University of Nebraska - Lincoln
DigitalCommons@University of Nebraska - Lincoln

Historical Materials from University of Nebraska-Lincoln Extension

Extension

1977

EC77-866 Estate Planning--Highlights of Changes Due to 1976 Legislation

Philip A. Henderson

Follow this and additional works at: http://digitalcommons.unl.edu/extensionhist

Henderson, Philip A., "EC77-866 Estate Planning--Highlights of Changes Due to 1976 Legislation" (1977). *Historical Materials from University of Nebraska-Lincoln Extension*. 4579.
http://digitalcommons.unl.edu/extensionhist/4579

This Article is brought to you for free and open access by the Extension at DigitalCommons@University of Nebraska - Lincoln. It has been accepted for inclusion in Historical Materials from University of Nebraska-Lincoln Extension by an authorized administrator of DigitalCommons@University of Nebraska - Lincoln.

AGRI
S
85
E7
77-866
C.1

ESTATE PLANNING--

HIGHLIGHTS OF CHANGES DUE TO 1976 LEGISLATION

by
Philip A. Henderson
Extension Economist

As a result of widespread demand for changes in federal laws pertaining to property transfers, legislation was enacted in 1976 and became effective January 1, 1977. Estates of less than half a million dollars are expected to benefit the most from the new legislation. Those with approximately 1 million dollars may find the federal estate tax about the same under the new law as under the old. Larger estates of 2 million dollars or more may actually pay more federal estate taxes under the new law than under the old law.

One of the major concerns of farm people was that the $60,000 specific exemption allowed in calculating the federal estate tax had not been changed since 1942. Likewise, the $30,000 lifetime gift exemption had not been changed for many years. Meanwhile, farm real estate values had increased tremendously. The index of Nebraska farm real estate value (1967 = 100) stood at 21 on March 1 of 1942 and at 271 on March 1 of 1976.

Instead of changing these exemptions, Congress elected to eliminate them and to provide a set of tax credits (Table 1) instead. A tentative tax based on the taxable estate and a new set of tax rates (Table 2) is calculated and from this, certain credits, including the appropriate unified tax credit may be subtracted.

Table 1. Unified Tax Credit Provided by 1976 Legislation.

Year	Credit	Roughly Equivalent to Following Amounts of Property
1977	$30,000	$120,667
1978	34,000	134,000
1979	38,000	147,333
1980	42,500	161,562
1981 & thereafter	47,000	175,625

CHANGE IN WAY OF FIGURING GROSS ESTATE

Taxable Gifts Included

The new law is designed to tax transfers made during a person's life and at death on a cumulative basis. Major exceptions include: lifetime

Extension work in "Agriculture, Home Economics and subjects relating thereto," The Cooperative Extension Service, Institute of Agriculture and Natural Resources, University of Nebraska-Lincoln, Cooperating with the Counties and the U.S. Department of Agriculture
Leo E. Lucas, Director

gifts of $3,000 or less to each recipient in any one year; taxable gifts made prior to 1977 (except those made within 3 years of death); property transferred to a spouse on a tax free basis under the new marital gift exemption provisions; and property transferred to charitable institutions. Thus, under the new law, the gross estate of a deceased individual will include all of the taxable gifts that person had made during his lifetime after 1976, taxable gifts made prior to 1977 which were made within the 3 years preceding death, and the amount of tax paid on taxable gifts made during the last three years of his life.

New Way of Figuring Land Value

Old Law

Prior to 1977, land was supposed to be valued at its market price for estate tax purposes.

New Law

The 1976 legislation gives executors and administrators the privilege of using "current use" value in place of market value for real estate used in a farm or other closely held business provided certain requirements can be met. The requirements are as follows:

1) The gross value of the estate cannot be reduced by more than $500,000 as the result of using values based on current use.
2) The decedent must have been a resident or citizen of the United States and the property must be located in the United States.
3) The current use value of the real estate and the personal property used in the business must make up 50% or more of the gross estate.
4) Qualified real property must make up at least 25% of the adjusted gross estate.
5) The decedent or a member of his family must have used the real estate for farming or for another closely held business for 5 of the last 8 years preceding the decedent's death.
6) The decedent or a member of his family must have materially participated in the operation of the farm or business for at least 5 of the last 8 years before the decedent's death.
7) The property must go to a qualified heir (would include any of his lineal ancestors; any lineal descendents of such ancestors; his spouse; or spouses of the lineal descendents). Adopted children are to be considered the same as natural children.

Method of Valuation (farm real estate)

Land that can qualify for application of current use value is to be valued on the basis of capitalized cash rent if possible. The average amount of cash rent paid for the use of comparable land in the area minus the average property tax on such land is to be divided by the effective average annual interest rate charged by the Federal Land Bank for all new loans made during the 5 most recent calendar years ending before the decedent's death. The resulting answer would be the "current use value."

If no comparable land in the area rents for cash, then the current use value can be calculated on the basis of: capitalized income, capitalized rent received, assessed land values, comparable sales, or any other factor(s) which would reflect use value.

Tax Benefits Subject to Capture

Under certain conditions, the additional federal estate tax which would have been involved had market price been used instead of current use value can be captured.

If the farm is sold to a person other than a qualified heir or if the use of the land is changed to something other than farming, capture of the additional tax will be triggered. If either of these events occurs within the first 10 years after the decedent's death, 100% of the additional tax will be due and payable. The proportion of the additional tax captured after the 10th year would decrease on a month by month basis from 100% at the end of the 10th year to none at the beginning of the 16th year.

In addition, failure (on the part of the decedent, the qualified heir, or some member of their families) to materially participate in the operation of the farm for periods of time aggregating 3 years or more during any eight year period which ends within the fifteen years following the decedent's death will also trigger capture of the additional tax.

Joint Tenancy Property

Old Law

Under pre-1977 law, property which the decedent held in joint tenancy with his spouse (or anyone else) was presumed to belong to the deceased joint tenant unless the surviving joint tenant(s) could prove that they had contributed to the acquirement of the property.

New Law

Any property which is placed in joint tenancy (between spouses) after January 1, 1977, will be considered as belonging half to the husband and half to the wife provided a gift tax return has been filed and any tax due has been paid.

If property has been held in joint tenancy by husband and wife prior to 1977, married couples have the right to "recreate" the joint tenancy in order to make it qualify for this new treatment. In order to "recreate" the joint tenancy, the existing joint tenancy would be broken up by each spouse taking back in his or her name the same proportion of the property each had contributed. A new joint tenancy would then need to be created and a gift tax return would need to be filed in support of the new "qualified" joint tenancy. Any later investments in this property (such as additions, modifications, etc.) must be considered from the standpoint of possible gift tax liability.

Any joint tenancy ownership which existed prior to 1977 which is not recreated in the manner described will be subject to the presumption that such property all belonged to the first joint tenant to die and the surviving joint tenant will need to prove contribution. For joint tenancy property which is subject to the "proof of contribution" rule, it should be noted that the surviving spouse cannot claim as a contributed share any portion of the property which was received by the survivor from the decedent as a gift not substantiated by a gift tax return.

The Nebraska legislature passed a law in early 1977 which authorizes the treatment of joint tenancy property (husband and wife) as belonging half to the husband and half to the wife for state inheritance tax purposes only.

Three Year Rule

Old Law

IRS assumed that all gifts made within three years of death were made in contemplation of death to avoid estate taxes. Consequently, all gifts made within three years of death were included in the gross estate unless the executor or administrator of the estate could prove that the motive for making these gifts was other than the avoidance of taxes.

New Law

None of the gifts made on the basis of the annual exclusion ($3,000 or less per donee) during the last three years of life will be pulled back into the estate, regardless of the reasons for making the gifts. On the other hand, all taxable gifts made within the last three years preceding death will be pulled back into the estate regardless of why such gifts were made. There will no longer be opportunity to have such gifts excluded from the estate even if the motive was clearly other than avoidance of taxes.

TAX RETURN NOT REQUIRED FOR ALL ESTATES

Under the new law, executors or administrators need not file a federal estate tax return in most instances if the decedent's estate was less than the following amounts:

Year of Death	Estates of Less Than:
1977	$120,000
1978	134,000
1979	147,000
1980	161,000
1981 and thereafter	175,000

It should be noted, however, that if the decedent had used part of his unified tax credit to offset gift taxes during his lifetime, then a federal gift tax return would be required for estates smaller than those indicated.

MARITAL (ESTATE) DEDUCTION

Old Law

The value of any property going to a surviving spouse could be subtracted from a deceased person's estate up to an amount equal to half of the adjusted gross estate as a marital deduction.

New Law

The value of property going to a surviving spouse can be subtracted from a deceased person's estate as a marital deduction to the extent of $250,000 or half of the adjusted gross estate, whichever is larger.

In some instances, the amount of the permitted marital deduction may be less. If the decedent had claimed a marital gift exemption during his lifetime (after 1976)(discussed in more detail later) in an amount which exceeded half of the actual gift to the spouse, then the permitted marital deduction at death would be reduced by the amount of the difference, i.e., the amount by which the marital gift exemption claimed exceeded half the value of the gift.

ORPHAN EXCLUSION

There is a new deduction or exclusion under the new law. It applies in those situations where, at the death of a parent, property goes to a minor child (including adopted children) who is left without a living legal parent. Such transfers can be offset in whole or in part by taking an offsetting deduction of up to $5,000 for each year the child's age is below 21. For example, if property passes to a 14 year old child, the orphan exclusion could amount to as much as 7 (21 - 14) x $5,000 or $35,000. The fact that an adopted child's real parent(s) is still living does not reduce the amount which can be claimed. If property goes to more than one minor child, more than one orphan exlcusion can be claimed.

TAXABLE ESTATE

Effective in 1977, the taxable estate will be the amount left after the subtraction of: permitted deductions (funeral expenses, administrative expenses, attorney fees, indebtedness, and losses incurred during administration of the estate); marital deduction; charitable bequests; and any orphan exclusions. There is no specific exemption ($60,000) as there was prior to 1977.

NEW TAX RATES

Old Law

Prior to 1977, taxable gifts made during one's lifetime were taxed at a lower rate than property transferred and taxable at death. Federal estate tax rates began at 3 percent (on taxable estates of $5,000 or less) and graduated to 77 percent (on any portion of an estate in excess of $10 million dollars). Gift tax rates were only three-fourths as high.

New Law

Starting January 1, 1977, taxable transfers made during lifetime (taxable gifts) will be subject to the same rates as transfers at death. A new set of rates will apply to both kinds of transfers (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 over $10,000.
Over $20,000 but not over $40,000	$3,800, plus 22 percent of the excess over $20,000.
Over $40,000 but not over $60,000	$8,200, plus 24 percent of the excess over $40,000.
Over $60,000 but not over $80,000	$13,000, plus 26 percent of the excess over $60,000.
Over $80,000 but not over $100,000	$18,200, plus 28 percent of the excess over $80,000.
Over $100,000 but not over $150,000	$23,800, plus 30 percent of the excess over $100,000.
Over $150,000 but not over $250,000	$38,800, plus 32 percent of the excess over $150,000.
Over $250,000 but not over $500,000	$70,800, plus 34 percent of the excess over $250,000.
Over $500,000 but not over $750,000	$155,800, plus 37 percent of the excess over $500,000.
Over $750,000 but not over $1,000,000	$248,300, plus 39 percent of the excess over $750,000.
Over $1,000,000 but not over $1,250,000	$345,800, plus 41 percent of the excess over $1,000,000.
Over $1,250,000 but not over $1,500,000	$448,300, plus 43 percent of the excess over $1,250,000.
Over $1,500,000 but not over $2,000,000	$555,800, plus 45 percent of the excess over $1,500,000.
Over $2,000,000 but not over $2,500,000	$780,800, plus 49 percent of the excess over $2,000,000.
Over $2,500,000 but not over $3,000,000	$1,025,800, plus 53 percent of the excess over $2,500,000.
Over $3,000,000 but not over $3,500,000	$1,290,800, plus 57 percent of the excess over $3,000,000.
Over $3,500,000 but not over $4,000,000	$1,575,800, plus 61 percent of the excess over $3,500,000.
Over $4,000,000 but not over $4,500,000	$1,880,800, plus 65 percent of the excess over $4,000,000.
Over $4,500,000 but not over $5,000,000	$2,205,800, plus 69 percent of the excess over $4,500,000.
Over $5,000,000	$2,550,800, plus 70 percent of the excess over $5,000,000.

TENTATIVE AND FINAL TAX

The taxable estate as calculated under the law in effect since January 1, 1977, multiplied by the appropriate tax rates gives a tentative tax from which certain credits can be subtracted. Since all taxable gifts made during the decedent's lifetime (only those made after 1976, unless made before 1977 in contemplation of death) were included in the gross estate, a credit against the tentative tax can be claimed for the amount of gift taxes paid by the decedent on the taxable gifts made after 1976 which were included. Credit can also be taken for the state death taxes (state inheritance taxes and state estate tax) on the decedent's estate. Appropriate credits can also be claimed for federal estate taxes paid on previous estates if part of the property in the current estate was taxed in a previous estate within the last 10 years. Finally, any portion of the unified tax credit which was not used by the decedent during lifetime (to offset gift taxes) can be subtracted. The portion of the tentative tax still remaining after these credits have been taken is the final federal estate tax.

TIME ALLOWED FOR PAYMENT OF TAX

The federal estate tax return is due within 9 months of death. However, there are provisions for spreading the payment of the tax out over a period of years.

Old Law

Under pre-1977 law the estate taxes could be paid over a period of years (up to 10 years) if it could be shown that "undue hardship" would result from having to pay the entire tax all at one time. Interest on any portion of the tax not paid was charged at the rate of 7 percent.

New Law

Under the new law, it is no longer necessary to show "undue hardship." An extension of time for payment of the tax can be obtained if "reasonable cause" for granting such an extension can be shown. "Reasonable cause" will be recognized in those instances where a closely held business or a farm makes up most of the estate and there are insufficient funds to pay the tax within the 9 month period without borrowing at an above average interest rate or if there are not enough readily salable assets due to legal entanglements. If the executor can show that he would have to sell assets at a sacrifice, this would also be recognized as reasonable cause.

If the value of the farm or closely held business assets make up either 35% of the gross estate or 50% of the taxable estate the executor may elect to pay the portion of the tax attributable to the farm or closely held business assets over a period of years (not to exceed 10) if reasonable cause can be demonstrated. The interest rate on any portion of the tax which is unpaid will be 7%.

If 65% of the decedent's gross estate is made up of farm or closely held business assets, the executor can apply for a 15 year extension of time. If the request is granted, no payment on the tax has to be made for up to 5 years.

Interest is charged on any portion of the tax attributable to the first $1 million of the estate which is not yet paid at a 4% annual rate. Interest on the portion of the tax attributable to the portion of the estate in excess of $1 million will be charged at a 7% rate. Interest must be paid even though no payments on the tax itself are made during these years. Payment of the tax must be started no later than 5 years after the nine month period following the decedent's death is up.

MARITAL GIFT EXEMPTION

Old Law

Prior to 1977, essentially half of any gift between spouses was deductible as a marital gift exemption. The amount deducted was non-taxable. In addition, a married person could give his spouse up to $3,000 worth of property a year on the basis of the annual gift exclusion. He (or she) could also claim a portion of or all of the lifetime gift exemption against gifts to his or her spouse. Thus, it was possible for one spouse to give the other spouse as much as $66,000 worth of property tax free if none of the lifetime gift exemption had been used in prior years. Thereafter, the most that could be given tax free was $6,000.

New Law

Under the new law, a married person can give the spouse up to $3,000 worth of property each year tax free. In addition, the first $100,000 worth of property (in excess of the amount given under the annual exclusion) transferred from one spouse to the other as a gift is tax free. The second $100,000 worth of property transferred to a spouse as a gift is fully taxable. One half of any gifts in excess of an accumulated total of $200,000 is tax free.

GENERATION SKIPPING TRANSFERS

The new law places limits on the extent to which property transfers can be made on a generation skipping basis. The limitation applies to those property transfers where the owner of property gives one or more persons in the next generation (that of his children) a right to income from property during part or all of their lifetime but actually grants ownership of the property to one or more persons in the second generation (that of his grandchildren). Under the new provisions, such generation skipping is limited to $250,000 per child of the person making the transfer. In other words, parents could put $500,000 worth of property in a trust with the provision that their 2 children were to get the income from the trust property as long as they (the children) live and, at the death of the last child, the trust property would go to the grandchildren. Any amount they might place in such a trust in excess of $500,000 would be subject to a special generation skipping tax. If the property placed in trust increases in value sufficiently so that the total value of the trust property exceeds $250,000 per child, by the time the last child dies, the appreciated value in excess of the $250,000 per child will be subject

to the special generation skipping tax. For details on the calculation of this tax, consult your attorney.

CARRYOVER BASIS FOR INHERITED PROPERTY

Old Law

If a person inherited property from a parent or grandparent (or anyone else), his basis in that property for income tax purposes was the value of the property at the decedent's death. Hence, if property were valued at $100,000 in the parent's estate, the person who received the property by inheritance from the parent had an income tax basis of $100,000 in the property. If he later sold the property for $150,000, he had a capital gain of $50,000 and paid tax on half of any such net long term capital gains.

New Law

Under the new law, the increase in value which occurs between the time property is acquired and the time of death (assuming the decedent still owned the property at the time of death) will be subject to taxation if and when the heir sells the property. However, capital gains that occurred prior to December 31, 1976, will be ignored.

If a child inherits stocks or bonds from a parent, the child's basis in those stocks or bonds will be the market value of these stocks as quoted in newspapers for December 31, 1976, or the nearest business day to that date. But if the child inherits farm land, the method of determining the December 31, 1976, value will necessarily be different. If and when the land is sold by the child, a calculated value as of December 31, 1976, will have to be determined. The procedure which will be used is as follows:

1) The value at the decedent's death will be compared to the decedent's basis adjusted for depreciation, improvements added, etc. It will be assumed that the increase in value occurred at a uniform daily rate.
2) On the basis of the adjusted average daily increase in value, a calculated value for December 31, 1976, will be determined by subtracting from the value at the decedent's death the product of the average daily increase multiplied by the number of days elapsed between December 31, 1976, and the date of death.
3) To this calculated value can be added the portion of federal estate taxes and state inheritance taxes which are attributable to the appreciation which occurred while the property was in the hands of the deceased parent.

The Cooperative Extension Service provides information and educational programs to all people without regard to race, color or national origin.