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Estate Planning for Missouri Families

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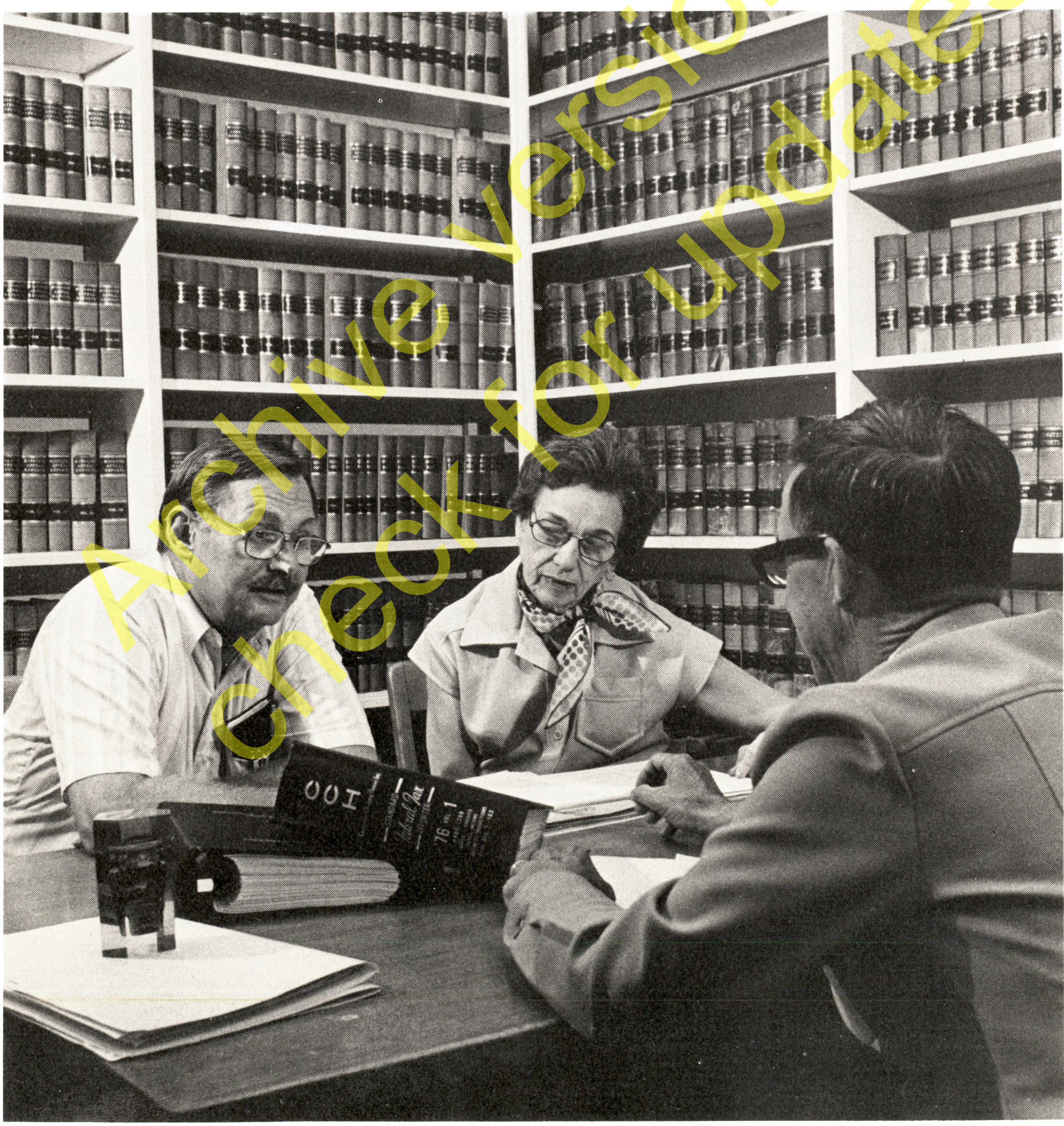

Warning

Estate Planning for Missouri Families represents an attempt to inform you of the basic changes made by the Tax Reform Act of 1976 and the Revenue Act of 1978. You are urged to consult with your attorney and other professional advisors when you consider making decisions about your own situation.

This publication is not to be relied upon as an authoritative basis for interpreting estate planning laws. You should consult with your attorney when legal problems arise.

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Estate Planning for Missouri Families

By
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It has been said that one of the blessings of life is that people never know how long it will last. Most people were better prepared for birth, about which they could do nothing, than for death or taxes, about which they can do a great deal. While death is an unpleasant subject, it is inevitable.

An estate plan will not enable you to avoid death or taxes—but it does allow preparation for them and lessens their impact on surviving family members. When a person dies, his estate does not disappear with him. It remains behind to be distributed by someone. Thus, if a person does not provide a workable transfer plan for the courts to follow upon his death, state statutes will provide a pre-determined rule of distribution.

What Is Estate Planning?

Estate planning involves more than the execution of a simple will. It is a comprehensive plan designed to create the desired economic and legal consequences in the disposition of your estate. It is the arrangement of affairs in such a manner as to provide adequate resources to care for you during retirement, to transfer property to the next generation with a minimal loss of assets, and to preserve your business operation for your chosen heirs.

Who Needs An Estate Plan?

Every property owner needs an estate plan. A proper one insures the economic and legal consequences you desire. An estate plan may save thousands of dollars if your estate is large enough to be subject to federal estate taxes. There may be an even greater need to plan a small estate. Careful planning for the small estate is essential to give you adequate income during retirement and care for your surviving spouse and minor children.

In this publication, *large estate* refers to an estate which is subject to federal estate taxes; *small estate* refers to one which is not. Since deductions allowed vary significantly from estate to estate (e.g., funeral expenses, expenses of administration), it is difficult to assign estate sizes above which federal estate taxes will always apply. In general, a married couple can avoid the federal estate tax on the estate of the first spouse to die after 1980 by proper planning if their assets have a fair market value of $425,000 or less. A single person will not generally be subject to this tax after 1980 if his estate is valued at $175,000 or less. Further revision of the estate tax laws is always a possibility. However, estate law changes will generally reflect inequities in the law. Whether such changes will affect you is a constant question requiring annual review of your estate plan. Changes in your estate size and composition can also merit review of your estate plan.

Many property owners do not realize they have accumulated sufficient assets to place them in the large estate category. Since different legal considerations exist in the planning of small and large estates you should inventory your assets at their present fair market value to determine which category your estate falls within. Do not value assets at your cost for estate tax purposes. Special valuation alternatives for farms and closely held businesses should not be ignored. See your professional advisors for complete information about these 1976 Tax Reform Act (TRA) provisions.

Property which is considered a part of your estate for federal estate tax purposes includes not only property owned at death but also certain other property in which you have some interest or control.

The section on "Valuable Records" on page 15 is

included to aid you in making this inventory. After making the inventory, you should consult with an attorney to determine what estate planning alternatives would be best in your situation.

Who Should Plan the Estate?

Formal, written *legal* documents are used as tools in estate planning. Because the interpretation of these legal documents is controlled by the meaning which statute and courts have given the language used, you should never attempt to plan your own estate.

A "homemade" plan can lead to an unnecessary wasting of assets because lawsuits are often required to determine the legal effect of each of the documents used to carry out the plan. Remember, when these documents are being interpreted, you will not be there to explain what you intended the language to mean.

An Attorney Is the Only Person Qualified To Plan an Estate

To plan your estate you should contact your lawyer and explain your objectives to him. He may find it necessary to consult with your accountant, life insurance agent, the representative of a bank or trust company, and other persons with a special knowledge of your estate. Your attorney will then draft all legal documents needed to implement your plan. The cost of securing an attorney's services will generally be much less than the wasting of assets which could occur in the absence of planning or with a homemade plan.

Objectives of Estate Planning

There are at least three general objectives in every estate plan:

1. To reserve sufficient resources to care for yourself during retirement;
2. To transfer property from one generation to the next in such a manner as to assure distribution of your assets to the person(s) of your choice; and
3. To conserve as much of your estate as possible for your survivors by minimizing death taxes.

Regardless of the size of your estate, the first objective of your plan is to take care of yourself during retirement. Since you are the person who has accumulated the assets which make up your present estate, it is only logical and fair that provisions be made to care for yourself first. The retention of control over a sufficient quantity of assets to assure you of an adequate retirement income also has the practical function of avoiding family disagreements.

The second objective of an estate plan is to transfer your property to the persons of your choice. For example, if you own your farm property, you may prefer that the farm be transferred to a son who has decided to remain on the farm and that other assets be distributed among the other children. One way of doing this is by the use of a properly executed will.

If you should die without having made a will, any property subject to probate will pass to your survivors in accordance with the Missouri statutes of intestate descent. Rarely do these laws function to distribute assets in the desired manner or to the person(s) of your choice. They may transfer title to your heirs as tenants in common, with each receiving an *undivided* interest in the whole rather than giving absolute title to heirs in individual assets.

The difficulties involved in dividing a business without destroying its efficiency as a productive economic unit might dictate that the only reasonable solution would be to sell the business and divide the proceeds among the heirs. Thus, your business might be sold to a non-family member. To help avoid this situation and assure that your assets will be distributed according to your wishes, planning is required.

The third objective of estate planning, the conservation of a maximum amount of your estate for your heirs, suggests that you may want:

1. To keep the expenses of probate administration at a minimum; and
2. To keep Missouri inheritance and federal estate taxes at a minimum.

When a person dies, the distribution of much of the property of the estate will have to be administered by the probate court whether he leaves a will or not. The individuals who share in that distribution are determined by referring to the will or to the intestate statutes where there is no will.

• Retirement
• Transfer of Property
• Conserve the Estate

The probate court serves to protect the rights of the heirs and to assure the orderly transfer of the property in accordance with the wishes of the deceased. The probate court also acts to protect the rights of creditors and at the same time to allow the estate to collect any debts that were owed to the decedent at the time of his death. The probate court also has the duty to make certain that the rights of the decedent's surviving

spouse are protected and that he or she is aware of the existence of those rights. In addition, the probate court has jurisdiction over the estates of minors and those who are found to be mentally incompetent and may appoint a guardian to handle the affairs of those who are incapable of managing their property. Finally, the probate court has the function of ensuring the collection of any taxes which might be due from the estate.

The administration of any estate involves certain expenditures which are generally governed by statute. For example, the compensation of an administrator or executor handling an estate in probate is set by statute. The Missouri rates of compensation for executors and attorneys, based on a sliding scale, are set out in Table 1.

Table 1.

Probate Administration Fee Rates Set by Missouri Statute for Executors, Administrators, and Attorneys

First	$5,000	5%
Next	$20,000	4%
Next	$75,000	3%
Next	$300,000	2¾%
Next	$600,000	2½%
All over	$1,000,000	2%

Source: Chapter 473.153, Revised Statutes of Missouri-1969, as amended.

Only the value of personal property in the probate estate and the proceeds of real property sold under order of the probate court are subject to these rates.

An attorney will be employed to handle all legal work necessary in probating your estate. The law directs that he shall also be paid in accordance with the statutory scheme set out in Table 1. Since both the executor (or administrator) and attorney are entitled by law to this compensation, doubling the percentage figure and multiplying it by the value of property which is subject to these costs will yield a fair approximation of the total expenses of administration in probate. The court may allow additional compensation to these individuals when reasonable and adequate for the work done.

The obvious way to avoid expenses of probate administration is to plan your estate so that your property is not part of the estate when it is admitted to probate. The cost of legal advice for this purpose is usually more than offset by the reduction in probate expenses.

Tax Considerations

Minimizing taxes will usually maximize the value of assets transferred to the next generation. Taxes which should be considered include Missouri inheritance, federal estate, and federal gift taxes. There is no state gift tax in Missouri.

- **State Inheritance Tax**
- **Tax Reform Act of 1976**
- **Federal Estate Tax**
- **Federal Gift Tax**

Missouri Inheritance Tax

This tax will be paid by the person who inherits your property unless your will directs that it be paid by your estate. It is based upon a graduated scale. As the value of property inherited increases, the tax rate increases.

Missouri statutes provide that the state inheritance tax is to be assessed on the *fair market value* of property owned solely by the deceased or his interest in tenancy in common property. It also applies to property transferred by gift within two years of the date of the donor's death if the gift is deemed to have been made in contemplation of death. Also included are life insurance proceeds payable to the estate of the deceased.

Missouri inheritance tax is not assessed on property that does not go through probate proceedings. Property held in joint tenancy or tenancy by entireties carries with it a right of survivorship so that upon the death of co-owner, the decedent's interest automatically becomes the property of the surviving co-owners. Property with a right of survivorship does not go through probate and is not subject to the Missouri inheritance tax. For additional information, see the section "Co-ownership of Property" on page 13.

The Missouri inheritance tax also serves as an inducement to keep property in the family since higher tax rates are imposed as the degree of blood relationship decreases. The Missouri inheritance tax rates are set out in Table 2.

The higher tax liability for distant as opposed to close relatives could be referred to as a "cost" of distributing property to that relative. For example, suppose you have a house worth $50,000. Prior to making your will, you want to decide whether to leave this property to your daughter or to your nephew. If you left the property to your daughter, the Missouri inheritance tax would be $750; if you left it to your nephew, it would be $2,655. Thus, it would cost $1,905 more in state inheritance taxes to leave your house to your nephew than to your daughter. This reflects both the higher exemption and lower rates applicable to a daughter's inheritance.

Advanced planning can take into account the varying influence of Missouri's inheritance tax laws. For more information, see the section "Tools Used To Implement the Estate Plan" on page 11.

Table 2.
Missouri Inheritance Tax Exemptions and Rates*

Relationship of Beneficiary	Exemption	Rates on Excess Over Exemption
1. Husband or wife, if no lineal descendants (children, grandchildren, etc.) surviving	$20,000, plus ½ of the estate	1% on first $20,000 2% on $20,000 to $40,000 3% on $40,000 to $80,000 4% on $80,000 to $200,000 5% on $200,000 to $400,000 6% on $400,000 and over
2. Husband or wife, if lineal descendants surviving	$20,000, plus ⅓ of the estate	Same as above
3. Lineal descendants if physically or mentally incapacitated	$15,000	Same as above
4. Lineal descendants or lineal ancestors not included above (sons, daughters, grandchildren, great grandchildren, mother, father, grandmothers, grandfathers, great grandmothers, great grandfathers, adopted children)	$5,000	Same as above
5. Brother or sister or their descendants, (nephews, nieces, grandnephews, grandnieces, etc.); son-in-law, daughter-in-law.	$500	3% on first 20,000 6% on $20,000 to $40,000 9% on $40,000 to $80,000 12% on $80,000 to $200,000 15% on $200,000 to $400,000 18% on $400,000 and over
6. Aunt or uncle or their descendants (cousins)	$250	Same as above
7. Granduncle or grandaunt or their descendants (cousins, sometimes referred to as "second cousins")	$100	4% on first $20,000 8% on $20,000 to $40,000 12% on $40,000 to $80,000 16% on $80,000 to $200,000 20% on $200,000 to $400,000 24% on $400,000 and over
8. All others except for charitable and governmental organizations that are exempt from the inheritance tax.	$100	5% on first $20,000 10% on $20,000 to $40,000 15% on $40,000 to $80,000 20% on $80,000 to $200,000 25% on $200,000 to $400,000 30% on $400,000 and over

*Source: Revised Statutes of Missouri, 1969, as amended.

The Tax Reform Act Of 1976

It will be helpful to highlight the major changes in the federal estate tax laws made by the Tax Reform Act of 1976, most becoming effective after 1976. A more detailed discussion will follow. The main thrust of the 1976 changes was to provide more estate tax relief to the small to medium-sized estates while tightening the rules for the larger estates.

- **New Tax Rates:** Table 3 shows the unified tax rates for estate and gift taxation. The new rates range from 18 to 70 per cent, while the pre-1977 rates ranged from 3 to 77 per cent.
- **Unified Credit:** The previous gift tax lifetime exemption of $30,000 and the estate tax exemption of $60,000 were replaced by a credit of $42,500 for 1980 scheduled to increase to $47,000 by 1981. The $47,000 credit would be approximately equivalent to an exemption of $175,000, depending on the estate tax bracket.
- **Liberalized Marital Deduction:** Equal to $250,000 or one-half of the adjusted gross estate, whichever is greater, assuming property to that extent passes to surviving spouse from the decedent.
- **Generation-Skipping Transfers:** In general, such transfers will be taxable upon distribution. However, up to $250,000 per child can be transferred to grandchildren without an estate tax being imposed

upon the death of the child (second generation).

- **Gifts Within Three Years of Death:** All gifts made after December 31, 1976, except to the extent of the annual $3,000 exclusion, will be automatically in the decedent's estate if made within three years of his death. This does away with the former "contemplation of death" presumption for gifts made within three years of death.
- **No Further "Step Up" in Basis:** Inherited property will carry with it the decedent's basis, with several exceptions. A "fresh start" rule allows inherited property a stepped up basis to reflect its value as of December 31, 1976. In addition, each estate is allowed a minimum aggregate carry-over basis of $60,000, limited to the fair market value of the property. The "fresh start" rule has been delayed for the period January 1, 1977 to January 1, 1980 by Revenue Act of 1978. During this period, inherited property would receive a stepped-up basis as under the pre-1977 rule. Check with your attorney and tax adviser to determine what further modifications may have been made with the "fresh start" rule for 1980 and later.
- **Farm Realty Valuation:** An "actual use" valuation alternative for real estate is available for qualified farms and closely held businesses rather than the usual "highest and best use" method.
- **Estate Tax Payment-Extension Rules:** If more than 65 per cent of a decedent's adjusted gross estate is an interest in a farm or closely held business, the executor may elect to pay the estate taxes in up to ten equal annual installments, with the first installment postponed up to five years. A special reduced four per cent interest rate is available on the estate tax attributable to the first $1 million of farm or other closely held property.
- **Jointly Owned Property Between Husband and Wife:** The surviving spouse no longer needs to prove contribution to exclude half of jointly owned property from a decedent's estate. However, a gift tax return should be filed and gift tax paid if due where one spouse furnishes all or a major part of the consideration. Only a joint tenancy or tenancy by entireties will qualify for this new rule.
- **Orphans' Exclusion:** An estate is allowed a deduction for transfers to minor children (fewer than 21 years of age) with no known surviving parent. The maximum deduction per child is $5,000 multiplied by the number by which 21 exceeds the child's age in years on the date of the decedent's death.

Federal Estate Tax

An understanding of the basic mechanics of the federal estate tax is essential to a proper interpretation of the material presented in this publication. The first step in determining whether your estate is subject to this tax is to calculate the value of your *gross estate*. Your gross estate includes all property owned by you at death and certain other property over which you may have retained some interest or control. Remember to value property at *current fair market values* at the time of death (or six months thereafter) and *not* at your cost. The deductions available are then subtracted from the gross estate to yield the net taxable estate. The tax is calculated on the basis of the net taxable estate using the federal estate tax rates set out in Table 3. Beginning in 1977, estates are allowed a credit against the tentative estate tax. This credit is $30,000 in 1977, $34,000 in 1978, $38,000 in 1979, $42,500 in 1980, and $47,000 in 1981 and thereafter (until further tax law changes are made).

The Gross Estate: Step One

It is impossible to set out an exhaustive list of property subject to federal estate tax. An attorney can advise you on whether particular assets are subject to this tax. The following summary discusses some of the more common assets which are included as part of your gross estate.

1. **Property which you own at death.** Examples include land held solely in your name, as well as stocks, trucks, and machinery. To remove these assets from your gross estate, you must completely divorce yourself of ownership and control.

2. **Life insurance policies on your life over which you hold any incidents of ownership or which are payable to your estate.** Policies of life insurance on your life over which you hold any incidents of ownership are a part of your gross estate. The incidents of ownership include the right to (1) name the beneficiary, (2) surrender the policy for cash, (3) borrow against the policy, (4) pledge it as security for a loan, and (5) assign the policy and revoke such assignments.

If you have any of these rights, you can effect a change in the disposition of its proceeds. Hence, the proceeds will be included in your gross estate, whether or not you exercise such rights. You must be willing to divorce youself of these rights if you desire to remove the proceeds from your gross estate for federal estate tax purposes.

Since all policies of life insurance payable to your estate are includible in your gross estate, this may serve as an inducement to change the beneficiary from your estate to intended heirs. This, along with divorcing yourself from the incidents of ownership, may ultimately decrease the size of your net taxable estate and thereby put you in a lower tax bracket.

However, it may be desirable to make your life insurance payable to your estate even though this will increase the size of your estate and the tax which will be due. For example, assume you own a 1000-acre farm and a large herd of cattle. Also, assume that you have little cash available and rely rather heavily upon operating credit. If, after your death, no liquid funds exist to pay the federal estate tax, it may be necessary to sell part of your cattle herd to satisfy the tax liability. Such a sale can impair the efficiency of the farming operation. Under these circumstances, you may prefer to make life insurance policies payable to your estate, even though doing so increases taxes, because it furnishes liquid assets from which the tax may be paid. This might yield the most desirable economic consequences over the long run for your survivors.

An alternative to making the policy payable to the estate may be a life insurance trust. See the trusts section under "Tools Used To Implement the Estate Plan" for more information.

Table 3.

Unified Estate and Gift Tax Rates*

If the amount with respect to which the tentative tax to be computed is:	The tentative tax is:
Not over $10,000	18% 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.

*Source: Internal Revenue Code of 1954, as amended, Section 2001.

3. **Property transferred at death by means of a right of survivorship.** In Missouri, two types of co-ownership interests, the joint tenancy and tenancy by entireties, are characterized by a right of survivorship. The usual co-ownership by a husband and wife is called a tenancy by entireties. Joint tenancy is co-ownership of property by two or more persons, not necessarily husband and wife, with a right of survivorship. Under a right of survivorship, when a co-owner dies, title to the property passes automatically to the surviving co-owner(s). Thus, the property is not subject to probate nor is any Missouri inheritance tax assessed.

For joint interests created between husbands and wives before 1977, the "rule of contribution" determined what portion of the co-owned property was to be in the decedent's gross estate for federal estate tax purposes. Under this rule, a surviving spouse can not exclude any portion of jointly-owned property from the deceased's estate unless she (he) can prove by adequate records that she provided part of the consideration for the property. This rule works a hardship in many situations, especially where the surviving spouse is a housewife with no substantial income apart from her husband's income.

The 1976 TRA does away with the need for such proof for joint interests created after 1976 if a gift tax return is filed and any gift tax due is paid. The value included in the decedent's estate where a gift tax return has been filed will generally be one-half the value of property held by husband and wife in either a joint tenancy or tenancy by entireties. Where a gift is made to a spouse, a gift tax return should be properly filed. For real and personal property joint tenancies and tenancies by entireties created before 1977, the rule of contribution continues to apply. See an attorney for more information as there are special rules for joint interests between husband and wife when determining whether a gift has been made.

Under the 1978 Revenue Act spouses may be given some credit on jointly owned property where they have materially participated in the farm business. A formula is used allowing an exclusion from the decedent's estate of 2 percent of the property value for each year of material participation by the surviving spouse, with a maximum exclusion of 50 percent. See your attorney to discuss the importance of gathering needed evidence to support a spouse's material participation.

4. **Gifts Made Within Three Years of Death.** The 1976 TRA has changed the former rule. After December 31, 1976 all gifts made within the three-year period ending with the decedent's death will be automatically included in the decedent's estate, except to the extent of the annual $3,000 exclusion. In addition, any gift tax paid on such gifts will be included in the gross estate.

Before the 1976 TRA, any gifts made within three years of death were *presumed* to have been made in contemplation of death for federal estate tax purposes, and their value was includable in the gross estate. A gift made in "contemplation of death" refers to one induced by a belief that the donor did not have long to live. Such gifts were included in the gross estate on the theory that they were made in lieu of a testamentary disposition of property (which would have been subject to the federal estate tax).

Don't confuse the federal estate tax three-year rule with the two-year contemplation of death rule applied by the Missouri inheritance tax laws.

5. **The value of property previously transferred to another if there has been a reservation of:**
   - a. **The right of use, enjoyment, or income from the property; or**
   - b. **The power to alter, amend, revoke, or terminate the transfer.**

Property you have disposed of during your lifetime but in which you have reserved certain rights may be includible in your gross estate. For example, suppose you give your son a farm but retain the right to its sole use during your lifetime. Here, you are in essentially the same position as if you had kept complete ownership of the property until death and then disposed of it by your will, the only difference being that you no longer have the power to convey absolute ownership.

The degree of control which you can safely retain and yet legally remove a given asset from your gross estate is governed by complicated provisions of the federal estate tax law. Consequently, you should consult with an attorney for more complete information.

Adding Up the Deductions: Step Two

If you are to minimize federal estate taxes and conserve the estate for your survivors, it is essential that you take full advantage of all deductions available by law. The principal deductions include the following:

1. Funeral expenses, expenses of administration in probate, claims against the estate, and casualty losses suffered during the settlement of the estate;
2. A marital deduction of $250,000 or 50 per cent of the adjusted gross estate (gross estate less the deductions in item one above), whichever is larger, if that much value is transferred to the surviving spouse; and
3. The amount of money or value of property left to charities and other organizations approved by the Internal Revenue Service.

Casualty losses refer to losses caused by fire, storm, and theft. They are deductible only to the extent that insurance or some other type of recoupment does not compensate the estate for the loss.

Certain transfers of money or other property for public, charitable, or religious uses are deductible. If you contemplate making such transfers, you should consult with your attorney to ascertain whether they will qualify as deductions.

The marital deduction is one of the greatest single tax savers in the federal estate tax area. Advice of an attorney is essential if you are to take full advantage of it. Wills, inter vivos (life-time) trusts, life insurance options, the use of jointly-owned property, and other dispositive arrangements must be planned with a view to taking maximum advantage of the marital deduction. Since it is impossible to predict the nature and extent of your estate at some indefinite date in the future, complicated marital deduction formulas for insertion in wills and trust instruments have been worked out. They are designed to utilize the marital deduction fully by making allowances for any changes in circumstances which may occur. These formulas should be prepared by an attorney.

Many individuals leave the majority or all of their assets to their surviving spouse simply to assure themselves that she or he will be adequately cared for after their death. But the estate of a surviving spouse has no marital deduction (unless remarriage has occurred), resulting in larger total federal estate taxes. Your attorney can help you plan to keep property available for use by the surviving spouse yet out of her (or his) estate.

Estate Exemption: Eliminated by the 1976 TRA

The $60,000 estate exemption has been eliminated after December 31, 1976 and replaced by a unified credit. The substituted credit represents a larger estate tax reduction than the former $60,000 estate exemption. However, a credit works to offset the tentative estate tax due, not the size of the gross estate. Because the estate tax rates are progressive (from 18 per cent to 70 per cent,) a credit of a given size does not give large estates a larger estate tax reduction.

Orphan's Exclusion

A new deduction introduced by the 1976 TRA (effective where the decedent dies after December 31, 1976) is the Orphan's Exclusion. Transfers to minor children (fewer than 21 years of age) with no known surviving parent are allowed a maximum deduction of $5,000 multiplied by the number by which 21 exceeds the child's age in years on the date of the decedent's death. For example, if a 15-year-old orphan were left an inheritance of $50,000, the decedent's estate would be allowed an "orphan's exclusion" of $30,000 (6 years times $5,000 per year).

Calculating the Tentative Tax: Step Three

The tentative federal estate tax is calculated by cumulating the lifetime transfers (gifts) and the items in the gross estate minus the various deductions. The unified estate and gift tax rates (Table 3) are then applied to determine the tentative federal estate tax due. Gift taxes paid on cumulated lifetime transfers (except for those on gifts made within three years of the decedent's death) are subtracted from the tentative tax. The effect of the unified estate and gift tax rates reduces much of the former incentive to make lifetime transfers.

Estate Tax Credits: The Important Fourth Step

The lobbying for increased relief from the estate tax originally focused on increasing the estate exemption (pre-1977: $60,000 per estate). However, what finally emerged was an estate tax *credit*. A credit is subtracted directly from the tax due, while the exemption served to reduce the size of the taxable estate before the tax was calculated.

The 1976 TRA provides for an estate tax credit of $30,000 for 1977, scheduled to increase to $47,000 by 1981 according to the following timetable:

Year	*Credit*	*Maximum Exemption "Equivalent"*
1977	$30,000	$120,666
1978	34,000	134,000
1979	38,000	147,333
1980	42,500	161,563
1981 and thereafter	47,000	175,625

The comparison of a credit with an exemption is misleading because of the progressive estate tax rates. As an estate increases in size, a given credit would offset the same amount of tax dollars due for either small, medium, or large estates. However, a given sized exemption would reduce estate taxes more as the size of the estate increased.

A percentage credit is an additional credit available if property is subject to estate tax more than once in ten years. For example, if a husband leaves property to his wife upon which federal estate tax is paid and the wife dies within 10 years, the wife's estate will be entitled to a credit for tax paid on the same property in the husband's estate. The percentage credit allowed decreases as the period by which the wife survives her husband increases, with no credit being allowed after 10 years have elapsed.

The amount of Missouri inheritance tax actually paid is another credit available. The credit allowed will increase as the size of your gross estate increases.

Under the 1976 TRA all gifts made within three years of the decedent's death, except to the extent of the $3,000 annual exclusions, are automatically included in the estate, along with any gift taxes paid. Because of the unified credit and unified rates for gift and estate taxes, there is no longer allowed an estate tax credit for gift taxes paid on gifts made within three years of the decedent's death for gifts made after 1976.

Gift taxes paid on transfers more than three years prior to the decedent's death will be subtracted from (credited to) the tentative estate tax calculation. The effect of cumulating all transfers, calculating the tentative estate tax, and then subtracting the gift taxes on gifts completed three years prior to the decedent's death is to push the estate into a higher estate tax bracket.

Applying the New Rules: An Illustration

Any illustration suggesting potential impacts of the federal estate tax laws can be misleading if the reader ignores the underlying assumptions. Therefore, you should always seek professional advice when considering your own unique situation.

In this illustration, let's assume that Mr. and Mrs. Estate Planner have not made any lifetime transfers (gifts) and therefore have an estate tax credit available equal to $42,500 for 1980, increased in 1981 to the maximum credit of $47,000. Assume Mr. Planner has all the property legally in his name and that there are no debts. Obviously, real life situations are more complicated and require the expertise of attorneys, accountants, and other professional advisors.

Now assume Mr. Planner dies first in 1980 and leaves Mrs. Planner as the sole heir. The following table summarizes the basic estate tax impact, with an additional assumption that Mrs. Planner neither increases nor decreases the value of her inheritance which is transferred to the children upon her death 10 years later (1990 when the credit is $47,000). The three situations in Table 4 indicate the potential estate tax impact for estates of different sizes under the above assumptions.

Each situation shows the potential federal estate tax liability for both estates under the above assumptions. The estate tax potential impact on Mr. Planner's estate for the selected estate sizes is greatly reduced by the marital deduction. However, Mrs. Planner's estate would not get a marital deduction unless she remarried and left property to her second husband. Hence, the estate of the first spouse to die is generally not faced with as much estate tax liability as is the estate of the surviving spouse on account of the marital deduction.

Special Valuation of Real Property Used for Farming

Under certain conditions, real property used for farming or closely-held business may be valued on the basis of its "actual use" rather than the usual fair market value standard of "highest and best" use. The

Table 4.

Mr. & Mrs. Estate Planner: An Illustration

	Situation A	Situation B	Situation C
Mr. Planner's Estate: 1980			
Gross Estate	$ 150,000	$ 300,000	$ 450,000
Less Administrative Expense[1]	(12,000)	(24,000)	(36,000)
Adjusted Gross Estate	$ 138,000	$ 276,000	$ 414,000
Less Marital Deduction	(138,000)	(250,000)	(250,000)
Taxable Estate	-0-	$ 26,000	$ 164,000
Tentative Estate Tax	-0-	5,120	43,280
Less Estate Credit	-0-	(5,120)	(42,500)
Estate Tax Due	-0-	-0-	$ 780
Mrs. Planner's Estate: 1990			
Gross Estate	$ 138,000	$ 276,000	$ 413,220
Less Administrative Expense[1]	(11,040)	(22,080)	(33,058)
Adjusted Gross Estate	$ 126,960	$ 253,920	$ 380,162
Less Marital Deduction	-0-	-0-	-0-
Taxable Estate	$ 126,960	$ 253,920	$ 380,162
Tentative Estate Tax	$ 31,888	$ 72,133	$ 115,055
Less Estate Credit	(31,888)	(47,000)	(47,000)
Estate Tax Due	-0-	$ 25,133	$ 68,055
Total Tax on Both Estates	-0-	$ 25,133	$ 68,835

[1] Administrative expense was estimated as 8% of the gross estate. It includes executor and attorney fees, probate court costs, management fees during probate, and funeral expenses.

maximum reduction of the gross estate allowed under this special election is $500,000.

The conditions for eligibility include the following:

(1) The decedent must have been a U.S. resident or a U.S. citizen;

(2) The property must be located in the U.S.;

(3) The property must pass to a member of the decedent's family, to include the spouse, parents, grandparents, lineal descendants, as well as adopted children;

(4) An agreement must be filed by the executor;

(5) The decedent or a member of his family must have owned the qualifying property and have substantially participated in the operation of the business in five of the decedent's last eight years; and

(6) The adjusted value of real and personal property used in the trade or business must make up at least 50 per cent of the adjusted value of the decedent's gross estate, and at least 25 per cent of the adjusted value of the gross estate must consist of the adjusted value of real property.

Farms, in general, are valued according to a formula. The "actual value" is the average annual gross cash rental for comparable farm-purpose land located in the same locality less the average annual state and local real estate taxes for such comparable land divided by the average annual effective interest rate for all new Federal Land Bank loans. This formula will not be used where it is established that there is no comparable land for determining average annual gross cash rental. In addition, the executor can elect to have valuation made on the basis of factors applied to other closely held business interests rather than based on the formula.

Since the special valuation rules have several legal prerequisites, you should consult with an attorney to determine the appropriateness of the election in your own situation. For more general information, see UMC Guide Number 505, Farmland Valuation For Federal Estate Tax Purposes, available at your extension center.

Generation-Skipping Transfers

The Tax Reform Act of 1976 includes new rules for "generation-skipping" transfers. The basic concept in a generation-skipping transfer is for a member of generation A to pass wealth to a member of generation B who will pass the wealth on to a member of generation C. The "skipping" refers to the exclusion of the property from the gross estate of generation B assuming that legal requirements were satisfied as to the amount of control that generation B could exercise over the property. Typically, a generation-skipping transfer involves a trust.

The possibility of skipping the estate tax has been reduced by the 1976 TRA. Under the new law, splitting of the benefits of property between two or more generations that are junior to that of the grantor-originator will not "skip" federal estate taxation. However, there remains a limited exception for transfers to grandchildren.

These rules are complicated. The generation-skipping transfer rules are generally applicable to transfers made after April 30, 1976, but limited exceptions are available for a transitional period. You are encouraged to discuss their relevance with your attorney and other professional advisors.

Postponing Estate Tax Payment

The 1976 TRA liberalized the earlier rule under which the Internal Revenue Service could allow the payment of estate taxes to be deferred up to 10 years. The previous rule required a showing of "undue hardship" whereas the new criterion is whether there is "reasonable cause." While this standard is imprecise, it is more favorable to the estate.

Executors have another option allowing estate taxes to be paid in up to 10 annual installments if the value of a closely held business exceeds 35 per cent of the value of the gross estate or 50 per cent of the value of the taxable estate. This option remains from the former estate tax law.

The major payment-extension provision added by the 1976 TRA is the "fifteen-year" rule. Under the fifteen-year rule, a qualified estate can defer payment of the estate tax up to five years and pay the estate tax in up to 10 equal annual installments. Interest is due at a special 4 per cent rate on the estate tax attributable to the first million dollars of the farm or closely held business property. A "qualified estate" under these provisions is one having more than 65 per cent of the decedent's adjusted gross estate as an interest in a closely held business (e.g., farms). Disposition of one-third of the qualifying property will accelerate the due date of the estate tax. Again, these new rules are complicated and should be discussed with an attorney.

Federal Gift Tax

Since ownership at the date of death is the critical factor in determining whether a particular asset will be within your estate for federal estate tax purposes, one obvious way of attempting to avoid this tax is to give property away prior to death. The federal gift tax prevents one from avoiding taxation by disposing of all his property as lifetime gifts. However, tax-free gifts can be made to a limited degree to a spouse and to others on a limited annual basis.

The impact of the federal gift tax falls upon the donor (giver), unlike the Missouri inheritance tax which is usually paid by the recipient.

The first $3,000 (annual exclusion) of gifts to each person each year is tax-free if it is a gift of a present interest. Basically, a present interest gift is one by which the donee (receiver of the gift) immediately obtains possession and enjoyment of the asset being given to him. If possession and enjoyment are postponed for a period of time, or if possession and enjoyment are subject to conditions or the will of another, this will be a gift of a future interest rather than a present one. If you have questions, your attorney can advise you as to whether a contemplated gift will create a present or a future interest.

The Tax Reform Act of 1976 eliminated the $30,000 lifetime exemption, effective for gifts after December 31, 1976. Exemptions claimed on gifts made prior to September 9, 1976 will not reduce the unified credit. Amounts allowed as exemptions on gifts made after September 8, 1976, but before January 1, 1977, reduce the unified credit, but only to the extent of 20 per cent of the exemption (a maximum of $6,000). Gifts made after December 31, 1976 but before July 1, 1977 are limited in the amount of the unified credit that may be applied against gift taxes to a maximum of $6,000. You should discuss the importance of these complicated provisions for your estate and transfer plans with your attorney.

Your spouse can elect to join in the gift and double the amount of the annual exclusion. This applies even though you are giving away property which you hold in sole ownership. The first $6,000 of gifts to each donee would be non-taxable under the annual exclusion. This joining-in election is made by showing the consent of both spouses on their respective gift tax returns (Form 709).

There are other deductions available under the gift tax law. Gifts to certain charitable organizations are exempt from the federal gift tax, as are gifts to governmental entities for public purposes.

The marital deduction for lifetime gifts between spouses was liberalized by the 1976 TRA. After December 31, 1976 the allowable deduction is the value of the gift for the first $100,000 of lifetime gifts between spouses. Thereafter, the allowable deduction is 50 per cent of transfers in excess of $200,000. The pre-1977 law allowed 50 per cent of such gifts as the marital deduction, regardless of the amount involved.

The federal gift tax is assessed on the fair market value of the property being transferred at the date of the gift. The value of your original investment in the property being given away is not used in calculating the gift tax liability.

In calculating the tentative federal gift tax, you must cumulate all taxable gifts for the present year and all previous years. Next subtract the amount of gift taxes previously paid, yielding the tentative gift tax. This amount is reduced by any "unified credit" not previously used. Because of the unified approach between gift and estate taxes, sizeable lifetime transfers can reduce the credit available against later estate taxes. The unified federal gift tax rates are given in Table 3.

To illustrate the computation of the federal gift tax, assume in 1981 that Mr. Giver transferred property valued at $250,000 to his wife. A marital deduction of $125,000 and an annual exclusion of $3,000 would reduce the taxable gift to $122,000. Turning to Table 3 for the "Unified Gift and Estate Tax Rates," the tentative gift tax is $30,400. If no previous lifetime transfers had been made, the full $47,000 credit (for years 1981 and thereafter) is available to offset the tentative gift tax of $30,400. This leaves an unused unified credit of $16,600 available to offset future gift taxes and/or to be applied against an estate tax due upon Mr. Giver's death.

For more information on the federal gift tax, see UMC Guide 503, Lifetime Gifts.

Filing Gift Tax Returns

Pre-1977 gifts in excess of the annual exclusion ($3,000) must still be reported quarterly on the special gift tax return (Form 709). Quarterly returns are not required on post-1976 gifts unless taxable gifts for the quarter

plus all other taxable gifts for the calendar year for which no return has been filed exceed $25,000. However, an annual return is required on or before the 15th day of February following the close of the fourth calendar quarter of the calendar year—if taxable gifts have been made and have not been reported on a quarterly return under the above provisions.

Tools Used to Implement the Estate Plan

The manner of property distribution is very important if optimal results are to be achieved by estate planning. A will, trust, gift, annuity, sale, or joint tenancy may be used individually or in various combinations to fit your particular situation. The form of business organization is also an important factor to consider in estate planning. Again, it is your particular circumstances which determine whether you can operate most advantageously as a sole proprietorship, a partnership, or a corporation.

- **Intestate Descent**
- **Wills**
- **Trusts**
- **Gifts**
- **Co-Ownership**
- **Sale**
- **Family Annuities**
- **Partnerships**
- **Corporations**

Intestate Descent

If no valid will is made, the state of Missouri has intestate statutes of descent which determine how and to whom property will be distributed. Seldom will these inflexible laws of descent provide for the desired property distribution. Although the intestate (without a will) laws might provide the desired distribution plan, you should consult with an attorney before assuming the intestate laws would carry out your wishes.

The need to consult an attorney is most important in light of the differences among states in their laws of intestate descent. The obvious way to avoid the uncertainty is to make a will. A publication on wills entitled, *A Will of Your Own*, C-863, is available from your local University Extension Center.

Wills

A will is a legally recognized document by which a person can distribute his property as he sees fit, can appoint an executor to handle the settlement of his estate, and can provide for a guardian for his minor children.

Most persons do not dispose of all their property by lifetime gifts but retain ownership and control over enough property to support themselves during retirement. If you do not leave a will directing distribution of your property, state law will control its distribution. You may prefer that certain of your heirs receive specific items of your property, ranging from family heirlooms to substantial holdings of land. Such desired distribution can be achieved by the execution of a will.

Every estate must have an executor or administrator to handle the settlement of the estate. By use of a will a person may designate the person he wishes to serve as executor. Otherwise, the probate court must appoint an administrator to carry out these duties and responsibilities.

Where both parents are deceased but leave minor children as survivors, a guardian must be appointed to care for the children and manage the financial assets for the minors. The court will face a difficult task in selecting the guardian unless guided by the wishes of the parents. In their wills the parents can designate the person(s) they prefer to raise the children.

If a change in circumstances dictates a change in provisions of the will, you should not hesitate to see your attorney. The provisions can be changed by executing a codicil (addition to a will) or a completely new will which revokes the old one. Technical legal rules govern the execution, validity, and interpretation of both wills and codicils; consequently, you should always have your attorney prepare them.

Trusts

A trust is created by transferring legal title of the trust property (corpus) to a trustee who manages the property for the benefit of chosen beneficiaries. A fiduciary relationship exists between the trustee and the beneficiaries. This relationship is defined in terms of trust and confidence and requires the trustee to act in the best interests of the beneficiaries in following the directions of the trust agreement.

Planning an estate for maximum long-run tax savings requires consideration of federal estate, gift and income tax consequences which result from the creation of a trust. The tax consequences are dependent upon the type of trust that is used. Both an inter vivos (lifetime) and a testamentary (after death) trust can be employed to advantage in estate planning under the proper circumstances. Inter vivos trusts can be broken

down into two general categories, revocable and irrevocable.

Testamentary Trust

A testamentary trust is created by provisions in the will and does not take effect until after the death of the property owner. Since the property remains under his direction and control until death, it will be in his estate for federal estate tax purposes. Hence, a testamentary trust does not avoid the federal estate tax for the property owner. However, testamentary trusts may serve several purposes such as providing property management for a surviving spouse or possibly keeping property out of the estate of a survivor. You should explore these possibilities with your attorney.

Inter Vivos Trust

An inter vivos trust involves the transfer of property from you (the settlor) to the trustee during your life. A revocable trust is one which gives you the power to revoke, amend, or alter the trust during your lifetime. An irrevocable trust arises whenever you completely dispose of your power to control the trust property or the income from it. The tax consequences of an inter vivos trust depend primarily upon the degree of control that you retain over the trust property.

(a) Federal Estate Tax: If you retain the possession or enjoyment, the right to the income, or the right to designate the persons who shall possess or enjoy the property, then the trust property is included in your gross estate. If you retain the right to alter, amend, revoke, or terminate the trust at any time before your death, the trust property will also be included in your gross estate. However, if you divorce yourself of these rights, it is possible to remove the value of the trust property from your estate for federal estate tax purposes.

(b) Federal Income Tax: If you are treated as the owner of the trust or any portion, you must report all income that comes from your portion in your personal income tax return.

As a general rule, you will be treated as the owner of the trust any time you can control the disposition of the trust property or its income without the approval or consent of any party who has a substantial beneficial interest in the trust. The theory of taxation here is much like that set forth in the estate tax situation above. As long as you retain control over the trust property, the income from it will be taxed to you.

(c) Federal Gift Tax: Gift tax liability often results from the creation of an irrevocable trust. If you retain no right to alter, amend, or revoke the trust, you have in effect given up all control over the property and have no interest which requires you to pay estate or income tax. When you have given up all control, the gift is deemed complete and the gift tax possibility must be faced.

As a general rule, property subject to gift taxes will not be subject to estate or income taxes.

Exceptions—It is possible that even though a federal gift tax has been paid on property, the property may later be included in the decedent's estate for federal estate tax purposes. These exceptions include:

(1) Gifts made within three years of decedent's death,
(2) Gifts by which you retain a reversionary interest if the value of this interest exceeds 5 percent of the value of the property immediately before your death; and
(3) The retention by you of the right to designate who may receive the income or corpus from the trust, or the retention of the right to alter, amend, or revoke the trust.

If you pay gift tax on property which later becomes a part of your gross estate for federal estate tax purposes, the gift tax previously paid is credited against the federal estate tax due.

Life Insurance Trust

A life insurance trust can be used in estate planning. By divorcing yourself of all incidents of ownership and making the policies payable to the trustee, the value of such policies can be effectively removed from your gross estate. This will help minimize the impact of the federal estate tax.

If the trustee is given discretion to pay estate taxes, assurance is given that liquid funds will be available for their payment. However, since the trustee is under a fiduciary duty to act in the best interests of the beneficiary, life insurance proceeds might not be used to pay estate taxes if the beneficiaries under the trust are not ones who will inherit the remainder of the estate. That is, payment of estate taxes by the trustee might not be in the best interests of the beneficiaries.

Trusts in General

Other types of trusts for either real or personal property may be desirable in your estate plan. A trustee can be selected for them who is adept at handling the particular type of property involved. The income from such property can be distributed to your heirs in the manner and proportions which you direct by the trust agreement terms. This may be done to relieve your heirs of the obligations of managing the trust property. It might be used, for example, when your heirs are minor children.

You may want to use either an irrevocable or a revocable inter vivos trust or a testamentary trust. Your selection depends on which will most advantageously meet your needs. Study of the gift, income, and estate tax consequences of each trust type is highly relevant in the selection process.

For more information on the use of marital trusts, see UMC Guide 504.

Gifts

A planned system of giving can save a significant number of tax dollars, if the exclusions and deductions previously discussed are effectively used.

Some knowledge of income tax consequences is also helpful in determining the relative merits of making lifetime gifts. When you sell property, not all of the sale price is income because the law specifically allows you to recover your investment first. More properly stated, a taxpayer is entitled to recover his "basis" in the property before any income is subject to tax. In its

simplest form, the term basis means the original cost of the property plus the cost of improvements less the amount of depreciation claimed or allowable.

For example, suppose you purchased a farm for $300,000 and claimed $15,000 depreciation on the buildings. Your basis in this farm for tax purposes would be the original cost ($300,000) less the depreciation claimed ($15,000) or $285,000. If you sell the farm for $400,000, your taxable income will be $115,000, the difference between the sale price and your tax basis.

If you should give your farm to your son, he will receive your basis in the farm for income tax purposes. He is entitled to add to your basis the amount of any gift tax paid on the transaction. Therefore, using the figures in the example above, if he later sold the farm for $400,000, the taxable income would again be approximately $115,000.

On the other hand, if your son inherited the farm upon your death, he will not necessarily receive your low basis. Under the pre-1977 law, inherited property received a "stepped-up" basis equal to the fair market value of the property at the time of decedent's death. In our example, a pre-1977 inheritance of the $400,000 farm would have a stepped-up basis equal to $400,000, reducing substantially the amount of potential taxable income should the farm be sold after inheritance.

Tax Reform Act of 1976: New Basis Rules for Inherited Property (Postponed until January 1, 1980).

The "stepped up" rule has been modified for inheritances after December 31, 1976. The basis of inherited property under the post-1976 rule will be "stepped up" to reflect its fair market value *as of December 31, 1976*. This December 31, 1976 fair market value is referred to as the "fresh start" basis. Any appreciation above the "fresh start" basis will not increase the basis.

In calculating the "fresh start" basis, the assumption is made that any appreciation in the carryover basis property occurred at a uniform rate during the decedent's ownership. This eliminates the need for appraisals as of December 31, 1976. The essential factors, assuming no adjustments are required for depreciation, amortization or depletion previously allowed, are 1) the property's estate tax value, 2) the decedent's adjusted basis immediately prior to his death, 3) the total number of days comprising his holding period, and 4) the number of days of his holding period preceding 1977.

> *Example:* A taxpayer inherits land from his father. His father had an adjusted basis in the land immediately prior to his death of $285,000. The land had an estate tax value at the date of his father's death of $400,000. The father had held the land for 1200 days—600 of which occurred prior to January 1, 1977. The amount of the "step-up" in basis for the taxpayer is computed as follows:
>
> $400,000 - $285,000 times 600/1200 = $57,500.
>
> The taxpayer has a modified "stepped up" basis of $342,500 ($285,000 plus $57,500). If he sells the land at its $400,000 fair market value, he will realize a capital gain of $57,500 ($400,000 minus $342,500).

Farms and closely held business can elect a special valuation for real estate, which was discussed previously under "The Gross Estate: Step One." If real estate is valued under this special method, a "Step-up" in basis is allowed but not above the special valuation amount. The election will be made by the executor of the estate after taking into account the objectives of the heirs. Consult UMC Guide Number 505.

Caution: The Revenue Act of 1978 postponed the effective date of the "fresh basis" rule until January 1, 1980. See your attorney and tax adviser for the latest developments.

Other Basis Rules in the 1976 TRA

Along with the "fresh start" basis rule, the Tax Reform Act of 1976 has added several other basis-related items that offset the limitation on the step-up in basis. First, an executor may elect to step-up the basis of up to $10,000 worth of personal or household effects to the fair market value. Secondly, the minimum aggregate carryover basis in all estate property is $60,000, assuming the fair market value of estate property equals or exceeds that amount.

A primary objective of estate planning is to transfer the most property possible to the succeeding generation. The income tax factors stated above must be considered if the sale of the family farm by your heirs can be foreseen. The nature and extent of your assets and the projected taxable income of your intended heirs may affect your decision whether to make a lifetime gift of the farm or other property.

Expert advice focused on your particular situation, coupled with long range planning, is essential if maximum tax savings are to be achieved.

Co-Ownership of Property

The three principal types of co-ownership are *tenancy in common, tenancy by entireties,* and *joint tenancy*. They may be created in either real or personal property and are characterized by an undivided interest in the whole asset. Other differing characteristics dictate which will accomplish your desired distribution of property.

Under the proper circumstances, co-owning property with your intended heirs in either joint tenancy or tenancy by entireties will maximize the value of assets transferred to the succeeding generation. A joint tenancy can exist between two or more persons, regardless of relationship, while a tenancy by entireties can exist only between husband and wife. Both are characterized by a *right of survivorship;* that is, when one co-owner dies, title passes automatically to the surviving co-owner(s).

Since title passes at the moment of death, property held in this fashion will not go through probate. Therefore, it will not be subject to either the administrative expenses of probate or Missouri inheritance taxes. Property held in tenancy in common does not pass by right of survivorship. Instead, tenants in common can pass their portion by their will or by the intestate laws.

However, there are circumstances under which the right of survivorship characteristic produces undesirable results. Suppose your farm is held in tenancy by

entireties with your spouse. Will holding property in this manner ultimately achieve the distribution of property which you desire? Assume that you die first. In the absence of a premarital agreement, if your surviving spouse remarries, her (or his) new partner will be entitled to the entire property if your spouse dies first.

Obviously, there are many contingencies which should be discussed with your attorney before using this or any other type of co-ownership in your estate plan.

Any member of a *joint tenancy* can force the partition (physical division) of the asset among co-owners. If it is not economically feasible to divide the property, one co-owner can force its sale with the proceeds being divided among the co-owners. This may be the very thing which you want to avoid. In any event the *legal result* of creating a joint tenancy is a co-ordinate loss of both control and the exclusive right to rents and profits.

For example, assume you own a farm which provides an adequate living and decide to create a joint tenancy with two heirs to avoid state inheritance taxes. If one of your heirs has an immediate need for cash because of personal family circumstances, he can obtain it (and destroy the joints tenancy) in one of three ways:

1. He can convey his undivided one-third interest to a third party (who in turn may force partition);
2. He can force the division of the farm into three tracts of equal value and sell his tract; or
3. If such division substantially impairs the efficiency of each tract as a productive unit, he may be able to force the sale of the entire farm, with the proceeds being divided among the three joint tenants.

At any rate, the tract or the cash you wind up with may not be sufficient to provide you with income adequate to meet retirement expenses. If any of the circumstances above can be foreseen, the use of a joint tenancy in your estate plan may be risky.

Many property owners have created joint tenancies and tenancies by entireties as a part of a homemade estate plan simply because these types of co-ownership pass title automatically at death by operation of law. It is true that this can be used legally to avoid Missouri inheritance taxes. However, since these types of co-ownership may result in adverse federal estate tax consequences, they should be used in large estates only upon the advice of your attorney.

If you are a co-owner of property with non-relative business associates, you may prefer to own such property as tenants in common. Here again, all owners have an undivided interest in the whole asset, but this type of tenancy does not have a right of survivorship. Rather than your interest passing to the surviving co-owners at death, it passes to your heirs. The use of a tenancy in common here will help to keep your property in the family.

Sale

Another tool which may be used to transfer property to the next generation is the simple sale. For example, after you retire, you could sell your farm to your son under terms which make it possible for him to grow with the farming operation. This assures that your son will get started in farming. It also provides cash to meet retirement expenses.

Family Annuities

A family annuity is very similar to an annuity purchased from a life insurance company. In the latter, you pay the life insurance company a lump sum in exchange for their promise to make specified montly payments to you for the rest of your life. The total of these payments may be either more or less than the sum which you paid them, depending on how long you live after purchasing the annuity.

With a family annuity, you need not make an immediate cash outlay. Rather, you can use a specific asset, such as your farm, to "purchase" the annuity. You can deed the farm to a family member in exchange for his promise to make monthly payments.

Partnerships

A father-son relationship can be used in estate planning to accomplish desired results. It permits and encourages your son to remain on the farm. His participation in management allows him to develop his farm managerial ability under your guidance.

This form of business organization allows gradual withdrawal from the responsibilities of ownership and management as you approach retirement. It also permits the younger generation to assume a more active role in operating the farm business.

More comprehensive information on partnerships is available at your local extension center. Ask for UMC Guides 510, 511, and 512, dealing with the farm partnership.

Corporations

In recent years, more and more consideration has been given to incorporating the farm business. There are cases in which creating a farm corporation can be used effectively as a tool in estate planning. For example, suppose essentially all of your assets are tied up in a large farming operation. Here it may be impractical to make lifetime gifts to remove property from your estate in an attempt to avoid federal estate taxes because gifts of assets essential to the farming operation can destroy its efficiency.

However, if you should incorporate and give away shares, you can decrease the size of your taxable estate while continuing to operate the farm at maximum efficiency. If the annual exclusion available under federal gift law is fully utilized in a planned system of giving, a large tax savings can be accomplished without affecting the income-producing capacity of your basic economic unit.

Using the corporation as a tool in your estate plan has the additional advantage of allowing you to retain

control over the operation. As long as you own 51 percent of the shares, you can elect a majority of the board of directors which is the governing body of a corporation.

There are some costs involved in incorporating the farm business. They can be more than off-set by derived benefits, however. For further information about incorporation see UMC Guide 400, *Should You Incorporate Your Farm?*.

Planning the Small Estate

Since, by definition, small estates are those which are not subject to federal estate taxes, tax considerations are of minimal importance in planning this type of estate. But this does not mean that estate planning is not beneficial in small estates. On the contrary, it may be that there is a greater need to plan small estates because careful planning is required to assure that you will be taken care of during retirement.

Careful Planning Needed for Retirement

Co-ownership of property, family annuities, and life insurance trusts are tools frequently employed in implementing small estate plans. They are usually complemented by a will which accomplishes the desired distribution of the remainder of the estate. However, it is emphasized that these are not the only tools which can or should be used in planning your estate. Under the proper circumstances, various other tools can be advantageously employed.

Since one of the primary objectives of estate planning is to care for yourself during retirement, projected benefits from social security should not be overlooked. The extent of benefits you may expect to receive can materially influence the plan for disposition of the remainder of your assets.

Planning the Large Estate

Since sufficient assets exist in the large estate to assure that you are properly cared for during retirement, planning the large estate centers around how the impact of taxes can be minimized while still achieving the desired distribution of property. It is in this case that estate planning can literally save thousands of tax dollars. It is essential that you get expert advice in long range planning to achieve inter-generational transfer of assets.

Planning Can Minimize Taxes

Wills, trusts, family annuities, and corporations are used frequently to implement large estate plans. Since the nature and extent of your assets, together with your particular objectives, often dictate the method of implementing an estate plan, the possibility of using the various other tools described should not be overlooked.

Valuable Records

As soon as someone dies, there will be someone else called upon to settle the decedent's estate. This will require the making of business decisions, along with locating important business and family records. Both husband and wife should keep a convenient inventory of these records and their location. Survivors are already burdened by the loss felt when a close friend or relative dies. You can greatly assist them by providing a complete and up-to-date inventory of the following financial records:

- Wills, deeds, leases, insurance policies, military service records, marriage certificate, birth certificates, and social security records.
- Stocks, bonds, and other investments.
- Outstanding debts, notes, and mortgages.
- Banks with your savings and checking accounts.
- Names and addresses of professional advisors, including attorneys, bankers, accountants, life insurance salesmen.

In addition to merely describing the above important records, be sure to indicate where they can be located. University of Missouri Extension Circular 863, *A Will of Your Own,* contains an inventory form for valuable records as an appendix. Probably no form or listing, no matter how long and complicated, will suit your estate exactly. However, your efforts to organize your valuable records now can help considerably those you leave behind.

Glossary Of Terms

Adjusted Gross Estate—For federal estate tax purposes, this refers to the gross estate less funeral expenses, expenses of administration in probate, debts of the estate, and casualty losses suffered during the settlement of the estate.

Administrator—A male person appointed by the probate court to administer the estate of a decedent. His duties include the collection of the assets of the estate, the payment of its debts, and the distribution of the residue.

Administratrix—A female person appointed by the probate court to administer the estate of a decedent, similar to the role of an executor.

Annuity—The periodical payment of a definite sum of money, with such payments to continue for life or for a definite number of years.

Beneficiary—The person who derives the primary benefit from the creation of a trust.

Bequest—A transfer of personal property by will.

Codicil—A supplement or an addition to a will; it may explain, modify, add to, subtract from, qualify, alter, restrain or revoke provisions in a will.

Contemplation of Death—The situation where property transfer is motivated primarily by the expectation of death.

Contingency—The possibility of coming to pass; an event which may occur.

Corpus—Trust property; the principal sum or capital, as distinguished from interest or income.

Decedent—A dead person.

Deed—The legal instrument used to transfer title to real property.

Donee—The recipient of a gift.

Donor—A person making a gift.

Estate—The interest which one has in both real and personal property; the dollar value of this interest.

Executor—A male person named in the will to carry out the directions and requests of the will, and to dispose of property in accordance with the provisions of the will.

Executrix—A female person named in the will to perform the duties of an executor.

Fiduciary Obligation—A relationship between two or more persons in regard to business or property, or in regard to the general business or estate of one of them, of such a character that one must repose trust or confidence in the other. In return, the law raises the rule that the fiduciary must exercise a corresponding degree of fairness and good faith, and in no way take selfish advantage of the relationship.

Gift—A voluntary transfer of real or personal property with no consideration.

Gross Estate—For federal estate tax purposes, the total value of all property, real or personal, tangible or intangible, that a decedent had beneficial ownership of at the time of death.

Guardian—A person legally approved by the probate judge to care for a minor or incompetent and/or his property.

Heir—A survivor who inherits property belonging to a decedent.

Inter Vivos—Transfer during the transferor's lifetime.

Intestate—To die without making a will is to die intestate.

Intestate Descent, Statutes of—Laws which specify the method and manner of distributing and disposing of the estate of a person who dies without a will.

Irrevocable Trust—A trust over which the maker (trustor) has no power of cancellation.

Joint Tenancy—Co-ownership of property, either real or personal, by two or more people. One of the major characteristics of this type co-ownership is the right of survivorship.

Legacy—A disposition of personal property by will. Modern usage sometimes extends legacy to include the disposition of interests in real property by will.

Life Estate—A property interest lasting only for the lifetime of the holder of the life estate (life tenant).

Lineal Descendant—One who is, by blood relationship, in the direct line of descent from an ancestor. By statute, the term now includes adopted children in some states, including Missouri.

Litigation—Lawsuit; a judicial content or controversy.

Marital Deduction—The deduction allowed in determining federal gift and estate tax liabilities if property is transferred to a spouse.

Mortgage—The legal instrument typically used to attach a claim to property in order to secure payment of a debt.

Non-Terminable Interest—For purposes of the marital deduction, this refers to an interest in property which will be taxable in the estate of the surviving spouse.

Personal Property—Property that is movable such as cars, machinery, stocks and bonds.

Probate—A general term used to include all matters over which the probate courts have jurisdiction. It refers to the judicial process of administering the estates of all decedents, whether they died with or without a will.

Real Property—Land, buildings, and other permanently placed property.

Revocable Trust—A trust which can be cancelled by the maker (trustor).

Right of Survivorship—This right is present in both a joint tenancy and tenancy by entireties. With these types of co-ownership, by virtue of simple survivorship, the surviving co-owner(s) accede to the decedent's ownership interest.

Settlor—One who creates a trust by transferring property to the trustee.

Tenancy by Entireties—A type of co-ownership which can exist between two persons who are husband and wife. Here the interest of the deceased co-owner passes to the surviving spouse under a right of survivorship.

Tenancy in Common—Co-ownership of property, either real or personal, by two or more people. There is no right of survivorship.

Testamentary—Pertaining to a will; any instrument is testamentary if drafted so as not to take effect until death.

Testate—Refers to a person who dies leaving a valid will.

Trustee—The legal relationship created by virtue of one party holding legal title to property, whether real or personal, for the benefit of another.

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