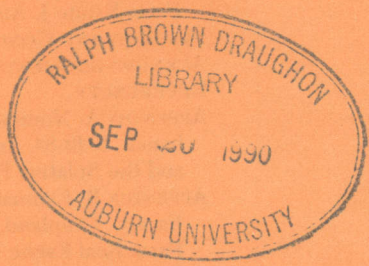


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# ESTATE PLANNING FOR ALABAMA FARMS

*A Case Study*



Alabama Agricultural Experiment Station  
Auburn University  
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# Estate Planning for Alabama Farms A CASE STUDY

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## INTRODUCTION

**M**ANAGEMENT OF THE FARM and farm-related small business can be a challenging experience. Probably no other single business has as many uncontrollable variables to manage as agriculture. Farmers are well acquainted with weather problems, but when the policies and politics of certain government programs (i.e., unexpected grain embargos, importation of foreign produced beef, uncertain export quotas, foreign policy agenda, domestic social policy, allotments, etc.) are added, the farmer businessman often finds himself in a “financial squeeze”—a struggle for economic survival.

Yet the majority of farmers will “weather” the storms. They will survive many adverse circumstances and will even build a sizeable estate. They will have mastered the difficult task of management in an environment where much is unpredictable; then, because of one slight oversight, they may lose much of what they have worked for years to accumulate. Such can be the plight of farmers and small business people who through either lack of knowledge or neglect fail to plan their estate.

Estate planning is the continuous process whereby an estate owner seeks to organize his affairs to fulfill objectives with regards

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to the accumulation, conservation, and distribution of wealth (5). This definition identifies three phases that largely characterize the estate planning process: the accumulation, conservation, and distribution of one's holdings. Although it is somewhat traditional to associate the third phase, "distribution," with "estate planning," the process does encompass two other major planning fields: personal and business financial planning (the accumulation phase) and federal and state income tax planning (the conservation phase).

The major emphasis of the research reported here was to analyze the estate transfer process, utilizing data collected from 10 selected farm case estates that had been transferred and settled within the past 15 years. These case estates were used to illustrate the function of various estate planning tools and to define the relative changes that have occurred in the transfer tax laws, both federal and state.

The research is divided into two phases: a descriptive phase and a technical phase. The descriptive phase is contained within this bulletin and focuses on analyses of the actual transfer of the 10 case estates. The technical phase is contained in a companion publication<sup>2</sup>, which explains the tools of farm estate planning and their role in the estate planning process. Combined, these analyses should provide useful insight into the estate planning process and make available to present or future estate owners information which they can use in planning their estates. The information presented in these research bulletins is not intended to be a substitute for legal or professional counsel; it is designed to be educational in nature.

### Research Objectives

This two-phase research project was the second segment of a two-segment estate planning project entitled "Estate Planning for Farmers." The project was executed with support provided under Hatch Project No. 576, through the Alabama Agricultural Experiment Station, Auburn University. The objectives for this study were four-fold in nature and provided the guidelines for the research effort:

1. Define, describe and evaluate the various tools of estate planning currently available to Alabama farmers, with special attention given to current-use valuation.
2. Analyze, using a case study approach, the means by which 10

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<sup>2</sup> Alabama Agricultural Experiment Station Bulletin 581, "Tools of Estate Planning for Alabama Farms."

full-time Alabama farm estates were transferred, giving emphasis to the objectives associated with the transfer, the tools selected by the estate owner to accomplish such objectives, the federal and state estate tax liability associated with the transfer, and the resulting effects upon the family and farm situation.

3. By utilizing current estimated land values, update the values of the 10 case estates in an effort to examine the potential tax liability that could be associated with a given estate owner's plan under present conditions. Then, by utilizing selected estates with these updated values, examine the effects of the application of selected estate planning tools in accomplishing the estate owner's objectives, with the overall aim of reducing the tax liability.

4. Provide a framework for understanding the application of the current (1985) estate planning laws by identifying the regulations in effect during the time of a given estate's transfer, and by examining various historical aspects of the estate transfer process.

The results of objectives one and four, gathered in phase two of the study, are reported in Alabama Agricultural Experiment Station Bulletin 581. The results and findings of objectives two and three are contained in this publication. All four objectives relate directly to the parent project, "Estate Planning for Farmers," as set forth by the Alabama Agricultural Experiment Station.

### Procedures

The objectives stated for this research dictated that primary data be used for the study, since secondary sources would not provide the essential information. Therefore, data were collected through personal interviews with the executor and/or executrix of a given estate. The questionnaire used was designed to secure data concerning the family situation prior to and after death, the farm business situation at the time of death, the estate plan of the decedent including his specific objectives and the means to accomplish these objectives, and the effects of the transfer on the business and whether the estate objectives were accomplished. The final part of the questionnaire was designed to determine the actual financial liability incurred by the estate, as reflected in the estate's actual federal estate tax return, Form 706.

For data collection, county extension personnel were asked to submit names, addresses, and type and size of farm information for farm estates that had undergone transfer within the last 15 years.

The criteria imposed for qualified estates were that the farm or farm-related business be the main occupation of the decedent and that a minimum of 300 acres be involved in the estate. County agents in 26 of the 67 Alabama counties responded. From the response, a qualified list of potential case estates was developed. These families were then contacted by phone to determine whether the estate owner was either a full-time farmer or the operator of a farm-related business. If the answer was affirmative, the families were then asked whether they would agree to participation in this research. Fifteen families were interviewed and 10 were selected for inclusion in the study. Although the cases selected were scattered in a random manner across the State, no statistical inferences were examined due to the smallness of the sample size and the stipulated bias with respect to physical size of the farms.

The data were subjected to analysis and compilation according to the period of transfer: pre-1977, 1977-81, and post-1981. These three periods were delineated based on the major changes in the estate tax laws of 1976 and 1981. The 10 case estates were also evaluated subject to the effects of current estimated land prices to determine the ability of the estate owner's plan to fulfill the estate objectives under current conditions. Finally, three selected case estates were exposed to hypothetical application of various selected estate planning tools in an effort to reduce the present estimated tax liability while fulfilling the estate owner's objectives.

### CASE STUDY ANALYSIS

The case study analysis was an examination of 10 selected farm estates that underwent transfer in Alabama over a 15-year period, 1968-82. Passage of the Tax Reform Act of 1976 and the consequent Economic Recovery Tax Act of 1981 marked the first major alterations in the estate tax laws since creation of the marital deduction in the Revenue Act of 1948 (8). The first four estates (A, B, C, and D) illustrate estate planning under the Tax Reform Act of 1976, the years 1977-81. The next three estates (E, F, and G) illustrate pre-1977 estate planning. Finally, the last three estates describe the major features of estate planning as specified by the Economic Recovery Tax Act of 1981, the post-1981 period.

Two other tax acts have been passed since the Economic Recovery Tax Act of 1981: The Tax Equity and Fiscal Responsibility Act of 1982 and The Technical Corrections Act of 1984. However, neither had any major impact on the estate tax laws.

## Farm Estate A

This farm estate transferred in the 1977-81 period and is an example of how "current-use" valuation of farm property was utilized to reduce federal estate taxes. The estate tax liability for both the "fair-market" and the "current-use" valuation methods is shown, illustrating the value of this tool for the estate planning process.

Farmer A was between 60 and 65 years old at death and had been farming for approximately 42 years. He had graduated from high school and had received 2 years of education at a major university. Farmer A was survived by his wife, three daughters, and a son. The children were between the ages of 30 and 40 at their father's death. Farmer A had one sister and three sons-in-law, but none of these were interested in farming or involved in the settlement process.

Farmer A's farm was organized and managed under a partnership arrangement, with the son and Farmer A holding 1/3 and 2/3 interest in the partnership, respectively. The farm consisted of about 1,190 acres of land; 620 acres were in cotton, 70 acres were in corn silage, and 500 acres were in permanent pasture which was utilized by a cattle enterprise of about 240 commercial brood cows. The partnership also rented 900 additional acres for pasture and the production of cotton. All the land owned by Farmer A was situated in one county.

About 5 years prior to his death, Farmer A had a will prepared which contained the following objectives:

1. Provide for the wife until her death. Farmer A planned to accomplish this objective by leaving his wife fee simple ownership in half his land (about 595 acres) and a granted life estate in the other half, with the three daughters holding equal remainder interests in the life estate. He also willed his wife 3/4 of his 2/3 interest in the farm partnership and left her all his personal property (i.e. insurance, cash, stocks, etc.).
2. Provide for the smooth, continuing operation of the farm. To accomplish this objective, Farmer A stated in his will that his son was to receive complete managerial control of the farm, since he would assume management of the partnership.
3. Provide an equitable distribution of the estate to the children. The son had been in partnership with his dad for at least 10 years, and under the son's leadership, the volume of business and farm income had increased considerably. This accomplishment was recognized in the father's will by the son being given an additional 1/6

ownership in the the farm. The son was also to receive, at his mother's death, all of the land Farmer A had left his wife in fee simple (approximately 595 acres) and entire ownership of the farm partnership. Farmer A provided for his daughters by naming them as remaindermen to the wife's life estate.

Farmer A had a simultaneous death clause in his will stating that if both husband and wife died simultaneously in an accident, the wife would be considered to have survived him; thus the estate would pass through her and be distributed according to her will. With current laws providing an unlimited marital deduction, it is just as critical for the wife to plan as for the husband, since she has the potential of inheriting a large estate. Mrs. A in this instance also had a will, and her will worked to complete her and her husband's wishes concerning the farm business. Farmer A and his wife had communicated with each other concerning their goals and objectives, and had thus developed an estate plan to complete their united purpose.

Other provisions of Farmer A's will included specific instructions as to which parcels of property would be left to the wife outright and which would be included in her life estate. The son and wife were named co-executors to administer the estate and were given broad powers of administration which excluded any posting of bond or court accounting of the administrative process. The marital deduction and the extent it was to be used was also included in the will. No guardian was specified in the will since the children had reached the age of majority.

Farmer A had used professional advice from several different sources in developing his estate plan. The family lawyer and accountant were both consulted for their advice and services, along with certain trust officials and other business friends.

Farmer A's estate is summarized in the following outline utilizing both the current-use and the fair-market valuation methods:

	Valuation method	
	Current-use	Fair-market
Real estate (1,190 acres).....	\$352,274	\$ 662,675
Notes and cash .....	271	271
Life insurance (5 policies).....	41,013	41,013
Jointly owned property (no land).....	26,790	26,790
Other miscellaneous property .....	348,966	348,966
Total gross estate .....	\$769,314	\$1,079,715

As indicated in the above summary, the current-use valuation



method decreased the gross estate by \$310,401. This contributed to tax savings as indicated by the following calculations:

	Valuation method	
	Current-use	Fair-market
Total gross estate .....	\$769,314	\$1,079,715
Debts, mortgages, liens .....	(-) 2,393	(-) 2,393
Administrative and funeral costs .....	(-) 14,669	(-) 14,669
Adjusted gross estate .....	\$752,252	\$1,062,653
Estate marital deduction (250,000 or 1/2 adjusted gross estate).....	(-)376,126	(-) 531,327
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$376,126	\$ 531,326
Tentative gross estate tax .....	\$113,683	\$ 167,391
Available unified credit .....	(-) 34,000	(-) 34,000
Credit for Alabama death tax .....	(-) 6,036	(-) 11,253
Federal estate tax due .....	\$ 73,647	\$ 122,138
Total estate tax due .....	\$ 79,683	\$ 133,391

The tax savings this farm gained from utilizing current-use valuation was \$48,491 in federal estate tax and another \$5,217 in state death tax, a total of \$53,708. Thus, current-use valuation proved helpful in easing the tax liability. This farm estate also utilized other estate planning tools in addition to current-use valuation. Prior to 1976, the lifetime specific gift exclusion of \$30,000 (\$60,000 if joint between spouses) was in effect and Farmer A used this \$60,000 available gift exclusion to bring his son into the farm partnership at 1/3 interest. This move saved the estate at least \$11,160 in additional federal and state death taxes, assuming there was no appreciation in value of this 1/3 partnership interest between the time the gift was made until the time of Farmer A's death and assuming Farmer A would utilize his same estate plan. Actually, the savings are under-estimated, because the value of the business had appreciated considerably under the son's influence.

In general, it can be said that Farmer A's estate plan fulfilled his objectives. Although other things could have been done to reduce the tax liability, the family feels Farmer A accomplished his objectives concerning the family and farm situation. Mrs. A is currently enjoying a nice income and the farm business is working smoothly. The son feels his and his sisters' interests are satisfied in Mrs. A's will, which as mentioned earlier, serves to complete Farmer A's total objective. A final analysis reveals the total financial expenditures associated with Farmer A's death.

Federal estate tax paid .....	\$73,647
State inheritance tax paid .....	6,036
Attorney fees .....	3,897
Accountant fees .....	8,453
Funeral expenses .....	2,319
The cost of death .....	\$94,352
The debt at death .....	2,393
Total financial liability assessed at death .....	\$96,745

This farm could have further decreased its financial liability. In fact, under current tax laws, as passed in the Economic Recovery Tax Act of 1981, it could have escaped taxes altogether because of the unlimited marital deduction (1,9). However, the tax burden at the death of the surviving spouse would probably have been large, depending on the date of death of the surviving spouse.

### Farm Estate B

This farm represents one of two "million dollar" estates included in the study. It is similar to farm estate A in that current-use valuation was utilized for valuing the land. Comparison is again made between the current-use settlement and the fair-market settlement, since this estate also transferred in the 1977-81 period.

Farmer B was 60-65 years old at the time of farm transfer. He had farmed all his life as a sole proprietor. He was a high school graduate and neither he nor his wife had ever attended any workshops or seminars on estate planning. Farmer B was survived by his wife, two daughters, and a son. The children were 28-38 years old at Farmer B's death. Farmer B had no living brothers or sisters.

Farmer B managed a farm of approximately 2,270 acres, of which 2,200 were owned solely and 70 acres were owned as tenants-in-common with his wife. The farm grew 500 acres of cotton, 570 acres of soybeans, 1,000 acres of timber, and 200 acres of permanent pasture which supported 150 commercial brood cows. This farm also rented an additional 700 acres, which was utilized in crop production and pasture.

Concerning the family situation, only Farmer B's son was interested in continuing the farm business; however, the two daughters and their families were interested in the farm assets for inheritance reasons. These facts were part of Farmer B's considerations in developing his will, which was adjusted approximately 6 months prior to his death. The provisions of the will are summarized as follows:

1. Provide for the wife until her death. To accomplish this objective, Farmer B willed his wife fee simple ownership in half his land (1,135 acres) and a life estate in the other half (1,100 acres) with the children holding equal remainder interests in the life estate. He also designated his wife to receive all personal farm property (i.e. farm machinery, cattle, etc.) in order to take full advantage of the marital deduction for that time. Finally, Farmer B designated all other personal property (i.e. life insurance, cash, stocks, and bonds) to go to the wife.

2. Provide an inheritance for his children that would not be taxed again at Mrs. B's death. Farmer B did this by naming his children as equal remaindermen to the wife's life estate. Farmer B also wanted his son to have the opportunity to continue farming if he so desired. To do this Farmer B stated in his will that he wanted his son to be able to rent the land in the life estate from Mrs. B and at Mrs. B's death have the option of either renting, or purchasing at fair-market value, the land owned in fee simple by her. It was Farmer B's desire to keep the land "intact."

3. Save taxes. Farmer B planned to do this by taking full advantage of the marital deduction, by utilizing any unified credit that might be available to the estate, and by employing current-use valuation in valuing the farm land.

Farmer B had few specific provisions in his will (i.e. no simultaneous death clause, specific bequests, or testamentary trusts). However, he did name his wife and son as co-executor/executrix and gave them broad powers of administration in handling the affairs of the estate.

Farmer B's estate is summarized as follows, utilizing both the current-use and fair-market valuation methods:

	Valuation method	
	Current-use	Fair-market
Real estate (2,235 acres).....	\$ 710,810	\$1,310,810
Stocks and bonds .....	13,438	13,438
Notes and cash .....	151,059	151,059
Life insurance (3 policies).....	85,765	85,765
Other miscellaneous property (cattle, machinery).....	251,000	251,000
Total gross estate .....	\$1,212,072	\$1,812,072
Debts, mortgages, liens .....	(-) 400,933	(-) 400,933
Administrative and funeral costs .....	(-) 32,153*	(-) 32,153*
Adjusted gross estate .....	\$ 778,986	\$1,378,986
Estate marital deduction (\$250,000 or 1/2 adjusted gross estate) .....	(-) 389,493	(-) 689,493
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$ 389,493	\$ 689,493
Tentative gross estate tax .....	\$ 118,228	\$ 225,912
Available unified credit.....	(-) 47,000	(-) 47,000
Credit for Alabama death tax.....	(-) 6,464	(-) 17,580
Federal estate tax due .....	\$ 64,764	\$ 161,332
Total estate tax due.....	\$ 71,228	\$ 178,912

\*Administration costs of this estate are high primarily because the executors paid themselves the maximum commission for administering the estate.

The tax savings gained by this farm from utilizing current-use valuation were \$96,568 in federal estate tax and \$11,116 in state estate tax, for a combined tax savings of \$107,684. The total estate tax due under fair-market valuation was about two and one-half times the

amount of tax due under current-use valuation. Thus, current-use valuation was helpful in reducing the tax liability.

Farmer B basically fulfilled his objectives. He met his objective of providing for his wife, since she was left ample assets to cover whatever needs she might have. The son was given the opportunity to continue farming, and he is currently managing all 2,270 acres of the farm. The daughters were provided an inheritance by being named as remaindermen to Mrs. B's life estate. However, in Farmer B's objective of saving taxes, the results probably could have been different. While the utilization of current-use valuation did reduce the tax liability considerably, some additional early planning on Farmer B's part could have been advantageous to the estate. For example, Farmer B made gifts of 100 acres to his son and 36.5 acres to both daughters, all of which was brought back into the gross estate to be taxed because the transfer was made within 3 years of Farmer B's death (1,9). This illustrates the importance of early planning of the estate to ensure all objectives are completely fulfilled. Early planning of an estate allows the estate owner time to evaluate his objectives in light of possible new and often changing circumstances. If the means to accomplish the objectives need to be changed, the estate owner has the liberty and time to do this.

A summary of the financial liability faced by the family at Farmer B's death appears in the following calculations:

Federal estate tax paid .....	\$ 64,764
State inheritance tax paid.....	6,464
Attorney and accountant fees .....	9,403
Funeral expenses.....	750
The cost of death .....	81,381
The debt at death .....	400,933
Total financial liability assessed at death .....	\$482,314
Actual financial liability resulting from death .....	\$ 81,381

The debt of this estate was the largest of all the estates studied, and was in the form of a mortgage on the land. However, since this farm was to continue in operation, the debt did not affect operation of the business. The debt was handled as another cost of operation, just as it was prior to Farmer B's death. For this farm estate, the actual financial liability payable was \$81,381 (\$482,314 - \$400,933).

### Farm Estate C

This farm estate transferred in the 1977-81 period. It is an example of how non-taxable gifts, specifically the lifetime specific gift exclusion, were used to reduce the value of the gross estate and thus the size of the taxable estate.

Farmer C was between 60 and 65 years old at his death and had farmed all his life. He had completed 8 years of formal education and had never attended any formal estate planning seminars. He was survived by his wife and five children. The three girls and two sons were between the ages of 30 and 40 at Farmer C's death. Only one son was involved with Farmer C in the farming operation. The other children were interested in the farm assets for inheritance reasons and this was one of Farmer C's considerations in his estate plan. Farmer C also had two brothers and three sisters at his death, but they were not involved in the settlement process.

The farm business was a sole proprietorship and had enterprises of row crops and livestock. Farmer C had previously owned 737 acres, but this had been reduced by 200 acres through a gift program. Of the 537 acres remaining, approximately 339 were devoted to cotton production and 113 acres were allocated to soybeans. The other 85 acres contained the homestead and permanent pasture, which supported 50 head of commercial brood cows. The farm also rented 500 acres, which was split 4 to 1 in the production of cotton and soybeans.

Farmer C had a will, which had been revised in the year of his death. He had the following objectives in his will:

1. Provide for the wife until her death. Farmer C planned to accomplish this by leaving his wife fee simple ownership in approximately half of his real property (269 acres) and a life estate in the other half (268 acres), with the children holding remainder interests. In his will, Farmer C set up this situation as a marital trust (Trust I) and a family trust (Trust II), with the wife being trustee of Trust I and the wife and on-farm son being co-trustees of Trust II. The wife also received the homestead and all other personal property (life insurance proceeds, cash, other miscellaneous property).

2. Provide an inheritance for the children. Farmer C had already accomplished part of this objective with his gift program, but reinforced this desire by citing the children as remaindermen to the family trust. Also, these testamentary trusts were structured to allow the on-farm son to continue the farming operation uninterrupted.

3. Save taxes and reduce administration costs. Farmer C helped accomplish this objective by making specific reference in his will to the marital deduction, the unified credit provision, and how these provisions were to be utilized in transferring his estate.

There were several other provisions in Farmer C's will that aided in the transfer process:

1. The will specifically delegated the wife and son broad powers of administration in handling the estate and specifically voided the posting of bond for the administration process.

2. A simultaneous death clause was included and specific guidelines were outlined stating that if both husband and wife died simultaneously in an accident, the wife would be assumed to have predeceased the husband and thus the property would be distributed according to specific guidelines set forth in his will.

3. A specific bequest of 40 acres was utilized to provide for the off-farm son.

These provisions aided the transfer process and the family was satisfied with the outcome. The on-farm son was allowed to continue total management of the business, utilizing most of the land. Also, since Mrs. C had a will at Farmer C's death, additional provisions were made for this son in her will. By going ahead and taking care of the other children in his will (i.e. granting the wife a life estate with the children as remaindermen), Farmer C saved his wife the burden of having a very large estate (i.e. her owning all property outright) and thus the possibility of a sizeable tax liability.

In preparing his estate plan, Farmer C used the services of both a lawyer and accountant, especially in the preparation of his will. Farmer C's estate plan is summarized in the following outline, illustrating the actual settlement with the gift program and an estimated settlement without the gift program:

	Actual estate settlement, in- cluding the gift program (537 acres)	Estimated estate settlement, ex- cluding the gift program (737 acres)
Real estate.....	\$518,240	\$711,253*
Notes and cash .....	75,229	75,229
Life insurance owned by decedent (3 policies)...	22,974	22,974
Other miscellaneous property .....	8,350	8,350
Total gross estate .....	\$624,793	\$817,806

\*The estimated real estate value was derived by dividing the actual total real estate value by the number of acres (537), then multiplying this figure by the number of acres in the gift program. The resulting value was added to the actual total real estate value to yield an estimated total real estate value.

The gift program consisted of 200 acres of land valued at \$60,000 given over a period of 2 years. Each of Farmer C's five children received 40 acres tax free. These gifts were helpful in reducing Farmer C's estate, thus avoiding payment of some estate taxes that

otherwise would have been due. The difference of \$193,013 in the value of the gross estate for the above settlements, less the original gift value of \$60,000, reflects the estimated appreciation in the value of the gifts (\$133,013) from the time they were made until Farmer C's death, a period of approximately 10 years.

Calculation of the estate taxes appears in the following outline:

	Actual estate settlement with gift (537 acres)	Estimated estate settle- ment without gift (737 acres)
Total gross estate.....	\$624,793	\$817,806
Debts, mortgages, liens .....	(-) 9,744	(-) 9,744
Administrative and funeral costs.....	(-) 8,106	(-) 8,106
Adjusted gross estate.....	\$606,943	\$799,956
Estate marital deduction (250,000 or 1/2 adjusted gross estate).....	(-)303,472	(-)399,978
Charitable bequests .....	(-) -0-	-0-
Taxable estate.....	\$303,471	\$399,978
Tentative gross estate tax.....	\$ 88,980	\$121,793
Available unified credit .....	(-) 38,000	(-) 38,000
Credit for Alabama death taxes .....	(-) 3,711	(-) 6,799
Federal estate tax due .....	\$ 47,269	\$ 76,994
Total estate tax due.....	\$ 50,980	\$ 83,793

The estimated tax saving from utilization of the gift program was significant. The difference in the federal estate tax liability was an estimated \$29,725 and the difference in the total tax liability, both federal and state, was an estimated \$32,813. A final look at Farmer C's estate settlement is given in the following summary:

Federal estate tax paid .....	\$47,269
State inheritance tax paid.....	3,711
Attorney's fees .....	3,000
Accounting fees.....	1,225
Funeral expenses.....	3,881
The cost of death .....	59,086
The debt at death .....	9,744
Total financial liability assessed at death .....	\$68,830

Although this farm did incur some tax liability, such liability would have been much greater had no planning taken place. Farmer C's plan probably could have been improved, but his plan did accomplish most of his objectives including helping reduce his estate's tax burden.

### Farm Estate D

This farm estate transferred in the 1977-81 period and is an example of an estate that escaped both the federal and state death tax

altogether. It is also an example of an estate that chose not to utilize current-use valuation.

Farmer D was between 60 and 65 years of age at his death. He had been a farmer all his life and had completed high school and 4 years at a major university. He was survived by his wife and two sons; the sons were between 30 and 35 years of age at their father's death. Both sons had graduated from college, but only one son was interested in the farming operation. Farmer D was also survived by a brother, but the brother was not involved in the settlement process.

The farming operation consisted mainly of beef cattle, approximately 150 brood cows and stocker calves. Other enterprises of the farm included a commercial haying operation, a mature pecan orchard of about 200 trees, and timber. Farmer D was a sole proprietor, but the sons were involved in the business on a part-time basis. Farmer D owned 290 acres solely and another 38 acres as a tenant-in-common with his wife. An additional 800 acres were rented and utilized for winter grazing and hay production.

Farmer D and his wife both prepared wills in 1965. Farmer D's will contained two provisions: take care of the wife for the remainder of her life and conserve as much of the estate as possible. Farmer D planned to accomplish these objectives by leaving his wife full ownership in all of his property, both real and personal, farm and non-farm. In doing this, Farmer D was utilizing as much of the marital deduction, which at the time of transfer was limited to \$250,000 or one-half the adjusted gross estate (1,9), as he could to aid in the transfer of the property. Farmer D also expressed a desire for the land to be held together and not be divided for sale if possible. This type of clause or statement in a will generally holds no legal credibility and cannot be enforced as such. However, as an expressed desire, it most often will be adhered to out of respect for the deceased. The only other provision of Farmer D's will was a simultaneous death clause, stating how the property would be distributed if he and his wife should die simultaneously. Though Farmer D's will was old, it was prepared with professional assistance and served to accomplish his basic objectives.



The settlement for this estate is given in the following summary:

Real estate (328 acres).....	\$213,050
Stocks and bonds.....	6,260
Notes and cash.....	12,228
Life insurance (7 policies).....	36,009
Jointly owned property (no land).....	5,363
Other miscellaneous property.....	79,604
Total gross estate.....	\$352,514
Debts, mortgages, liens.....	(-)101,951
Administrative and funeral costs.....	(-) 6,617
Adjusted gross estate.....	\$243,946
Estate marital deduction	
(\$250,000 or 1/2 adjusted gross estate).....	(-)250,000
Charitable bequests.....	(-) -0-
Taxable estate.....	\$ -0-
Tentative gross estate tax.....	\$ -0-
Available unified credit.....	(-) 38,000
Credit for Alabama death tax.....	(-) -0-
Federal estate tax due.....	\$ -0-
Total estate tax due.....	\$ -0-

There are two items within the above settlement that stand out: the valuation of the real estate and the debt of the farm business.

Current-use valuation was excluded from valuing the farm real estate. There were probably several reasons for this: (1) the estate was not large enough to realize any tax savings from employment of current-use since the farm debt and marital deduction served to reduce the taxable estate to zero, (2) the employment of current-use would have limited the options as to how this property could be utilized for a 15-year period following the decedent's death (1,9), and (3) the income tax consideration involved, namely that of an increase in the value of the basis for the property for determining capital gains and/or losses. Since real property is the major item of value in most farm estates, its valuation needs to be carefully evaluated, with consideration given to all possible tax and family situations.

The second item evident within this estate settlement is the debt of the farm business. The debt was in the form of a mortgage on the land. The debt served to reduce the gross estate and thus reduced the potential estate tax liability. However, while the potential estate tax liability was reduced, the debt liability remained. A debt liability may or may not be detrimental to a farm estate, depending mainly on whether the business is to continue. If the business is to continue, the debt usually can be refinanced and continue as a part of the fixed costs of operation. However, if the business is not to continue, the debt most likely will become due and payable. If the latter situation is the case, the economic "squeeze" faced by the family will be dictated by the amount of liquid assets available to the

estate. If there are relatively few liquid assets, the estate must sell assets that may be relatively non-liquid in nature, assets that may not be easily converted to cash (i.e., cattle, land, machinery). The problem with liquidating these type assets is that the seller is at the "mercy" of the current market for these items. Sometimes, the available current demand for such assets is weak and the estate suffers an economic loss due to the untimely sale of such assets.

For Farmer D's estate, Mrs. D assumed the debt liability and utilized certain estate assets left her to help cover the liability. All livestock and some machinery were sold and receipts from these were applied to the debt. She also had some liquidity available (approximately \$54,497, excluding any cash that might have been in a joint checking and savings account) to help with these needs. As a result, the wife was able to keep the land and is currently renting the property to one of the sons.

The final settlement for this estate appears in the ensuing outline:

Federal estate tax paid .....	\$ -0-
State inheritance tax paid.....	-0-
Attorney, accountant, and appraisal fees.....	5,454
Funeral expenses.....	1,163
The cost of death .....	\$ 6,617
The debt at death .....	101,951
Total financial liability assessed at death .....	\$108,568

### Farm Estate E

This farming operation is an example of an estate being transferred by the surviving spouse. This estate also shows some of the changes that have occurred in the estate tax laws. For example, at the death of this farm owner, current-use valuation and the unified credit provision did not exist. However, land values had not inflated at this time either, so much of the estate was able to escape tax liability.

This farm estate transferred prior to 1977 and was owned by a widow whose farmer husband had died prior to 1968. In his will, Farmer E had anticipated a tax burden, so he designated that Mrs. E and their daughter, an only child, were to share all the property as tenants-in-common. Mrs. E was to own 2/3 and the daughter 1/3 undivided interests in the property. This arrangement included all farm assets: land, machinery, and cattle. Farmer E owned 1,592 acres of land at his death; therefore, Mrs. E had approximately 1,061 acres included in the valuation of her estate.

Mrs. E died approximately 9 years after Farmer E and was between 55 and 60 years old at that time. She and her husband had

farmed together for approximately 25 years. She had completed high school, but neither Farmer E nor Mrs. E had ever attended any workshops on estate planning. Farmer and Mrs. E had one child, a daughter who was 45 to 50 years of age and married at Mrs. E's death. Mrs. E had one sister and two brothers who also survived her, but they were not involved in the settlement process.

At Farmer E's death, the daughter and her husband had assumed management of the farm along with Mrs. E, but no formal partnership or corporate agreement was ever developed. At Mrs. E's death, the farm consisted of approximately 465 row crop acres including corn, soybeans, and peanuts or cotton, depending on the year. There were also approximately 50 head of commercial brood cows on 325 acres permanent pasture and 575 acres of managed timber. An additional 200 acres were along a river and were for the most part covered by backwater from a dam.

Mrs. E did not have a will at the time of Farmer E's death, but did develop one sometime thereafter. The main objective in Mrs. E's will was to pass all property, both real and personal, to her daughter. She also had a desire for the farming operation to continue and be maintained within the family (which the daughter has done), but this was not mentioned in the will. Basically, there were no other objectives noted in the will, primarily because there was no surviving spouse in this instance. So nothing was mentioned of the marital deduction, testamentary trusts, the simultaneous death-clause, or specific requests; all was left to the daughter. Mrs. E did acquire professional help from a local lawyer in developing her will.

Mrs. E's estate settlement is summarized in the following outline:

Real estate (1,061 acres)* .....	\$106,133
Stocks and bonds .....	13,654
Notes and cash .....	3,783
Life insurance (1 policy) .....	1,000
Other miscellaneous property .....	12,122
Total gross estate .....	\$136,692
Debts, mortgages, liens .....	(-) 2,910
Administrative and funeral costs .....	(-) 2,999
Adjusted gross estate .....	\$130,783
Marital deduction (1/2 adjusted gross estate) .....	(-) -0-
Lifetime specific exemption .....	(-) 60,000
Charitable bequests .....	(-) -0-
Taxable estate .....	\$ 70,783
Tentative gross estate tax .....	\$ 12,519
Available unified credit .....	(-) -0-
Credit for Alabama death tax .....	(-) 246
Federal estate tax due .....	\$ 12,273
Total estate tax due .....	\$ 12,519

\*Appraised value of \$100 per acre at time of death.

The main problem with this estate was that no marital deduction was available, but since Mrs. E's goal was to transfer the entire estate to her daughter, other estate planning tools were available and could have been utilized, such as the lifetime specific gift exclusion of \$30,000 per donor individual and annual tax free gifts of \$3,000 per donee (1,9). However, these were not utilized and the result was payment of the tax.

Nevertheless, Mrs. E did fulfill her objective. The farm was transferred to the daughter, complete and intact. Also, no land, machinery, or other farm assets had to be sold to pay the tax, since Mrs. E had sufficient liquidity in reserve to accomplish this.

A final summary of Mrs. E's estate appears in the following outline:

Federal estate tax paid .....	\$12,273
State inheritance tax paid.....	246
Attorney fees .....	2,022
Funeral expenses.....	977
The cost of death .....	\$15,518
The debt at death .....	2,910
Total financial liability assessed at death .....	\$18,428

### Farm Estate F

This farm estate, which transferred prior to 1977, is an example of an estate where little planning took place; in fact, only one attempt was made to help this estate situation. The heirs of the estate are still feeling the effects of this oversight, even though several years have elapsed since the death of the estate owner.

Farmer F was between 70 and 75 years of age at his death and had been a farmer all his life. He had completed 12 years of high school and 1 year of college. He was married and had one child, a daughter, who was 25-30 years old at his death. Farmer F also had three sisters, but they were not involved in the settlement process. Farmer F had never attended any seminars on estate planning. He was the sole proprietor of this farming business, which consisted of about 1,807 acres at his death. The business was mainly a cow-calf and timber operation, with approximately 945 acres devoted to a timber contract and 850 acres in pasture and hay fields. The other 12 acres contained Farmer F's homestead. The farm at one time had over 200 commercial brood cows, but this number had decreased to around 50 at the time of death.

Farmer F took one step in planning his estate which helped the family's situation to some degree. Approximately 6 years prior to his death, Farmer F gave 270 acres of land to Mrs. F, utilizing his life-

time specific gift exclusion of \$30,000 and annual gift exclusion of \$3,000 to transfer the property (9), which contained some swamp-land. This gift helped reduce the total tax liability of the estate. There were no family disputes involved in the settlement, which greatly simplified the process.

Farmer F’s estate settlement is shown in the following calculations, considering the actual settlement which included the gift and an estimated settlement which excluded the gift:

	Estate with gift (1,807 total acres)	Estate without gift (2,077 total acres)
Real estate.....	\$263,629	\$303,019*
Stocks and bonds .....	5,416	5,416
Notes and cash .....	20,623	20,623
Life insurance (3 policies).....	6,758	6,758
Other miscellaneous property .....	13,345	13,345
Total gross estate .....	\$309,771	\$349,161

\*This estimated real estate value was derived by dividing the actual total real estate value by the number of acres (1,807), then multiplying this figure by the number of acres in the gift program (270). This value was then added back to the actual total real estate value to yield an estimated total real estate value.

As can be seen in the above calculations, the gift of 270 acres had appreciated in value from \$33,000 at 6 years prior to death to \$39,390 at death. Thus, Farmer F not only transferred the gift, but also the appreciation on the gift.

The remainder of Farmer F’s settlement process was as follows:

	Estate with gift (1,807 acres)	Estate without gift (2,077 acres)
Total gross estate .....	\$309,771	\$349,161
Debts, mortgages, liens .....	(-) 27,221	(-) 27,221
Administrative and funeral costs .....	(-) 14,901	(-) 14,901
Adjusted gross estate .....	\$267,649	\$307,039
Bequests to spouse .....	(-) 32,799	(-) 32,799
Lifetime specific exemption .....	(-) 60,000	(-) 60,000
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$174,850	\$214,240
Tentative gross estate tax .....	\$ 43,155	\$ 54,972
Available unified credit .....	(-) -0-	(-) -0-
Credit for Alabama death tax .....	(-) 2,036	(-) 2,982
Federal estate tax due .....	\$ 41,119	\$ 51,990
Total estate tax due .....	\$ 43,155	\$ 54,972

Farmer F’s gift of 270 acres saved the estate an estimated \$10,871 in federal taxes and another \$946 in estimated state death taxes for a combined estimated tax savings of \$11,817. Thus, by giving property to his wife (270 acres at a value of \$33,000), Farmer F saved his estate \$11,817, or about one-third the value of the gift. A good ques-

tion now might be, "What would the estate settlement have been like if Farmer F had made a will?"

One problem with Farmer F dying intestate was that the marital deduction was completely left out of the estate planning scheme. The marital deduction at the time of Farmer F's death was limited to one-half of the adjusted gross estate (8,9). However, even with this limit, the estate still could have benefited from its use. The brief summary which follows shows the effect of the marital deduction being included in Farmer F's actual estate settlement:

Total gross estate .....	\$309,771
Debts, mortgages, liens .....	(-) 27,221
Administrative and funeral costs .....	(-) 14,901
Adjusted gross estate .....	\$267,649
Marital deduction (1/2 adjusted gross estate) .....	(-)133,825
Lifetime specific exemption .....	(-) 60,000
Taxable estate .....	\$ 73,824
Tentative gross estate tax .....	\$ 13,371
Available unified credit .....	(-) -0-
Credit for Alabama death tax .....	(-) 270
Federal estate tax due .....	\$ 13,101
Farmer F's estate settlement as is (no will); real tax liability: .....	\$ 43,155
Farmer F's estate settlement with a will; estimated tax liability .....	(-) 13,371
Excess of tax paid; estimated cost of no will for this estate: .....	\$ 29,784

The price of not using the marital deduction, for this particular estate, was relatively high. The above difference in the two tax figures is not just a "paper difference." It is a real cost that this estate had to bear, resulting in the estate having to liquidate approximately 332 acres of land and some equipment to pay this and other debts. Finally, because there was no will, some confusion was associated with the settlement process. Mistakes were made in valuing certain parts of the business and there was disagreement between the administrators of the estate and the Internal Revenue Service as to how certain property should be valued. This confusion resulted in additional estate tax returns having to be filed and an additional \$4,000 being paid as interest on additional taxes due. A final summary of expenses assessed at Farmer F's death appears in the following outline:

Federal estate tax paid .....	\$41,119
State inheritance tax paid .....	2,036
Attorney and accountant fees .....	14,300
Interest on additional tax .....	4,062
Funeral expenses .....	601
The cost of death .....	62,118
The debt at death .....	27,221
Total financial liability assessed at death .....	\$89,339

## Farm Estate G

This farm estate is an example of how gifts were used jointly by husband and wife to transfer the entire farm virtually estate tax free. The gifts made were both taxable and non-taxable in nature, since Farmer G utilized all legal exemptions and exclusions allowed at that time. This estate transferred prior to enactment of the Tax Reform Act of 1976, and many of the available exclusions and exemptions have undergone a "restructuring" since that time. However, the important feature to note in this example is that Farmer G examined the means available to avoid taxes, then developed a plan to accomplish his objectives. The first step in estate planning is the realistic evaluation of one's situation.

Farmer G was 60 to 65 years old at death and had farmed all his life. He had completed 12 years of education and, although having never attended any estate planning workshops, had read various estate planning publications published by Auburn University, *Progressive Farmer*, *Successful Farming*, *Farm Journal*, and other similar publications. Farmer G was married and had three children (all married) between the ages of 30 and 40. He also had two sisters, but neither was involved in the settlement process.

Farmer G operated his farm as a sole proprietor for many years, but after the two sons matured, the business was converted into a partnership, with Farmer G and the sons each owning 1/3 interest. All farm assets except the land were included in the partnership. Farmer G retained title to the 800 acres of land. The enterprises of the business included: (1) 260 acres of row crops, utilizing corn, cotton, soybeans, and grain sorghum, (2) 130 purebred brood cows on 275 acres of pasture, (3) 225 acres of timber, and (4) 30 commercial brood sows. The homestead was situated on 12 acres. No additional land was rented for use in this business.

In developing his estate plan, Farmer G had made a will several years before his death. His will was updated about 6 months prior to his death and included the following objectives:

1. Provide for his wife until her death. Farmer G planned to accomplish this by leaving to his wife the homestead of 12 acres, his personal property including stocks and bonds, insurance proceeds, and cash in the joint checking account, and his 1/3 interest in the farming operation.

2. Keep the farm in the family and the land "intact." Farmer G had largely accomplished this objective through his gift program to his sons, about 2½ years prior to his death.

3. Save taxes and administration costs. Farmer G planned to accomplish this goal by utilizing the marital deduction along with a gift program. He also granted his executor broad powers of administration, which precluded additional administrative costs.

In developing his estate plan, Farmer G utilized the expertise of various professionals. There is a cost involved in securing such help, but it is generally negligible when compared to the costs of no planning and the tax liability that could result.

Farmer G's estate settlement is given in the following calculations:

Real estate (home and 12 acres) .....	\$ 52,000
Stocks and bonds .....	13,294
Notes and cash .....	-0-
Life insurance (2 policies) .....	12,926
Jointly owned property (no land) .....	15,618
Other miscellaneous property (1/3 farm partnership) .....	87,380
Total gross estate .....	\$181,218

Notice that under real estate, only 12 acres are included. This is because of the gift program that Farmer and Mrs. G. utilized approximately 2½ years prior to his death. The settlement process continues as shown in the following outline:

Total gross estate .....	\$181,218
Debts, mortgages, liens .....	(-) 1,145
Administrative and funeral costs .....	(-) 3,228
Adjusted gross estate .....	\$176,845
Estate marital deduction (1/2 adjusted gross estate) .....	(-) 88,423
Lifetime specific exemption .....	(-) 60,000
Charitable bequests .....	(-) -0-
Taxable estate .....	\$ 28,422
Tentative gross estate tax .....	\$ 2,779
Available unified credit .....	(-) -0-
Credit for Alabama death tax .....	(-) -0-
Federal estate tax due .....	\$ 2,779
Total estate tax due .....	\$ 2,779

The net federal estate tax paid for this farm was \$2,779. Farmer G utilized his will to take advantage of the marital deduction and reduce his taxable estate by \$88,423. Farmer G also utilized a gift program which served to keep the farm in the family and reduce the estate's tax liability. The gift program involved 788 acres and is summarized in the following outline:

Value of gift (788 acres) .....	\$157,377
Annual gift exclusion of \$6,000 for joint giving between husband and wife (4 donees) .....	(-) 24,000
Lifetime specific gift exclusion, \$30,000 (\$60,000 joint husband and wife) .....	(-) 60,000
Net taxable gift value .....	\$ 73,377
Net gift tax paid .....	\$ 6,306



Each of the two sons received approximately 394 acres of land, valued at \$78,688 (\$157,377/2). Prior to the Economic Recovery Tax Act of 1981, an estate owner could give away \$3,000 per year to as many individuals as desired and a husband and wife together could give away \$6,000 per individual per year (1,9). Farmer G and his wife combined their giving to give \$12,000 to each son and his wife, thus making a total of \$24,000 that was given away tax free. This gift was allowable under Internal Revenue Service regulations at that time.

Farmer and Mrs. G also used their lifetime specific gift exclusion of \$60,000 to give an additional \$30,000 to each son again tax free. After these tax free gift advantages were used, a net taxable gift value of \$36,688 per son remained, which resulted in a total gift tax of \$6,306 (\$3,153 x 2). These gifts were successfully proved "not in contemplation of death"; i.e., there was a life motive in making the gifts (1,9). Thus, the gifts were not brought back into the estate at Farmer G's death. Also, the gifts were an excellent means of transfer since the rate of the tax was, at that time, three-fourths that of the estate tax rate (4,6). Thus, Farmer G was taxed at a lower rate on these transfers.

What degree would Farmer G's estate tax liability have changed if these transfers had not occurred? This question cannot be answered in total accuracy, mainly because appreciation or depreciation in the value of the property cannot be fully determined. However, an estimate can be made and once this figure is calculated, it can be compared with the actual total tax paid by Farmer G (including that for his gifts and the estate) to determine if Farmer G saved taxes. Farmer G's plan:

Total estate tax.....	\$2,779
Total gift tax (\$3,153 x 2).....	6,306
Total tax on transfer of estate.....	\$9,085

Farmer G's estate, no plan (assuming no appreciation in the value of the property from the time the gift was made until Farmer G's death):

Real estate (home and 800 acres) .....	\$209,377
Stocks and bonds .....	13,294
Life insurance (2 policies) .....	12,926
Jointly owned property (no land) .....	15,618
Other miscellaneous property .....	87,380
Total gross estate .....	\$338,595
Debts, mortgages, liens .....	(-) 1,145
Administrative and funeral costs .....	(-) 3,228
Adjusted gross estate .....	\$334,222
Estate marital deduction (1/2 adjusted gross estate) .....	(-)165,111
Lifetime specific exemption .....	(-) 60,000
Taxable estate .....	\$107,111
Tentative gross estate tax .....	\$ 22,833
Available unified credit .....	(-) -0-
Credit for Alabama death tax .....	(-) 674
Federal estate tax due .....	\$ 22,159
Farmer G's estimated tax liability, no gifts .....	\$ 22,833
Farmer G's actual tax liability, utilizing gifts .....	(-) 9,085
Farmer G's estimated tax savings .....	\$ 13,748

This example illustrates how a farmer did some planning, utilizing the tools and means that he determined were best for his particular situation. The important point is that Farmer G acted, and the family believed his plan accomplished his objectives.

A final summary will reveal this estate's total financial liability assessed at death:

Federal estate tax paid .....	\$ 2,779
State inheritance tax paid .....	-0-
Attorney fees .....	534
Accountant and other fees .....	1,118
Funeral expenses .....	1,576
The cost of death .....	6,007
The debt at death .....	1,145
Financial liability at death .....	7,152
Costs of gifts .....	6,306
Total costs of estate transfer .....	\$ 13,458

## Farm Estate H

This farm estate, which transferred after 1981, is an example of how the marital deduction and the unified credit tax provision were combined to reduce estate taxes. It is also an illustration of how the Economic Recovery Tax Act of 1981 affected farm estate planning.

Farmer H was 65 to 70 years of age at death. He had farmed all his life and had completed 8 years of education. Farmer H was survived by his wife and five children. The children were ages 25 to 40 at their father's death. He had several brothers and sisters, but they were not involved in the settlement process. This farm had row crop

enterprises of peanuts, corn, and soybeans and livestock enterprises of commercial brood cows and feeder pigs. There was also a small amount of timber acreage. The farm was operated under a partnership arrangement, with Farmer H and two of his four sons each having  $\frac{1}{3}$  interest. Farmer H owned approximately 413 acres solely and approximately 256 acres as a joint tenant with right of survivorship with his wife. The partnership owned about 3 acres and rented approximately 773 acres in addition to that already owned by Farmer H, bringing the total land farmed to about 1,445 acres. This additional acreage was used for pasture and row crops.

Farmer H had a will which was written 7 years prior to his death and was revised 5 years later. The will contained the following provisions:

1. Provide for his wife until her death. This was accomplished by leaving the wife fee simple ownership in half the real property (including that jointly owned) and a granted life estate in the other half, with the five children holding equal remainder interests in the life estate. The wife then received  $\frac{1}{2}$  of Farmer H's  $\frac{1}{3}$  interest in the partnership (a  $\frac{1}{6}$  interest) and all personal property (i.e. insurance, cash, stocks, and bonds, etc.).

2. Treat all the children fairly. To do this, Farmer H named all five children as remaindermen to the life estate, all receiving equal interests. Also, each on-farm son was designated to receive an additional  $\frac{1}{12}$  ownership in farm partnership ( $\frac{1}{2}$  of  $\frac{1}{2}$  of  $\frac{1}{3}$  interest).

3. Save taxes and administration costs. Farmer H planned to accomplish this by taking full advantage of any unified credit that might be available to the estate and by utilizing in a proper manner the new "unlimited" marital deduction. He then planned to save taxes at his wife's death by giving her a life estate in half of his real property, with his children holding remainder interests. He specified for his executrix to have broad powers of administration in handling the affairs of his estate to help reduce administration costs.

Farmer H had another provision in his will that is a good safeguard: the simultaneous death clause. This clause stated how the property was to be distributed if Farmer and Mrs. H should die simultaneously.

Under current (1984-85) estate tax laws, husband and wife are considered as one economic unit and thus unlimited tax free transfers can occur between them (9). However, a trap to avoid is the "lumping" of assets into the surviving spouse's estate. Farmer H,

having gained some legal advice and expertise, avoided this trap by creating a life estate in part of his property for his wife, thus assuring that these assets would not be taxed again at her death.

Farmer H's estate settlement is given in the following calculations:

Real estate (413 acres).....	\$388,984
Stocks and bonds.....	1,130
Notes and cash.....	5,847
Life insurance (7 policies).....	49,426
Jointly owned property (including 128 acres).....	106,353
Miscellaneous property (partnership interests; 1 acre included).....	\$ 55,867
Total gross estate.....	\$607,607
Debts, mortgages, liens.....	(-) 67,014
Administrative and funeral costs.....	(-) 8,641
Adjusted gross estate.....	\$531,952
Estate marital deduction (unlimited).....	(-)303,804
Charitable bequests.....	(-) -0-
Taxable estate.....	\$228,148
Tentative gross estate tax.....	\$ 63,807
Available unified credit.....	(-) 62,800
Credit for Alabama death tax.....	(-) 1,876
Federal estate tax due.....	\$ -0-
Total estate tax due.....	\$ 1,876

The marital deduction and the unified credit provision were used together to pass this estate free of federal estate tax. Since unified credit is a "dollar for dollar" reduction of the gross tax liability, it was used to a maximum. The marital deduction was used to reduce the adjusted gross estate by the amount needed to allow the taxable estate to pass tax free under the unified credit provision. The amount of taxable estate that will pass tax free is in the Internal Revenue Code, section 2001 (7), by comparing the current available unified credit (Appendix F) to the amount of tax due. When the amount of tax due equals the available unified credit, that corresponding size taxable estate will pass tax free.

Farmer H accomplished at least part of his objectives. Mrs. H was provided for by receiving half ownership (fee simple) in the real property and ownership of a life estate in the other half. She also received 1/6 interest (1/2 of 1/3 interest) in the farm partnership. As to the children being treated fairly, this will depend at least in part on the wife's will. The two sons who were farming were treated equally with the other children (all holding equal remainder interests in Mrs. H's life estate), except that each one received an additional 1/12 interest in the farm partnership. These sons have since purchased their mother's interest in the business. However, a clause that would have given them the option to purchase the real

property at fair-market value was omitted from the revised will and these sons are concerned about the future and the business being able to continue. Thus, farmer H may have fulfilled only part of his objectives.

Farmer H's estate plan did not utilize the current-use valuation provision, an election that can be selected for use at death if the requirements for its use have been previously fulfilled (7). This provision would have provided no benefits since other estate planning tools (i. e. the unlimited marital deduction, current available unified credit, and the life estate) served to reduce and eliminate the federal estate tax liability. Also, since current-use valuation was not used, there were no restrictions associated with the continued use of the property and the property itself received a "stepped-up" basis equal to its current fair-market value for income tax purposes (1,9). A final analysis reveals the total financial liability at death:

Federal estate tax paid .....	\$ -0-
State inheritance tax paid.....	1,876
Total administration costs (including attorney, accountant, and funeral expenses .....	8,641
The cost of death .....	10,517
The debt at death .....	67,014
Total financial liability assessed at death .....	\$77,531

### Farm Estate I

This farm is an example of how the lifetime specific gift exclusion, the marital deduction, and the unified credit provision were combined to exempt an estate from all federal estate tax liability. The lifetime specific gift exclusion provision is no longer in effect since it was replaced by the unified credit provision in the Tax Reform Act of 1976 (9). However, because Farmer I had done some planning prior to 1976, he was able to take advantage of this particular provision. Estate planning is a continuing process where laws are subject to change; therefore, it is important for farmers and business people to be aware of the changes in order to react appropriately.

This estate transferred after 1981, when Farmer I was 75-80 years old. He had farmed for approximately 36 years, but had retired for health reasons approximately 5 years prior to his death. Farmer I had graduated from high school and had received 2 more years of education at a major university. He had attended at least one workshop on estate planning, sponsored by a local bank, and had read various articles on estate planning in *Farm Journal*, *Progressive Farmer*, and *Southern Living*. Farmer I was survived by his wife, a

son, and daughter. The children were 25-30 years old at his death, were married, and were not interested in farming. Farmer I was also survived by one sister at his death, but she was not interested in farming nor involved in the settlement process.

Farmer I was the sole proprietor of the farming business. His operation, prior to his health problems, was a commercial cattle and timber operation. Prior to 1970 the farm contained 370 acres of pasture, which supported about 125 brood cows, and 335 acres of woods; total land was thus about 705 acres. All the land was situated in one county.

Farmer I had prepared a will in 1970 and revised it in 1980. Also in 1970, Farmer I utilized his lifetime specific gift exclusion and annual gift exclusion to transfer the homestead and 70 acres of pastureland to his wife. This move was of great value in helping the estate conserve taxes, because this property has since been converted into a subdivision with a significant increase in value. Since his children were not interested in farming, Farmer I had the following objectives in his will:

1. Provide for the wife for the remainder of her life. This was accomplished by setting up a marital trust, Trust A, and a family trust, Trust B, with the wife having a life estate in Trust B. In forming these testamentary trusts, the will named the wife as trustee of both trusts and gave her broad powers of administration. The will provided that all expenses and taxes, including debts, were to be paid out of the family trust. The will specified that Mrs. I was to receive the pastureland in her trust (300 acres), with the timberland and all land along the river (335 acres) to be placed in the family trust. Mrs. I also received all personal property, including stocks, bonds, cash from the joint savings account, and other miscellaneous property. Farmer I had already provided partially for his wife's welfare with his gift program in 1970.

2. Conserve as much of his estate as possible and minimize all liabilities, including estate taxes. To accomplish this objective, Farmer I set up the family trust, thereby making sure that at least part of his property would not be taxed again at Mrs. I's death. Mrs. I had no power in directing the benefits or changing this trust in any manner; she could only have its use.

3. Provide some inheritance for the children. Farmer I helped to accomplish this objective by naming his two children as equal remaindermen to the wife's life estate.

Farmer I also had other provisions in his will to fulfill these objectives. He made specific reference to the marital deduction and the extent it was to be utilized in relation to the unified credit provision. Furthermore, he included a simultaneous death clause, stating how the property would be distributed if simultaneous death occurred. Finally, Farmer I delegated broad powers of administration to his executrix in handling the affairs of his estate, thus eliminating bond or the need for court accounting of the administrative process. Farmer I's will was developed by a close friend who was a lawyer. He also received advice from various trusted business friends.

Farmer I's estate settlement is summarized in the following outline:

Real estate (635 acres).....	\$242,000
Stocks and bonds.....	8,000
Notes and cash.....	467
Life insurance.....	-0-
Jointly owned property (no land).....	15,593
Other miscellaneous property.....	8,175
Total gross estate.....	\$274,235
Debts, liens, mortgages.....	(-) 262
Administrative and funeral costs.....	(-) 3,525
Adjusted gross estate.....	\$270,448
Estate marital deduction (unlimited).....	(-)179,247
Charitable bequests.....	(-) -0-
Taxable estate.....	\$ 91,201
Tentative gross estate tax.....	\$ 21,336
Available unified credit.....	(-) 62,800
Credit for Alabama death tax.....	(-) -0-
Federal estate tax due.....	\$ -0-
Total estate tax due.....	\$ -0-

As noted in the summary, Farmer I's gross estate of \$274,235 escaped federal estate and state death taxation altogether. Because of the sizable difference in the available unified credit and the tax liability, Mrs. I utilized a disclaimer, a relatively new estate planning tool, to pass on some property immediately to the children. This was done to keep Mrs. I's estate from becoming excessively large, since she believed she had sufficient assets to meet her needs. A final summary of the expenditures associated with death are given in the following outline.

Federal estate tax paid.....	\$ -0-
State inheritance tax paid.....	-0-
Attorney fees.....	300
Accountant fees.....	2,372
Funeral expenses.....	853
The cost of death.....	3,525
The debt at death.....	262
Total financial liability assessed at death.....	\$3,787

## Farm Estate J

The final farm estate examined also transferred in the post-1981 period and was the largest case reviewed. The total gross estate was in excess of \$2 million, with about \$500,000 being paid in federal estate taxes.

This farm is an example of an estate passing through relatives and illustrates the importance of early planning not only for the estate owner, but for potential heirs as well. Estate planning is not merely a one-generation effort; rather, it is a process that should involve several generations, each successively building upon the foundation previously laid. The estate planning process of wealth accumulation, conservation, and finally distribution should be accomplished within the context of the total estate objective, an objective carefully developed and prepared by the potential estate owner. Once the plan is developed, comparison against the current federal estate tax laws will provide a relatively close estimate of the potential tax liability, and alterations can be made accordingly. Proverbs 13:22 of the Holy Bible states, "A good man leaves an inheritance to his children's children." This can only be accomplished with careful, well-informed planning by the estate owner.

This farm estate had as its owner a woman, Mrs. J, who had inherited the property from her aunt approximately 7 years prior to her own death. Mrs. J had been married but was divorced many years prior to receiving the inheritance. She was between 55 and 60 years of age at death. She was survived by her two sons and the former spouse, who was not involved in the settlement process. She had no surviving brothers or sisters. Mrs. J had completed 4 years of college and had been involved with the farm for several years.

As for the estate, the majority of this farm (including the land) was owned and operated under a partnership arrangement with Mrs. J and her two sons as partners. Ownership of the partnership was as follows: Mrs. J, 38.2 percent; the two sons, 23.25 percent each; and an additional 15.3 percent was undivided, separate, and held equally among them. Mrs. J owned 837 acres solely (including the homestead) and approximately 3,663 acres as land interest in the partnership. Roughly 677 acres of her solely owned property were utilized in the production of row crops, with corn, soybeans, and cotton dominating the rotational scheme. This same land was also double-cropped with wheat or oats. The 3,663 acres in the partnership were utilized exclusively in a timber enterprise, which included the planting, cultivating, managing, and harvesting of



timber on a rotational basis. All property was in Alabama and the farm rented no additional land.

Mrs. J's estate plan had only one main objective: leave all property, both real and personal, to her sons equally. Her will utilized specific bequests and devises to designate certain properties to each son; the devises included all personally held real property. However, there were no testamentary trusts established and since there was no spouse, the marital deduction was not available. Mrs. J's estate plan also included utilization of the annual gift exclusion. She utilized this tool to pass approximately \$79,000 in cash, stocks, and bonds to her sons over an 11-year period, tax free. It was also Mrs. J's desire that the farm partnership remain operative. Mrs. J's estate settlement appears in the following outline:

Real estate (837 acres, with home, solely owned) .....	\$ 558,857
Notes and cash .....	15,545
Life insurance (2 policies) .....	11,973
Other miscellaneous property (38.2 percent partnership interest, including approximately 3,663 acres) .....	1,548,483
Total gross estate .....	\$2,134,858
Debts, mortgages, liens .....	(-) 156,337
Administrative and funeral costs .....	(-) 62,912
Adjusted gross estate .....	\$1,915,609
Estate marital deduction .....	(-) -0-
Charitable bequests .....	(-) -0-
Taxable estate .....	\$1,915,609
Tentative gross estate tax .....	\$ 742,824
Available unified credit .....	(-) 62,800
Credit for Alabama death tax .....	(-) 93,524
Credit for tax on prior transfer .....	(-) 40,182
Federal estate tax due .....	\$ 546,318
Total estate tax due .....	\$ 639,842

The preceding settlement contains an estate tax credit that was not available for any of the previous settlement examples: the credit for tax (due or paid) on prior transfers. This credit is available against the tax liability of property within an estate that transfers twice within a 10-year period and is basically a provision that helps avoid "double taxation" on the property, Appendix E. The credit only applies to property that specifically transferred twice within 10 years and is based on the tax liability generated solely by the particular property. There are limitations for the total amount of credit allowed and the time frame within which the estate transferred. Currently, "the credit is limited to the smaller of the following amounts: (1) the amount of the federal estate tax attributable to the transferred property in the transferor's estate, or (2) the amount of the federal estate tax attributable to the transferred property in the decedent's estate" (4).

There are also limitations relative to the percentages of the total amount of credit allowed based on the number of years involved. An outline of these percentage limitations is contained within Appendix E. In Mrs. J's estate, a credit of \$40,182 was allowed against some of the property she had received in the partnership. The credit was based on 40 percent of the total tax liability generated by the property.

Mrs. J was able to fulfill her objectives for the two sons to receive all the property, in equivalent value, that was not lost to taxes. However, the tax burden was heavy, and the sons had to liquidate approximately 4,000 acres of timberland to satisfy the tax and other debts. The situation was also complicated somewhat by the tax that was due from the original estate's transfer. So the business as a whole has suffered a loss of approximately one-third its assets, a relatively serious setback. Why was the tax burden so large? Three reasons were discovered that may help provide an answer to that question.

1. The marital deduction was not available for inclusion in the estate plan. Currently (1985), the marital deduction alone can eliminate the entire tax liability (both federal and state) on any size estate.

2. Mrs. J's health precluded the purchase of additional life insurance to help with liquidity needs. Also because of health reasons, the private annuity was eliminated from utilization in the planning scheme.

3. Current-use valuation was not selected for valuing the real property. Reasons as to why this tool was excluded from the estate plan are unclear, but such reasons may be related to either the rigidity of the qualifications associated with current-use or to the desires of the heirs. At any rate, current-use was omitted from the estate plan.

A final assessment of the financial liability of Mrs. J's estate appears in the following summary:

Federal estate tax paid .....	\$546,318
State inheritance tax paid.....	93,524
Attorney fees .....	1,344
Accountant fees .....	7,000
Funeral expenses.....	4,568
Interest on deferred taxes .....	50,000
The cost of death .....	\$702,754
The debt at death .....	156,337
Total financial liability assessed at death .....	\$859,091

## EFFECTS OF CURRENT (1984) LAND VALUES VERSUS NO ESTATE PLANNING

The 10 case estates were evaluated utilizing present real estate values for farmland and were compared with the consequences of no estate planning under the present estate tax structure. All real estate values utilized were based on fair-market valuation and were updated utilizing information from the U.S. Department of Agriculture publication, "Farm Real Estate Market Developments, Outlook and Situation Report," as developed by the USDA Economic Research Service (10).

In general, farm real estate prices in Alabama have increased on a year-to-year basis since 1950, and only since 1981 have these prices moderated, Appendix A. However, this decline has been relatively small, and when compared to a previous era of 8 to 10 years ago, farm real estate prices have increased significantly, making necessary the need for revising existing estate plans.

The estimated average price of an acre of farmland, including farm buildings, in Alabama on a year-to-year basis from 1949 to 1984 is reported in Appendix A. The prices set forth are estimated averages as established by the USDA Economic Research Service and serve as guidelines to the relative changes that have occurred in farm real estate values. These stated prices may not reflect the true market conditions within a given locality; therefore, consideration should be given to the actual conditions of such locality. For this study, the relative percentage changes in these average prices were assumed to be indicative of the relative percentage changes in the real price levels, and this concept was incorporated into the scheme of determining the present estimated values for the case estates. For example, the estimated average price of farm real estate in Alabama for 1984 was approximately 540 percent greater than the average price of similar real estate found in 1967. The relative percentage changes in the average price levels are included in Appendix A, as are the per acre indices of relative prices (1967 = 100), all on a year-by-year basis.

The current real estate values utilized in this section for the case estates were derived by finding the per acre price of the real estate as established in a particular farm's federal estate tax return. This figure was multiplied by the yearly percentage changes in the price levels from Appendix A, up to and including the current year, to yield a current estimated per acre price. This estimated per acre

price was multiplied by the total number of acres involved to yield a present estimated real estate value.

In determining the estimated current value of the total gross estate, only the real estate values were adjusted. This was done because real estate composes the largest single value component of most full-time farms and is the most important appreciable asset on farms in general. The value of such things as personal property (machinery, cattle, investments, insurance, etc.) and debts was held constant, as only a current estimate of the value of the total gross estate was necessary for illustrative purposes.

An important assumption made in developing this section relates to current-use valuation of real property. In the original settlements, two estates utilized current-use, while the others did not. For farms, current-use valuation of real property represents an election that is available to the executor of an estate as an alternative valuation method at the time of death (7,9). Because this method of valuation is an option, the individual farm circumstances must be examined at the time of death to determine if such election should be made. The individual case estates were assumed to employ the same valuation procedure currently as they did at the time of original estate transfer. That is, if a given case estate did not utilize special valuation at the time of transfer, it was assumed this same farm would not utilize special valuation under present conditions. Estates A and B utilized special valuation at the time of transfer, and thus current-use was employed in estimating the present value for these estates.

The calculation of the estimated per acre current-use value for the present estate situation was accomplished by finding the per acre value of the real estate at the time of farm transfer. Since both estates A and B employed the current-use method in valuing all the real property, the original current-use per acre value was found by dividing total value of the real property by the number of acres on the farm. Once this per acre value was found, the "formula method" (9) of calculating the per acre current-use value was utilized to estimate a present per acre current-use value. The formula method of estimating this value is presented below.

Average annual per acre gross cash rent for the property	—	Average annual per acre state and local tax on the property
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Average annual effective interest rate charged on new Federal Land Bank loans

The components of the numerator for the above current-use valuation equation are given in Appendix B. These are the average estimated cash rent per acre for whole farms, cropland, and/or pastureland in Alabama and the average annual per acre farm real estate tax, 1977 through 1984. In Appendix B, three different cash rent figures are given and each could be used for calculating the current-use value depending on the type of farm. This study utilized the cash rent figure for whole farms.

The equation now reads:

$$\frac{\text{Average annual per acre gross cash rent for farms in Alabama} - \text{Average annual per acre tax on the property}}{\text{Average annual effective Federal Land Bank interest rate}} = \text{O.C.U.V.}$$

where O.C.U.V. is the original per acre current-use value. The original per acre current-use values for farm estates A and B were \$296.03 and \$318.04, respectively.

The numerator of the above equation can be further simplified to become "net rent," as given in Appendix B. Net rent is the average annual per acre gross cash rent of the property minus the average annual per acre tax on the property. For example, the average net rent in Alabama in 1979 was \$24.68 (\$25.60, the average per acre cash rent for whole farms, minus \$0.92, the average in per acre taxes). The equation can now be rewritten as:

$$\frac{\text{Net rent per acre}}{\text{Average annual effective interest rate}} = \text{O.C.U.V.}$$

The original per acre net rent value for both farms A and B was calculated by inserting the original current-use per acre value into the above equation, along with the average annual effective interest rate for the year in which the farm transferred, and solving for net rent. The average annual effective interest rates for each of the 12 Federal Land Bank districts are given in Appendix C on a per year basis, 1977-84. Since Alabama is in the New Orleans (now Jackson, Mississippi) district, only the rates for this district were utilized.

Once the original per acre net rent value for the example farm was found, it was divided by the average per acre net rent for all Alabama farms in the original year of transfer to yield an "adjustment

factor." The adjustment factor represented an estimated difference by which a particular farm would deviate from the "average" farm. This adjustment factor was multiplied by the 1984 average net rent per acre value to yield an estimated 1984 net rent per acre for the particular example farm in question. This resulting value was inserted back into the equation, along with the 1984 average annual interest rate, and solved to yield an estimated 1984 per acre current-use value for the farm.

With respect to the calculations for the total gross estate, the estate summaries for estates A, C, F, G, H, I, and J are divided into two parts, reflecting the value of the gifts that were transferred. These gifts were added back to the estate to reflect the "no plan" situation and were included at the original (unappreciated) values; however, if land was used in the gift program, the land values were updated to reflect current estimated values.

Relative to calculation of the tax, the marital deduction utilized in this section for the estate owner's updated plan was based on the specifications for the marital deduction as set forth in the estate owner's original plan. The value of the marital deduction for the hypothesized current intestate estate was based on the current Alabama Probate Code, section 43-8-41 (2).

### Farm Estate A at Present Estimated Values

Farm Estate A transferred in the 1977-81 period and at that time had a total fair-market farm real estate value of \$662,675, or \$557 per acre for the 1,190 acres, including farm buildings and the homeplace. The 1984 total estimated fair-market value of the farm real estate was \$1,079,330, an increase of almost 63 percent from the time of farm transfer. The 1984 estimated estate settlement of Farm A appears in the following outline:

	Estimated 1984 fair-market total value
Real estate (1,190 acres at \$907 per acre) .....	\$1,079,330
Notes and cash .....	271
Life insurance .....	41,013
Jointly owned property (no land) .....	26,790
Other miscellaneous property (2/3 farm partnership) .....	348,966
Total gross estate, farmer A's plan .....	\$1,496,370
Estimated value of son's 1/3 interest in farm partnership .....	\$ 174,483
Total gross estate, no estate plan .....	\$1,670,853

*Calculation of the Estimated Tax, Fair-market Valuation*

	Farmer A's estate plan	Intestacy; no estate plan
Total gross estate .....	\$1,496,370	\$1,670,853
Debts, mortgages, losses .....	(-) 2,393	(-) 2,393
Administration and funeral cost .....	(-) 14,669	(-) 14,669
Adjusted gross estate .....	\$1,479,308	\$1,653,791
Estate marital deduction .....	(-) 869,464	(-) 851,896
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$ 609,844	\$ 801,895
Tentative gross estate tax .....	\$ 196,442	\$ 268,539
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 14,394	(-) 22,891
Federal estate tax due .....	\$ 85,748	\$ 149,348
Total estate tax due .....	\$ 100,142	\$ 172,239
Current estimated total estate tax, no plan .....		\$ 172,239
Current estimated total estate tax, Farmer A's plan .....		100,142
Current estimated estate tax savings .....		\$ 72,097

The preceding estimated estate settlements outline the potential tax liability (\$100,142 and \$172,239) that would exist if the estate currently transferred utilizing fair-market valuation for the real estate. Farmer A's plan has a current estimated tax liability of about 58 percent of that as established under the Alabama Probate Code. However, even with some planning the projected total estate tax liability is still large at \$100,000.

The following settlement options outline a comparison of Farmer A's estate plan under current conditions utilizing current-use valuation for valuing the real estate. The estimated settlement for no estate planning is also shown utilizing current-use valuation, since this provision represents an election that can be utilized at the time of estate transfer.

	Estimated 1984 estate settlement utilizing current-use valuation; total value
Real estate (1,190 acres at \$267 per acre) .....	\$329,330*
Notes and cash .....	271
Life insurance .....	41,013
Jointly owned property (no land) .....	26,790
Other miscellaneous property (2/3 farm partnership) .....	348,966
Total gross estate, Farmer A's plan .....	\$746,370
Estimated value of son's 1/3 interest in farm partnership .....	174,483
Total gross estate, no estate plan .....	\$920,853

\*Currently, current-use valuation can reduce the fair-market valuation of the property by a limit of \$750,000 (I,7,9). The estimated total value of the real property in this example was \$317,730 (1,190 acres x \$267 per acre), \$761,600 below the established estimated fair-market value of \$1,079,330. Therefore the property is valued under current-use valuation at \$329,330 to meet the requirement of the value reduction limit. Also, the marital deduction utilized in Farmer A's estate plan below is based on this \$329,330 real estate value.

*Calculation of the Tax, Current-use Valuation*

	Farmer A's estate plan	Intestacy; no estate plan
Total gross estate .....	\$746,370	\$920,853
Debts, mortgages, losses .....	(-) 2,393	(-) 2,393
Administration and funeral costs .....	(-) 14,669	(-) 14,669
Adjusted gross estate .....	\$729,308	\$903,791
Estate marital deduction .....	(-)494,464	(-)476,896
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$234,844	\$426,895
Tentative gross estate tax .....	\$ 65,950	\$130,944
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 2,036	(-) 7,661
Federal estate tax due .....	\$ -0-	\$ 26,983
Total estate tax due .....	\$ 2,036	\$ 34,644
Current estimated total estate tax, no plan .....		\$ 34,644
Current estimated total estate tax, Farmer A's plan .....		2,036
Current estimated total estate tax savings .....		\$ 32,608

As can be seen in the above calculations, the inclusion of current-use valuation in the estate plan served to reduce the tax liability of Farmer A's estate under present estimated conditions in both the "estate plan" and "no estate plan" situations. The calculated current-use value of the property was actually reduced below the value as calculated at the original time of farm transfer. Since the formula method was used in the calculation process, a general rise in the level of interest rates since the time of farm transfer could be responsible for this decrease.

Concerning property distribution, Farmer A's plan (both in these calculations and in the former ones for fair-market valuation) allowed Mrs. A to receive, by way of the marital deduction, half the land in fee simple ownership (595 acres). She received the other half in the form of a granted life estate, with the four children holding remainder interests in the life estate. The life estate is a tax saving feature for the surviving spouse's estate because the surviving spouse can have full control of the property with the right to receive an income from it. However, because the surviving spouse does not actually own the property, it will be excluded from the surviving spouse's estate at death. Utilization of this tool by Farmer A reduced the tax liability of Mrs. A's estate. Mrs. A also received half the total partnership interest (3/4 of Farmer A's 2/3 interest) and all other personal and jointly held property of Farmer A. Also because Farmer A's plan was dynamic in nature, a 1/3 partnership interest was effectively omitted early from the gross estate and was directed to the desired heir, an interest which had appreciated considerably from the time of original transfer.

Under the no estate plan situation, Mrs. A would receive \$50,000 plus half of the remaining adjusted gross estate in outright owner-



ship (2). She would not receive a life estate in the other half of the adjusted gross estate, since this property (including part of the land and partnership interest) would be split equally among the four children. This situation would probably complicate the workings of the partnership and restrict the growth of the business.

In summary, Farmer A's plan, as exercised under current estate planning regulations, served to distribute the estate in accordance with the stated objectives at a minimum tax outlay.

### Farm Estate B at Present Estimated Values

Farm Estate B transferred in the 1977-81 period and at the time of transfer was valued under fair-market valuation at \$1,310,810 for the 2,235 acres involved, including farm buildings. The 1984 estimated total fair-market real estate value was \$1,200,195, or \$537 per acre. This \$537 per acre value represents a decrease of about 8 percent from the original fair-market value of approximately \$586 that was assigned to the property. The current estimated estate settlement of Farm B appears in the following outline.

	Estimated 1984 fair-market total value
Real estate (2,235 acres at \$537 per acre) .....	\$1,200,195
Stocks and bonds .....	13,438
Notes and cash .....	151,059
Life insurance .....	85,765
Other miscellaneous property .....	251,000
Total gross estate .....	\$1,701,457

### Calculation of the Tax, Fair-market Valuation

	Farmer B's estate plan	Intestacy; no estate plan
Total gross estate .....	\$1,701,457	\$1,701,457
Debts, mortgages, losses .....	(-) 400,933	(-) 400,933
Administration and funeral costs .....	(-) 32,153	(-) 32,153
Adjusted gross estate .....	\$1,268,371	\$1,268,371
Estate marital deduction (unlimited in 1984) .....	(-)1,110,757	(-) 659,186
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$ 157,614	\$ 609,185
Tentative gross estate tax .....	\$ 41,236	\$ 196,198
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 522	(-) 14,367
Federal estate tax due .....	\$ -0-	\$ 85,531
Total estate tax due .....	\$ 522	\$ 99,898
Current estimated total estate tax, no plan .....		\$ 99,898
Current estimated total tax, Farmer B's plan .....		522
Current estimated total tax savings .....		\$ 99,376

The preceding estimated estate settlements depict the potential estate tax liabilities that would exist if the estate currently transferred utilizing fair-market valuation. Farmer B's estate plan shows a current estimated tax liability of \$522, as opposed to \$99,898 for the no estate plan situation, at fair-market values. The difference in tax of about \$99,000 is attributable to the difference in the marital deduction of the two plans: \$1,110,757 for Farmer B's plan as opposed to \$659,186 for the intestate plan.

The above settlement options appear in the following outline utilizing current-use valuation:

	Estimated 1984 current-use total value
Real estate (2,235 acres at \$256 per acre) .....	\$ 572,160
Stocks and bonds .....	13,438
Notes and cash .....	151,059
Life insurance .....	85,765
Other miscellaneous property .....	251,000
Total gross estate .....	\$1,073,422

#### *Calculation of the Tax, Current-use Valuation*

	Farmer B's estate plan	Intestacy; no estate plan
Total gross estate .....	\$1,073,422	\$1,073,422
Debts, mortgages, losses .....	(-) 400,933	(-) 400,933
Administration and funeral costs .....	(-) 32,153	(-) 32,153
Adjusted gross estate .....	\$ 640,336	\$ 640,336
Estate marital deduction .....	(-) 791,822	(-) 345,168
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$ -0-	\$ 295,168
Tentative gross estate tax .....	\$ -0-	\$ 85,254
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) -0-	(-) 3,484
Federal estate tax due .....	\$ -0-	\$ -0-
Total estate tax due .....	\$ -0-	\$ 3,484
Current estimated total estate tax, no plan .....		\$ 3,484
Current estimated total estate tax, Farmer B's plan .....		-0-
Current estimated total estate tax savings .....		\$ 3,484

The preceding calculations reveal the effect of current-use valuation being included in the estate plan. The present estimated tax liability decreased under the "no estate plan" situation from \$99,898 to \$3,484; it decreased under the "estate plan" situation from \$522 to 0.

Analysis of the above calculations reveals a marked difference in the present estimated tax liability of Farmer B's plan as established under fair-market valuation, as opposed to the tax liability as established at the original time of transfer under current-use valuation, \$522 compared to \$71,228, respectively. This occurs even though

the land under fair-market valuation is presently estimated at a much higher value than it was at the original time of farm transfer under current-use valuation. The reason for this relates to the new status of the marital deduction and debt of the business. Together these two available deductions effectively remove in excess of 98 percent of the total gross estate from the taxable estate. The marital deduction itself, as stipulated in Farmer B's will, reduces the estate by about 75 percent. The marital deduction at the time of original transfer was limited to \$250,000 or one-half the adjusted gross estate (1,9). Therefore, even though the surviving spouse could receive property in complete ownership by way of a will, there was a limit as to how much of this property could qualify for the marital deduction. However, under current laws, the marital deduction has become unlimited and all property passing to the spouse in complete ownership can qualify (1,9).

Concerning the property distribution, Farmer B's plan under both the fair-market and current-use valuation methods transfers most of the property to Mrs. B. She receives 1,135 acres outright and all other personal property, both farm and non-farm. All this property currently qualifies for the marital deduction and this accounts for the tax liability being so low under Farmer B's current estimated plans, \$522 under fair-market valuation and 0 under current-use valuation. The wife also receives 1,100 acres in a life estate, with the children holding remainder interests. The property distribution under the Alabama Probate Code would change Farmer B's arrangement considerably. Under the Code, Mrs. B would receive \$50,000 outright, then half the adjusted gross estate in fee simple, including both real and personal property (2). The three children would then divide equally the remaining half of the estate in fee simple ownership, again including both real and personal property. No life estate would exist under the Code.

In summary, Farmer B's plan under current estimated conditions proved satisfactory in distributing the property in the desired manner, with a minimum loss to taxes.

### Farm Estate C at Present Estimated Values

Farm Estate C transferred in the 1977-81 period and at that time had a total fair-market real estate value (including land and buildings) of \$518,240—\$965 per acre for the 537 acres involved. The 1984 estimated total fair-market real estate value was \$695,415, or \$1,295 per acre, an increase of about 34 percent from the time of

farm transfer. Farmer C's current estimated estate settlement is outlined as follows:

Real estate (537 acres at \$1,295 per acre) .....	\$ 695,415
Notes and cash .....	75,229
Life insurance .....	22,974
Other miscellaneous property .....	8,350
Total gross estate, Farmer C's plan .....	\$ 801,968
Current estimated value of 200-acre gift program (\$1,295 per acre)	\$ 259,000
Total gross estate, no estate plan .....	\$1,060,968

*Calculation of the Estimated Tax*

	Farmer C's estate plan	Intestacy; no estate plan
Total gross estate .....	\$801,968	\$1,060,968
Debts, mortgages, losses .....	(-) 9,744	(-) 9,744
Administration and funeral costs .....	(-) 8,106	(-) 8,106
Adjusted gross estate .....	\$784,118	\$1,043,118
Estate marital deduction .....	(-)454,908	(-) 521,559
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$329,210	\$ 521,559
Tentative gross estate tax .....	\$ 97,731	\$ 163,777
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 4,535	(-) 10,862
Federal estate tax due .....	\$ -0-	\$ 56,615
Total estate tax due .....	\$ 4,535	\$ 67,477
Current estimated total estate tax, no plan .....		\$ 67,477
Current estimated total estate tax, Farmer C's plan .....		4,535
Current estimated estate tax savings for 1984 death .....		\$ 62,942

There is a \$62,942 difference between the current estimated tax liabilities of Farmer C's plan under present conditions and the estimated intestate plan as outlined in the Alabama Probate Code. A major item contributing to the size of the tax liability of the intestate plan was Farmer C's gift program of 200 acres. This gift had appreciated from \$60,000 at the time of transfer to \$259,000 under current estimated conditions. The current estimated tax liability on this gift was \$44,677, or about 71 percent of the current estimated total estate tax for the hypothesized intestate estate. This tax was found by calculating the tax due for the total gross estate less the estimated value of the gift, under the intestate plan for estate distribution. The resulting tax was then subtracted from the tax of the intestate estate, \$67,477, to yield the estimated tax associated with the gift, \$44,677. Therefore, Farmer C's gift program helped his estate considerably relative to the current estimated tax situation.

The current estimated tax liability of Farmer C's estate is also less than the tax liability incurred by the farm at the time of actual transfer, \$4,535 as compared to \$50,980. Two items are primarily responsible for this situation: the marital deduction and the unified credit provision. The change of the marital deduction to an "unlim-

ited" status allows for all property left to the spouse to be eligible for the deduction. The amount of unified credit available in 1984 had also increased considerably and would exempt an estate of \$325,000 from tax liability, Appendix D.

Relative to the marital deduction and consequent distribution of property for the intestate estate, the Alabama Probate Code sets the guidelines. In this case, the marital deduction was half the adjusted gross estate, since one child of Farmer C's was the result of a previous marriage in which that spouse had died (2). This intestate marital deduction is in contrast with such provision in Farmer C's plan, where Farmer C designated for his spouse to receive half of his real property and all personal property (cash, life insurance, etc.). This contrast is clearly seen when Farmer C's marital deduction (\$454,908) is compared with the intestate marital deduction for Farmer C's estate plan (omitting the 200-acre gift of \$259,000, 1/2 of \$784,118 or \$392,059). The difference of \$62,849 saves the estate approximately \$18,200 in taxes. With respect to the property distribution, the probate code would grant Mrs. C half ownership in all the property (half the adjusted gross estate). The five children would divide equally the remaining half portion, with the half sibling taking equally with the full siblings (2). This particular situation would probably have precluded the fulfillment of Farmer C's objective of having the farm business continue, since the on-farm son would lose control of part of the land.

In summary, Farmer C's estate plan, with the aid of the current estate tax laws, continued to be effective in fulfilling Farmer C's estate objectives, even when subjected to increased current real estate values.

### Farm Estate D at Present Estimated Values

The 1984 estimated total gross estate of this farm was \$425,480 under fair-market valuation. The 328 acres of farm real estate (including buildings) had a value of \$286,016 or \$872 per acre. This figure represents an increase of about 34 percent over the value held by the property (\$213,050) at the time of actual transfer in the 1977-81 period. Farmer D's current estimated estate settlement appears in the following outline:

Real estate (328 acres at \$872 per acre).....	\$286,016
Stocks and bonds.....	6,260
Life insurance.....	36,009
Notes and cash.....	12,228
Other miscellaneous property.....	79,604
Jointly owned property (no land).....	5,363
Total gross estate.....	\$425,480

*Calculation of the Estimated Tax*

	Farmer D's estate plan	Intestacy; no estate plan
Total gross estate .....	\$425,480	\$425,480
Debts, mortgages, losses .....	(-)101,951	(-)101,951
Administration and funeral costs.....	(-) 6,617	(-) 6,617
Adjusted gross estate .....	\$316,912	\$316,912
Estate marital deduction .....	(-)316,912	(-)183,456
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$ -0-	\$133,456
Tentative gross estate tax .....	\$ -0-	\$ 33,837
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) -0-	(-) 268
Federal estate tax due.....	\$ -0-	\$ -0-
Total estate tax due .....	\$ -0-	\$ 268
Current estimated total estate tax, no plan.....		\$ 268
Current estimated total estate tax, Farmer D's plan .....		-0-
Current estimated estate tax savings for 1984 death .....		\$ 268

In the preceding estimated settlement under Farmer D's plan, the tax liability is zero. Three factors are primarily responsible for this situation: (1) the size of the estate, (2) the debt of the estate, and (3) the marital deduction. The 328 acres of Farmer D's estate did not significantly increase the value of the gross estate after being subjected to current estimated price levels. The size of the farm debt served to reduce the gross estate below the level that would currently pass tax free under the unified credit provision. The marital deduction was utilized to the fullest extent possible, since Farmer D designated property to go to his wife. Because of these factors, the taxable estate was zero and thus no tax liability was incurred by the estate.

With respect to the current estimated intestate estate plan for Farmer D's estate, the total tax liability changes only slightly to \$268. However, the probate code would have distributed the property in a different manner than prescribed in Farmer D's will. Under the code, Mrs. D would have received \$50,000 "off the top" of the gross estate, plus half the remaining balance of the adjusted gross estate. The two sons would then have split equally the remaining half of the adjusted gross estate (2).

In summary, Farmer D's estate plan continued to fulfill his desired objectives when subjected to increased current real estate price levels. For this particular size estate, Farmer D's plan appears to have worked satisfactorily. A possible improvement would have been the purchase of additional life insurance (probably term) to help cover the mortgage and thus avoid any threat of a forced sale of assets. Mrs. D could have been made the owner of the policy to prevent the proceeds from being included in Farmer D's estate.

### Farm Estate E at Present Estimated Values

This farm estate had the largest percentage increase in estimated real estate value of the cases examined, changing from a total value of \$106,133 in the pre-1977 period to a current value of approximately \$535,805, an increase of about 405 percent. Only the fair-market method of valuation was utilized in valuing the 1,061 acres involved. The current settlement for Farmer E's estate appears in the following outline:

Real estate (1,061 acres at \$505 per acre) .....	\$535,805
Stocks and bonds .....	13,654
Life insurance .....	1,000
Notes and cash .....	3,783
Other miscellaneous property .....	12,122
Total gross estate .....	\$566,364

#### Calculation of the Estimated Tax

	Mrs. E's estate plan	Intestacy; no estate plan
Total gross estate .....	\$566,364	\$566,364
Debts, mortgages, losses .....	(-) 2,910	(-) 2,910
Administration and funeral costs .....	(-) 2,999	(-) 2,999
Adjusted gross estate .....	\$560,455	\$560,455
Estate marital deduction .....	(-) -0-	(-) -0-
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$560,455	\$560,455
Tentative gross estate tax .....	\$178,168	\$178,168
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 12,418	(-) 12,418
Federal estate tax due .....	\$ 69,450	\$ 69,450
Total estate tax due .....	\$ 81,868	\$ 81,868
Current estimated total estate tax, no plan .....		\$ 81,868
Current estimated total estate tax, Mrs. E's plan .....		81,868
Current estimated estate tax savings for 1984 death .....		\$ -0-

It is apparent from the preceding estimated settlements that increasing farm real estate values have had an effect on the present estimated tax liability of this estate. The total estate tax due has increased approximately 554 percent over that which the estate incurred (\$12,519) at the original time of transfer. Also apparent is the present tax liability which, when calculated under Mrs. E's plan, shows no difference from the tax liability as calculated under the probate code for intestate estates. Review of the circumstances surrounding the original estate transfer reveals that there was no surviving spouse to qualify for the marital deduction. Therefore, other tools would have to be incorporated into the estate plan for it to be effective in reducing the present estimated tax liability. Probably two of the easiest and most effective tools to employ in this situa-

tion, considering Mrs. E's single estate objective to pass all property to her daughter, would be utilization of the annual gift exclusion and the employment of current-use valuation. Either of these tools, singly or in combination, would have helped reduce the tax liability.

With respect to property distribution, there would currently be no difference between Mrs. E's plan and the Alabama Probate Code. For this particular estate situation, the code, Section 43-8-42, (2) would allow the entirety of the property to pass to the daughter, just as Mrs. E's will would.

In summary, Mrs. E's present estimated estate plan showed no difference from the present estimated intestate plan with regard to the tax liability and the property distribution. However, there are tools currently available that would aid in reducing the tax liability for estates that are in this particular situation.

### Farm Estate F at Present Estimated Values

Farm Estate F represented the only intestate estate examined in this study. Farm Estate F transferred in the pre-1977 period and at that time had a total real estate value (including buildings and 1,807 acres) of \$263,629, a per acre value of approximately \$146. The 1984 total estimated real estate value was \$684,853, or \$379 per acre. This change represented an increase in value of 160 percent from the time of actual farm transfer. Farmer F's current estimated estate settlement is given in the following outline:

Real estate (1,807 acres at \$379 per acre) .....	\$684,853
Stocks and bonds .....	5,416
Life insurance .....	6,758
Notes and cash .....	20,623
Other miscellaneous property .....	13,345
Total gross estate, Farmer F's plan .....	\$730,995
Current estimated value of 270-acre gift program (\$379 per acre) ..	\$102,330
Total gross estate, no estate plan .....	\$833,325



*Calculation of the Estimated Tax*

	Farmer F's estate plan	Intestacy; no estate plan
Total gross estate .....	\$730,995	\$833,325
Debts, mortgages, losses .....	(-) 27,221	(-) 27,221
Administration and funeral costs .....	(-) 14,901	(-) 14,901
Adjusted gross estate .....	\$688,873	\$791,203
Estate marital deduction .....	(-)369,437	(-)420,602
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$319,436	\$370,601
Tentative gross estate tax .....	\$ 94,408	\$111,804
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 4,222	(-) 5,859
Federal estate tax due .....	\$ -0-	\$ 9,645
Total estate tax due .....	\$ 4,222	\$ 15,504
Current estimated total estate tax, no plan .....		\$ 15,504
Current estimated total estate tax, Farmer F's plan .....		4,222
Current estimated estate tax savings for 1984 death .....		\$ 11,282

Examination of the preceding estimated settlements shows some of the effects of increased property values on the estate. The real estate in this example has increased about 160 percent since the time of farm transfer. However, because of changes in the Alabama Probate Code and the federal estate tax laws, these increased real estate values have had little effect on the estimated tax liability. In fact, if comparison is made between the present estimated tax liability and the actual tax liability incurred by the estate at the original time of transfer, the tax liability has decreased by \$38,933 (\$43,155 - \$4,222).

Since Farmer F's estate was intestate, the difference in the above estimated tax liabilities can be attributed in part to Farmer F's gift of 270 acres to his wife. The estimated tax liability of the gift (\$11,282) actually decreased slightly from that which was estimated at the time of transfer (\$11,822). This shows in part that the present Alabama Probate Code, along with the present federal estate tax laws, has become more effective in its ability to distribute estates with a reduced tax burden. In general, however, there will always be greater administration costs associated with an intestate estate than with a testate estate.

With respect to property distribution, both the above estimated settlements would be distributed under the Alabama Probate Code. In each case, Mrs. F would receive \$50,000 "off the top" of the estate, then half of the adjusted gross estate. Since the daughter was an only child, she would receive the other half of the adjusted gross estate (2).

The current Alabama Probate Code awards the spouse a much greater share of the estate than previous Alabama statutes, such as the statute of "curtesy and dower." Under the old laws of descent and distribution in Code of Alabama, 1977 (3), the spouse would have received a life estate in one-third of the real property (Sections 43-5-1,2;) and half of the personal property outright (Section 43-3-10). The only part of the property that would have qualified for the marital deduction would be that property she had received outright. This fact is reflected in the original settlement under "bequests to spouse."

In summary, because of revisions in the Alabama Probate Code and changes in the federal estate tax laws, the tax burden of Farmer F's estate was actually less under present estimated values than at the time of actual farm transfer. The specific areas that were responsible for this situation were the marital deduction and the unified credit provision.

### Farm Estate G at Present Estimated Values

Farm Estate G transferred in the pre-1977 period and at that time had a total real estate value (including the home) of \$52,000. This value is low because 788 acres were given away prior to Farmer G's death. The real estate was valued using fair-market valuation. The per acre value for the real estate (including the home) of \$4,333 at the time of farm transfer increased to approximately \$8,744 at current levels, thereby yielding a total current estimated real estate value of \$104,928. This change represented an increase of roughly 100 percent. The current estimated settlement for this estate is outlined in the following summary:

Real estate (12 acres at \$8,744 per acre).....	\$104,928
Stocks and bonds.....	13,294
Life insurance.....	12,926
Jointly owned property (no land).....	15,618
Other miscellaneous property (Farmer G's partnership interest)...	87,380
Total gross estate, Farmer G's plan.....	\$234,146
Current estimated value of 788-acre gift program (\$643 per acre)...	\$506,684
Value of sons' 2/3 partnership interests.....	\$174,760
Total gross estate, no estate plan.....	\$915,590

*Calculation of the Estimated Tax*

	Farmer G's estate plan	Intestacy; no estate plan
Total gross estate .....	\$234,146	\$915,590
Debts, mortgages, losses .....	(-) 1,145	(-) 1,145
Administration and funeral costs .....	(-) 3,228	(-) 3,228
Adjusted gross estate .....	\$229,773	\$911,217
Estate marital deduction .....	(-)229,773	(-)480,609
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$ -0-	\$430,608
Tentative gross estate tax .....	\$ -0-	\$132,207
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) -0-	(-) 7,779
Federal estate tax due .....	\$ -0-	\$ 28,128
Total estate tax due .....	\$ -0-	\$ 35,907
Current estimated total estate tax, no plan .....		\$ 35,907
Current estimated total estate tax, Farmer G's plan .....		-0-
Current estimated estate tax savings for 1984 death .....		\$ 35,907

As can be seen in the preceding estimated calculations, the total gross estate of the no-estate-plan situation is several times larger than the total gross estate as estimated under Farmer G's plan. Included under the no-plan situation is the current estimated value of Farmer G's 788-acre gift program and the value of the sons' partnership interests. The difference in the above estimated tax liability can therefore be attributed to these two items.

Farmer G's estate plan under current estimated real estate values shows a tax liability of zero. However, consideration needs to be given to the cost of executing the gift program. The cost of transferring the land (788 acres) to the sons was \$6,306 at the original time of transfer and, although this cost does not show up in Farmer G's current estimated plan, it does represent a cost of transfer even under the current situation. The current estimated estate tax savings of Farmer G's plan over the hypothesized no-estate plan is \$35,907, if the two plans are compared against each other at the time of death. However, if the estate plans are compared over time, the tax savings are \$29,601 (\$35,907 - \$6,306). This latter figure would more clearly represent the true tax savings when comparing the two plans.

With respect to property distribution, Farmer G's plan distributes the land to his sons and Mrs. G is left ample assets for her care. The probate code would have distributed the estate in a different manner, Mrs. G receiving half the value of the adjusted gross estate (including both real and personal property) plus \$50,000. The children would split equally their part of the property. For this particular estate, the property distribution under the probate code has the potential of causing a much higher tax liability for Mrs. G's es-

tate because the code increases Mrs. G's estate considerably over that provided her in Farmer G's plan. Thus, Farmer G's plan has served to distribute the property in an effective manner, reduce the tax liability for the estate at his death, and also reduce the potential tax liability at his wife's death, even when subjected to current estimated real estate values.

### Farm Estate H at Present Estimated Values

This farm estate transferred in the post-1981 period. The total fair-market real estate value at the time of transfer was \$388,984, or approximately \$942 per acre for 413 acres, including buildings. The 1984 current estimated value of the real estate was \$361,788, or \$876 per acre. This change represents a decrease in value of approximately 7 percent, and reflects to some degree the general conditions that have been associated with the rural real estate market during the past 2 to 3 years. Farmer H's current estimated estate settlement is given in the following summary:

Real estate (413 acres at \$876 per acre).....	\$361,788
Stocks and bonds.....	1,130
Life insurance.....	49,426
Notes and cash.....	5,847
Other miscellaneous property (Farmer H's 1/3 partnership interest).....	55,867
Jointly owned property (128 acres at \$773 per acre).....	98,944
Total gross estate, Farmer H's plan.....	\$573,002
Value of sons' 2/3 partnership interests.....	\$111,734
Total gross estate, no estate plan.....	\$684,736

### Calculation of the Estimated Tax

	Farmer H's estate plan	Intestacy; no estate plan
Total gross estate.....	\$573,002	\$684,736
Debts, mortgages, losses.....	(-) 67,014	(-) 67,014
Administration and funeral costs.....	(-) 8,641	(-) 8,641
Adjusted gross estate.....	\$497,347	\$609,081
Estate marital deduction.....	(-) 252,485	(-) 329,541
Charitable bequests.....	(-) 0-	(-) 0-
Taxable estate.....	\$244,862	\$279,540
Tentative gross estate tax.....	\$ 69,156	\$ 80,844
Available unified credit.....	(-) 96,300	(-) 96,300
Credit for Alabama death tax.....	(-) 2,277	(-) 3,109
Federal estate tax due.....	\$ 0-	\$ 0-
Total estate tax due.....	\$ 2,277	\$ 3,109
Current estimated total estate tax, no plan.....		\$ 3,109
Current estimated total estate tax, Farmer H's plan.....		2,277
Current estimated estate tax savings for 1984 death.....		\$ 832

The decline in real estate values from the original time of farm transfer, along with an increase in the available unified credit, exempted this farm from federal estate tax liability under both Farmer H's plan and the hypothesized no estate plan. The estimated tax savings of Farmer H's plan over the no-plan situation is \$832. This figure reflects the difference in the state inheritance tax liabilities of the above alternative plans for the estate.

The marital deduction for both of the above calculations is important in reducing the potential tax liabilities. Under Farmer H's plan, Mrs. H receives half the total of all real estate (including jointly owned property), half of Farmer H's one-third interest in the farm partnership, and all personal property. Under the no-plan situation, Mrs. H receives half of the adjusted gross estate (including both real and personal property) plus \$50,000. Both marital deductions in this instance effectively reduce the taxable estate below the levels that are tax exempted by the available unified credit. The result is that both estimated estates are exempted from federal tax.

Relative to the property distribution, the probate code provides for Mrs. H to receive \$50,000 plus half the value of the adjusted gross estate, including both real and personal property. The children then receive the balance of the estate to divide equally. Farmer H's original plan provided for Mrs. H to receive half the total real estate in fee simple ownership and a life estate in the other half of the real property. Also, Farmer H's plan provided for Mrs. H and the two on-farm sons to share the one-third partnership interest, a situation that would not have occurred under the present Alabama Probate Code.

### Farm Estate I at Present Estimated Values

The 1984 current estimated total real estate value for this farm was \$224,790, or \$354 per acre for the 635 acres involved. This value represents a decrease of approximately 7 percent from the original value of \$242,000 at the time of farm transfer in the post-1981 period. The current estimated settlement for this farm estate appears in the following outline:

Real estate (635 acres at \$354 per acre).....	\$224,790
Stocks and bonds .....	8,000
Jointly owned property (no land) .....	15,593
Notes and cash.....	467
Other miscellaneous property.....	8,175
Total gross estate, Farmer I's plan .....	\$257,025
Current estimated value of 70-acre gift program (\$2,020 per acre)..	\$ 41,400
 Total gross estate, no estate plan .....	 \$398,425

*Calculation of the Estimated Tax*

	Farmer I's estate plan	Intestacy; no estate plan
Total gross estate .....	\$257,025	\$398,425
Debts, mortgages, losses .....	(-) 262	(-) 262
Administration and funeral costs .....	(-) 3,525	(-) 3,525
Adjusted gross estate .....	\$253,238	\$394,638
Estate marital deduction .....	(-)138,435	(-)222,319
Charitable bequests .....	(-) -0-	(-) -0-
Taxable estate .....	\$114,803	\$172,319
Tentative gross estate tax .....	\$ 28,241	\$ 45,942
Available unified credit .....	(-) 96,300	(-) 96,300
Credit for Alabama death tax .....	(-) 118	(-) 757
Federal estate tax due .....	\$ -0-	\$ -0-
Total estate tax due .....	\$ 118	\$ 757
Current estimated total estate tax, no plan .....		\$ 757
Current estimated total estate tax, Farmer I's plan .....		118
Current estimated estate tax savings for 1984 death .....		\$ 639

Farmer I's current estimated estate plan shows a federal tax liability of zero and a state death tax liability of \$118. There was no other previous tax paid, since Farmer I's gift of 70 acres to his wife passed tax free at the original time of transfer. The marital deduction under Farmer I's current plan includes 300 acres of land currently valued and all other personal property of the estate (stocks and bonds, jointly owned property, etc.). The estimated settlement under the current no-estate-plan situation for Farmer I's estate also shows a federal estate tax liability of zero. The state inheritance tax liability is calculated at \$757.

With respect to property distribution, the probate code would award a greater share of the property to the children in outright ownership. The marital deduction under this situation provides for Mrs. I to receive \$50,000 plus half of the adjusted gross estate, including both real and personal property. The children in this case receive the other half of the property to divide equally. Mrs. I's total share would be less than that given her by Farmer I's plan, since the 70-acre gift would be shared with the children. Also under the probate code, the trust situations as designed in Farmer I's will would not exist. Even though the present estimated tax savings are not great in magnitude, Farmer I's plan does save the estate approximately \$600 and distributes the property in a manner that meets and fulfills particular family needs.

### Farm Estate J at Present Estimated Values

Farm Estate J transferred in the post-1981 period and at the time of transfer had a total fair-market real estate value of \$558,857 for

the 837 acres of real estate solely owned. The 1984 estimated real estate value was \$621 per acre for a total of \$519,777. This represents a decrease of approximately 7 percent from the time of transfer. The current estimated settlement for estate J is shown in the following calculations:

Real estate (837 acres at \$621 per acre).....	\$ 519,777
Stocks and bonds.....	-0-
Life insurance.....	11,973
Notes and cash.....	15,545
Other miscellaneous property, partnership interest (approximately 3,663 acres at \$393 per acre).....	1,439,559
Total gross estate, Farmer J's plan.....	\$1,986,854
Value of gift program to sons.....	\$ 79,000
Total gross estate, no estate plan.....	\$2,065,854

*Calculation of the Estimated Tax*

	Mrs. J's estate plan	Intestacy; no estate plan
Total gross estate.....	\$1,986,854	\$2,065,854
Debts, mortgages, losses.....	(-) 156,337	(-) 156,337
Administration and funeral costs.....	(-) 62,912	(-) 62,912
Adjusted gross estate.....	\$1,767,605	\$1,846,605
Estate marital deduction.....	(-) -0-	(-) -0-
Charitable bequests.....	(-) -0-	(-) -0-
Taxable estate.....	\$1,767,605	\$1,846,605
Tentative gross estate tax.....	\$ 676,222	\$ 711,772
Available unified credit.....	(-) 96,300	(-) 96,300
Credit for Alabama death tax.....	(-) 82,868	(-) 88,556
Federal estate tax due.....	\$ 497,054	\$ 526,916
Total estate tax due.....	\$ 579,922	\$ 615,472
Current estimated total estate tax, no plan.....		\$ 615,472
Current estimated total estate tax, Farmer J's plan.....		579,922
Current estimated estate tax savings for 1984 death.....		\$ 35,550

The current estimated tax liabilities of both the preceding settlements are high relative to such liabilities of the other estates involved in this study. The difference of \$35,550 in tax savings for Mrs. J's plan over the no-plan situation reflects the potential estimated tax liability of Mrs. J's gift program to her sons. Approximately half the value of the gifts would have been paid in tax had the gifts not been made.

Mrs. J's estate plan incurred a present estimated tax liability of about \$580,000. This is a decrease of approximately \$60,000 from the tax liability actually assessed at the time of farm transfer and reflects the depressed nature of current farm real estate values. The only item in this instance that separates Mrs. J's estate settlement from the current no-plan situation is the gift program. Had Mrs. J been able to utilize other estate planning tools in reducing the taxable estate (specifically current-use valuation of the farmland, the

private annuity, and the annual gift exclusion for other family members), her overall objective of transferring the estate intact to her sons could probably have been more fully accomplished, with a reduced tax burden. However, even though the tax liability was large, Mrs. J's plan still helped save taxes.

With respect to property distribution, the current Alabama Probate Code would have passed all the property, both real and personal, equally to the two sons. This arrangement would not have differed greatly from Mrs. J's will, except that the will named specific properties for each son.

In summary, while Mrs. J did have a plan, at least some of the resulting tax liability could have been avoided had the plan been in execution early. However, for one reason or another, a plan was not implemented early, and the result was payment of the tax.

### **SELECTED ESTATE PLANNING TOOLS IN ALTERNATIVE PLANS VERSUS ESTATE OWNER'S PLAN UNDER CURRENT ESTIMATED CONDITIONS**

Three case estates at present estimated values were selected to illustrate the potential effects of alternative plans being applied to the estate situations. The alternative plans were formulated within the circumstances associated with the original estate transfers and thus reflect realistic alternatives that could have been employed by the estate owners to aid in reducing the estate's tax liability. Only those tools which would be allowed under a given estate's circumstances were utilized in developing these individualized alternative plans. Selection of these example estates was based primarily on the present estimated tax liability, but consideration was also given the estimated tax liability of the surviving spouse's estate since the unlimited marital deduction is currently effective.

There are no doubt alternatives other than the following that could be developed for these farm estates. However, those described are relatively simple and serve to accomplish the objectives of the estate owners within their particular situations.

#### **Farm Estate B, An Alternative Plan**

Farm Estate B transferred in the 1977-81 period and at that time employed current-use valuation for the real estate. The estimated



1984 estate settlement appears below, followed by an estimation of the tax liability for the surviving spouse's estate:

Real estate (2,235 acres at \$256 per acre) .....	\$ 572,160
Stocks and bonds .....	13,438
Notes and cash .....	151,059
Life insurance .....	85,765
Other miscellaneous property .....	251,000
Total gross estate .....	\$1,073,422
Debts, mortgages, losses .....	(-) 400,933
Administration and funeral costs .....	(-) 32,153
Adjusted gross estate .....	\$ 640,336
Estate marital deduction .....	(-) 791,822
Taxable estate .....	\$ -0-
Tentative gross estate tax .....	\$ -0-
Available unified credit .....	(-) 96,300
Credit for Alabama death tax .....	(-) -0-
Federal estate tax due .....	\$ -0-
Total estate tax due .....	\$ -0-
Current estimated total estate tax, Farmer B's plan .....	\$ -0-

Apparent in the above calculations is the amount of the marital deduction (\$791,822) which exceeded the value of the adjusted gross estate (\$640,336). Currently, all property received by a surviving spouse in ownership by way of a will qualifies for this deduction; hence, the reason for the value of the marital deduction in the above outline.

Because of this particular situation with the marital deduction (resulting from the provisions of Farmer B's will and the current estate tax laws) and current-use valuation, Farmer B's estate escaped all tax liability at his death under present estimated conditions. A casual inspection of the above summary may lead to the conclusion that Farmer B's estate plan did a "good" job of distributing his estate. Such a conclusion would be partially true, since Farmer B's estate plan under current conditions would pass his estate tax free and would distribute it according to his desires. However, examination of the estimated settlement for the estate received by Mrs. B from Farmer B reveals that this estate could be taxed rather heavily upon

Mrs. B's death. The estimated settlement for Mrs. B's potential estate appears in the following outline:

Total gross estate .....	\$791,822
Debts, mortgages, losses .....	(-) ?
Administration and funeral costs .....	(-) ?
Adjusted gross estate .....	\$791,822
Estate marital deduction .....	(-) -0-
Charitable bequests .....	(-) ?
Taxable estate .....	\$791,822
Tentative gross estate tax .....	\$264,611
Available unified credit .....	(-)192,800
Credit for Alabama death tax .....	(-) 22,407
Federal estate tax due .....	\$ 49,404
Total estate tax due .....	\$ 71,811
Current estimated total estate tax, Farmer B's plan .....	\$ -0-
Current estimated total estate tax, Mrs. B's estate, as designated under Farmer B's plan .....	\$ 71,811
Total estimated tax liability for both deaths .....	\$ 71,811

Several assumptions were made in developing the preceding estimated calculations for Mrs. B's estate. The total gross estate includes only property passed to Mrs. B by Farmer B in his will. This included 1,135 acres of land and all other personal farm and non-farm property of Farmer B. It did not include the value of any property that Mrs. B may have personally owned before Farmer B's death. Also, all property was held constant at its current value, including the land under current-use valuation. No appreciation was considered in the calculations and thus the total gross estate is conservatively estimated. The mortgage, the administration and funeral costs, and the charitable bequests are variables in the calculation process, and the actual tax liability will vary according to the influence exerted by these variables. A final assumption relates to the amount of unified credit for the estate. The calculation for the estimated tax liability allowed the maximum level of unified credit (\$192,800) which, in 1987 and beyond, will exempt an estate of \$600,000 from all federal estate tax liability.

The conservative assumptions exercised in the above estimated estate summary reveal that this estate could have a tax problem at Mrs. B's death. While Farmer B's plan may have been "good" under current conditions in accomplishing his objectives for his death, the same plan is inadequate in its ability to conserve the estate at Mrs. B's death, primarily because the plan causes Mrs. B's estate to become unnecessarily large by way of the marital deduction. The "unlimited" status of the marital deduction makes this tool extremely flexible for utilization in an estate plan; however, improper use of the marital deduction can lead to tax problems in the surviving spouse's estate.

Concerning solutions for this estate situation, there are probably many which could be developed. The solution selected was relatively simple and easily accomplished within the confines of Farmer B's estate objectives. The objectives of Farmer B's will at the original time of farm transfer were (1) provide for the wife until her death, (2) provide some inheritance for the children, and (3) save taxes. In an effort to fulfill these objectives, Farmer B had originally designated Mrs. B to receive 1,135 acres outright, 1,100 acres in a life estate, and all other personal farm and non-farm property. The children were to be provided for in the life estate, with taxes to be saved by taking full advantage of the marital deduction (then limited to \$250,000 or one-half the adjusted gross estate) and any unified credit that might be available. The solution proposed would fulfill the above objectives and eliminate most of the tax liability in Mrs. B's estate. The solution is stated in the following summary:

Decrease the size of the marital deduction in Farmer B's will by placing all 2,235 acres of land in a life estate for Mrs. B. The children would then hold equal or whatever interests deemed appropriate by Farmer B. The life estate would allow Mrs. B control and use of the property, without actual ownership. Thus, the life estate will be excluded from her estate at her death.

Decreasing the size of the marital deduction in Farmer B's estate would tend to increase the tax liability for his estate and decrease the tax liability for Mrs. B's estate. However, much of the tax liability created by this alternative in Farmer B's estate would be offset by the available unified credit, which Farmer B's current provisions completely ignore. Also by utilizing the land in the life estate, the appreciable asset of the farm is removed from Mrs. B's estate. Thus, not only the land at its current value but also its potential appreciation is sheltered from the tax. The alternative calculations for both estates appear in the following summary:

*Farmer B, Revised Plan, Current Estimated Values*

Total gross estate .....	\$1,073,422
Debts, mortgages, losses .....	(-) 400,933
Administration and funeral costs.....	(-) 32,153
Adjusted gross estate .....	\$ -640,336
Estate marital deduction .....	(-) 501,262
Taxable estate .....	\$ 139,074
Tentative gross estate tax .....	\$ 35,522
Available unified credit .....	(-) 96,300
Credit for Alabama death tax .....	(-) 313
Federal estate tax due .....	\$ -0-
Total estate tax due .....	\$ 313

*Mrs. B, Revised Estimated Estate Summary, Current Values*

Total gross estate .....	\$	501,262
Debts, mortgages, losses .....	(-)	?
Administration and funeral costs .....	(-)	?
Adjusted gross estate .....	\$	501,262
Estate marital deduction .....	(-)	-0-
Charitable bequests .....	(-)	-0-
Taxable estate .....	\$	501,262
Tentative gross estate tax .....	\$	156,267
Available unified credit .....	(-)	192,800
Credit for Alabama death tax .....	(-)	10,050
Federal estate tax due .....	\$	-0-
Total estate tax due .....	\$	10,050
Current estimated total estate tax, Farmer B's alternative plan .....	\$	313
Current estimated total estate tax, Mrs. B's estate under Farmer B's alternative plan .....	\$	10,050
Current estimated total estate tax, both deaths, Farmer B's alternative plan .....	\$	10,363

As can be seen in the above totals, the estimated tax liability for the combined deaths of Farmer and Mrs. B under the alternative plan is considerably less than under Farmer B's original plan (\$10,363 as opposed to \$71,811). This difference of \$61,448 has resulted without changing any of the basic objectives of Farmer B's will. Only the means to accomplish the objectives were altered.

Another possible solution with basically the same tax consequences would be creation of a testamentary trust (or trusts) with either all or part of the land. Like the life estate, the trust(s) could be designed to allow the son to continue farming, with the wife and daughters designated as trustee(s) and/or beneficiaries depending on which structure best fits the family situation.

A third solution would be for Farmer B to maintain his estate plan as is, leaving Mrs. B the responsibility for distributing her own estate. However, because time of death is so uncertain, there is no guarantee that Mrs. B would be able to execute the necessary plan. The risk involved for this alternative would be higher than for the previous mentioned alternatives. It should be recognized that, if this is the case, Mrs. B would have to be much more discrete in the selection and utilization of tools in her estate plan since no spouse is available for the marital deduction. Utilization of the annual gift exclusion would probably be the primary tool employed, because \$10,000 per year could be given to as many donees as desirable, tax free. Mrs. B could thus effectively reduce her estate by \$60,000 per year to her three children and their spouses for as many years as necessary to reduce her estate under that level covered by the unified credit provision.

### Farm Estate E, An Alternative Plan

This farm estate transferred in the pre-1977 period. Because current-use valuation for the real property was not available at that time, it was not considered for inclusion in the alternative plan developed under the present conditions. Also, since there was no surviving spouse involved in this estate (the estate owner was a widow), the marital deduction was excluded from the alternative plan. The estimated 1984 estate settlement appears in the following outline:

Real estate (1,061 acres at \$505 per acre) .....	\$535,805
Stocks and bonds .....	13,654
Life insurance .....	1,000
Notes and cash .....	3,783
Other miscellaneous property .....	12,122
Total gross estate .....	\$566,364
Debts, mortgages, losses .....	(-) 2,910
Administration and funeral costs .....	(-) 2,999
Adjusted gross estate .....	\$560,455
Estate marital deduction .....	(-) -0-
Taxable estate .....	\$560,455
Tentative gross estate tax .....	\$178,168
Available unified credit .....	(-) 96,300
Credit for Alabama death tax .....	(-) 12,418
Federal estate tax due .....	\$ 69,450
Total estate tax due .....	\$ 81,868
Current estimated total estate tax, Mrs. E's plan .....	\$ 81,868

As can be seen in the above calculations, the current estimated tax liability for the estate under Mrs. E's plan at present estimated values is rather high. Two reasons for this are that the marital deduction and current-use valuation provisions were both unavailable for utilization in the estate plan. These two tools are primarily applied to an estate at the time of death, since they are testamentary in nature. Therefore, in developing the alternative plan for this estate, consideration was given to the use of other tools, some of which were of an *intervivos* nature.

A review of Mrs. E's estate objectives reveals that her desire was to pass all property, real and personal, to her daughter. There are two tools, along with their possible modifications, that are readily available for utilization in this situation: the annual gift exclusion and the unified credit provision. The alternative plan for this estate is stated as follows:

Utilize the annual gift exclusion to pass property (either real or personal) tax free to the daughter, at least in that amount necessary to reduce the taxable estate to the level that will pass tax free under the unified credit provision.

If lifetime gifts under the annual gift exclusion had been employed in this estate plan by Mrs. E, the gross estate could have

been effectively reduced by about \$192,000 from the time of Farmer E's death to the present time, assuming Mrs. E would make the gifts to both her daughter and the daughter's husband. The \$192,000 is a conservative estimate because it represents only the value of the annual gift exclusion over those years. However, the estate would probably have been reduced even more because if land had been the substance of the gift, the exclusion would have passed not only the land at its gift value, but also any appreciation that might have accrued to the land. The projected settlement of Mrs. E's estate plan with the inclusion of lifetime gifts is shown by the following estimated settlement:

Total gross estate before gifts .....	\$566,364
Lifetime gift utilizing the annual gift exclusion (\$6,000 x 22 years, plus \$20,000 x 3 years) .....	(-)192,000
Total gross estate after gifts .....	\$374,364
Debts, mortgages, losses .....	(-) 2,910
Administration and funeral costs .....	(-) 2,999
Adjusted gross estate .....	\$368,455
Estate marital deduction .....	(-) -0-
Charitable bequests .....	(-) -0-
Taxable estate .....	\$368,455
Tentative gross estate tax .....	\$111,075
Available unified credit .....	(-) 96,300
Credit for Alabama death tax .....	(-) 5,791
Federal estate tax due .....	\$ 8,984
Total estate tax due .....	\$ 14,775
Current estimated total estate tax, Mrs. E's Plan .....	\$ 81,868
Current estimated total estate tax, Mrs. E's alternataive plan with gifts .....	\$ 14,175
Current estimated total estate tax savings .....	\$ 67,903

The above estimated settlements reveal the realistic tax liabilities that this estate could encounter under present conditions, assuming current-use valuation would not be employed in the appraisal scheme. The estimated tax savings gained from the inclusion of gifts in the estate plan are also shown and, as can be seen, these reduced the estate tax liability about 82 percent from \$81,868 to \$14,775.

Transfer of the estate by annual tax free gifts reduces the gross estate gradually, but effectively. In general, for the gift to be effective, the donor must relinquish all control and ownership of the gift. Many estate owners are sometimes reluctant to do this, and the reasoning for this attitude is understandable. Also understandable, however, is the question, "Who would you rather receive your property — your family or the government?"

There are two other estate planning tools that can be of service to estate owners in this situation, and these could have been employed by Mrs. E if she had so desired: the irrevocable trust with a "Crummey" provision and the corporation. Under both of these tools, the

estate owner could maintain some control over the gifts without ownership. For the irrevocable trust, the control would be in an indirect manner. The trust agreement would state the conditions of how the beneficiaries could receive or use the property. For the corporation, the estate owner would have more direct control because 51 percent ownership in the stock governs the direction and actions of the corporation. For Mrs. E's estate, the main concern with both these tools would be the consequences of utilizing land as the gift corpus. In this case, competent farm tax lawyers and accountants may need to be consulted.

### Farm Estate J, An Alternative Plan

This farm estate transferred in the post-1981 period and is similar to farm estate E in that no spouse was available for utilization of the marital deduction. It is also similar to farm estate E in that current-use valuation was not employed in appraising the farm real estate. The estimated 1984 estate settlement under Mrs. J's original plan appears below:

Real estate (837 acres at \$621 per acre).....	\$ 519,777
Stocks and bonds.....	-0-
Life insurance.....	11,973
Notes and cash.....	15,545
Other miscellaneous property partnership interest.....	1,439,559
Total gross estate.....	\$1,986,854
Debts, mortgages, losses.....	(-) 156,337
Administration and funeral costs.....	(-) 62,912
Adjusted gross estate.....	\$1,767,605
Estate marital deduction.....	(-) -0-
Taxable estate.....	\$1,767,605
Tentative gross estate tax.....	\$ 676,222
Available unified credit.....	(-) 96,300
Credit for Alabama death tax.....	(-) 82,868
Federal estate tax due.....	\$ 497,054
Total estate tax due.....	\$ 579,922

The preceding outline shows Mrs. J's estate plan under current conditions. The calculation of the total gross estate gives consideration to Mrs. J's gift program of \$79,000, which was accomplished for the two sons over an 11-year period.

Review of the circumstances surrounding this estate reveals that major obstacles were involved which prevented the use of certain basic tax saving tools in the estate plan. There had been a divorce and this prevented the utilization of the marital deduction. Mrs. J's health was poor and this precluded the purchase of additional life insurance as well as the use of the private annuity. The partnership was arranged in such a manner that either it did not qualify for, or

the executors chose not to use, current-use valuation. These factors combined to basically limit the options available to this estate for reducing the tax liability. However, had some early intense planning been applied to the situation, Mrs. J could possibly have accomplished her estate objective of passing the property equally to the two sons with a reduced tax liability.

The tools applied to the alternative plan for this situation had the capability of either reducing the gross estate or reducing the taxable estate. The proposed alternative estate plan for Mrs. J's estate under current conditions appears in the following summarization:

Increase the level of lifetime gifts, utilizing the annual gift exclusion, to include other family members within the two sons' families. Utilize the unified credit provision to aid in transferring the specific devises to the two sons at a reduced tax cost. Then by way of the will, establish a "life estate" in the residual property, naming the two sons to receive an income interest for life in such property, with remainder interests (the principal) to vest in either a private charitable foundation or another charitable entity of some type (for example, an educational institution, a timber or forest preservation and/or promotional foundation, etc.). This arrangement could then be utilized to qualify the remainder interest for the charitable deduction and could help reduce the tax liability.

This particular arrangement would not be commonplace in its usage and results only from the circumstances surrounding this estate.

The settlement for this plan is outlined below and has included five grandchildren who, along with the two sons' wives, could qualify for the annual gift exclusion over the same 11-year period as the two sons:

Total gross estate .....	\$1,706,854
Debts, mortgages, losses .....	(-) 156,337
Administration and funeral costs .....	(-) 62,912
Adjusted gross estate .....	\$1,487,605
Estate marital deduction .....	(-) -0-
Charitable bequests .....	(-) 967,828
Taxable estate .....	\$ 519,777
Tentative gross estate tax .....	\$ 163,117
Available unified credit .....	(-) 96,300
Credit for Alabama death tax .....	(-) 10,791
Federal estate tax due .....	\$ 56,026
Total estate tax due .....	\$ 66,817

The total gross estate in the above settlement is \$280,000 less than the total gross estate for Mrs. J's plan and reflects the utilization of the annual gift exclusion over an 11-year period for the two



sons' wives and five grandchildren (10 years X \$3,000 per year, and 1 year X \$10,000 per year). The gifts to the children could be made to an irrevocable trust with a "Crummey" provision with the parents established as trustees. Various types of property could be used to fund this arrangement, be it certain parcels of land or cash from the sale of timber. If the gifts were made with property of an appreciable nature (i.e. land), the effect on the gross estate would be more pronounced because not only the gift value but also any appreciation would be removed from the gross estate.

Establishment of the charitable deduction by way of the private charitable foundation or other charitable entity requires specific wording and structure and would need to be accomplished with professional legal help. In general, the provision could be structured for the two sons to receive an income interest with the remainder to charity; the two sons could receive the income produced by the charitable trust for their life. The advantage of this particular tool is that the family could still retain a monetary benefit from the property. The disadvantage is that direct control of the property is lost; however, this was the case anyway since much of the property had to be sold to pay the taxes. While giving to "charity" may not be the number one priority of an estate plan, if done correctly it can save taxes and provide benefits for the family or business as well. Again, competent legal assistance would need to be secured to establish this provision.

The settlement shows the unified credit provision used to pass \$519,777 in specific devises to the sons at a reduced tax cost. However, the provision may have been more effective if used during Mrs. J's life, especially if property of an appreciable nature (such as land) is utilized in the transfer. Utilization of the unified credit provision during life means that it would not be available at death; however, if it would exclude more property from the tax, it would be more efficiently utilized in life.

Concerning the property distribution, each son would receive a little less property under this alternative plan than otherwise would have been transferred under Mrs. J's actual plan at the time of death. However, the income interest from the charitable entity should help lessen this difference and, in the long run, the sons would gain from this arrangement.

## SUMMARY AND CONCLUSIONS

This study sought to describe and explain the various aspects of the farm estate transfer process. The primary focus of the research

centered on 10 actual farm case estates that had undergone transfer within the past 15 years. The actual settlement process of these estates was examined in detail, with consideration given to the objectives and means of transfer, the federal and state estate tax liability associated with the transfer, and the resulting effects of the transfer upon the family and farm situation. Of the 10 cases examined, 7 (A, B, C, D, G, H, and I) had the primary estate objective of caring for the wife for the remainder of her life. Providing for the wife until her death thus seemed to be the main concern of farm estates involved in this study. The most common method used to accomplish this objective was to leave the wife fee simple ownership in half the real property and a life estate in the other half. Varying proportions of personal or farm personal property were left to the wife in each of these instances.

The second and third objectives of the estate plan became more varied and personalized with the individual estate, and these included both tax and non-tax objectives. Dominant in these secondary objectives, however, was the desire to provide an inheritance for the children that would represent a "fair treatment" for each child. In most instances, if the farm operation was to continue, consideration was given to the on-farm heirs. In two of the estates examined, the wife was the estate owner, and in both instances the main objective of the estate plan was to leave all property directly to the immediate children. One case passed under the intestate laws of descent and distribution in the pre-1977 period.

Concerning tax liability, the range of federal estate tax paid for the 10 case estates in their original settlements was rather varied, the low being 0 as recorded in estates D, H, and I and the high being \$546,318 as recorded in estate J. Estates A, B, C, and F incurred federal tax liabilities ranging from \$41,119 to \$73,647, and estates E and G incurred federal estate tax liabilities of \$12,273 and \$2,779, respectively. Two cases in this study, A and B, utilized current-use valuation in the estate plan. This tool aided in reducing their federal tax liability, an estimated \$48,491 for estate A and an estimated \$96,568 for estate B.

With respect to the effects of the transfer on the family and farm situation, most of the heirs of the various estates did believe that the estate owners' objectives were accomplished in the transfer process. Several operations have been rearranged as the result of the transfer, and some are no longer directly involved in agriculture. No major family problems developed as a result of transfer for any of the 10 case estates examined.

In the second part of the research, the 10 case estates were updated to current estimated values by updating the estimated land values of the particular estate. Because of the current "unlimited" status of the marital deduction, the current level of unified credit available, and other tools such as current-use valuation, the estimated tax liability of several estates actually decreased from the earlier period of actual transfer. Estates A, B, C, and F experienced drastic decreases in their estimated tax liabilities under the estate owner's actual plan. Farm estate F experienced a tax decrease from the earlier actual settlement because of the updated Alabama Probate Code. Estates D, G, H, I, and J also experienced some decrease in the estimated tax liabilities, although such decreases were not as pronounced as in the four previously mentioned estates. Estate E, contrary to the other estates, underwent an approximate five-fold increase in the estimated tax liability, with respect to the actual period of estate transfer. When compared to the current estimated tax liabilities for no estate planning, all estates except E displayed a savings over the plan imposed under the Alabama Probate Code. This held true under both fair-market and current-use valuation alternatives. Estate E was an exception because the plan for this estate corresponded exactly to the Alabama Probate Code for the given set of circumstances involved. There was no difference in the updated estimated tax liability of estate E's plan and the Alabama Probate Code's distribution of the property.

In the final part of the research, three case estates were selected to illustrate the effects of the application of certain estate planning tools to the estate transfer process. The three cases for this phase were selected on the basis of the size of the present estimated tax liability that would be incurred in both the estate owner's and the surviving spouse's estate. The objective of this phase was to develop an alternative plan that would reduce the estimated tax liability within the circumstances associated with the particular estate. In all three cases, an alternative plan was developed which accomplished the estate owner's objectives with a considerable reduction in the present estimated tax liability. The tax liability of estate B was reduced from \$71,811 for both deaths to \$10,363; the tax liability of estate E was reduced from \$81,868 to \$14,775; and the tax liability of estate J was reduced from \$579,922 to \$66,817. In the property distribution for each case, the heirs under the hypothesized alternative plans received the same or greater amounts of property as allowed under the original transfer plan.

Results of this research seem to indicate that while the federal

transfer tax does exist, most estate or transfer tax liability can be avoided if farmers and farm-related small businesses will take the time to do the necessary planning. While most estates in this study incurred some level of federal transfer tax liability, the results indicate that, with the current tools available and the range of flexibility of these tools under current legislation, many farm and farm-related estates should be able to eliminate most intergenerational transfer tax and non-tax problems. The results also indicate that avoidance of the tax liability can occur without loss of the estate owners' non-tax objectives for the estate transfer process. Both tax and non-tax considerations can thus be accomplished with a properly developed and executed estate plan.

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## APPENDIX A

NOMINAL AVERAGE FARM REAL ESTATE PRICES IN ALABAMA,  
1949-84, INCLUDING THE PERCENTAGE CHANGE  
IN PRICE AND THE RELATIVE PRICE INDEX

Year	Average price per acre	Change in price	Price index (1967 = 100)
	<i>Dollars</i>	<i>Percent</i>	
1949	51		
1950	49	(-) 3.9	31
1951	53	8.2	33
1952	58	9.4	36
1953	60	3.4	38
1954	56	(-) 6.7	35
1955	60	7.1	38
1956	67	11.7	42
1957	71	6.0	45
1958	76	7.0	48
1959	86	13.2	54
1960	91	5.8	57
1961	95	4.4	60
1962	99	4.2	62
1963	106	7.1	67
1964	118	11.3	74
1965	130	10.2	82
1966	142	9.2	89
1967	159	12.0	100
1968	170	7.0	107
1969	187	10.0	118
1970	200	7.0	126
1971	226	13.0	142
1972	236	4.4	148
1973	267	13.1	168
1974	331	24.0	208
1975	364	10.0	229
1976	425	16.8	267
1977	477	12.2	300
1978	527	10.5	331
1979	639	21.3	402
1980	792	23.9	498
1981	935	18.1	588
1982	922	(-) 1.4	580
1983	876	(-) 5.0	551
1984	858	(-) 2.1	540

Source: United States Department of Agriculture, *Farm Real Estate Market Developments*, Outlook and Situation Report. Economic Research Service, Selected Annual Issues, Washington, D.C.

## APPENDIX B

ESTIMATED PER ACRE AVERAGE CASH RENT FOR WHOLE FARMS, CROPLAND, AND PASTURE LAND, ESTIMATED AVERAGE FARM REAL ESTATE TAXES PER ACRE, AND AVERAGE ANNUAL NET CASH RENT FOR FARMS, ALABAMA, 1977-84

	1977	1978	1979	1980	1981	1982	1983	1984
Cash rent, farms.....	\$22.60	\$23.50	\$25.60	\$28.30	\$29.00	\$30.10	\$30.60	\$28.80
Cash rent, cropland ...	27.20	28.80	31.60	35.00	35.30	36.10	37.80	35.40
Cash rent, pasture .....	11.80	12.10	13.60	16.10	17.10	17.40	17.40	18.20
Taxes .....	0.57	0.67	0.92	0.90	0.90	1.20	1.20*	1.20*
Net rent.....	22.03	22.83	24.68	27.40	28.10	28.90	29.40	27.60

\*Calculated estimates of the average per acre rent in Alabama for 1981-84, since no official estimates have currently been published.

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## APPENDIX C

AVERAGE ANNUAL EFFECTIVE INTEREST RATES CHARGED ON NEW FEDERAL LAND BANK LOANS, AVERAGED OVER THE FIVE PREVIOUS YEARS, 1977-84, FOR ALL 12 LAND BANK DISTRICTS

	1977	1978	1979	1980	1981	1982	1983	1984
	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.	Pct.
Baltimore, Md.....	8.65	8.86	9.04	9.24	9.66	10.48	11.82	12.07
Columbia, S. C. ....	8.58	8.79	8.96	9.17	9.40	9.81	10.93	11.14
Houston, Texas.....	8.29	8.48	8.60	8.76	9.09	9.74	10.88	10.92
Louisville, Ky. ....	8.64	8.80	8.88	9.21	9.53	10.02	11.39	11.76
New Orleans, La.....	8.26	8.48	8.72	8.96	9.33	9.88	11.13	11.37
Omaha, Neb. ....	8.70	8.92	9.05	9.25	9.59	10.17	11.52	11.86
Sacramento, Calif.....	8.67	8.82	9.04	9.35	9.63	10.12	11.35	11.43
St. Louis, Mo.....	8.50	8.71	8.93	9.20	9.77	10.37	11.71	11.93
St. Paul, Minn.....	8.21	8.47	8.69	8.95	9.30	9.84	11.17	11.43
Spokane, Wash.....	8.63	8.88	9.10	9.31	9.60	10.13	11.31	11.57
Springfield, Mass.....	8.42	8.55	8.65	8.81	9.10	9.52	10.71	11.03
Wichita, Kans. ....	8.52	8.72	8.88	9.08	9.56	10.26	11.65	11.91

Source: United States Department of the Treasury, Internal Revenue Service. *Federal Estate and Gift Taxes*, Publication 448; 1979, 1980, 1982, and 1984.



## APPENDIX D

## UNIFIED CREDIT AVAILABLE PER ESTATE AS ESTABLISHED IN THE TAX REFORM ACT OF 1976 AND THE ECONOMIC RECOVERY TAX ACT OF 1981

Year	Available credit	Amount of transfer exempt from estate and/or gift tax
1977	\$ 30,000	\$120,666
1978	34,000	134,000
1979	38,000	147,333
1980	42,500	161,563
1981	47,000	175,625
1982	62,800	225,000
1983	79,300	275,000
1984	96,300	325,000
1985	121,800	400,000
1986	155,800	500,000
1987	192,800	600,000

## Sources:

1. *Internal Revenue Code*; Volume 2, 1983; 2010(b), Commerce Clearing House, Inc., Chicago, Ill.
2. *Analysis of the Economic Recovery Tax Act of 1981*, 1981, Matthew Bender Company, Inc., Section 161, New York, N.Y.
3. Uchtmann, Donald L., J. W. Looney, N. G. P. Krausz, and H. W. Hannah. *Agricultural Law: Principles and Cases*, 1981, 567 pp., McGraw Hill Book Co., Inc.
4. *Federal Estate and Gift Taxes: Code and Regulations*, p. 9, February 1984, Commerce Clearing House, Inc., Chicago, Ill.

## APPENDIX E

**Credit Allowed for Estate Tax on Prior Transfers**

This is a credit that is allowed against the tax liability of property within an estate that transfers twice within a 10-year period. The credit is limited strictly to the tax liability generated by the particular property, and is generally not available for the estate as a whole. The amount of credit is limited to the smaller of the following: (1) the amount of federal estate tax attributable to the transferred property in the transferor's estate, or (2) the amount of federal estate tax attributable to the transferred property in the transferee's (decendent's) estate.

The credit is limited in amount to the smaller of the tax liabilities generated by the property in either the transferor's or the transferee's estate. There is also a limit with respect to how much of either of the above can be applied as a credit, depending upon the number of years involved. If the transferee deceased within 2 years of the transferor, the credit is 100 percent of either (1) or (2) above. If the transferee deceased after 2 years of the transferor, the credit shall be as follows:

1. 80 percent, if the transferee deceased within years 3 and 4 of the transferor,
2. 60 percent, if the transferee deceased within years 5 and 6 of the transferor,
3. 40 percent, if the transferee deceased within years 7 and 8 of the transferor,

and

4. 20 percent, if the transferee deceased within years 9 and 10 of the transferor.

No credit is allowed if the transferee did not decease within 10 years of the transferor.

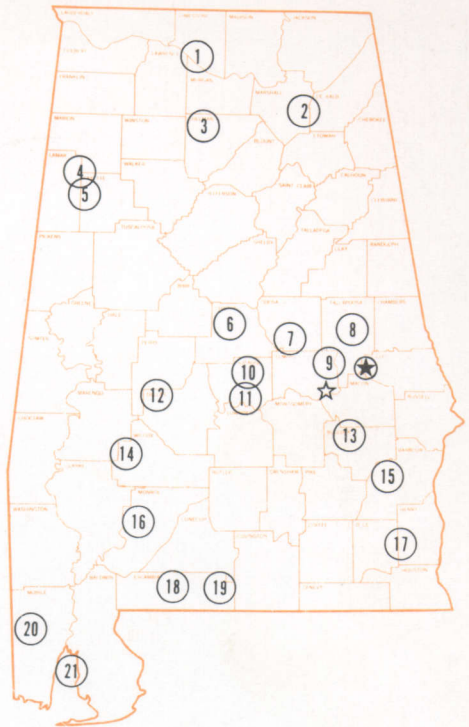
**Sources:**

1. *Internal Revenue Code*, Volume 2, Section 2013, 1983, Commerce Clearing House, Inc., Chicago, Ill.
2. Internal Revenue Service, Department of the Treasury, *Federal Estate and Gift Taxes*, Publication 448, Rev. Sept. 1984, 33 pp., U.S. Government Printing Office, Washington, D.C.
3. *Federal Estate and Gift Taxes: Code and Regulations*. February 1984, Commerce Clearing House, Inc., Chicago, Ill.



## Alabama's Agricultural Experiment Station System AUBURN UNIVERSITY

With an agricultural research unit in every major soil area, Auburn University serves the needs of field crop, livestock, forestry, and horticultural producers in each region in Alabama. Every citizen of the State has a stake in this research program, since any advantage from new and more economical ways of producing and handling farm products directly benefits the consuming public.



### Research Unit Identification

- ★ Main Agricultural Experiment Station, Auburn.
- ☆ E. V. Smith Research Center, Shorter.

1. Tennessee Valley Substation, Belle Mina.
2. Sand Mountain Substation, Crossville.
3. North Alabama Horticulture Substation, Cullman.
4. Upper Coastal Plain Substation, Winfield.
5. Forestry Unit, Fayette County.
6. Chilton Area Horticulture Substation, Clanton.
7. Forestry Unit, Coosa County.
8. Piedmont Substation, Camp Hill.
9. Plant Breeding Unit, Tallassee.
10. Forestry Unit, Autauga County.
11. Prattville Experiment Field, Prattville.
12. Black Belt Substation, Marion Junction.
13. The Turnipseed-Ikenberry Place, Union Springs.
14. Lower Coastal Plain Substation, Camden.
15. Forestry Unit, Barbour County.
16. Monroeville Experiment Field, Monroeville.
17. Wiregrass Substation, Headland.
18. Brewton Experiment Field, Brewton.
19. Solon Dixon Forestry Education Center, Covington and Escambia counties.
20. Ornamental Horticulture Field Station, Spring Hill.
21. Gulf Coast Substation, Fairhope.