ESTATE PLANNING FOR DAIRYMEN

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Introduction

Every dairyman has an obligation to himself and to his family to acquire some knowledge of estate planning and develop a satisfactory plan. After spending a lifetime in acquiring and developing his property, a dairyman has the right to decide how it will be distributed after his death, rather than leaving the decision to others. The development of a satisfactory plan should be based upon considerations of the property owned and the needs and future plans of the family. Some common objectives of a property transfer plan include: (1) providing security for the surviving spouse, minor children, and incompetents, (2) providing an income for the widow for the rest of her life, (3) treating all children equitably, (4) helping a son get started in business, (5) preserving the business unit for future generations, and (6) minimizing estate and income taxes along with general estate settlement costs.

Obviously no one plan is the "best" for all families. However, an understanding of the principles, methods and procedures of property transfers and estate settlements will enable the individual to develop a satisfactory transfer plan consistent with his family situation. The development of any plan should be made with the aid and advice of a competent attorney.

Forms of Property Ownership

In addition to establishing goals, the individual dairyman should have an understanding of the ways he can own property if he is to develop a satisfactory estate plan. Many dairymen hold title to property in fee simple. From a legal standpoint, a title in fee simple confers the entire bundle of rights in the property to the individual. He would have the right to pledge the property as collateral for a loan, encumber it and dispose of it by sale, gift or will.

Tenancy in common is a form of joint ownership where each tenant holds title to a separate, undivided interest in property and each has equal possession of the property. A tenancy in common is created when property is conveyed to two or more persons or when a piece of property is received by two or more persons by contract, gift, will or intestate distribution. Intestate distribution occurs by virtue of state law in the absence of a will. Tenants in common do not have survivorship rights; at death title passes to the deceased tenant's heirs by will or intestate distribution.

Tenancy "with right of survivorship" is characteristic only of joint tenancies and tenancies by the entirety. Joint tenancy "with right of survivorship" property passes by operation of law to the survivor which in effect provides a built-in will to transfer property to the survivor. Tenancy by the entirety property is real property owned jointly by a husband and wife.

The life estate is a less common type of property ownership. Created by will or deed, the life estate allows a person, called the life tenant, to have undisturbed possession of the property during his lifetime with title passing to the heirs or remainderman upon the death of the life tenant(s). For example, a husband can create a life estate through a will for the benefit of his widow or other beneficiary. The life estate can provide use of property and income from it during the widow's lifetime. Upon the death of the life tenant, the property automatically passes to the remainderman.

Federal Estate Tax

Because of its importance, the federal estate tax is discussed in some detail. The federal estate tax is levied upon all the property the decedent owned, wherever situated. The total value of the property is called the gross estate. The tax is imposed upon the taxable estate (gross estate less allowable deductions and exemptions) of the decedent before the property is distributed. However, in the event the estate doesn't pay the tax when due, the beneficiaries may be called upon to pay the tax. The amount will be limited, however, to the value of the property acquired by each beneficiary.

The Gross Estate

The major items included in the gross estate include:

(1) All property in which the decedent owned a fractional or entire interest.

> Example: real property, machinery and livestock, stocks and bonds, an interest in a business, bank accounts, accounts receivable, etc.

(2) Life insurance proceeds payable to the estate.

(3) Life insurance proceeds payable to beneficiaries if the decedent had any rights of ownership in the policy.

> Example: the right to change the beneficiary, to cancel the policy, or to pledge the policy for a loan, are incidents of ownership.

(4) The full value of property owned jointly with right of survivorship less any portion which originally belonged to the survivor or which the survivor purchased from the decedent or others for an adequate and full consideration in money or money's worth.

> Example: Assume a man purchases a business for $20,000 taking title in his name and his wife's in joint ownership. Suppose he dies first, at which time the value of the business is $30,000. If he contributed all the money for the property, the entire $30,000 will be included in his gross estate. If, however, the wife had contributed $5,000 to the purchase price of the business, then upon the husband's death <u>only</u> three-fourths of the value of the property would be included in his estate. His estate would then include $22,500.

(5) Property which the decedent transferred to another but reserved the income and/or use thereof during his lifetime or reserved the right to designate the person who should possess or use the property (retained life estate).

> Example: Assume that a man gives his residence to his son, but reserves the right to occupy the dwelling rent free during his life; this transfer of property will be included and taxed in the father's estate at death.

(6) Gifts made within 3 years prior to the decedent's death if made in contemplation of death.

> Example: Some of the facts and circumstances which are considered in determining whether the gift was made in contemplation of death are the donor's age, health, the type of property given, the time span between the gift and the donor's death, the retention of control by the donor, and the execution of a will concurrently with the making of the gift.

(7) Annuities payable to the decedent either alone or in conjunction with another person or persons.

> Example: Suppose a man buys an annuity under which payments will be made to himself and his wife jointly during their joint lives and continued in favor of the survivor during his life. This is a joint and survivor annuity. If

the husband and wife each contributed $10,000 to the purchase of the annuity contract and the value of survivor's annuity is $18,000 at the husband's death, then one-half of the annuity or $9,000 is included in his estate.

Deductions

Deductions from the gross estate are allowed for the following:

(1) Funeral expenses, enforceable debts, unpaid taxes, the costs of administering the estate, and casualty losses occurring during the estate settlement period. The residual is then called the adjusted gross estate.

Example: If the decedent's gross estate amounted to $250,000 and the expenses listed above amounted to $10,000, then the adjusted gross estate is $240,000.

(2) The marital deduction. If the decedent transfers property to his spouse at death, he is entitled to a deduction from the gross estate. This deduction cannot exceed 50 percent of the adjusted gross estate, even though more than one-half actually goes to the spouse.

Example: If the adjusted gross estate is $240,000, then the maximum marital deduction is $120,000.

(3) Charitable deduction. Money or property transferred to charitable, educational and religious institutions or organizations.

Exemptions

An exemption of $60,000 is allowed to all estates. Thus, the first $60,000 after all deductions are subtracted from the gross estate, passes free of estate tax. In our example, the adjusted gross estate of $240,000 less the sum of maximum allowable marital deduction of $120,000 and the $60,000 exemption leaves a taxable estate of $60,000. If the net estate amounts to less than $60,000 after all deductions, no tax is due. Also, if the decedent's adjusted gross estate is $120,000 or less and he leaves at least half of his estate to his wife, no estate tax would be due. In summary, the gross estate less deductions and the $60,000 exemption equals the taxable estate.

Tax Rates

Tax rates are graduated from 3 percent for estates of less than $5,000 to 77 percent for taxable estates of $10,000,000 or more.

Credits against the computed estate tax are allowed for taxes paid on prior transfers, state inheritance taxes, federal gift taxes and foreign death taxes.

The federal estate tax return (Form 706) is due 9 months from the date of the decedent's death. An extension of the date of tax payment may be requested and obtained when the payment places an undue hardship on the estate.

Federal Gift Tax

The making of a gift is a method that allows completion of a property transfer during the property owner's lifetime. A properly made gift can reduce the size of one's taxable estate. A gift is easy to make as far as legal transfer is concerned. Real estate may be given by a properly signed deed while personal property can be given by handing over the property with the intention of making the recipient the present owner. When a true gift is made, the owner turns the complete use, enjoyment and income from the property over to the recipient. Any retention of the use or income of the property by the owner may nullify recognition of the transfer as a gift for timely inheritance and estate tax purposes. As further assurance that a gift will be so recognized, a federal gift tax return should be filed. The transfer of any property in the form of a gift may incur a gift tax. The federal government imposes a tax upon the privilege of transferring property.

Here are some of the advantages of gifts as part of an estate plan:

(1) A gift can be made to a person of any age including minors.

(2) A gift of property may enable the recipient to use the property when he needs it most.

(3) Ownership via gift may result in more productive use of the property in the hands of the recipient than the donor.

(4) Property transferred by a timely gift will remove such property from the donor's taxable estate. Gifts of property which are likely to appreciate greatly in value will especially help reduce donor's taxable estate.

(5) Gift tax rates are less than estate tax rates.

There are also some disadvantages in using gifts as part of an estate plan:

(1) Unless the parents have other income, a gift may deplete assets and income and consequently impose financial hardships on them in later life.

(2) A transfer by gift may result in family friction if the reason for the gift is not understood by all family members.

(3) The donor has no control over subsequent use or disposition of a bona fide gift.

(4) Gifts may be subject to inheritance taxes if they are made within 3 years prior to death.

Any lifetime transfer of property by one person to another is a gift for gift tax purposes to the extent the giver, or donor, does not receive an equal value in money or other property in return. Taxable gifts are not restricted to the most usual and obvious kinds of property such as gifts of cash, stocks and bonds or real property. Selling property at less than face or market value, foregoing a debt, or permitting another to withdraw funds from a joint bank account deposited by the donor are some examples of other transactions that may be considered gifts. The tax is imposed upon the donor but if the donor does not pay the tax when due, the donee or recipient of the gift may be called upon to pay it to the extent of the value of the property received by him.

The federal gift tax statute provides several exclusions, exemptions and deductions which may be used to reduce the value of property subject to the tax.

Exclusion

In any calendar year, the first $3,000 of gifts made to any one donee is excluded in determining the total amount of taxable gifts for the calendar year.

> Example: If a man gave $5,000 to each of his three sons in a single year, he would get an exclusion of $3,000 per son. His total exclusion would be $9,000 and his taxable gifts would be $6,000, provided he had used up his lifetime exemption.

If a gift of a future interest in property is made, the $3,000 annual exclusion is not available. For gift tax purposes future interests include any interest in property where the possession or enjoyment of the property is deferred or subject to the will of some person other than the owner.

> Example: A father transfers $20,000 in property in trust to his son. Interest income from the trust property is to accumulate for ten years and then be distributed to the son or the son's estate. This gift is a future interest and would not qualify for the $3,000 annual exclusion.

Specific Exemption

Every person has a lifetime exemption of $30,000. This amount may be given away without a gift tax being levied. This exemption can be used all in one year or over a period of years. In years when individual gifts exceed $3,000, the excess is applied against the $30,000 exemption until it is depleted.

> Example: If a gift of $5,000 is given to a child, the first $3,000 is applied against the annual exclusion; the other $2,000 is applied against the lifetime exemption of $30,000.

Split Gifts

With the consent of the wife (or husband), the donor may "split" the gift with his spouse so that it may be treated as having been given one-half by each. This rule applies even though one spouse is the sole owner of the property. Thus, the first $6,000 of gifts made jointly to any one donee is excluded in determining the total amount of taxable gifts for the year. Similarly the lifetime exemption for joint gifts is increased to $60,000. Thus, splitting gifts enables a husband and wife to initially give away up to $66,000 in one year and incur no gift tax, while taking the $66,000 off the top of any future taxable estate where the tax rate would be higher. Splitting gifts does not allow the spouses to divide their respective lifetime exemptions. For example, if a husband who has used up his lifetime exemption of $30,000 makes a gift of $18,000 to a daughter, he cannot use his wife's lifetime exemption to avoid gift taxes. If the gift is treated as a split gift, the wife can apply the annual exclusion of $3,000 and $6,000 of her exemption. The husband could apply his annual exclusion of $3,000 and report a taxable gift of $6,000.

Deductions

When a gift is made by one spouse to another, the donor receives the benefit of the gift tax marital deduction which provides that one-half of the gift passes tax free without regard to the $3,000 annual exclusion. Consequently, a donor may give his spouse up to $6,000 each year without incurring a gift tax liability or using any of his $30,000 lifetime exemption. The deduction applies if the recipient of the gift was married to the donor at the time of the gift. The deduction does not apply, however, to a gift in which the recipient's interest is terminated at a certain date or because of certain occurrences. The total amount of gifts made during the calendar year for charitable bequests can be deducted.

Tax Rates

Gift tax rates are exactly three-fourths of the comparable estate tax rates.

The gift tax computation for each year is based upon all of the accumulated gifts made over a period of years.

> Example: If the first year's gifts in excess of exclusions, exemptions and deductions were $5,000, the gift tax for the first year would be $112.50. If the next year's taxable gifts were $10,000, the tax would be $787.50 (tax on $15,000 of gifts) less $112.50 (tax on prior gifts) or $675.00.

No credits are provided for by the federal gift tax statute. A federal gift tax return is required if, during any calendar year, a donor made gifts to any one in excess of $3,000. This return (Form 709) must be filed on or before the 15th day of the second month following the close of the calendar quarter in which gifts were made.