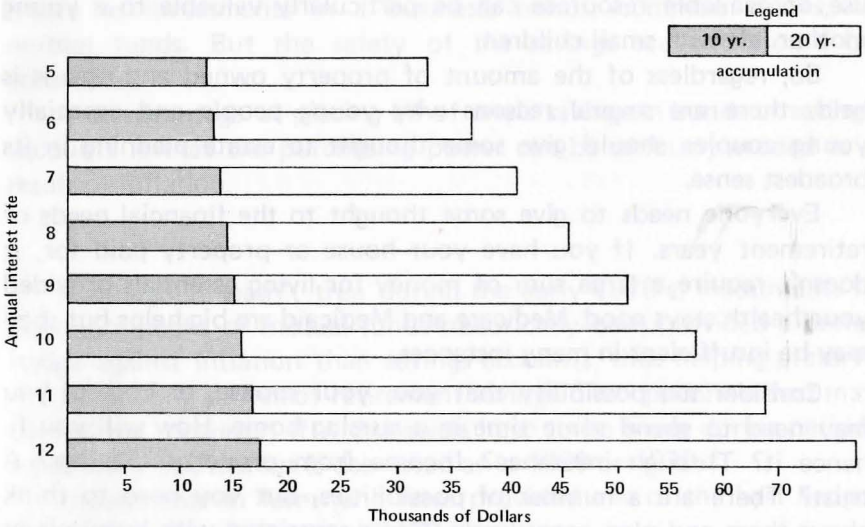

Figure 3. Accumulated value of $1000 invested each year for 10 or 20 years if compounded annually.

The young couple who manages to save $1000 every year from age 25 to age 65 and can make this money earn at the rate of 7% will have nearly $200,000. Had they started on their savings program 5 years sooner, they would have had $285,750! That extra $5000 saved in those early years would make a difference of more than $85,000 in the size of their estate at retirement time.

An adequate, judiciously chosen life insurance program can play an extremely important role in a young family's estate plan. In early years when the amount of accumulated property is small, it can provide security for the surviving spouse and children.

A will provides a young couple with the opportunity to have something to say about who will act as guardian for minor children. In this day and age it is entirely possible that both the father and mother might be killed in a common accident. If minor children are left, they will need a guardian. The law permits parents to nominate a guardian for their children in their wills. Otherwise, the court will appoint a guardian.

It's true, of course, that many young couples don't own a lot of property. But this may make it all the more important that they have wills, particularly if there are small children to be raised and educated. When resources are limited, it may be extremely important for a surviving spouse to have complete access to whatever resources there are. A will which provides a carefully worked out plan for the use of available resources can be particularly valuable to a young mother left with small children.

So, regardless of the amount of property owned and how it is held, there are several reasons why young people and especially young couples should give some thought to estate planning in its broadest sense.

Everyone needs to give some thought to the financial needs of retirement years. If you have your house or property paid for, it doesn't require a large sum of money for living essentials provided your health stays good. Medicare and Medicaid are big helps but they may be insufficient in many instances.

Consider the possibility that you, your spouse, or both of you may need to spend some time in a nursing home. How will you finance it? Through insurance? Income from property? Savings? A trust? There are a number of possibilities, but you need to think about them and plan accordingly. Costs associated with hospitals or

nursing homes are high, particularly if a person needs intensive care.

Aside from the effects of inflation, the amount of money needed to meet retirement needs depends on the rate of interest earned on savings and the amount which will be withdrawn each month or year.

Table 1 shows the approximate number of dollars required to provide various levels of monthly income when savings are invested in one form or another to earn different rates of interest. These figures assume that both the principal amount and the interest earnings would be used up in the time periods shown.

To illustrate how the table can be used, let's suppose a couple estimates their retirement income needs at $400 a month for 10 years. Their savings are earning at an annual rate of 6%. Locate the 6% row in the ten year section of Table 1. Follow this row to the right until you come to the $400 a month column. There you see $36,079. This is the number of dollars, invested at 6%, which would provide an income of $400 a month for 10 years if both the interest earnings and the principal amount were completely used up in the 10 year period.

You may want to talk with your banker about how savings for retirement might best be invested. Savings need not be placed in an ordinary savings account. Savings accounts may not pay as high a return as investments in a business, bonds, common stocks, or mutual funds. But the safety of the savings account should be considered.

A disadvantage of placing all of one's savings in bonds or savings accounts is that the purchasing power can be seriously eroded as a result of inflation.

Although it wasn't true during the early 1970's, investments in common stocks or mutual funds historically have provided a better hedge against inflation than savings accounts, thus helping preserve the purchasing power of retirement savings. The opposite effect may be realized, however, if withdrawals have to be made during periods when the stock market is depressed as in 1969 or 1970.

Investments in farm land have provided one of the best hedges against inflation during the last 30 or so years.

It may be desirable to put part of your savings in a savings

TABLE 1. Approximate amount of savings invested at various rates of interest (compounded quarterly) required to provide specified monthly incomes.

Time period	Interest rate	Monthly income (dollars) 200	300	400	500	600	700	800	900	1000
5 years	5	10604	15905	21207	26509	31811	37113	42414	47716	53018
	6	10353	15529	20705	25882	31058	36234	41411	46587	51763
	7	10110	15166	20221	25276	30331	35386	40441	45497	50552
	8	9876	14814	19753	24691	29629	34567	39505	44443	49381
	9	9650	14475	19300	24125	28950	33775	38600	43425	48250
	10	9431	14147	18863	23579	28294	33010	37726	42441	47157
10 years	5	18874	28312	37749	47186	56623	66061	75498	84935	94372
	6	18039	27059	36079	45098	54118	63137	72157	81177	90196
	7	17257	25885	34513	43142	51770	60399	69026	77655	86283
	8	16523	24784	33045	41307	49568	57829	66091	74352	82614
	9	15834	23751	31668	39585	47502	55419	63336	71253	79170
	10	15187	22781	30374	37968	45562	53155	60749	68342	75936
15 years	5	25326	37989	50652	63315	75978	88640	101303	113966	126629
	6	23746	35619	47493	59366	71239	83112	94985	106858	118732
	7	22308	33462	44616	55769	66923	78077	89231	100385	111539
	8	20996	31493	41991	52489	62987	73485	83982	94480	104978
	9	19797	29695	39593	49492	59390	69289	79187	89085	98984
	10	18700	28050	37399	46749	56099	65449	74799	84149	93499
20 years	5	30358	45537	60716	75895	91074	106253	121432	136611	151790
	6	27984	41975	55967	69959	83951	97942	111934	125926	139918
	7	25878	38817	51756	64695	77634	90573	103512	116451	129390
	8	24006	36009	48011	60014	72017	84020	96023	108026	120028
	9	22336	33504	44672	55840	67008	78176	89345	100513	111681
	10	20843	31265	41687	52108	62530	72952	83373	93795	104217
25 years	5	34283	51425	68566	85708	102849	119991	137132	154274	171415
	6	31130	46695	62259	77824	93389	108954	124519	140084	155648
	7	28402	42602	56803	71004	85205	99406	113606	127807	142008
	8	26031	39047	52063	65079	78094	91110	104126	117141	130157
	9	23963	35945	47927	59909	71890	83872	95854	107835	119817
	10	22152	33227	44303	55379	66455	77530	88606	99682	110758

account, time certificates, or in bonds where the principal amount is protected and part in something like land, common stocks or mutual funds. Some consideration should be given to setting up a trust which, among other things, might provide for retirement needs. This would be a means of securing trained and experienced help in managing savings and other investments to the best advantage.

Those who own large amounts of property have the more obvious reasons for estate planning. Federal estate taxes are assessed according to the size of the taxable estate; and the larger the taxable

estate, the bigger the proportion collected as estate tax. Taxwise, then, it is important for families with large amounts of property to consider ways of reducing the size of the taxable estate.

However, those who have small to medium estates actually may have greater need to avoid estate taxes. The amount of their estate may be barely adequate to meet the basic needs of a surviving wife and children. Any amount taken away in the form of taxes would decrease the amount available for these basic needs. Hence, even though the actual number of tax dollars saved may not be as great as for larger estates, they are more critical to the needs of heirs and so relatively more important.

No one likes to pay taxes if he doesn't have to. Estate planning can sometimes substantially reduce the amount of estate taxes which must be paid. For example, a farm couple who hold title to a farm as joint tenants might cause their children to pay considerably more estate taxes than would be necessary. A little time spent with an attorney at a comparatively nominal cost could result in tax savings of several thousand dollars.

HOW DO YOU MAKE AN ESTATE PLAN?

The first thing you need to do is to sit down as a family and give some thought to your objectives. Think about them. Compare ideas. Write down these ideas as well as some of the problems you see so you'll be sure to have them in mind when you talk with your attorney.

You can save yourself some money if you collect your thoughts **before** you go to the attorney so you won't take as much of his time. It will help, too, if you can make out a complete list of the property you own as well as what you owe. (A separate publication, EC 72-855, "Property Statement and Family Objectives for Estate Planning," is designed for this purpose and can be obtained from your county agent or the Department of Agricultural Communications at the University of Nebraska.) Be sure to include the amount and kind of life insurance you have. Indicate how the title to property is held as well as who should have the property if you die. This helps your attorney get a grasp of your situation and an idea of what needs to be done.

At this point, you should be ready for your first visit to your attorney. No doubt it will be necessary to see him more than once;

depending on how complicated your situation may be.

INSTRUMENTS WHICH CAN BE USED IN ESTATE PLANNING

There are a number of "tools" which can be used to accomplish objectives in estate planning. Your attorney will know which ones can be used to the best advantage in your case.

Some of the more common "tools" are discussed here. Perhaps the one which comes to mind first whenever we talk about estate planning is a will.

Wills

A will is a written instrument by which a person disposes of his property in the manner that he desires. A properly drawn will simplifies the distribution of an estate, avoids legal and financial tangles, and hastens settlement for the heirs[2]. It can save taxes if carefully planned and, even more important, it can be used to assure more equitable treatment of family members.

Two witnesses are required by Nebraska law. Generally, it is desirable to use individuals younger than the testator (person making the will) as witnesses since younger people are more apt to be living and available when the estate is probated.

A testator has the privilege of designating an executor and an alternate executor in his will. If this is not done, the court will appoint an administrator. (The new Nebraska probate code which went into effect January 1, 1977, uses the term "personal representative" in place of the terms "executor" and "administrator.")

Similarly, a guardian can be designated in a will. This may be an important feature for young couples with children. If a guardian is not designated in the will, one will be appointed by the court.

In most cases, it is advisable for the wife, as well as the husband, to have a will. Terms and provisions of the wills should be coordinated and you may want to discuss the provisions of the wills with heirs. Such discussions help to avoid uncertainty and family strife at the time the will is carried out.

A will can become outdated by changing economic and family

[2]See Nebraska extension circular EC 77-865 for additional discussion of the use of wills.

conditions. It is vital that the maker review his will periodically to make any necessary revisions.

If a new will is made, it is important that any old will be destroyed. This will prevent controversy at the time of death as to which will should be probated or which will fulfills the decedent's intent. A change in a will can be made by means of a codicil. It should be signed, witnessed, and attached to the will. Any number of codicils are permitted. For a more detailed discussion of wills, see extension circular EC 77-865, "Have It Your Own Way - By Making a Will."

Different Ways of Holding Property

Property can be held in various ways from a legal standpoint. Each has its place, no doubt, but the impact on the cost of transferring property can be considerable.

Joint Tenancy

Joint tenancy, meaning joint tenancy with a right of survivorship, is a method of holding title to property whereby each co-owner holds an undivided interest in the entire property. Upon the death of one of the co-owners, his undivided interest is extinguished and the surviving joint tenants share the full ownership. This property does **not** have to be probated and is **not** subject to a will. It automatically passes to the survivor(s) at the death of one of the joint owners. However, property held in joint tenancy does not escape taxation by the state and federal governments.

Legislation passed in 1976 provides that property owned in joint tenancy by husband and wife will be treated (for federal estate tax purposes) as being owned 50% by the husband and 50% by the wife **provided** the property was acquired **after** December 31, 1976, **and** that the joint tenancy was created as a result of a taxable gift. In all other instances where husband and wife own property in joint tenancy, the property will be subject to the same treatment provided by law prior to January 1, 1977. In other words, it will be presumed that all other joint tenancy property beloned to the first joint tenant to die unless the surviving joint tenant(s) can prove: 1) they contributed all or a portion of the purchase price; 2) they (the surviving tenant(s)) received all or a portion of the joint tenancy

property as a gift or inheritance; 3) the property was received as a gift by all of the joint tenants including the decedent. Joint tenancy property involved in an estate which was received as a gift by two or more people (including the decedent) as joint tenants will be treated as having been contributed by the joint tenants in equal proportions.

State legislation which went into effect January 1, 1977, considers joint tenancy property as belonging half to the husband and half to the wife for purposes of figures state inheritance taxes.

Upon the death of one of the co-owners, the survivors assume full ownership with a minimum of expense, trouble and time. Joint tenancy ownership of the house in town, the family auto, or a bank account will enable the surviving wife or husband to have ownership and possession upon the death of the other party without going through probate or waiting for an estate settlement which would normally take up to nine months or more, even if there are no complications. Thus, joint tenancy is desirable for the ownership of certain property. Many owners own only part of their property in joint tenancy, however, so a probate of the remainder of the estate is likely.

Joint tenancy may suffice for many smaller estates, but where larger estates are involved, it may result in higher federal and state death taxes.

For example, Fred and Mary Farmer have a farm estate including a jointly-held farm, with a gross value of $250,000 at the time of Fred's death. They have three children and Mary is 65 years old. No gifts have been made during their lifetimes and we'll assume that the funeral expenses, administrative expenses, attorney fees, etc., total $15,000, leaving an adjusted gross estate of $235,000. Since the farm is held in joint tenancy, it automatically goes to Mary at Fred's death; and we shall assume that Fred willed all of the other property to Mary also. There would be no federal estate tax at Fred's death since the legislation passed in 1976 provided for a minimal marital deduction of $250,000. Thus, all of the property would pass to Mary at Fred's death free of any federal estate tax.

Then Mary dies. This is where the tax problems arise. Mary has not used up the estate and its gross value remains at $250,000. Again, we assume $15,000 of deductible expenses, leaving an adjusted gross estate of $235,000. Mary has not remarried so there is no marital deduction against her estate. Using the figures in Table 2,

Table 2. Unified rate schedule.

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

the tentative tax on $235,000 would be $66,000. If Mary dies after 1980 there would be a unified tax credit of $47,000 (Table 3) and an allowance of $3,480 for state death taxes which can be deducted from the $66,000, leaving $15,520 as the amount of federal estate tax due at Mary's death. There is a good chance that all of this could have been avoided as we shall see later.

Table 3. Credits (provided by 1976 legislation) to be used against the calculated gross federal estate tax.

Year	*Amount of credit*
1977	$30,000
1978	34,000
1979	38,000
1980	42,500
1981 and thereafter	47,000

There may be other disadvantages to joint tenancy.

A parent who puts title to property in joint tenancy with himself and a son or daughter as the joint tenants cannot recover the child's half without the consent of the child. This could create an awkward situation and hard feelings. In addition, the son or daughter could sell their interest in the farm, creating a tenancy-in-common situation between incompatible parties.

A parent holding property in joint tenancy with several children may find it difficult to use the property as collateral for a loan if the children refuse to sign a mortgage.

There is a risk of unintentionally disinheriting children. If a surviving spouse remarries and places the property in joint tenancy with the second spouse and precedes the second spouse in death, the property would all go to the second spouse. Depending on the provisions of the second spouse's estate plan, the children of the original couple could be completely disinherited.

If a man and wife holding property in joint tenancy and having no children are fatally injured, one may precede the other in death. If the last to die has no will, the "jointly held" property would all go to the parents of the last to die, excluding the parents of the spouse who died first.

The creation or termination of a joint tenancy between husband and wife may have gift tax implications. If the joint tenancy was created before 1955, the contribution made by a husband or wife toward the purchase of property constituted a gift at the creation of the joint tenancy to the extent that the contribution made by either spouse exceeded the value of the rights retained by the spouse making the contribution.

For example, let's say Fred and Mary purchase a farm in 1948 for $20,000 and place the farm in joint tenancy. Fred contributes $15,000 toward the purchase price from their joint bank account, and Mary adds $5,000 from some money she inherited from her

father. Thus, Fred has contributed 3/4 of the purchase price and Mary only 1/4. This assumes that Fred earned the money which was in the joint account. As joint tenants, Fred and Mary each could claim an undivided 1/2 interest in the property purchased. Thus, when Fred contributed $15,000 toward the purchase price, he made a gift of $5,000 to Mary. There would not be a gift at the termination of this joint tenancy since the gift took place at the creation of the joint tenancy.

If part of the money in the joint bank account has been earned by Mary and deposited in the joint account while she was teaching school or was otherwise employed outside the home, the amount of her earnings would have been considered in determining whether a gift was involved.

Had Fred and Mary bought this same farm **after** December 31, 1954, the results would have been different. In this case, there would **not** have been a gift from Fred to Mary at the creation of the joint tenancy, **unless Fred, in the year in which the transaction took place, elected to treat the $5,000 as a gift.** Assuming Fred did **not** elect to treat the $5,000 as a gift in the year when the joint tenancy was created, there would be a gift at the time the joint tenancy was terminated (except when terminated by death) if the portion of the proceeds received by Fred or Mary were larger than 3/4 and 1/4 respectively.

Should Fred and Mary choose to change their method of holding this property from joint tenancy to tenancy-in-common, there would be a taxable gift to the extent that the value of Mary's 1/2 interest in the property as a tenant-in-common exceeded the value of the 1/4 interest which she had acquired by her original contribution. For purposes of determining the dollar value of the gift, the value of the 1/2 and 1/4 interests are based on the value of the property when the joint tenancy is severed.

The effects of the creation or termination of a joint tenancy on gift taxes are rather complicated and dependent upon the laws in effect at the time. Thus, a lawyer should be consulted to determine the gift tax effects in each situation.

Tenancy-in-common

Mary and Fred (see preceding example) could have held their farm as tenants-in-common. Under this type of ownership each

co-owner holds an undivided half interest in the property. This type of ownership is common and most courts will assume a tenancy-in-common unless the proper wording for a joint tenancy is used. A tenancy-in-common is frequently created when land is inherited among several heirs. If one of the owners dies, his share descends to his heirs through his will or according to intestate law.

If Mary and Fred had taken title to the property as tenants-in-common, there would have been a gift of $5,000 from Fred to Mary when title was taken. Fred could have willed Mary the right to use his half of the property during the rest of her life (a life estate)[3] and ownership of the property to the three children at Mary's death. Using the $250,000 as the gross value of property owned by Fred and Mary, Fred's share would be $125,000. Assuming $8,500 of permitted deductions, the adjusted gross value of Fred's estate would be $116,500. Mary's half, valued at $125,000, would not be included in Fred's estate.

Since Fred did not actually leave any property to Mary there would be no marital deduction so Fred's taxable estate would also be $116,500. Using the rates shown in Table 2 the unadjusted federal estate tax would be $28,750. If Fred's death occurs in 1977 (or anytime thereafter), the credits shown in Table 3 would be large enough to more than offset the unadjusted calculated tax. Consequently, there would be no federal estate tax at Fred's death.

When Mary dies and her estate ($125,000 less assumed deductible expenditures of $8,500) passes to the children, they will have no federal estate tax to pay. Thus, owning the property as tenants-in-common instead of as joint tenants with rights of survivorship could save the children about $15,000 in federal estate taxes.

Mary should also have a will leaving Fred a life estate in her half of the farm with the remainder to the children. If Mary dies first and has no will, $35,000 plus half of the remainder would go to Fred, thus increasing the amount of his estate to more than the credits shown in Table 3 could protect. Consequently, there would be some federal estate tax at Fred's death if Mary should precede him in death and has no will.

A disadvantage of the tenancy-in-common is that one of the co-owners could have the property physically divided or force it to be sold to receive his share of the proceeds. This usually is not a

[3]See section on Life Estate for some dangers associated with use of a Life Estate provision.

problem between husband and wife, however.

When property is owned in the form of tenancy-in-common, unequal contributions toward the maintenance or improvement of the property may cause hard feelings. This is more likely to be a problem when brothers, brothers-in-law or father and sons are the tenants-in-common. It is less apt to be a problem between husband and wife.

Partnership

A partnership may aid in transferring property from one generation or one party to another. The son can secure an interest in either real or personal property or both by gift or purchase, or a compensation for labor and management contributed to the partnership. The partnership is a very flexible ownership arrangement and may be handled in many ways in planning an estate.

The partnership's flexibility may be a disadvantage if it becomes unstable at the death of one of the partners. In this respect, it is similar to tenancy-in-common. At the death of a partner, the remaining partner may be forced to settle up and distribute to the deceased partner's estate a share of the partnership assets. In a farm operation, this could result in the disruption or dissolution of the farm business.

Such disruption could be avoided, however, if the deceased partner's heirs are bound to honor the partnership by a written provision in the partnership agreement. Such a provision would prevent much of the instability that may arise in settling the estates of the respective partners.

A partnership is somewhat unique in that a partner may leave his share of the property to his partners with complete disregard for his spouse or family. If the partners have made this arrangement, the spouse's statutory share under Nebraska's intestate laws means nothing.

Corporations

The increasing size of farm business poses significant problems from the standpoint of estate planning. The larger the estate, the larger federal estate taxes are apt to be. Most farm families would

like to cut down on the amount of tax if such a reduction seems feasible.

One possibility is to make as much use of gift privileges as possible. Although it is theoretically possible to transfer small, undivided interests in the assets of a business regardless of the form of business organization, it is both awkward and costly to transfer ownership of land in parcels small enough to comply with the $3,000 limitation on annual gifts.

From this standpoint, incorporation has much to offer. Shares of stock provide a simple and convenient way for making property transfers by gift. They may be transferred without necessarily disrupting the continuity of the business and it is comparatively easy and much less costly to give away $3,000 worth of stock than $3,000 worth of real estate.

In some instances, a son operating the family farm or working with his father may make substantial contributions to the value of the farm or business in one form or another. His contribution to the increased value of the business assets can be compensated by the transfer of shares of stock or by issuing him new, additional stock.

A possible disadvantage of using a corporation may be that minority shareholders can be "locked in" to the corporation, when they'd rather withdraw their portion of the estate. A plan could be developed, however, whereby those wishing to withdraw the value of their inheritance from the corporation could do so by selling their shares to the corporation or to other shareholders.

In some instances, incorporation may simplify estate settlement. If **land** is owned in two or more states, a separate probate proceeding is generally required in each state. However, a single probate proceeding may be sufficient if the deceased simply owned corporation **stock** in two or more states.

The corporation structure does not offer any special freedom from death or gift taxes. But the ease of transfer does facilitate the use of gifts for tax saving purposes. The formation of a corporation, like estate planning, calls for the help of an attorney and possibly an accountant.

Life Estate

If the value of property held in sole ownership or as a tenant-in-common is large enough to more than offset the marital

deduction and credits allowed, it would be subject to some federal estate tax. The value of property left to a surviving spouse would add to the estate of the remaining spouse and could greatly increase the amount of federal estate tax assessed against the remaining spouse's estate. This second taxation could be avoided or substantially reduced by the use of a life estate provision.

Under this arrangement, a husband or wife would leave the surviving spouse the right to use property during the rest of the surviving spouse's lifetime but, upon his or her death, the property would go directly to the person or persons designated in the will of the first deceased. Thus the property does not become a part of the surviving spouse's estate and so is not subject to federal estate taxes at the surviving spouse's death.

There are some potential dangers associated with the use of a life estate provision.

Since the person receiving the life estate interest usually does not expect to ever actually own the property, there is a danger that he (or she) might neglect it and fail to maintain its value. Such neglect could result in a considerable lessening of the value of the property and thus infringe on the inheritance of those who are actually to receive title.

It also should be recognized that a life estate interest in property limits the salability of that property. The person to whom the property was actually willed could only sell the property subject to the life estate interest. Most buyers would be reluctant to buy property on these terms. It should be recognized, however, that the life estate interest could be purchased from the life tenant or voluntarily deeded by the life tenant to make the property merchantable.

Power of Appointment

The power of appointment is another means of adding flexibility to the estate plan. The future cannot be clearly foretold, so this power helps the owner avoid rigidity in the estate plan. The power of appointment may be given to whomever the testator chooses, but is often used in conjunction with a life estate for a spouse.

The will may state: "I hereby devise this half section of land to my wife for life, giving said wife the power to appoint that land to

and among my children in any way as she sees fit." In this manner, the wife is given the responsibility to decide how to divide the land among the children at a later time. One of the children may die, or become incapacitated. Their financial status and needs may vary greatly or change after the testator's death. The husband has specified that the land must go the children, which is the only restriction on the wife's power of appointment. The testator may also specify how the land will be distributed if the spouse does not exercise her power of appointment.

There is an advantage in using the life estate with a power of appointment as opposed to a life estate with a remainder interest. A remainder interest has a taxable value from the moment of death of the person who grants it. A power of appointment has no value to the person receiving the property until the power is exercised. If a remainder interest is left to the children with a life estate to the wife, and one of the children dies after the father has died but before the mother, estate tax will have to be paid on the child's remainder interest. Such is not the case with the power of appointment, as the mother may decide how the property shall be divided among the children living at her death if she exercises the power of appointment given to her through her will.

Trusts

Trusts are being used more frequently as an estate planning tool than in years past. In many instances, people have avoided the trust because they consider it too complicated. Yet it need not be complicated—no more than the person creating the trust wishes to make it. Acutally, one of the advantages of trusts is flexibility. The maker can place all kinds of restrictions on the trust, or he can delegate broad powers to the trustee to deal with problems that are unforeseen at the time the trust is created.

What is a trust? The basic ingredients are:

1. A person (or persons) who creates the trust, known as the "settlor."
2. Trust property, known as the "corpus."
3. A person or institution who administers the trust, known as the "trustee."
4. The person or persons who ultimately receive the trust

property, known as the "beneficiaries."

A trust is created by transferring legal title of the corpus (trust property) to a trustee, who manages the property and administers the trust for the benefit of named beneficiaries. The trustee should be one in whom you have confidence. He is required by law to act in the best interest of the beneficiaries, consistent with the terms of the trust agreement.

The trustee may be a trust company, bank, or adult individual. A trust company or trust department of a bank has the advantage of the certainty of its existence, and continuity of management and accounting services. However, some people would prefer to use family members or acquaintances whom they are confident have the ability, interest, and knowledge of the trust property to do a good job of managing. In some instances, it may be desirable to use a trust company or division of a bank and a friend or relative as co-trustees.

Trustee fees may be provided for in the trust instrument, but must always be approved by the court as fair and reasonable.

In general, trusts provide security for your beneficiaries and insure competent management of your business even after you are gone. This is invaluable in cases where the wife or heirs have little management ability or are not interested in the farming business. In the event of a sudden death, a trustee would be able to provide minors with income until they are ready to take over management.

There are two major categories of trusts, living and testamentary. In a living trust, the corpus is actually placed in trust while the settlor is alive. If the settlor retains the right to terminate the trust and receive the property back, it is a **revocable** living trust. If the trust instrument provides the the property cannot be taken back, then it is an **irrevocable** living trust.

A testamentary trust is provided for in a will and does not come into existence, of course, until the death of the settlor.

Some characteristics of and reasons for particular trust arrangements are:

Revocable Living Trust

1. Does not remove trust property from settlor's estate and therefore does not reduce death taxes.

2. May provide income for a child, aged parent, or other relative for a specified time. Income taxation may also be transferred from

settlor to the beneficiary, who may be in a lower income tax bracket.

A good example of how this may be used to advantage is a "Clifford-type trust." If this trust is set up for at least 10 years and certain requirements are met, the settlor could send his children to college on income from the trust, have the income taxed to the children who are in a lower tax bracket, and receive the trust property back after the children have received their education.

3. Can save time and cost of probate if trust is not revoked prior to death of settlor.

4. Settlor is relieved of management responsibilities.

5. If plan of distribution is being carried out during his lifetime, settlor can see how plan is working, and make adjustments in his estate plan accordingly.

Irrevocable Living Trust

1. Does remove trust property from settlor's estate and does reduce federal estate taxes. There are gift implications when property is placed in trust, however. Gift tax exemptions and exclusions may be utilized.

2. May transfer income taxation from settlor to trust or beneficiaries.

3. Will eliminate need for and cost of probate.

4. Cannot be revoked or changed by settlor after creation.

Testamentary Trust

1. Comes into being with probate of settlor's will.

2. Does not reduce probate costs or death taxes of settlor.

3. Useful for protection of minor, handicapped, or wasteful heirs.

4. Can add flexibility to estate plan by granting trustee discretionary powers to deal with needs and problems of beneficiary.

5. May reduce probate costs and death taxes for second generation beneficiaries. For example, trust may provide for children to receive only that portion of the income and trust property necessary for living expenses, education, etc., with remainder to go to grandchildren at children's death. Grandchildren would save the taxes and probate costs which would otherwise have been incurred at the death of the children. Such an arrangement is sometimes referred to as "generation skipping." The legislation passed in 1976 limits the

amount of property that can be handled in this way to $250,000 per child.

6. Can insure competent management of your business even after your death, which may be invaluable in situations where a wife or heirs have little management ability or interest in the business.

The flexibility of any trust may be demonstrated by the following typical provisions: "If because of any emergency, misfortune, illness, circumstances, or conditions generally, the income from the trust estate should not be sufficient for the reasonable support and maintenance of my surviving wife, after taking into consideration any other resources, reasonably available to her, the trustee in its sole discretion shall expend so much of the principal of the trust estate as may be necessary for the necessities and reasonable requirements of such beneficiary. Trustee shall in any event, make available to my surviving wife, sufficient income or principal to enable her to maintain a standard of living befitting a widow in her circumstances."

7. *The marital deduction trust* is a form of testamentary trust often used to reduce estate taxes and ensure support of the surviving spouse. In general, the settlor provides in his will that half of his property is to go into a trust with the surviving spouse named as beneficiary with a general power of appointment over the corpus. Property placed in this trust would qualify for the marital deduction. The settlor also provides that the other half is to be put into a separate trust but, in this case, no general power of appointment is given to the surviving spouse. The trust instrument would provide that the income (from this second trust) is to go to the surviving spouse and might authorize the trustee to "invade the principal," i.e., to use part of the corpus for the surviving spouse's needs. At the surviving spouse's death, the property in this second trust goes to the beneficiary named in the predeceased spouse's will.

This arrangement ensures use of the marital deduction to achieve estate tax savings and the support of the surviving spouse, and at the same time, ensures competent management for the entire estate of the first to die.

In setting up a trust, it is essential for your legal counsel to determine your primary objective in order to draft the type of trust instrument which will fulfill your needs. If immediate estate tax savings are a dominant purpose, an irrevocable trust is necessary and the settlor must, in turn, part with the management and control over

the property placed in such a trust.

Before discarding the idea of using a trust because of its seeming complexities, discuss its possible advantages with your attorney to see if it can be useful in your estate plan.

Life Insurance

Life insurance has many uses in estate planning. It can increase the estate of the owner and add to the security of its beneficiaries. It can be used to provide badly needed cash to meet the financial needs associated with estate settlement. It can provide retirement income for you or your spouse, money to educate the children, or money to pay off a mortgage. It can also be used to offset bequests of land or other property, thus helping keep a business unit together in the hands of an operating heir.

As an example of the latter, a father might leave a quarter section of land to one son which is valued at $100,000. To treat another son or daughter somewhat comparably, he might take out a $100,000 life insurance policy with the second son or daughter as the beneficiary. Such an arrangement should be reviewed from time to time since inflation could result in a substantial increase in the value of land but have no effect on the amount of the insurance, thus resulting in unequal treatment of the beneficiaries at the time of death.

To use insurance to the best advantage, the advice of a good insurance counselor as well as that of your attorney may be desirable.

Contrary to what many people believe, however, the entire amount of the decedent's life insurance is part of the decedent's estate for federal estate tax purposes if the decedent had the incidents of ownership of the policy. These incidents include the right to change the beneficiary, to borrow against the policy, to select the method of settlement, and the right to the case surrender value. The only way to avoid having the insurance proceeds included in the estate is to have someone else own the policy with the decedent having none of the incidents of ownership. Insurance proceeds are not included in the gross estate for state inheritance or estate tax purposes, unless the policy is payable to the estate of the insured.

Life insurance policies should be reviewed periodically due to rapid developments of new policies and changing family conditions.

Sale by Contract

The usual sale by contract may involve the sale of land or other property to a son or son-in-law for a definite price payable in installments for a definite number of years. Legal title may remain in the seller as security until the final installment is paid or until some specified portion is paid when a mortgage would be taken as security for remaining payments.

The installment land contract is a useful estate planning device for several reasons. Through a family installment sale, a son may be able to set up a going business with incentive to improve the farming operation. The sale relieves the parents of management responsibilities and can provide steady income for retirement. Sale at a fair market price eliminates gift tax questions. To the extent that the price is less than the market, a gift would be involved.

There may also be income tax advantages to the sellers. They are taxed upon payments received only to the extent that they represent capital gain. If the buyer's payment in the first year is no more than 30% of the sale price, the capital gain may be prorated over the future installment period.

Occasionally an installment contract is drawn up with no mention of interest or with a specified interest rate of less than 6%. In such cases, the Internal Revenue Service assumes that the total dollar amount indicated in the contract includes interest at a 7% rate. This provision and its consequences should be recognized in drawing up any installment contract.

The following illustration shows how the 6% rule can affect the tax consequences. A sells property to B for $100,000 under an installment contract which provides that B is to make a down payment of $29,500 (29.5% of $100,000) and make payments at the end of each succeeding year of $7,050 for 10 years. A 5% interest rate is provided for in the contract.

Internal Revenue Service (IRS) assumes that interest, even though unstated, was part of the total amount and that the rate was 7%. Using IRS discount tables, unstated interest over the 10 year period amounts to $6,336.73 interest and that the actual sale price

of the property was therefore $100,000 less the $6,336.73 or $93,663.27. The $29,500 was thus more than 30% of the selling price of $93,663.27 and the transaction was not eligible for treatment as a contract sale. As a result, all of the capital gains tax on the sale would be due in the year of sale and a portion of each succeeding payment would be considered interest income or ordinary income for the seller and would represent an interest expense for the buyer.

There are other potential problems with contract sales. Family disputes may arise. The buyer may die before the contract is completed or he may default on his payments for other reasons. These problems can be minimized by setting out the complete agreement in writing so that both parents (seller) and son (buyer) are certain of their rights and obligations.

If there is a capital gain involved and the parents die before the payments are completed, income tax on the remaining portion of the capital gain (not yet reported) would be due in the years payments are received. If there is only one heir and that heir is buying property from the parents on an installment contract basis, any unpaid portion of the capital gains tax becomes due in the event of the parents' death.

Any payments still due at the time of the parents' death would become part of their estate.

It should be recognized, of course, that any appreciation in the value of the land accrues to the son once the contract for sale is negotiated unless it specifically provides otherwise.

Gifts

Those who have sizable estates may wish to make use of gifts as a means of transferring property to the next generation. The law permits each person to give up to $3,000 worth of property away annually to each of as many donees as he wishes without being subject to the federal gift tax **provided** the gifts are complete (no strings attached).

Thus, a parent can give $3,000 to each of his children, his grandchildren, or others on an annual basis, thereby reducing the amount of his estate. His spouse can make similar gifts or can give consent so that a total of $6,000 can actually be given to each child

on an annual basis without being subject to the federal gift tax.

Where gifts between spouses are involved, the law has different provisions. One spouse can give the other up to $3,000 worth of property on the basis of the annual gift exclusion. But, in addition, the 1976 legislation provides that the first $100,000 worth of property given to a spouse is tax free. The second $100,000 worth is taxed at regular rates. Half of any gifts in excess of $200,000 is tax free. It should be recognized, however, that any amount claimed as a marital gift exemption in excess of half of the actual gift will be deducted from the amount available as an estate marital deduction.

Prior to 1977, every person also had a lifetime gift exemption of $30,000, but such an exemption is no longer available. The 1976 legislation at the federal level did away with this exemption for years beginning after December 31, 1976. People who made use of their lifetime gift exemption prior to September 8, 1976, will not be penalized by the new tax laws. There will be a penalty against gifts made between September 8, 1976, and January 1, 1977, which were chargeable to the lifetime gift exemption. The penalty will be in the form of a reduction in the amount of federal estate tax credit available. The credit will be reduced by 20% of the amount of any gift made during this time period which was chargeable to the lifetime gift exemption.

Before 1977, taxable gifts enjoyed a more favorable tax rate than did estates. As a result of the 1976 legislation, however, taxable gifts are subject to the same tax rates as property transferred at death.

Under the new legislation passed in 1976, a gift tax return does not have to be filed until the taxable gifts for any given year reach $25,000. A gift tax return must be filed within 1½ months of the end of the quarter in which taxable gifts reached the $25,000 level. If the total amount of taxable gifts within a single year never reaches the $25,000 level but some taxable gifts have been made, then a gift tax return must be filed within 1½ months after the end of the last calendar quarter of that year.

The federal gift tax is a tax upon the act of making a gift during one's lifetime and is based on the market value of property transferred. The tax is imposed upon the donor or person making the gift; but if the donor fails to pay the tax when due, it falls upon the donee, or receiver of the gift.

Keogh Act

A new tool in estate planning was made possible by the passage of the Keogh Act in 1963. Under its provision, self-employed farmers can set aside a portion of their earned income for retirement purposes and thereby defer income tax payments until after age 65.

Provisions of the act have only remote and indirect bearing on federal estate or gift taxes but they do make it possible for a farmer to: (1) build up a fund which can be drawn on for retirement income, and (2) reduce his income tax payments during his lifetime, thereby making it possible to add more to his estate.

Social Security

Social security also needs to be considered in developing an estate plan. It provides: (1) some money at the time of death to help defray expenses associated with the insured's death; (2) money to the widow for care and support of minor children; and (3) retirement income. All three have a bearing on important aspects of an estate plan. Medicare can help tremendously in preventing the erosion of savings in the event of sickness.

Annuities

Property can be sold to a son who pays for it by purchasing a commercial annuity for the parents equal to the property's purchase price. The insurance company would pay a guaranteed income to the parents upon their attaining retirement age.

Private annuities may also be used to transfer property. The giver transfers property to the recipient in exchange for the latter's promise to pay the giver a certain annual income for life or for some specified period of years. If the annuity has been set up for a specified period of years, any payments yet to be made at the time of the giver's death would be a part of the giver's estate.

DETERMINING THE TAXABLE ESTATE AND THE FEDERAL ESTATE TAX

Real estate makes up a major part of the estates of most farm and ranch families. The legislation passed in 1976 includes a

provision whereby real estate used in a farm, ranch, or other closely held business can be valued at current use value instead of fair market value for purposes of determining the gross value of an estate under certain prescribed conditions. The requirements which must be met are:

1. The decedent must have been a resident or a citizen of the United States and the property must be located in the United States.

2. Current use value cannot be used to reduce the gross estate by more than $500,000.

3. The value of the real estate and personal property used in the farm or closely held business must make up at least 50 percent of the decedent's gross estate.

4. The real estate must pass to a qualified heir, i.e., a member of the decedent's family.

5. At least 25 percent of the adjusted gross estate must be qualified farm or other closely held business real estate.

6. The property must have been used by the decedent or some member of his family for five out of the last eight years ending with the decedent's death.

7. The decedent or some member of his family must have materially participated in the operation of the farm, ranch, or closely held business in at least five out of the eight years ending with the decedent's death.

The current use value can be determined in one of two ways. The first involves capitalization of cash rent. Average annual gross cash rent for comparable land less property taxes is divided by the average effective interest rate charged on new loans made by the Federal Land Bank during the five most recent calendar years. This method cannot be used if there is no comparable land being rented for cash. The second method is based on one or more of the following factors:

1. Capitalization of income that the property would yield over a period of years under prudent management.

2. Capitalization of the fair rental value.

3. Assessed values if the state bases assessments on current use.

4. Comparable sales not significantly influenced by metropolitan or resort areas.

5. Any other factor that would fairly value the property.

If the property is sold to nonfamily members or ceases to be used for farming, ranching, or other closely held business purposes within

15 years after the death of a decedent, the tax benefits realized at the death of the decedent as a result of using current use value will be forfeited. If either a sale to nonfamily members or a change in use occurs within 10 years, the tax benefits will be forfeited in full. The proportion of tax benefits forfeited will be phased down from 100% at the end of the 10th year to zero at the end of the 15th year.

Failure on the part of the decedent, qualified heir, or some member of their families to materially participate in the operation of the farm, ranch, or closely held business for three or more years in any eight year period ending after the decedent's death but before the qualified heir's death will also be grounds for recapture of the tax benefits by IRS.

The 1976 legislation made important changes in the definitions of the gross and taxable estate. Under the new law, the gross value of an estate for federal estate tax purposes includes:

1. The value of all property owned on a sole ownership basis at the time of death.
2. The value of the appropriate share of property owned as tenants-in-common.
3. The decedent's share of joint tenancy property where the joint tenancy was created after 1976 by means of a taxable gift.
4. The value of all other property owned in joint tenancy less any portion that did not originate with the decedent.
5. Taxable gifts made after 1976 during the decedent's lifetime.
6. Gift taxes paid on taxable gifts made within three years of death.
7. Property given away during life if the decedent retained some interest in or control over the property.
8. Property given away in which the decedent kept a life estate for himself.
9. Property over which the decedent had a power of appointment which he could have exercised in favor of himself, his creditors, or his estate.
10. The amount of insurance payable to the estate.
11. The amount of insurance on the life of the decedent payable to beneficiaries if the decedent had any ownership rights in the policy.
12. The value of payments to be received by a surviving beneficiary under an annuity contract if the decedent, at the time of

death, had the power to designate who should receive future payments.

The adjusted gross estate is then determined by subtracting certain permitted deductions from the gross value of the estate. Permitted deductions include: indebtedness; funeral expenses; costs of administering the estate, including attorney fees; and any losses that occur during the settlement of the estate due to fire, storm, other casualty, or theft.

Still other deductions can be made after the adjusted gross estate has been determined. One of the most important is the marital deduction. Under the new legislation, the marital deduction is the value of property going to a surviving spouse up to a maximum of $250,000 or half of the adjusted gross estate, whichever is larger. In addition, the value of property left to charitable, religious, or educational organizations may be subtracted. The 1976 legislation provided for a new deduction, i.e., the orphan exclusion. If, at the death of the last surviving parent, property is transferred to a child who is less than 21 years of age, $5,000 worth of property can be excluded from the taxable estate for each year of age below 21. Thus, if there was a 15 year old child, $30,000 worth of property could be excluded (21 - 15 = 6 x $5,000 = $30,000).

The portion of the gross estate still remaining after deductions have been taken is called the taxable estate.

Note that the specific exemption of $60,000 which was available to everyone prior to 1977 is no longer available. Both the specific exemption and the $30,000 lifetime gift exemption were replaced by the tax credits shown in Table 3.

As soon as the taxable estate is determined, a tentative tax is calculated by applying the tax rates shown in Table 2. Credits against this tentative tax are allowed for: state death taxes, gift taxes paid by the decedent on taxable gifts made after 1976, foreign death taxes paid, and a portion of any federal estate taxes paid within the last 10 years on the transfer of property included in this estate, and the appropriate tax credit shown in Table 3.

STATE INHERITANCE TAXES

In general, all property which passes by will or by the intestate laws of Nebraska, is subject to the state inheritance tax. For purposes of inheritance tax, property should be valued at the amount of

money which it would produce if offered and sold for cash at the time of the decedent's death. As a result of state legislation passed in 1976, joint tenancy property will be considered as belonging half to the husband and half to the wife for purposes of determining state inheritance taxes.

Where property passes to a surviving spouse or to children of the deceased, part of such property is exempt from tax. The surviving spouse and minor children can claim a homestead exemption of $5,000 and a living allowance for the time during which the estate is being administered. The surviving spouse and children (regardless of age) can claim a personal property allowance of $3,500. The personal property allowance is also available to children at the death of the second parent. Similarly, the living allowance is available to minor children at the death of the second parent. The surviving spouse is also entitled to a deduction equal to his or her intestate share of property passing either by will or by intestate law. These exemptions are in addition to the exemptions shown in Table 4.

Another important exemption from taxable property is life insurance on the decedent payable to a named beneficiary. Debts, funeral expense, and expenses of administration are deductible. No interest is charged if the tax is paid within 10 months from the date of the death of the decedent. If the decedent inherited the property within the five years preceding his death from a person who died within these five years, then the property is exempt from the inheritance tax to the extent that this tax was actually assessed and paid upon the previous death. The rate schedule for Nebraska's inheritance tax is shown in Table 4.

Table 4. Rate schedule for Nebraska's inheritance tax.

Transferee (exemption rates apply to each heir individually)		*Rate*
Father, mother, husband, wife, child brother, sister, etc. (close relatives)	Up to $10,000	none
	Over $10,000	1%
Uncle, aunt, niece, nephew, or descendant of the same (remote relatives)	Up to $2,000	none
	Over $2,000 and not exceeding $60,000	6%
	Over $60,000	9%
All other cases	Up to $500	none
	Over $500 and not exceeding $5,000	6%
	Over $5,000 and not exceeding $10,000	9%
	Over $10,000 and not exceeding $20,000	12%
	Over $20,000 and not exceeding $50,000	15%
	Over $50,000	18%

Although this tax is called a "state inheritance tax," the amount of the tax is actually paid to the county in which the property is located, if it is real estate, or to the county where the decedent resided, if it is personal property.

To illustrate how the rates shown in Table 4 apply, let's assume there is an estate of $150,000 of which $80,000 is to go to the mother (wife of the deceased), $30,000 to each of two children, $5,000 to a nephew, and $2,500 to each of two former employees. The state inheritance taxes payable are as follows:

Mother—$80,000 less exemptions = no tax.

Child A—$30,000 less $10,000 = $20,000 x 1% = $200 tax.

Child B—$30,000 less $10,000 = $20,000 x 1% = $200 tax.

Nephew—$5,000 less $2,000 = $3,000 x 6% = $180 tax.

Former employee No. 1—$2,500 less $500 = $2,000 x 6% = $120 tax.

Former employee No. 2—$2,500 less $500 = $2,000 x 6% = $120 tax.

STATE ESTATE TAX

There is a state estate tax, although there often is no state estate tax due when a person dies. It is a tax to prevent death taxes from flowing to the federal government if they can be retained by the State. The federal estate tax allows a credit for a maximum amount of state tax on a given estate. Nebraska requires that if the state inheritance taxes paid on an estate do not equal the maximum amount allowed by federal statute, then the difference between the amount allowed and the amount of state inheritance taxes due shall be paid to the State of Nebraska as a state estate tax.

For example, if the Federal Estate Tax allows $400 for state death taxes (based on the value of your estate) and state inheritance taxes amount to only $300, then the state estate tax would be due in the amount of the $100 difference. The state estate tax is due within 10 months of death.

STATE LAWS OF INHERITANCE

Those who fail to make a will inadvertently have some estate planning done for them. In the absence of a will, state laws govern how a decedent's property shall be divided (see Figure 1).

STEPS IN PROBATING AN ESTATE

The following steps are not a comprehensive list of all that must be done to settle an estate. However, they serve to alert the deceased's family, executor, or administrator to some of the procedures that must be carried out and that can be expected following a death of someone who has an estate.

Before the funeral, the family should notify and consult with the attorney who, in their opinion, will be handling the estate. He must begin his task of gathering information, counseling the family, and taking care of any emergencies brought about by the death. The attorney and the executor, if known, may appreciate the opportunity to contact relatives, who may have come great distances to attend the funeral and are faced with the necessity of returning shortly to their homes and jobs, concerning possible estate settlement problems. The actual choice of the attorney is made by the personal representative, i.e., the executor or administrator.

The will should be checked before the funeral for provisions regarding the funeral or other matters that need immediate attention. If an executor is named in the will, he should be notified before the funeral.

Under Nebraska's new Probate Code which became effective on January 1, 1977, several different courses of action are possible for settlement of the estate. The heirs, with the help of their attorney, may choose between no action, informal probate, formal probate, court supervised administration, and small estate administration. These choices are available whether there was a will or not.

If the heirs decide to go through formal probate, the procedure would be approximately as follows:

1. The will is filed with the County Court. Any person having custody of the will is required to deliver it with reasonable promptness to a person able to secure its probate, or, if no such person is known, to the County Court. Those persons who are able to probate the will include: the executor named in the will, spouse, child, creditor, other heirs or beneficiaries of the decedent.

In the absence of a will, an administrator would be appointed by the County Court to handle the estate.

2. A petition to probate the will is filed, normally by the named executor. The County Judge will issue an order fixing the time and

place for the hearing on the petition and notice of the hearing will be published in a local newspaper three consecutive weeks.

3. If the will is not self-proved, a witness to the will shall be subpoenaed to give testimony as to the proof of the will; one witness is enough if the will is not contested. If the will is self-proved, it is not necessary for a witness to the will to appear.

4. An order admitting the will to probate is issued by the County Court.

5. Once the will has been proved and admitted to probate, the County Judge will fix the amount of the bond for the executor or administrator if bond is called for. The amount of the bond will be fixed at a sum which the County Judge deems reasonable under the circumstances to insure that the executor or administrator fulfills his duties to the heirs, creditors, and to the court.

If the executor is found to be legally competent, the court will issue a legal document called Letters Testementary to the executor upon receipt of the bond and oath of the executor. (These would be Letters of Administration if there was no will.)

6. If there is a minor child, a guardian must be appointed to protect his or her interests during probate. This may by done through a petition for guardianship by relatives or other interested parties. In the absence of such persons, the petition could be initiated by the county. A hearing on the appointment of a guardian may be held but is not required.

7. The executor or administrator is required to file within two months after the issuance of the Letters Testementary or Letters of Administration an inventory of real and personal estate which has come to his knowledge and any cause of action on which he has the right to sue. The executor may hire independent appraisers to assist him in valuing the items in the inventory. Appraisal fees are paid by the estate.

The executor will also attempt to collect all debts owed by the decedent.

8. The Clerk of the Court must publish a notice to all creditors for three consecutive weeks that the will has been admitted to probate and that a personal representative has been appointed. The first publishing of this notice must be within 30 days after the personal representative has been appointed.

9. A surviving spouse and certain children of the deceased are guaranteed certain minimum amounts of property which are exempt

from and have priority over the claims of unsecured creditors, beneficiaries, and other heirs. The exemptions are as follows:

a) A homestead allowance of $5,000 is available to the surviving spouse and or minor children.

b) $3,500 worth of personal property in the form of household furniture, autos, household furnishings, appliances and personal effects. This exemption is available to a surviving spouse and children (either minors or adults).

c) A family allowance to support the spouse and minor children during the time the estate is being administered. The personal representative can distribute up to $500 per month for this purpose without a court order.

10. A federal estate tax return must be filed within nine months of the decedent's death when the gross estate (including the value of taxable gifts made after 1976) is equal to or greater than the following dollar amounts:

Year	Gross value of estate, including taxable gifts during lifetime
1977	$120,000
1978	134,000
1979	147,000
1980	161,000
1981 and thereafter	175,000

State inheritance and estate tax liability must also be determined and any tax due must be paid within 10 months of death.

11. It will be necessary to obtain a statement from the County Treasurer certifying the status of personal property taxes. Any amounts due and payable must be paid before the estate can be settled.

12. The executor or any interested party may petition for an order of complete settlement of the estate.

13. After notice to all interested parties and a hearing, the court may enter an order approving settlement of the estate and discharging the personal representative from further claim or demand of any interested person.

Probate procedure and the estate settlement require the attorney's knowledge of many laws. An attorney can also be of great assistance in counseling the executor and the heirs as to their duties

and rights.

The length of time for probating small, uncontested estates is generally about five to seven months, allowing for reasonable continuances in court hearings to accommodate lawyers, family members, and other concerned individuals, and the court.

Larger, more complex estates may require from one to two years or longer, depending on the problems incurred, and how well the estate was planned.

COSTS OF SETTLING ESTATES

Your will should give the executor instructions regarding what he can do when he probates your estate. If you do not, the executor is going to question whether he has the right to do certain things such as sell, mortgage, or lease property. If the executor is not sure of his rights, it will be necessary for him to go to the court and get permission for action he may wish to take. Every time the executor goes to court, it will cost the estate money. So list in detail the powers you want the executor to have.

In planning your estate, the costs of transfers must be anticipated. Many of these costs must be paid in cash shortly after the death. Expenses of the last illness, funeral and burial costs, outstanding debts and claims, taxes and costs of administration must be paid before the property transfer is fully effected.

Court Costs

Court costs are fees paid to the clerk of the district court for the services performed by that office. An appraisal of property may be made to establish value for Nebraska inheritance tax purposes. The appraisal fees are part of the court costs. Conflicts among heirs over distribution of property, sale of property to pay debts, partition actions to divide property, and similar actions will increase the costs. On the whole, court costs are a very small part of the estate settlement costs.

Administrator and Executor Fees

The person who serves as administrator or executor of the estate

is entitled to a fee for his services. Fees are no longer fixed by statute; the only requirement is that they be "reasonable."

Attorney Fees

The executor or administrator hires an attorney to handle the legal duties in administering the estate, and he is paid by the estate. As a general rule, attorney fees can be expected to amount to somewhere between 2 and 5% of the estate involved. If the estate is complicated, requiring an unusually large amount of the attorney's time, fees will undoubtedly be higher.

Fees are slightly less for jointly owned property which does not have to be probated. Additional charges would be made also if the attorney performs any extraordinary services such as defending the estate in the event of a contested claim.

Bond Costs

If the administrator or executor must give a bond before undertaking his duties, the costs are paid from the estate. The amount of the bond if required is set by the court and is usually an amount equal to the value of the personal property of the estate plus the estimated gross annual income of the estate during administration.

If individuals, such as other heirs, serve as surety on the bond, no cost need to be incurred. Otherwise, if the bond is secured by a professional surety company, the charge would be about $4 for each $1,000 up to $100,000, and a lesser rate thereafter.

IMPORTANCE OF LIQUIDITY

Estate settlement costs generally require payment rather promptly after death. In addition, federal estate taxes are due within 9 months after death, and the Nebraska inheritance taxes are due within 10 months after death.

In estimating the availability of cash or readily convertible assets, you should consider ordinary debts that are payable, prospective taxes, and the estate settlement costs. The total of these offers a rough guide in forecasting the need for liquid assets.

EXAMPLES OF TAX CONSEQUENCES

Example No. 1

The family consists of father, mother, two sons, and a daughter. Father is 55; mother, 50; the older son, 27, is married, and an electrical engineer. The daughter, 23, is married to a doctor. The younger son is 18 and interested in farming.

Assets	*Value*
Farm, 240 acres, bought in 1945 for $125 an acre The wife contributed no money. Now valued at $800 an acre. Husband and wife hold in joint tenancy (created prior to 1977, no gift tax return filed)	$192,000
Machinery and equipment	50,000
Average grain inventory	10,000
Livestock	20,000
Bank account held in joint tenancy	3,500
U.S. bonds in husband's name	6,000
Life insurance on husband with wife as beneficiary, owned by husband	10,000
Life insurance on wife with husband as beneficiary, owned by husband	3,000
TOTAL ASSETS	$294,500

Taxable gifts made during lifetime

None

Debts

Mortgage on farm	$20,000
Accounts payable	2,000
TOTAL DEBTS	$22,000

What would happen to this estate if the family had no estate plan and the father died (1981 or later) without a will?

First, the mother would receive all the property that was held in joint tenancy. This would be the farm and bank account. She would also receive the $10,000 life insurance. The remaining property, after payment of accounts, taxes, and expenses, would pass by Nebraska's laws of descent. This means that in this estate the mother would

receive $35,000 plus half of the remaining personal property and the children would receive the other half. The children's share would be divided evenly three ways. The personal property includes: equipment and machinery, household furniture, and personal belongings; grain; livestock; and bonds. Based on the above assets, this is the father's taxable estate:

Taxable Estate	*Value*
Farm	$192,000
Machinery, equipment, household furniture and personal belongings	50,000
Grain	10,000
Livestock	20,000
Bank Account	3,500
Bonds	6,000
Cash surrender value of insurance on wife	500
Insurance on deceased's life	10,000
Total Gross Estate	$292,000
Less permitted deductions	36,850
Adjusted Gross Estate	$255,150
Less marital deduction	$237,575
Taxable estate	$17,575
Tentative tax	3,315
Tax credit	47,000
Federal estate tax due	0

There would be no federal estate tax due. A wife can inherit as much as $250,000 worth of property or half the adjusted gross estate without having to pay any federal estate tax (marital deduction). Thus the taxable estate is $17,575 and the tentative tax on that amount is $3,315. The tax credit for 1981 and later years is $47,000, however, which cancels out the $3,315. There would be no state inheritance tax on the property going to the children since Nebraska allows each of these heirs a $10,000 exemption. The state inheritance tax on the mother's share of the personal property would be approximately $514.

What are the taxes at the mother's death?

If the mother does not remarry and survives her husband by 10 years, and the size of the estate does not change substantially, her taxable estate might be:

Taxable Estate	*Value*
Farm (debt now paid off)	$192,000
Personal property	30,000
Cash from husband's insurance (what is left)	5,000
Insurance on her life (policy owned by her)	3,000
Total Gross Estate	$230,000
Less permitted deductions	13,600
Adjusted Gross Estate	$216,400
Marital deduction	0
Taxable estate	$216,400
Tentative tax	60,048
Less credits: State death taxes	3,034
Unified tax credit	47,000
Net federal estate tax due	$10,014

A federal tax of approximately $10,014 would be paid and the state taxes would be $3,034. Thus, total taxes at the mother's death would be approximately $13,048. Total tax paid after the death of both parents, with no estate plan, would be $13,562.

How could this estate be planned to reduce taxes, and to provide ample family security and an equitable inheritance for the heirs? Here is one possible plan.

Step No. 1

Change the title of the farm from joint tenancy to tenancy-in-common. This would put half the net value of the farm ($86,000) in the wife's name and would leave half in the husband's name. In addition, the husband could transfer the bonds and ownership of the life insurance to the wife. This could all be done without involving any gift tax (provided the cash surrender value of the insurance policy is no more than $11,000) since the husband can give his wife $103,000 worth of property tax free on the basis of the annual gift exclusion and the gift tax marital deduction.

Step No. 2

If the son remains interested in farming, make some arrangement for him to work into the farming operation and gradually assume more management responsibilities. A partnership agreement could be drawn up to fit the situation. The father may wish to give some of

the equipment to the son or sell him half of it on an installment basis. Put any father-son agreement in writing.

Step No. 3

Both parents make wills. The son should also make a will if he gains an interest in the operation through a partnership.

Each parent leaves their half interest in the farm to the other for life and remainder to the children undivided. Each thus creates a life estate for the other. Each parent also includes a clause which allows the son (if he remains on the farm) to purchase the farm.

The father leaves machinery ($40,000) and half the livestock to the son who is on the farm. He equalizes this bequest by making the daughter and older son beneficiaries of term insurance on his life. Ownership of these policies is placed in the hands of the son and daughter. If the father's estate grows, he can later make gifts from his personal estate. By taking advantage of the gift tax exemptions, he can thus effect further tax savings.

The grain, half the livestock, and all of the household and personal goods is left to the mother.

Step No. 4 (optional)

The father could carry reducing term or ordinary life insurance to cover the mortgage. This step is desirable but not essential, as the surviving parent could continue to make the mortgage payments.

How much in taxes will such a plan save?

The tax following the father's death would be about $470. The tax savings would occur after the mother's death. Tax after her death would be about $850. Total tax savings through use of this plan would be approximately $12,240.

Example No. 2

The family consists of a father, 58, mother 52, and three children. The oldest, a son, is 24 and handicapped. A daughter is 21 and married to a college professor in California. The younger son is 16 and undecided as to whether he wants to farm. The estate consists of the following:

Assets	*Value*
Farm, 500 acres, valued at $1,500 an acre, husband and wife hold in joint tenancy	$750,000
Machinery and equipment	50,000
Grain	15,000
Livestock	40,000
Taxable gifts made during lifetime	60,000
Tax paid on taxable gifts made in last 3 years	2,000
Bank account held in joint tenancy	5,000
Insurance on husband, wife is beneficiary, owned by husband	20,000
TOTAL ASSETS	$442,000
Debts	
Cattle notes	$25,000
Accounts payable	3,000
TOTAL DEBTS	$28,000

If the father has a will in which he leaves everything to his wife, what would be the federal and state inheritance taxes at his death?

Gross estate		$942,000
Less permitted deductions		58,775
Adjusted Gross Estate		$883,225
Less marital deduction		441,612
Taxable Estate		441,612
Tentative tax		$135,948
Less credits:		
Gift taxes paid	$30,000	
State death taxes	10,064	
Unified tax credit	47,000	
Net federal estate tax due		$65,884

The Federal estate tax is $65,884. State death taxes would be about $10,064.

If the mother survives her husband by 10 years, and the gross estate remains at the same value as when left to her, what will be the taxes when she passes the estate on to her children?

The federal estate taxes would be about $169,326. Total taxes

paid after the death of both husband and wife would be almost $267,258.

How can this estate be planned to minimize taxes, to provide ample security for the family, and to provide an equitable inheritance for the heirs?

Plan No. 1

Husband takes title to the farm in his name only. He wills half of his estate to his wife and places the second half in trust with his wife to get the income from the trust as long as she lives with the remainder to go to the children. This would give her flexibility to make special provisions for the handicapped son if she should feel such provisions desirable. In addition, he transfers ownership of the life insurance policy to his wife.

Total taxes on both estates would be about $153,090. Although this would be a sizable amount of tax, it would be about $114,000 less than with the original arrangement.

Transferring title to the husband only would not result in any gift tax if the farm property had all been contributed by him originally in the form of farm earnings. Had he inherited part or all of the farm or received part or all of it as a gift, IRS would consider that he had contributed these portions also.

The tax under this plan could be further reduced by gifts during the lifetime of the father and mother.

Plan No. 2

Step No. 1—Incorporate. Assuming that the property had been purchased originally with money earned by the husband, any transfer of stock from the husband to the wife would constitute a gift. The husband could take advantage of the marital gift exemption and annual gift exemptions and transfer $100,000 worth of stock to his wife immediately in addition to $3,000 worth each year without incurring any gift tax.

Step No. 2—Make new wills. Husband and wife leave shares to each other for life with the power to appoint shares to children. You might want to make provision for younger son to buy daughter's shares if he decides to farm.

Step No. 3—Set up trust for handicapped son. Tax-free gifts of shares, bonds, or insurance could be made to the trust each year. Attempt to secure the services of a trustee who is acquainted with your family and who possesses some knowledge of farm management. If the trust is irrevocable and created during the father's lifetime, the trust property will not be included in the estate or be probated.

Total estate taxes under this plan could be substantially less, but there would be some expenses you would not incur under other plans such as the cost of incorporating, trustee fees, and some additional attorney or consultant fees for setting up such a plan.

Step No. 4 (optional)—It might be wise to build up some liquidity in this estate. This could be accomplished through the purchase of bonds, or more life insurance on the father and mother, to provide needed cash at critical times without disrupting the farm operation.

SUMMARY

The job of estate planning is complex but important. A good job of estate planning calls for a thorough knowledge of the various tools available and how they can be used to achieve objectives of the individual.

Estate planning is not a do-it-yourself project. This is best accomplished by an attorney or a trust officer of a bank. Start as soon as a person has acquired responsibility either in the form of a family or through ownership of property. Make changes as circumstances dictate. Finally, remember that if you don't make an estate plan, state laws make one for you, and it may not be to your liking.

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