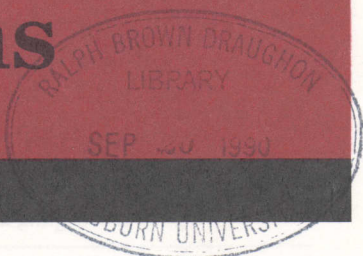




Tools

of Estate Planning for Alabama Farms



ALABAMA AGRICULTURAL EXPERIMENT STATION
AUBURN UNIVERSITY

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TOOLS OF ESTATE PLANNING FOR ALABAMA FARMS

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FARMS AND FARM-RELATED businesses often encounter problems in estate transfer. Among the troublesome situations encountered are an imposed burdensome tax liability, family strife and quarrels, uncertainty for the distribution and future use of property, and excessive probate and administrative costs. In an effort to help reduce these problems, a study was designed to identify and describe various tools for planning and transferring the farm estate. The marital deduction, selected trusts, life insurance, forms of business organization, and current-use valuation of farmland, along with many other aids to the estate transfer process, were examined in the study reported herein. Historical aspects of the estate transfer process identified in the study provide a framework for understanding the current estate transfer regulations.

Concerning the tools of estate planning, this report does not promote one tool more than another because all are useful. The individual estate owner must determine which tools best achieve his unique estate objectives. Once an estate owner is familiar with the basic estate planning concepts, a competent farm or small-business estate lawyer, accountant, insurance agent, or professional estate planner can provide the specific details for the planning process. It is assumed that the effectiveness of the professional estate planner in developing a complete, efficient, and workable estate plan will be enhanced by the estate planning knowledge of the estate owner. This concept was an underlying theme of the study that was arranged around the objective of trying to broaden the understanding of individuals with respect to estate planning.

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RESEARCH OBJECTIVES AND PROCEDURE

This is the second phase of a two-phase research project entitled, "Estate Planning for Alabama Farms and Farm-Related Small Businesses." The first, or descriptive phase, of the research is contained in Alabama Agricultural Experiment Station Bulletin 580², and consists of a case study analysis of 10 farm estates that transferred within the past 15 years. Both phases of this research were the second segment of a parent research project entitled, "Estate Planning for Farmers," which was executed with support provided under Hatch Project No. 576 through the Alabama Agricultural Experiment Station, Auburn University. The four objectives for this two-phase study, which provided the guidelines for the research effort, were:

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 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, utilize selected estates with these updated values and examine the effects of the application of selected estate planning tools in accomplishing the estate owner's objectives, with the overall objective of reducing 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 examining various historical aspects of the estate transfer process.

Results of objectives one and four are contained in this phase of the study. Results of objectives two and three are reported in Bulletin No. 580, the descriptive phase of this study. All four objectives contribute directly to the second and third objectives of the parent project.

²Alabama Agricultural Experiment Station Bulletin 580, "Estate Planning for Alabama Farms: A Case Study."

TOOLS OF ESTATE PLANNING

Historical Perspectives

The progressive estate tax structure was first permanently instituted in 1941 (40). It remained relatively stable for many years, with little effort made to initiate legislative changes. From the introduction of the marital deduction in the Revenue Act of 1948 (36) until the Tax Reform Act of 1976, there were no major changes in these laws. However, the Tax Reform Act of 1976 (TRA 1976) and the consequent Economic Recovery Tax Act of 1981 (ERTA 1981) brought major revisions to the estate tax structure, revisions that are beneficial to farmers and small businesses in general. The major provisions of both these acts are summarized below with references back to the 1948-76 period.

The Tax Reform Act (TRA) of 1976 covered the period January 1, 1977, through December 31, 1981, with some transition arrangements involved prior to the beginning of the period. The dominant features of the Tax Reform Act with respect to estate planning were the following.

1. The Act abolished the lifetime specific exemption of \$60,000 per estate and the lifetime specific gift exclusion of \$30,000 per individual (\$60,000 if joint between husband and wife) and created the Unified Credit Tax provision. The unified credit provision combined the estate and gift tax schedules of the pre-1977 period into a single unified transfer tax schedule, thus making the estate and gift tax rates equal. This provision has simplified the transfer tax system.

2. It created the "current-use" valuation method of appraising the value of farm real estate for estate tax purposes (Section 2032A of the Internal Revenue Code). The current-use valuation method represents an alternative to the fair-market valuation method for appraising the value of farm real estate. This provision could be used to reduce the value of the gross estate by up to \$500,000.

3. It restructured the estate tax marital deduction. Prior to 1977, the estate marital deduction allowed was one-half the value of the adjusted gross estate. Under TRA 1976, the marital deduction was adjusted to \$250,000 or one-half the adjusted gross estate, whichever was greater. This basically allowed an exemption of up to \$250,000 at the death of the first spouse, if the property was transferred in fee simple ownership to the surviving spouse. A marital deduction was not allowed for any life estate passing to the spouse.

4. It restructured the gift tax marital deduction. Prior to 1977, this deduction was similar to the estate marital deduction in that one-half the value of a taxable gift made to a spouse was allowed as a deduction; the other half of the gift was subject to the gift tax. The Tax Reform Act changed this provision to allow the first \$100,000 of gifts transferring to a spouse to do so free of gift tax; however, the next \$100,000 of gifts transferring to the spouse was fully (100 percent) taxable. For all gifts passing to the spouse in excess of this combined \$200,000, one-half the value of these gifts was subject to gift tax.

5. The Act abolished the "contemplation of death" clause with respect to taxable gifts made within 3 years of death. Prior to 1977, certain taxable gifts given within 3 years of the transferor's death could escape being "brought back" into the estate for estate tax purposes, if it could be successfully proven a "life motive" existed in making the gifts; that the gifts were not made in "contemplation of death." In an attempt to halt litigation on the matter, the TRA 1976 provided that all taxable gifts, regardless of the motive, would be included in the transferor's gross estate if made within 3 years of death.

6. It amended the rules concerning joint-tenancy property held between spouses. Prior to the Tax Reform Act, the full value (100 percent) of the property held in a joint-tenancy right-of-survivorship relationship, whether spousal or nonspousal, was included in the estate of the first co-tenant to die, except that portion for which the surviving co-tenant could prove responsibility for consideration furnished. Because of the right-of-survivorship provision of the deed, the full value of the property could be taxed in both the husband's and wife's estate, since the property would automatically vest in the wife in fee simple upon the husband's death; hence the possibility of double taxation. The TRA 1976 helped ease this problem somewhat for spousal joint tenancies by introducing the "qualified joint-interest" concept. Under this "qualified joint-interest" concept, only 50 percent of the value of spousal jointly held property was included in the estate of the first to die, if certain requirements were met; however, the requirements were difficult to meet. The Revenue Act of 1978 modified this concept somewhat by allowing certain farm or other small-business property, held under a joint-tenancy relationship between spouses, to utilize a "2-percent credit" rule. This rule allowed a spouse involved in the business to get credit for her contribution to the business at the rate of 2 percent per year for a maximum of 25 years; thus, 50 percent of the value of the jointly held property could be excluded from the estate of the first spouse to die. However, a dollar limit of \$500,000

was imposed on the amount that this provision could be used to reduce a decedent's gross estate.

7. The Act liberalized Section 6166 of the Internal Revenue Code, the extension of time for payment of the estate tax. Prior to 1977, the estate tax attributable to certain property could be paid in 10 equal yearly installments if such property, as an interest in a closely held business, composed at least 35 percent of the gross or 50 percent of the taxable estate of the decedent. The TRA 1976 renamed Section 6166 as 6166A and created a new Section 6166. The new section 6166 allowed a 15-year time period for payment of estate taxes attributable to farm or other closely held business property. To qualify for this election, the property associated with the farm or closely held business must have comprised at least 65 percent of the decedent's adjusted gross estate.

There were many other provisions associated with the Tax Reform Act of 1976, but the above were probably the most important to farm estate planning.

On January 1, 1982, the Economic Recovery Tax Act (ERTA) of 1981 took effect and, with its inception, the federal estate tax laws were again significantly altered. This Act served to delete, liberalize, or simplify provisions of the earlier Tax Reform Act, and the changes were to the advantage of farmers, small businesses, and small estate owners in general. The principal features of ERTA 1981 with respect to estate planning were the following.

1. ERTA altered the unified credit tax provision. Under the TRA, unified credit allowed against the estate or gift tax liability increased yearly from 1977 through 1981, with a maximum of \$47,000 reached in 1981. This \$47,000 would exclude an estate of \$176,625 from all federal estate tax liability. ERTA liberalized this provision such that unified credit will increase to \$192,800 by 1987, and at that time exclude an estate of \$600,000 from all federal tax liability.

2. ERTA liberalized application of the current-use valuation method of appraising real property. ERTA expanded the \$500,000 limit by which current-use valuation could be used to reduce the gross estate to \$600,000 in 1981, \$700,000 in 1982, and \$750,000 in 1983 and thereafter. ERTA also expanded other provisions of the current-use section, especially those dealing with timberlands and closely held businesses. Finally, changes were also made to reduce the "recapture" period from 15 to 10 years post-mortem. For decedents dying prior to January 1, 1982, a 15-year recapture period ex-

ists; for those dying after December 31, 1981, a 10-year recapture period is in effect.

3. ERTA expanded the flexibility of the marital deduction. ERTA combined the estate and gift tax marital deductions and eliminated all restrictions and limits associated with transfers between spouses. The amount of property that can now transfer between spouses is unlimited and free of transfer tax, no matter whether the transfer is made during life or at death through the will. For estate tax purposes, any amount of the decedent's estate can be used in the marital deduction and whatever amount is used will be excluded from taxation.

4. ERTA eliminated the 3-year limitation on the transference of taxable gifts. Under the TRA 1976, all taxable gifts made within 3 years of the transferor's death were "brought back" into the gross estate. ERTA eliminated this limitation and taxable gifts can now be transferred at any time prior to the transferor's death without being brought back into the estate. There are a few restrictions.

5. ERTA simplified the rules governing transfer of joint-tenancy, right-of-survivorship property. Under the ERTA 1981, one-half of all property held under a joint-tenancy, right-of-survivorship arrangement with a spouse is included in the first decedent's estate and half is excluded, regardless of which spouse furnished consideration. The 2-percent credit rule and its restrictions, along with the \$500,000 value limitation, were eliminated. For non-spousal joint tenancies, the old rule still applies.

6. ERTA simplified the regulations concerning the installment payment of the tax, Section 6166. ERTA repealed all of Section 6166A, and liberalized Section 6166. The 15-year time period, the 4-percent interest rate on the first \$345,800 of tax due, and the "no principle, interest only" payment for the first 5 years still apply. However, the percentage of the decedent's adjusted gross estate, which must be comprised by the property used in the farm or other closely-held business, was reduced from 65 to 35 percent, thus allowing more small businesses to qualify for this provision.

7. ERTA liberalized the annual gift exclusion. The annual gift exclusion of \$3,000 per year per donee had been in effect for a number of years. Each raised this limit to \$10,000 per year per donee, with the number of donees remaining unlimited. The gift is income tax free to the donee. For husband and wife giving jointly, the amount was raised from \$6,000 to \$20,000 per year per donee. The annual gift exclusion is valid and non-taxable even if executed within 3 years of death.

As with the Tax Reform Act of 1976, there were many other provisions contained in the Economic Recovery Tax Act; however, the above represent the most important with respect to farm estate planning.

Considerations of Property Ownership

Examination of the tools of estate planning begins with an area that is sometimes overlooked in the planning process: the deeds of the real property and concurrent form of property ownership. Real property, primarily land, represents the major asset of the farm estate. Increased (inflated) land prices have tended to increase the value of many farm estates relative to the federal estate tax (45). According to Clonts (16), farm real estate prices in Alabama have increased every year for the last 50 years, with the exception of 5 years (1933, 1940, 1950, 1954, and 1982) for the period 1933 to 1982, inclusive (46). The importance of the value of real property to the farm and small business is reflected in the passage of the current-use valuation provision for farm and timberland (43), as outlined by the Tax Reform Act of 1976 and consequent Economic Recovery Tax Act of 1981.

Property deeds specify the form of ownership under which real property is held and thus are important to the estate planning process in that they dictate how real property may be transferred from one generation to the next. Real property will not transfer to a desired source unless it is allowed to do so within the valid deed of such property (45). For example, if husband and wife own property as joint tenants with right of survivorship, the husband's death will cause complete ownership of the property to vest in the wife. Even if the husband had a will and specified in such instrument that his "on-farm" son was to receive ownership in the property, such arrangement would be disregarded because of the joint-tenancy, right-of-survivorship aspect of the deed (45).

It is important, therefore, in the estate planning process for the deed to be in synchronization with the will. The problem to be avoided is having the will and deed(s) in conflict. If there is a conflict, the deed will take precedent over the will (31). What usually causes the most problem is the joint-tenancy with right-of-survivorship deed, although tenancy-by-the-entirety deeds (not found in Alabama) can cause similar problems. The arrangement, therefore, under which property is owned needs to be reviewed to ensure that such arrangement will readily lend itself to fulfilling the goals of the estate plan. If changes need to be made, care should be exercised to

avoid potential gift tax liabilities. Basically there are three forms of ownership under which real property can be held in Alabama: (1) sole ownership, (2) tenancy in common, and (3) joint tenancy with right of survivorship.

Sole ownership of real property is the simplest form of property ownership. In this arrangement, ownership of the real property is vested in one individual solely and the type of deed is usually fee simple; one name is set forth as grantee within the deed. Solely owned property is capable of being transferred by will or by any other means the owner of the property would so choose (i.e. gift, sale, or trust) (45). If transferred by will, solely owned property currently (1985) receives a "stepped-up" basis for income tax purposes which the heir of such property can utilize if the property is sold (43). If the owner of solely owned property dies without a will, the property is distributed in accordance with the Alabama Probate Code (19) and is subject to the probate process.

A second type of property ownership in Alabama is tenancy in common, which is a type of ownership that exists between two or more individuals. In Alabama, all deeds containing the names of two or more grantees in the premise are assumed to operate under a tenancy-in-common arrangement, unless specifically stated otherwise (31). The parties of a tenancy-in-common arrangement own undivided interests in the property, and the interests may or may not be equal. However, the interests are inheritable and can be transferred by will or deed to whomever the owner testator of such interests so desires (31). If the owner of an interest in tenancy in common property dies intestate, the interest of such property is subject to probate and is distributed according to the Alabama Probate Code (19).

A third type of property ownership in Alabama is joint-tenancy with right of survivorship. The distinct characteristic of joint-tenancy property is the right-of-survivorship feature, which transfers ownership of the property to the surviving co-tenant(s) at the death of any of the other co-tenants (31). The right-of-survivorship feature precludes the confereance of such property by a will; thus, interests in joint-tenancy property are non-inheritable (43). At the death of a co-tenant, his interests automatically vest equally in the surviving co-tenant(s) (45). Jointly owned property is common among farm families and is most often utilized between spouses. Joint-tenancy property ownership is similar to tenancy-in-common ownership with respect to the tenants holding undivided interests; however, with joint-tenancy property the interests are equal, whereas with tenancy-in-common property the interests may or may not be equal.

One of the major concerns for joint-tenancy property is how it relates to the federal estate tax. The Economic Recovery Tax Act of 1981 simplified part of the regulations governing administration of joint-tenancy property in an estate plan, especially relative to such relationships between spouses. Currently between spouses, only half the value of the property in a joint-tenancy relationship is included in the estate of the first to die; the other half is excluded (43). This provision holds regardless of which spouse furnished the consideration for the property. The one-half portion of the property that is included in the estate will also receive a stepped-up basis with respect to income tax, which will be available to the surviving spouse; the other half of such property does not receive a basis change (43). With respect to joint tenancies between non-spouses, the old rule (pre-1981) regulating joint-tenancy relationships still applies. This rule states that the total value of the joint-tenancy property is included in the estate of the first to die, except that for which the surviving co-tenant(s) furnished adequate consideration (43). For example, if a father and son hold property in a joint-tenancy, right-of-survivorship relationship, all such property will be included in the estate of the first to die except that for which it can be proved the survivor furnished adequate consideration. The responsibility for burden of proof in such cases rests upon the survivor (43). In the case of intestacy, the ownership of joint-tenancy property vests in the surviving co-tenant(s) and is not subject to distribution under the Alabama Probate Code.

Form of ownership under which real property is held obviously is an important consideration in developing an estate plan. Care needs to be exercised to assure that the deeds to the real property are in agreement with the overall estate plan objectives.

The Will and Marital Deduction

The will is the cornerstone of the estate planning process and is the basic instrument whereby property is transferred at death (43). The will is also the instrument that can appropriately specify the utilization of the marital deduction, and proper utilization of this deduction is an important tool for saving estate taxes. The greatest attribute of the will is flexibility; it is a tool that can be utilized by every estate to address almost any situation. The will offers the estate owner the opportunity, within the boundaries of law, to specifically control the distribution of the estate.

In Alabama, as well as in all states, the guidelines and requirements for a valid will are determined by the state (18). This is in con-

trast to several of the other estate planning tools where the requirements for the application of such tools are determined by Congress and/or the Internal Revenue Service (IRS). The current Alabama Probate Code was developed in 1982 and went into effect January 1, 1983 (17). The current code replaced, simplified, and clarified many of the previous existing laws concerning the transfer of estates and contains the guidelines as to how wills may be executed, probated, contested, and constructed. The basic legal requirements for a valid will in Alabama are contained in Appendix D, as derived from the Alabama Probate Code, Sections 43-8-130 and 131 (18).

Concerning the marital deduction, a variety of ways exists for this provision to be structured within a will. Popular during the period of the Tax Reform Act of 1976 was a "half and half" type arrangement, where the wife was given fee simple ownership in half the property and a life estate in the other half. This situation was sometimes facilitated by the utilization of a dual trust system; "marital" and "family" trusts were utilized in the same half-half distributive scheme. In these instances, the reference in the will was worded so that utilization of the "maximum marital deduction" would be clearly emphasized. This was in consideration of the marital deduction being set at \$250,000 or one-half the adjusted gross estate (whichever was larger) at that time.

Establishment of the unlimited marital deduction in the Economic Recovery Tax Act of 1981 (5) has caused the determination of the size of the marital deduction to become more discrete than in the past. Thus, a general reference to the utilization of the "maximum marital deduction" is no longer appropriate, as this arrangement could produce a "stacking" of assets in the surviving spouse's estate. Because of the progressive nature of the estate tax schedule, this asset "stacking" could lead to serious estate tax consequences for the surviving spouse.

Flexibility of the new marital deduction has created a situation where an "optimal" amount can be determined and utilized. Instead of a general "50-50" fee simple-life estate arrangement for a spouse (although in some cases this is still valid), the spouse may currently receive any percentage of the estate without any tax consequences. This affords the estate owner the opportunity to plan for the minimization of taxes in both his and the spouse's estate, since the husband and wife relationship is currently considered as a single economic unit (43), the same treatment this relationship receives for income tax purposes. Therefore in determining the optimal size of

the marital deduction, consideration should be given to the present size of the spouse's estate as well as the estimated size of such estate upon the spouse's death, in addition to the estimated size of the estate at the testator's death. Consideration for determining the optimal marital deduction should also be given to both the current and future levels of unified credit that might be available to the estate, as the unified credit provision can transfer property tax free to anyone, up to its specified limit.

A properly developed will is foundational to an efficient estate plan; it is the focal point around which the entire estate plan revolves. Without a will, the estate "plan" that would enable the family to control the distribution of the property is non-existent, and control of the property distribution in such instances is forfeited to the state to be distributed in accordance with the Alabama Probate Code.

Current-use Valuation

The Tax Reform Act of 1976 established an entirely new estate planning concept for farmers and owners of small, closely held businesses. Current or special-use valuation of real property allows the real property utilized in certain small businesses and farms to be valued according to its actual or "current" use, rather than its "highest and best" use or fair-market value (33,43,32). This means that real property can be valued according to its agricultural productive value and omit having its speculative or developmental potential influence the value. At present, the current-use valuation provision can be used to reduce the value of the gross estate by as much as \$750,000. This value reduction limit was increased from \$500,000, as originally established in the Tax Reform Act of 1976, by the Economic Recovery Tax Act of 1981 and applies to estates of 1983 and forward (32,43).

Not every farm or small business will benefit from utilization of current-use valuation in terms of both economics and practicality. For example, upon examination of the potential adjustment in the basis for the property, it may be that basis considerations for capital gains purposes, as associated with fair-market valuation, outweigh the benefits associated with utilization of current-use for estate tax purposes. Also, Section 2032A of the Internal Revenue code is highly specific regarding utilization of this particular tool, and some farmers and small businesses may find these regulations too restrictive to justify use in an estate plan.

Specific guidelines and regulations exist to which an estate must

conform to utilize the current-use provision (32,43). For full-time farming families, the guidelines are generally not difficult to meet, but for those outside farming (i.e. speculators, investors, “hobby” farmers) the regulations are restrictive and thus utilization of Section 2032A is almost an impossibility. This was exactly the legislative intent—to make this provision available only to those who were actually involved in a qualified business (34,43). While the amendments to Section 2032A under the Economic Recovery Tax Act of 1981 liberalized regulations associated with the provision, making the benefits available to a wider range of farms, including timber owners, “tree farms” (9,24), and small businesses, the basic regulations still carry enough power to restrict most, if not all, non-farm, non-small business entities.

The qualifications for utilization of current-use valuation in an estate plan fall into two categories: pre-death and post-death. The 1985 pre-death regulations are outlined as follows.

1. The decedent must have been a resident of the United States.
2. The property in question must itself be located within the United States.
3. The property must vest in a qualified heir of the decedent.
4. The property must have been utilized in the qualified use claimed at death.
5. Fifty percent of the decedent’s gross estate must consist of real and personal property used in the business and this 50 percent test must be evaluated utilizing the fair-market value of the property.
6. Twenty-five percent of the adjusted gross estate must consist of real property used in the business, again evaluated according to the fair-market value of the property.
7. The real property of the above 25 percent test must have been owned and utilized in a qualified use by the decedent or a member of the decedent’s family for 5 of the 8 years immediately preceding the decedent’s death, retirement, or disability (15,24,28).

The term “qualified heir” is defined as a member of the decedent’s family. The decedent’s family includes the decedent’s parents, spouse, lineal descendants, lineal descendants of the parents (decedent’s siblings) and their spouses, lineal decedents of the decedent’s spouse, and spouses of the lineal descendants. The qualified heir is important because at least 50 percent of the decedent’s adjusted gross estate, which is claimed to qualify for current-use valuation,

must vest in one or more of these qualified heirs. The real property of the 25 percent test must also pass to the qualified heir(s) (28,34).

Another important term is "qualified use," which is defined as the property being used in a farming or agriculturally related operation (or use in certain qualified trades or businesses other than farming) as is being claimed. The term farming or agriculturally related operation includes the raising of livestock (cattle, sheep, swine, horses), dairy, poultry, fruit, fur-bearing animals, plantations, ranches, nurseries, ranges, orchards, woodlands, timber farms, truck farms, greenhouses, and all row-cropping and forage growing enterprises (34,47). Qualified use also means that the decedent must have had an equity interest in the farming operation for a period of 5 of the 8 years immediately preceding death. The 1981 Tax Act liberalized this regulation somewhat by allowing a member of the decedent's family, the qualified heir, to comply with the regulation. The prescribed time period was made to either precede the decedent's death, disability, or retirement, provided the disability or retirement was followed by death and not by another period of gainful employment. Two elements must be met to clear the "qualified use" test: (1) the property claimed to qualify for current-use valuation must be being utilized in the business, and (2) the decedent or qualified heir must be involved in the business for the designated 5 of the 8 years immediately preceding the decedent's death, disability, or retirement. For the land, this test is termed "qualified use"; for the decedent or qualified heir, this test is termed "material participation" (15,28,34).

Another test to meet is the "present interest" test. The present interest test states that the qualified heir must receive a present interest in the designated property in order for election of current-use to be valid (28). Also, each qualified heir who accepts qualified property must file an agreement stating acceptance of the election of current-use valuation and, in the agreement, must accept responsibility for any recapture of federal estate tax which may occur if the property fails to meet the prescribed qualified use in the post-death or recapture period (12). Currently for 1985 and forward, the recapture period is 10 years. The agreement is filed with the federal estate tax return (13,39,47).

The above regulations are primarily pre-death in nature. There are also regulations for the post-death period. The regulations in the post-death period were designed to ensure that if the property was claimed to have been utilized in a farming or small-business setting, it would in fact continue to be so used. The post-death or recapture

period is currently 10 years immediately following the decedent's death for deaths after 1981 and 15 years for deaths prior to 1982 (15,28,39). The 15-year period included a 5-year "phase out" period with respect to the recapture of federal estate tax, but this "phase out" was repealed in the Economic Recovery Tax Act of 1981. Both the 10- and 15-year recapture periods include a 2-year maximum "grace period" which occurs immediately post-death and which can be exercised by the qualified heir if so needed (15,28). The exercise of any part of this grace period, for example 1 year, will necessarily extend the recapture period by that same time frame (1 year).

As previously mentioned, the regulations associated with the post-death or recapture period were designed to ensure the continued use for which the property was claimed to be used. Congress recognized the inequity that would have occurred had the property been allowed to be valued in one manner and then immediately thereafter sold while being valued under another manner in which the value was higher (34); a windfall profit would have occurred artificially through legislation as opposed to the fair operation of the open market. The recapture period itself refers to that period of time in which the federal estate tax associated with the fair-market valuation of the property, which would have resulted if the property had been valued under the fair-market approach as opposed to the current-use approach, can be "recaptured." This recapture of federal estate tax can occur because a special government lien is imposed on all qualified farm or closely held business real property for which a current-use valuation election has been made (12,28). Therefore, any disposition of the property automatically triggers a recapture of the avoided tax; however, there are some exceptions.

In the post-death period, the regulations to assure the integrity of current-use valuation property fall into two categories: (1) those insuring the qualified heir(s) continuance in the business in which they claimed to be engaged, and (2) those keeping the real property associated with special valuation within the stated use (34).

Violation of the above requirements results in the recapture of the avoided tax. Violations can occur in three distinct forms.

1. The disposition of current-use property by either sale or transfer. "If interests in land under a special-use valuation election are transferred (or sold) to someone who is not a member of the qualified heir's family, the federal estate tax benefits from the utilization of special-use valuation are recaptured" (28).

2. The cessation of the property from qualified use: "If each qual-

ified heir fails to meet the 'qualified use' test (an equity interest in the farm operation), the federal estate tax benefits from special-use valuation are recaptured" (28).

3. The failure of the heirs to meet the material participation requirement. "As a general rule, absence of material participation for more than 3 years during any 8-year period ending after the decedent's death triggers recapture of special-use valuation benefits" (28). In certain cases, "active management" may substitute for "material participation." Material participation is defined in part by the IRS as evidence of an intent to engender a business-like posture, to make idle lands productive. It is also defined in a manner similar to that outlined for use in determining the self-employment tax (15). This concept especially holds true for farms and woodlands.

Important to recognize is that the recapture period regulations, especially those of qualified use, are based on participation by the qualified heir or a member of his family, while the pre-death period regulations are based on participation by the decedent or a member of his family, including the qualified heir (26). This distinction needs to be clearly understood to ensure the efficient employment of the current-use valuation provision.

As mentioned earlier, the basis of the property for income tax and capital gains purposes is an important consideration when deciding whether to utilize current-use valuation. Prior to the Economic Recovery Tax Act of 1981, if current-use valuation had been utilized in an estate and a recapture event occurred, no adjustment was allowed for the capital gains basis of the property, even though the benefits of current-use valuation were forfeited as a result of recapture. However ERTA 1981 changed this restriction, and currently allows the property basis to be adjusted to reflect the fair-market value of the property as of the date of death (or the alternate valuation date if so selected), provided a recapture event occurs and the estate tax associated with the property undergoes recapture. This provision now allows some flexibility in electing current-use valuation; if current use is elected for utilization and later (within the 10-year recapture period) the family decides that the property needs to be sold or the farming operation needs to cease, then although recapture will occur, the family can enjoy the benefit of an adjustment in the property basis that reflects the basis under the fair-market valuation. Election for such an adjustment in the basis is irrevocable (13,26,28).

Current-use valuation may also be used for the estate when some of the real property is held by an entity, such as a partnership or corporation, as long as such property is being utilized in the qualified

business. There are two specific tests which help determine whether such entity-held property will qualify for current-use valuation. The first helps define whether the decedent has an interest in a closely held business, and the second qualifies all the decedent's property with respect to the qualified business. These are referred to as the "Tier I" and "Tier II" tests and are given as follows:

1. The Tier I Test. Under this test, a decedent's interest in a closely held business must be the following:

a. partnership - the interest must comprise 20 percent or more of the total capital interest or the partnership must have 15 or fewer partners, and

b. corporation - the decedent must own 20 percent or more of the voting stock or the corporation must have 15 or fewer shareholders (28).

2. The Tier II Test. Under this test, 50 percent or more of the adjusted value of the decedent's gross estate must be comprised of property, both real and personal combined, that is used in the qualified business. This test can be met by summing the qualified business property that is held by the decedent with the same type property that is held indirectly through the business entity. In a similar fashion the real property alone must comprise at least 25 percent of the adjusted value of the decedent's gross estate. This test is met in a similar manner as the above 50 percent test. Both the 50 and 25 percent tests are met by using the fair-market value of the property (28).

Another aspect of current-use valuation is the treatment of woodlands and tree farms. Growing timber poses a unique problem in that there are often questions as to whether such property should be valued as personal property or real property. Therefore, in order to make current-use valuation more applicable to a wider range of farms, the Economic Recovery Tax Act liberalized the original regulation dealing with the woodlands and tree farms to allow standing timber to be valued as part of the realty; originally the IRS had treated standing timber as a growing crop and growing crops were not allowed to qualify for current-use valuation. This change made qualification for current-use valuation much easier for timber farms, since the specific percentage requirements were more easily met. Timber valued in such a manner is referred to as "qualified woodlands." If the timber in an area of "qualified woodlands" is harvested within the 10-year recapture period, recapture of the avoided estate tax will occur (13,15,26).

A final aspect of current-use valuation that merits brief attention is the valuation procedure through which the actual current-use value is determined. Currently, there are two basic valuation procedures: the farmland or capitalization of rent method and the market or multiple factor method.

The farmland method is available for utilization only by farms and can only be applied to farmland. This method utilizes the average of the annual gross cash rent of farms of similar type and locality for the last 5 full calendar years, the average property tax of such property over the same period, and the average annual effective Federal Land Bank interest rate on long term loans, by district, over the same 5-year time frame. In this method, the average per acre taxes are subtracted from the average gross per acre rent. The resulting figure, net rent, is divided by the average Federal Land Bank interest rate to yield an approximate per acre current-use value of the property. The interest rates utilized are calculated and published by the IRS (12,28,34).

The market or multiple factor method can be used by farms and by certain qualified closely held businesses for their holdings of real property. There are five factors that can be used to find a value under the market method:

1. "The capitalized earnings value of the property based on the expected earnings for farming or closely held business purposes over a reasonable period of time under prudent management using traditional cropping patterns for the area, and taking into account soil capacity, terrain configuration, and similar factors;
2. "The capitalized earnings value based on the fair rental value of the land for farm or closely business purposes;
3. "The assessed land values based on property tax assessments when the land is located in a state which provides current-use assessment values as the assessment law for farmland or closely held business real property;
4. "Any comparable sales of other farm or closely held business land in the same geographical area, which is far enough removed from a metropolitan or resort area so that non-agricultural use is not a significant factor in the sales price; and
5. "Any other factor which fairly values the farm or closely held business qualified real property" (12).

For families and businesses qualified, willing, and capable of meeting the necessary requirements, current-use valuation can offer

a definite means of helping reduce the estate tax liability of the farm estate (12,28,34).

Lifetime Gifts: The Annual Gift Exclusion and the Unified Credit Provision

As already seen, the Economic Recovery Tax Act of 1981 restructured much of the estate planning framework. Two provisions significantly altered by the ERTA were the annual gift exclusion and the unified credit provision. The changes in these provisions, combined with those that occurred in the marital deduction, have served to expand the flexibility of the estate planning process under both the inter-vivos (during life) and testamentary scenarios. Probably the more pronounced effect, however, has occurred under the inter-vivos scenario where lifetime gifts are involved: the level of gifts that can now pass tax free has been significantly increased above previous levels. Currently, the annual gift exclusion is fixed at \$10,000 per year per donee, or if the husband and wife combine their giving, \$20,000 per year per donee (5). No transfer tax is assessed on gifts up to and including these levels and currently the number of donees is unlimited (5). The annual gift exclusion can be utilized only during the estate owner's life.

The unified credit provision was increased such that it will currently (1985) pass estates of \$400,000 or less free of transfer tax (Appendix B). Unified credit is scheduled to increase so that by 1987, an estate of \$600,000 will pass free of transfer tax. Unified credit, in contrast to the annual gift exclusion, may be applied either during life or at death, but whatever level is used during life will be unavailable at death (43). The marital deduction also can be utilized for inter-vivos transfers to the spouse. Such intra-spousal transfers are entirely tax free and without limit, and can occur at any given time (5).

Whether lifetime gifts are a viable option for inclusion in an estate plan depends entirely on the circumstances of the individual estate. Lifetime gifts are not a "blanket solution" for the problems of every estate, but at the same time, they should probably not be thought of as the "tool of the last resort." Indeed, there are several avenues available where gifts can be made indirectly but still allow the grantor some measure of control over the assets. Two such avenues are the irrevocable trust with a "Crummey" provision and the corporate or partnership form of business organization where shares of stock or business interests may be shifted from one family member to another.

Some of the main reasons for utilizing lifetime gifts, whether direct or indirect, might be the following:

1. To reduce the gross estate in an effort to decrease the potential estate tax liability.
2. To aid in the support of elderly parents.
3. To help a child buy a home or start a business.
4. To reduce a grantor's potential income tax liability by shifting property (i.e., share of appreciating or income-producing assets) into the lower tax brackets of younger or older family members.
5. To enable a child to learn money management (43).

An important advantage in making lifetime gifts is that the gift currently does not constitute taxable income for the donee, primarily because the donor should have already paid the tax on such property; thus, the gift is received by the donee tax free (5,43). However, income produced from the gift would be considered taxable income for the donee (43).

There are reasons that could cause a reluctance to utilize lifetime gifts, such as the following:

1. Potential loss of control over property and particularly the actions of others (more likely to occur where direct instead of indirect gifts had been made).
2. Dislike for dissipating capital.
3. Fear of spoiling others with "too much money."
4. Reluctance to contemplate one's own death (43).

Often the reasons for not making gifts are very real, especially if there are strained relationships in the family. However, if a tax problem exists, indirect giving as previously mentioned may still hold some merit as a viable alternative for the estate owner.

There may be other factors that need to be evaluated when consideration is given to utilization of lifetime gifts in an estate plan. For farm businesses, some possible guidelines for utilizing lifetime gifts might be the following:

1. Is the potential gift appreciable in nature and, if so, is such appreciation potentially great or small?
2. Would transference of the proposed gift be a significant detriment to the efficiency of the farm business, giving considerations to both the long and short run?
3. What are the income and estate tax considerations involved for

both the donor and donee, giving attention to the income producing capabilities of the property?

4. What is the liquidity nature of the gift involved; would it be considered liquid or non-liquid?

5. Is the potential donee mature enough to responsibly manage the gift property or would trusts need to be employed in the management scheme?

Lifetime gifts may or may not be a viable tool for inclusion in an estate plan, depending on the personal preference of the estate owner. However, the restructured annual gift exclusion and unified credit provision have certainly increased the flexibility and range of conditions under which lifetime gifts may be employed. Competent farm estate planners can be of great service in helping structure an effective gift program.

Installment Payment of the Federal Estate Tax

The installment payment of the federal estate tax was established in 1958 by way of the Small Business Tax Revision Act of that same year (40). The provision, also known as the extension of time for payment of the estate tax or the estate tax deferral provision, is contained in Section 6166 of the Internal Revenue Code and is designed to allow certain estates the privilege of making payments on their respective tax liability over a specified number of years at a modest interest rate. The provision was originally designed specifically for the protection of non-liquid farms and small businesses from estate tax burdens which often meant decimation of the business by way of forced sales (40). Today, Section 6166 has become fairly liberal in its requirements for qualification, so much so that now most farms and closely held businesses can easily employ this provision in an estate plan.

The original requirements for employment of Section 6166 included a 10-year installment payment schedule at a statutory interest rate on the deferred amount of tax (40). The interest rate utilized was floating in nature, being tied to the prime rate as charged by large banks (40). For eligibility, at least 35 percent of a decedent's gross estate or at least 50 percent of the taxable estate must have consisted of an "interest in a closely held business." Interest in a closely held business was defined as any sole proprietorship, a partnership where the decedent had included in his gross estate at least 20 percent of the total capital interest of the partnership and/or the partnership must have had 10 or fewer members, or a corporation where at least 20 per-

cent of the value of the voting stock was included in the decedent's gross estate and/or a corporation that had 10 or fewer members (40).

The Tax Reform Act of 1976 renamed this original Section 6166 as Section 6166A and established a new Section 6166 (43). Under new Section 6166, the benefits of the provision were more liberal than the previous 6166, but the requirements for qualification were also more strict. Section 6166 as defined under TRA 1976 allowed an installment payment of the estate tax for that tax attributable to the closely held business. Such payment was amortized over a 15-year period, with interest only being due during the first 5 years (6). An interest rate of 4 percent was allowed on the first \$345,800 of tax due, with a statutory rate being applied to all tax in excess of this amount (43). To qualify for utilization of Section 6166, at least 65 percent of the value of a decedent's adjusted gross estate must have been comprised of an interest in a closely held business, as used in determining the decedent's gross estate (40). Also under new Section 6166, interest in a closely held business was liberalized somewhat by allowing the number of partners and shareholders involved in the closely held partnership and/or corporation to expand to a limit of 15, as opposed to a limit of 10 as established under the original Section 6166 (40).

The Economic Recovery Tax Act of 1981 simplified this section of the code by completely repealing Section 6166A (the original Section 6166) (6). ERTA 1981 then modified the existing Section 6166 by reducing the percentage requirement of a decedent's adjusted gross estate that must be comprised of an interest in a closely held business from 65 to 35 percent; all remaining regulations continued intact and are currently in effect.

Concerning calculation, the actual amount of estate tax liability that can be deferred under Section 6166 is that amount which results specifically from the value of the closely held business, and not the total amount of tax liability which results from the entire estate (43). This concept is expressed in the following mathematical equation:

$$\frac{\text{Value of interest in closely held business}}{\text{Value of total gross estate}} \times \text{Total estate tax} = \text{Amount of tax eligible to be paid in installments}$$

The amount of estate tax that may be deferred is the proportional amount of total tax that the value of the decedent's interest in a closely held business bears to the total value of the decedent's gross estate.

With respect to penalties, Section 6166 is similar to Section 2032A in that certain post-death regulations exist to prevent misuse of the

provision. Termination of the deferral and extension privilege occurs upon the happening of any of the following: (1) "One-half or more of the qualifying closely held business is sold, exchanged, or otherwise disposed of; (2) one-half or more of the business's assets are withdrawn; or (3) any payment of interest or tax is not made within 6 months of its original due date" (23).

Breach of any of the above stated conditions results in the remaining balance of tax and interest becoming due and payable immediately (23).

The installment payment of the federal estate tax can be a useful tool in estates that may tend to have a liquidity problem and that can qualify for its provisions.

Life Insurance

Use of life insurance in estate planning is not a new concept and probably represents one of the oldest estate planning tools in existence. However, the life insurance policies currently available (1985) offer benefits and opportunities that deserve the consideration of farm and small-business estate owners. There are basically three types of life insurance: endowment, term, and whole life (31). Each has its own unique characteristics which may make each type more or less favorable for an estate plan, depending upon the objectives of the owner.

Endowment Insurance

Endowment life insurance is probably one of the lesser known and lesser used insurance types and carries the highest premium because it basically represents a savings plan. The face value of the policy is payable to the beneficiary at a stated time or upon the death of the insured, whichever is earlier. Endowment insurance provides both insurance protection and a savings vehicle, but its primary function is a savings plan, to provide a stated amount of funds at a stated time.

Endowment insurance may or may not compare favorably with other savings plans, but if comparison is made, consideration needs to be given to the insurance aspect of the program and this cost added to the competing savings alternative. Relative to income taxes, the difference between the amount of money paid into the endowment policy and the amount of money received at the time of endowment will be subject to income tax. However, these taxes may not be

substantial, especially if the owner of the policy is in a lower tax bracket at the time of endowment (14).

Term Insurance

Term insurance is “pure” insurance protection (it contains no savings feature) and in the “short” run is the least expensive insurance available. However, if kept for the “long” run, term insurance is expensive in terms of premium outlays. The reason for this is that as a person gets older, the probability of death increases and since insurance rates are based in large part on statistical probabilities of death, the premium rate increases through the life of the individual. So while term insurance appears to be cheap in the “younger” years, it can get quite expensive in the “older” years (14,41). Term insurance coverage could be compared to paying rent for a house—no equity is built up for the “rentor” and the costs are constantly increasing. Term insurance can be described as temporary insurance, insurance for a “term” or short time period; it is usually not insurance that should be kept over a lifetime. However, for a short time, term insurance can be efficiently used to supplement an existing insurance program, where death protection for a spouse or business is a prime consideration and extra funds are currently limited. In an instance like this, term insurance does help obtain a large amount of coverage for a relatively small premium dollar (14,41).

Several types of term insurance exist and each can be used for a specific function in an estate plan. One of the more common term policies is yearly renewable term, where the insurance coverage remains constant, but the premium increases on a yearly basis. Variations of this type exist, such as 3-year level, 5-year level term, and even 10-year level term. In each of these, the premium and coverage remain fixed over the contract period and, at the end of such period, the premium will increase if the coverage is to be continued (14,41). Period level term policies may or may not compare with annual renewable term policies relative to cost. Comparison can be made by examining the total costs in premiums over the policy period for the same given amount of coverage. Comparison can also be made by examining the average cost per \$1,000 of coverage for the policies. However, comparison is usually helpful since many policies with varying prices are available.

Another popular term insurance is decreasing term insurance. This type term insurance has a constant or steady premium, which is usually higher in earlier years than yearly renewable term. The pre-

mium is constant throughout the life of the policy, but the amount of coverage decreases over the policy life—hence the name decreasing term insurance. Mortgage insurance is a type of decreasing term insurance. A decreasing term policy offers the advantage of a constant insurance premium, one which generally is considerably less than a premium on a whole life policy of the same amount of coverage; however, the coverage for decreasing term insurance decreases constantly through the life of the policy. This decreasing coverage may or may not be a problem for a given estate owner, depending on his particular goals and objectives.

The point to understand about all term insurance is that the cost of the coverage increases through the life of the individual and the money spent for the premiums does not yield any returns or dividends to the purchaser, nor is the premium money available for use by the purchaser. There is a philosophy relative to term insurance that says “buy term and invest the difference,” referring to the difference between the cost of the term policy and a similar policy of whole life insurance. This may be a viable alternative for purchasing life insurance, but the income tax consequences of the investment need to be analyzed before this step is made.

Whole Life Insurance

Whole life insurance, sometimes referred to as ordinary life insurance, differs from endowment insurance in that premiums are usually paid for the entire life of the owner and payoff of the insurance is not due until death (14,27). The premiums are thus lower than premiums for a similar policy of endowment insurance. When compared to term insurance, the premiums are initially higher on the “front” end, but lower on the “latter” end since whole life offers the advantage of a constant premium for the life of the insured. Whole life differs from term insurance in that it combines a savings account, often referred to as “cash value,” with the insurance protection and thus affords a means of capital accumulation. The capital accumulation aspect of a whole life insurance policy offers a unique characteristic to an estate builder—the accumulation occurs free of current income tax (14,27). This income tax favored treatment of the savings aspect of whole life insurance makes the policy attractive as a means of investment and capital preservation. The whole life policy also allows the owner to build equity into the policy which is advantageous in that the cash values are available for borrowing. The interest rate associated with such borrowing is usually quite favorable and such ac-

crued interest on the borrowed capital is fully income tax deductible for the policy owner, if such interest is repaid by the owner and not just deducted by the company from the insurance proceeds. So the owner of a whole life policy has not only insurance protection, but also a source of available funds for borrowing if need arises (14,27). The main objections to whole life insurance over the years have been related to the amount of premium relative to term insurance and the apparently low rate of return generated by the savings feature (4 percent is usually the guaranteed minimum). However, these two objections have been drastically altered within the last 4 to 5 years by changes that have occurred within the insurance industry.

A variation of whole life insurance has been developed that makes the earnings on the policy competitive with and sometimes even exceeding money market rates of return. This variation of whole life is often referred to as universal life or variable life (30), and the rates of return currently (1985) range from 8 to 13 percent. These universal life policies receive the same tax favored treatment as traditional whole life policies and thus offer not only insurance protection but an attractive means of savings and capital accumulation (21). There are some universal and variable life policies currently available that will compete with term insurance for the lowest total premium cost over a 20-year period. This means that a farmer 20, 30, or even 40 years old could purchase a universal life policy and pay out less in total premium dollars than he would for a comparable amount of term coverage kept over the same 20-year period. In addition, the universal life policy would have a sizable amount of cash value available for the owner's use during and at the end of this time period, ready cash at a low interest rate that can be used to pay bills, meet a mortgage payment, or invest in a particular venture. Also, some of these universal life policies allow the premiums to be scheduled by the estate owner for any number of years: 1, 5, 8, 10, or whatever is best suited for the estate owner (21). A one-time premium can even be paid, and this type outlay represents the least expensive means available to purchase this type policy. Also, if the premiums are scheduled over several years, the premiums for some years can even be skipped and the insurance will yet remain in force. However, if a year is skipped, it does have to be made up at a later time.

In general, the earlier whole life insurance of any type is purchased, the less expensive and more cost efficient it is. Also, the larger the policy size, the more cost efficient is the insurance. So a very cost efficient policy would be one that is purchased by a young individual, who pays the entire policy in one lump sum on as great a

face value (coverage) as the individual will ever need. This particular situation is rarely possible, of course, but the point is that the earlier whole life insurance is purchased, the more cost efficient it is on any given size policy.

Insurance can be used in a number of ways in conjunction with an estate plan. Probably two of the more basic situations are the following:

1. Provide a ready source of funds whereby on-farm heirs can purchase farm assets from off-farm heirs (27). In this situation, on-farm heirs are the owners and beneficiaries of the policy(s) insuring the life of the estate owner. At the estate owner's death, the proceeds go directly to the on-farm heirs as beneficiaries, and can be used to purchase farm assets from off-farm heirs that may have accrued to them by way of the estate owner's will. Also, the proceeds of the policy are kept out of the decedent's estate and are thus exempted from federal estate tax because the insured was not the owner of the policy, but rather the on-farm heirs. This same principle could also apply to either a partnership or a corporation, where the partnership or corporation itself insured the lives of the partners or corporate members. Here the partnership or corporation, at the death of a member, would have the necessary funds to buy out potential non-desirable partners and thus retain the integrity of the partnership or corporation. The legal document that would aid in accomplishing this would be a buy-sell agreement, where the number of shares involved, the price per share, and the terms of the sale would all be specifically set forth.

2. Provide a liquid source of capital whereby the family can meet various obligations that often arise at death (27). In this particular situation, insurance helps protect sometimes non-liquid family and farm assets, assets that if exposed to a forced sale would possibly not reflect a truly desirable price to the sellers. Thus, insurance can help keep these assets intact and help ensure the continued normal operation of the business.

Whatever the situation, insurance can often be used quite readily in an estate plan if it is properly structured and in agreement with the overall estate plan objective. The trap to avoid is having the insurance work against or be out of synchronization with the estate plan objective, since this usually causes unnecessary tax problems and is needlessly expensive.

With respect to taxation, the proceeds of a life insurance policy are

generally exempt from federal income tax because the policy is most often purchased with “after-tax” dollars; no tax deduction was allowed the owner for the expended premium payments. Proceeds of an insurance policy may or may not be included in an estate owner’s estate for federal estate tax purposes, depending on whether the insured estate owner is the owner of the insurance policy, or has retained an “incidence of ownership” in the policy such as a right to borrow the cash value. If the estate owner is the insured and the owner of the policy, the insurance proceeds will be included in the estate and thus subject to the federal estate tax. If the estate owner (the insured) is not the owner of the policy, the policy proceeds will pass outside the estate tax free to the beneficiary(s). If the beneficiary is the owner of the policy, the proceeds of the policy are excluded from the insured’s estate and the beneficiary-owner receives the insurance proceeds federal estate tax free. An irrevocable trust can also be utilized to exclude the insurance proceeds from estate taxation not only in the insured’s estate, but also in the beneficiary’s estate.

Life insurance can be a useful tool to include in an estate plan, since it is flexible enough to be used in a variety of situations. Regardless of the insurance selected to fulfill a particular estate need, it is important to make sure that policy designations of beneficiary(s) and owner(s) are in agreement with the overall estate plan objective.

Trusts

A trust is basically a relationship of confidence that exists between a grantor, one who establishes the trust and provides the trust corpus, and a trustee who is responsible for administering the trust. A trust generally involves the setting aside of some property, either real or personal, for the benefit and enjoyment of another, known as the beneficiary, at either the present or a future time. By definition, “A trust is a confidence (fiduciary) relationship between a trustee and beneficiary(s) whereby the trustee holds legal title to specific property under a duty to deal with the property for the benefit of the beneficiaries.” The trustee holds legal title and the beneficiaries hold “equitable title” (45). Certain types of trusts can be restrictive in terms of how they can be administered and utilized. However, reasons do exist for the apparent inflexibility, and these usually relate to either the design of the trust structure or to tax problems, whether income, gift, or estate.

Trusts have a wide range of usefulness and lend themselves to uti-

lization in specific situations. The type of trust employed in the estate planning process should reflect the goals, objectives, and desires of the estate owner. Some trusts are traditional in nature and some are more contemporary in their design. Many types are utilized for estate planning, but some can also be used in the income tax planning scheme of an estate owner. Basically there are two major categories of trusts: testamentary and inter-vivos (31).

Testamentary Trusts

Testamentary trusts are trusts that take effect upon the estate owner's death. This trust is formed within the framework of a decedent's will; a decedent grantor establishes this type trust in his will. A testamentary trust is irrevocable in nature—once it is established it cannot be altered. However, it can be given a "life" of a stated number of years, at the end of which the trust will expire (43,45).

There are many reasons why an individual may desire to establish a testamentary trust. Probably one of the main reasons would be the testator-grantor's desire to have his business continue, to provide a "safeguard" for the business and/or provide guidance for the heirs in managing the farm operation. Another reason might be to provide a discretionary and secure means of support and livelihood for the surviving spouse. Still another reason might be to have discretionary control of assets exercised in the care of minor children (31). Whatever the reason, testamentary trusts can be structured in a variety of ways to help meet a particular farm's needs. Most qualified farm estate lawyers, accountants, and estate planners can help draft a will and trust instrument to allow for the flexible distribution, within certain limits, of trust assets. There are two primary advantages of a testamentary trust: (1) The decedent-testator retains control, possession, and use of his assets until death, and (2) the heirs receive a "stepped-up" basis in the property for income tax purposes (43).

There is also a major disadvantage of a testamentary trust; the property, at its current value, is included in the decedent's estate for estate tax purposes and therefore this trust will not help reduce a decedent's taxable estate (11). So the deciding economic factor in relation to a testamentary trust is the comparison of the income tax consequences of the heirs receiving a "stepped-up" basis in the property, as opposed to the estate tax consequences of keeping the property within the decedent's estate. The benefits of receiving a stepped-up property basis may outweigh the corresponding estate

tax liability associated with maintaining the property within the estate owner's estate. This question needs to be addressed when considering a testamentary trust.

Inter-vivos Trusts

The second major classification of trusts is the inter-vivos trust (Latin: "among the living"). An inter-vivos trust is one that is established during the life of an estate owner. As the testamentary trust was primarily irrevocable in nature, an inter-vivos trust may be either revocable or irrevocable. A revocable inter-vivos trust can be withdrawn or "revoked" by the grantor. It is a trust in which the grantor retains an "incidence of ownership" and, therefore, the trust contents, both corpus and retained earnings, are included in the grantor's estate at death (43). With respect to estate taxes, a revocable inter-vivos trust and a testamentary trust are similar, with both being included in the decedent's gross estate (31).

The other type of inter-vivos trust is the irrevocable inter-vivos trust which cannot be altered or changed in any manner. Once it is established it remains fixed until it expires, and the grantor forfeits all right and possession of property contained within such trust.

There are several advantages of an irrevocable inter-vivos trust. One of its main advantages is that it can serve to take assets out of the grantor's gross estate, thus reducing the grantor's taxable estate. It can also reduce the spouses' taxable estate, thereby reducing estate taxes in both estates. The gross estate in this instance is reduced not only by the amount of initial assets contained within the trust, but also by any appreciation that might be attributed to these assets (38). Another important advantage of the irrevocable trust, especially for farms, is that when insurance is used as the trust corpus, all the proceeds are available to help with the liquidity needs; the insurance proceeds contained in the irrevocable trust are not included in the estate owner's gross estate and consequently avoid being taxed (38,42). Still another advantage of the irrevocable inter-vivos trust, especially for small or closely held businesses, is that it can be used to take property out of an estate to qualify the estate for the percentage requirements of special estate tax saving provisions, namely Section 2032A, special use valuation of farm and timberland, and Section 6166, extension of time for payment of federal estate taxes (38).

There are two distinct disadvantages, however, of an irrevocable

trust: the grantor loses all control, possession, and use of the property and, once the trust is established, it cannot be altered (36). However, the disadvantages of the irrevocable trust may not be too unfavorable when consideration is given to the utilization of personal property (for example, life insurance policies) in the trust, property that is not necessarily associated with the everyday workings of the farm.

Short-term, Contemporary Trusts

There are at least three other types of trusts that are more contemporary in nature and, for the most part, are short-term in design. These are: (1) the "Clifford" Trust, (2) the "Crummey" Trust, and (3) the "Q-Tip" Trust.

THE "CLIFFORD" TRUST. This trust "is a short-term, irrevocable, inter-vivos trust that meets the requirements of the Internal Revenue Code (I.R.C.) 671-677" (3). The Clifford Trust is used mainly as an income tax saving device, specifically by allowing a diversion of taxable income away from a high income tax bracket grantor to a low income tax bracket beneficiary, i. e., a child or elderly parent. The workings of the trust are fairly simple. The grantor shifts some property, either real or personal, to an irrevocable inter-vivos trust, which must be set up to last at least 10 years and generally a maximum of 20. Upon expiration of the trust, the ownership of the contents reverts to the grantor (3). However, during the duration of the trust, all earnings of the trust principle are taxable income to the beneficiary and not the grantor. This feature of income tax savings is definitely a major advantage of the Clifford Trust. The grantor has shifted his potential high bracket income tax liability to a lower bracket beneficiary and has relinquished control of the property for a stated time period. The property will then revert to the grantor at the appointed time. Unlike most other irrevocable inter-vivos trusts, the grantor of the Clifford Trust can retain the title of trustee. The main obstacle to overcome is that the so-called "grantor-trustee" must be able to prove that the benefits of the trust are available and exercisable primarily for the beneficiary, and not the grantor-trustee (3).

There are two other advantages of a Clifford Trust. The first is that it has the potential to shift relatively large amounts of property gift-tax-free to the beneficiary. This is because the gift tax is based on the present value of the income interest of the property, which in turn is

derived from guidelines set by the Treasury Department. The guidelines currently (1982) are utilizing an appreciation rate of 6 percent (Treasury Regulation 25.2512-9 (f), Table B) (3). So if the earnings or appreciation of the trust corpus is greater than 6 percent, this excess is passed to the beneficiary gift tax free. The second advantage of the trust is that it will exclude its contents from the grantor's gross estate, if the grantor dies while the trust is in effect. So the Clifford Trust serves not only to aid in reducing income taxes, but can also aid in the estate planning scheme of a grantor by helping reduce estate taxes. Upon termination of the trust, the estate tax saving feature is lost, as the ownership of the trust contents reverts to the grantor.

THE "CRUMMEY" TRUST. A second type of contemporary trust is the "Crummey" Trust. The name "Crummey" was derived from the case that made this trust famous, *Crummey vs. Commissioner of Internal Revenue*, 297 F.2d 82 9th Circuit Court 1968 (1,2). The Crummey Trust is basically an irrevocable inter-vivos trust with a special provision added to it which allows gifts to the trust of \$10,000 (\$20,000 if combined between spouses) or less to qualify for the annual gift tax exclusion as outlined in the current estate tax laws of the Internal Revenue Code (2). Generally, gifts to an irrevocable inter-vivos trust are considered by the IRS to be of "future interests" for the beneficiary of the trust and thus will not qualify for the annual gift tax exclusion (38). The Crummey provision, however, when incorporated into the trust document provides the beneficiary (s) with a "present interest" in the trust contents and thus allows the grantor of such property to utilize the annual gift exclusion to shelter the transfer from any tax liability. A "present interest" in the trust is defined by the IRS as "an unrestricted right to the immediate use, possession, or enjoyment of the property, or income from the property" (2). The Crummey provision satisfies this limitation by allowing the beneficiary of the trust the right to withdraw property, or income from the property, for a limited time; i.e., a minimum of 30 days after the property is transferred to the trust. Therefore, the Crummey provision aids the estate owner in that it makes available the right to make gifts of property or cash on a child's or heir's behalf, without having to pay a gift tax on the transfer, as long as the value of the gift is limited to the current annual gift exclusion (2,4). In some instances, the Crummey provision may be limited by the so-called "five by five" restriction (2). However, a competent farm estate lawyer, accountant, or financial planner can explain this and the means necessary to avoid any possible hindrances.

QUALIFIED TERMINABLE INTEREST PROPERTY. This type trust is probably the newest of the contemporary design trusts. The qualified terminable interest property trust, "Q-Tip" as it is sometimes referred to, is designed as a specific means of taking care of a surviving spouse, while at the same time designating the distribution of the property at that spouse's death (36). For example, if a widower with a substantial accumulation of wealth (land, cattle, etc.) remarries late in life, his desire might be to ensure that this second spouse is properly taken care of at his death. An obvious way to do this might be to leave her a life estate in his property with remainder interest to the children of his first marriage. However, if he approaches the problem in this manner, he will lose the utilization of the marital deduction because property in a life estate is classified as "terminable interest" property. The "Q-Tip" Trust helps solve this problem by allowing the testator to grant this second spouse a complete income interest in the property; she has the right to all income which the property generates. The remaining property at her death can then pass to the desired remaindermen, while at the same time allowing this grantor-testator to take advantage of the marital deduction (36). The property utilized in such an arrangement is classified as "qualified terminable interest property" and the key is that the income generated from the property is totally at this second spouse's disposal, payable to her at least annually. The value of the trust property is then included in this second spouse's estate for estate tax purposes, which is not the case with an ordinary life estate. The "Q-Tip" Trust "flip-flops" the estate tax liability from the estate owner's death to the death of this second spouse.

Concerning classification, the "Q-Tip" Trust would be categorized as an irrevocable testamentary trust and is therefore established in an estate owner's will. Election for utilization of this trust must be made on the federal estate tax return by the executor of the estate and such election is absolutely irrevocable (36). In making the election, care should be exercised so as to not cause undesirable estate tax consequences in this second spouse's estate. If the spouse has ample assets, the election may cause more harm than good concerning estate taxes.

Trusts can be useful tools in planning an estate if they are correctly structured to the farmer's needs. To ensure a viable and efficient trust operation, estate owners need to have specifically defined goals communicated to competent estate planners; in the case of farmers, "competent" estate planners are those who are well aware of the working procedure of farms.

Considerations of Business Organization

The arrangement of business organization can be important in helping facilitate the particular estate planning objectives. There are three basic types of business organization: (1) the sole proprietorship, (2) the partnership, and (3) the corporation; variations and combinations of these basic types also exist (8). Each type has its own characteristics that may make it either advantageous or disadvantageous to an estate plan and each, therefore, should be examined to determine which type best facilitates accomplishment of the estate owner's objectives.

The Sole Proprietorship

The sole proprietorship is the most common form of business organization in American agriculture. In the sole proprietorship, the proprietor owns and controls all equity interests in the business, receives all business income, absorbs all business losses, and assumes full liability for all obligations of the business (7).

A sole proprietorship can have both a positive and negative effect on an estate plan. The distinguishing characteristic of the proprietorship, the combined entity of the business with the life of the proprietor, is responsible for this situation. The proprietor is free to organize, plan, and disperse his estate and business assets in any way he chooses, being constrained only by the boundaries of the law (8). The sole proprietorship also readily facilitates the utilization of two potentially important tax saving tools for an estate: the current-use valuation provision and the installment payment of the tax provision, Sections 2032A and 6166 of the Internal Revenue Code, respectively. Qualifications for utilization of these two provisions are easily met because the business has its entity in the estate owner.

The characteristic of the business entity being within the personage of the proprietor can be disadvantageous to an estate plan. For example, death of the sole proprietor causes the business to also expire (8). The business, technically speaking, has no entity apart from the proprietor, and continuity of the business generally does not go beyond the life of the proprietor (20). Continuation of the business is dependent upon how the business assets are dispersed and the decisions of the heirs receiving such assets. This would not be the case with either a partnership or a corporation because the business entity in these arrangements can be separated from the life of the estate owner. With respect to credit acquisition, death of the sole proprie-

tor usually forces a realignment of the potential credit position since responsibility for the credit must now vest in a new entity, an entity which may or may not prove responsible. Finally, because of the oneness of the business entity with the sole proprietor, there is no separation of business liability from personal liability in the sole proprietorship. The business liabilities can extend without limit to the personal estate of the sole proprietor and vice versa (7,8).

There are two other aspects of estate planning that may be important considerations for a sole proprietorship: gifts and life insurance. Under current laws, the sole proprietor must relinquish total ownership and control of gifts if the gifts are made with the intention of reducing the gross estate (7). If the proprietor retains an "incidence of ownership" in the gifts, the gifts are brought back into the proprietor's estate for estate tax purposes, at current fair-market value. So if the proprietor desires to utilize the annual gift exclusion to pass property to his children for estate tax purposes, ownership and control of the property must vest in the children if the property is to escape inclusion in the grantor's estate (7). If the property happens to be business assets (i. e., land), the proprietor has to relinquish control of part of his production potential.

With respect to life insurance in the sole proprietorship, the premiums must be paid with "after tax" dollars and, unlike the corporation under certain circumstances, the proprietorship currently receives no income tax deduction for the premiums as business expenses (7). Also, proceeds of a life insurance policy owned by the proprietor, while income tax exempt to the family because the insurance was purchased with "after tax" dollars, are included in the proprietor's estate for estate tax purposes.

Finally, with respect to the gross estate and calculation of the estate tax, all assets of the sole proprietorship owned by the proprietor are includable in the gross estate for estate tax purposes. This may be different from a partnership or corporation where the business entity itself can own some or all of the business assets, and these assets, at least in part, can be omitted from the gross estate (27).

The Partnership

A partnership is defined as "an association of two or more persons who work together as co-owners of a business for profit" (27). A partnership is formed when two or more individuals come together, along with their various talents, abilities, and resources, in an effort to transact business. Although it is not mandatory, it is recommended

that a written agreement be used to set forth the various responsibilities of each party involved (8).

Two types of partnerships exist: general and limited. These differ on the basis of the degree of involvement and liability associated with the partners. In a general partnership, each partner shares equally the management responsibility and authority to deal with third parties. Each partner can also be held fully liable for all obligations which may accrue to the partnership by way of the other co-partners (7). A limited partnership is characterized by the limited obligations of the limited partners. Limited partners cannot participate in the managerial process like the general partners; however, neither are limited partners personally liable for any actions of the partnership entity beyond their capital investment (7). A limited partner's primary responsibility is to supply a capital input.

With respect to estate planning, there is little difference between the partnership and the sole proprietorship. Exceptions to this statement are noted in Sections 2032A and 6166 of the Internal Revenue Code, where specific requirements are outlined for the estate to qualify for these particular provisions. The flexibility of the partnership is similar to that of the sole proprietorship. The estate owner is free to transfer his interests in the partnership to whomever he desires, especially if the interest is a limited one. However, if the interest is general in nature, such transference must have unanimous approval from the other general partners, if the transferee is to receive the status of general partner (7). This approval is necessary for the integrity of the business to be maintained. A transference can be made without the approval of the general partners, but if this type of transference occurs, the transferee does not receive the status of general partner; rather, the transferee is regarded as a "limited" partner and is not allowed to participate in the management of the business (7).

The business entity in a partnership is separate from the life of any particular partner, and agreements can be established in the partnership contract allowing the surviving partners to purchase the decedent partner's share of the business, particularly in a general partnership (7,8). This purchase arrangement would be accomplished through use of a buy-sell agreement. The death of a partner could, however, bring about the dissolution of the partnership arrangement. With respect to liability against lawsuits, the business entity can be named as defendant, but often the individual partners are also named. Therefore, separation of the business entity of a partnership

may or may not be distinct from the partners, depending on the goals of the partners involved and the nature of the partnership agreement.

The credit acquisition and general liability of a partnership may or may not differ from a sole proprietorship, again depending on the type of partnership. If the partnership entity is distinct, credit acquisition after the death of a partner will probably not be greatly affected. If the partnership entity is not distinct, a realignment of the credit position may be required. In general, the death of a general partner would tend to have a greater effect on the business than the death of a limited partner. Concerning business liability, the general partnership is much like the sole proprietorship, with liability able to extend to the personal estate of the decedent (8). However, the limited partner's business liability does not extend to his personal estate (27).

With respect to Sections 2032A and 6166 of the Internal Revenue Code, partnerships and corporations may be subject to special treatment. Specific requirements are established that must be met in order for an estate to utilize these tax saving provisions. If the partnership owns land or other real property, the decedent must meet two important tests for the property to be eligible for special-use valuation. These tests are sometimes referred to as the "Tier I" and "Tier II" tests (28) outlined below:

1. Tier I. In a partnership carrying on a qualified agricultural trade or business, the decedent's interest must comprise 20 percent or more of the total capital interest or the partnership must have 15 or fewer partners. This Tier I test is also referred to as an "interest in a closely held business" (28).

2. Tier II. At least 50 percent of the decedent's adjusted gross estate must consist of property, both real and personal combined, that is utilized in the agricultural business. This 50 percent test can be met by the summation of the property personally held and the property held by the partnership entity, to the extent that both are used in the agriculturally related business. Also, the real property held in the estate must comprise 25 percent of the adjusted gross estate, again considering the summation of the real property personally held and the real property held by the business entity, as long as both are utilized in the agriculturally related business.

Under both the Tier I and Tier II tests, the fair-market method of valuation is utilized (28) and these tests hold for both the general and limited partnerships. When considering Section 6166, the partnership again must meet the Tier I test, but the Tier II test changes. The

Tier II test under Section 6166 calls for the decedent's "interest in a closely held business," the Tier I test, to comprise at least 35 percent of the adjusted gross estate (25). These qualifications must be met in order for the decedent's estate to utilize the provisions of Sections 2032A and 6166.

Relative to gifts, the partnership may or may not display much difference from a sole proprietorship. The partnership receives no benefit from giving away property since the partnership itself pays no federal income or estate tax; the partnership files only an informational tax return, Schedule K (7). The main purpose, therefore, of a gift from the partnership would be to bring another individual, generally a younger family member, into the partnership, thus providing some incentive for a younger individual to remain in the business. However, such a transfer of interest would necessitate, to some degree, a decrease in the established partner's interest and thus would have to pass under the established partner's individual unified credit, annual gift exclusion, or both, depending on the size of the transfer and whether it was to be tax free in nature. A partner in a partnership can make gifts of property to whomever he desires; however, in a partnership, these gifts would generally be limited to the partner's personal assets since, unlike the sole proprietor, the partner does not control all the business assets. A variation of these principles could exist in a family partnership, where interests in the business could be transferable among the various family-partner members. However, there would need to be strict legal documentation of these changing arrangements, since the IRS generally does not give the benefit of the doubt with respect to tax liability.

Concerning life insurance, the treatment is basically the same as a sole proprietorship if each partner in the partnership owns his own insurance. The proceeds, while income tax exempt, are includable in the decedent's estate for estate tax purposes and thus add to the value of the estate. Often in a partnership, however, the insurance will be owned either by the individual partners on each other's life (referred to as a cross-purchase plan) or the partnership itself will own the insurance on the lives of the individual members (referred to as the entity plan) (35,44). Insurance in these last two cases is often called "key man" insurance and is a non-deductible business expense for the partnership or individual (7,8,20,44). However, because these premiums are non-deductible as a business expense for income tax purposes, the proceeds are also non-taxable income when received by the partnership. This is an advantage for the business. These insurance proceeds can be used by the partnership to purchase the de-

ceased partner's interest in the business by way of the buy-sell agreement (35,44). This particular set-up merely represents an exchange of assets, cash for the business interest, and therefore in most instances will not "add to" or "subtract from" the value of the estate. If the amount of proceeds received by the deceased partner's estate exceeds or is less than the value of the partnership interest as passed to the partnership, a capital gain or loss, respectively, has accrued to the estate and would be reportable on the decedent's final income tax return. Whether there is a capital gain or loss would depend on valuation of the business interest under the terms of the buy-sell agreement.

Finally, with respect to the gross estate and the calculation of the estate tax, only the decedent partner's interest in the partnership is included in the estate for estate tax purposes. Co-ownership of the business assets thus shelters part of the value of these assets from the gross estate (27).

The Corporation

The corporation, another available form of business organization, is a body of persons formed and authorized to act as a separate legal entity for conducting business activities. Under current Alabama law, a single individual can incorporate. The corporation has its own rights, responsibilities, and existence apart from that of its human agents. The corporation can sue or be sued and is a separate taxpayer from its shareholders (27).

Two types of corporations exist: regular and Subchapter S. The most important difference between these types is in regard to federal income taxation; the Subchapter S corporation is not subject to the corporate income tax, the accumulated earnings tax, or the personal holding company tax (8). Rather, the Subchapter S corporation passes on all tax liability to its shareholders and thus affords a greater measure of flexibility to its shareholders than the regular corporation. Another potential difference relates to size; Subchapter S corporations are generally smaller, as in numbers of shareholders, and are more of a "closely held" nature than regular corporations (8).

Each of these types can further be delineated into either an "open" or a "close" corporation. A close corporation is one in which the directors and officers have the power to fill vacancies within their own ranks without allowing the general body of shareholders any choice or

vote in the matter. An open corporation is one in which all members or shareholders have a vote in election of directors and other officers.

With respect to estate planning, the corporation is somewhat different from a sole proprietorship or a partnership. In the corporation, there is no direct ownership of assets, as is generally the case with either the proprietorship or the partnership (27). The corporation holds title to the assets (20), which are held in the form of stock, the stock being sub-divided into voting and/or non-voting units called shares. The shares are divided in various proportions among the members (shareholders) of the corporation, with the shareholder(s) holding 51 percent or more of the voting stock controlling the policy and directive operations of the corporation (27). Thus in a corporation, control of the business is held by the majority stockholder(s). This designed structure of the corporation allows a measure of flexibility in the estate planning process, since ownership of assets, up to and including 49 percent, can be transferred without the loss of control over such assets (27). This was not the case in the sole proprietorship, where transference of ownership of an asset also meant the loss of control over the asset if the gross estate was to be reduced. Likewise in a partnership, the transference of a partnership interest, while reducing the transferor's gross estate, ultimately shifts control over such assets to the transferee even though the assets may be continued to be used in the partnership. The transferee in this instance could dissolve the partnership by simply withdrawing his interest (8). An important characteristic, therefore, of the corporation that sets it apart from both the partnership and proprietorship is the total and complete separation of business entity from the individual's entity. This characteristic allows for the retained control of transferred assets within the corporation structure, since the corporation itself can legally hold title to property.

Transferred assets within a corporation cannot be withdrawn at will, but rather have to be sold, distributed, or transferred within the guidelines as set forth in the corporation by-laws. Thus, a corporation can provide a measure of security for its stockholders that is not afforded a proprietorship or partnership, with respect to the continued use of transferred assets (27). A discontented shareholder can withdraw from the corporation, but such action will have little effect on the corporation. Finally, because of the corporation's formal organization and independent legal status, transference of shares or interests in the corporation again must comply with the guidelines as established in the by-laws. However, such transference is relatively easy to verify and this greatly aids the estate planning process.

There are other aspects of the corporation that also may make it advantageous in estate planning. Because the business is a completely separate entity, the continuity of the business is perpetual (20). The business is not contained within the life of any given shareholder. Business liability and personal liability are totally separated; liability of the business does not extend to the personal assets of the estate owner. This is true for both business and legal liabilities. Also with respect to credit acquisition, separation may or may not be distinct from the estate owner, depending on the "track record," size, and assets of the corporation.

With respect to Sections 2032A and 6166 of the Internal Revenue code, the corporation, like the partnership, may be subject to special requirements if these two provisions are to be used in an estate plan for the property held by the corporation. The "Tier I" and "Tier II" tests apply for both Sections 2032A and 6166. For Section 2032A, the tests are the following (28):

1. Tier I. In a corporation carrying on a qualified trade or business, the decedent's interest must comprise 20 percent or more of the value of the voting stock, or the corporation must have 15 or fewer shareholders.

2. Tier II. At least 50 percent of the decedent's adjusted gross estate, including both real and personal property, must be utilized in the agricultural business. To meet this test, the decedent's interest in the property held by the corporation can be summed with the decedent's personally held property, to the extent that the property personally held is involved in the business. Also, the decedent's real property as used in the business must comprise at least 25 percent of the adjusted gross estate, again found by summing the real property held by the corporation and that personally held, as long as both are utilized in the agriculturally related business.

As in the partnership, both tests are evaluated utilizing the fair-market valuation method. The Tier I and Tier II tests also apply for utilization of Section 6166 but, as in the partnership, the Tier II test changes. Under the Tier II test, the decedent's interest in the closely held business must comprise at least 35 percent of the adjusted gross estate (25). Under this Tier II test, all types of stock can be utilized to meet the requirement (25).

Concerning gifts, the corporation may have some advantage over both the proprietorship and the partnership in that up to and including 49 percent of the stock can be transferred by the incorporator-transferor without loss of control of the corporation (27). This affords

some flexibility in estate planning, since about half the business, along with the potential appreciation, can be dispersed without serious consequences for the estate owner. The transfer can be made annually under the annual gift exclusion, or if a larger amount needs to be transferred, the transferor's unified credit can be used. If the estate owner wanted to make gifts of property personally held, then title and control of the gifts, as in the proprietorship and partnership, must be relinquished if the estate is to be reduced.

With respect to life insurance, the treatment is the same as for the proprietorship if the shareholder owns his own insurance. However, the corporation, like the partnership, could own the insurance on the lives of the shareholders and if such was the case, the insurance (known as "key man" insurance) would then be treated like that of a partnership (44). The corporation can also hold insurance on the lives of its employees, and this type insurance can be a deductible expense for the corporation. There are a wide variety of ways in which these arrangements can be structured; these, however, are beyond the scope of this research.

Finally, concerning the gross estate and calculation of the estate tax, only the individual's interest in the corporation is includable in the gross estate. Thus, like the partnership, part of the value of the business assets can be sheltered from the gross estate of a decedent-shareholder (27).

The Buy-sell Agreement

An important part of an estate plan that relates to the form of business organization is the so-called "buy-sell" agreement. This particular instrument would be the tool used by a partnership or corporation to facilitate the orderly and efficient exchange of cash or cash equivalent for the business interests of a deceased or retired partner/shareholder. The capital assets would transfer to the corporation or partnership in full and unadulterated ownership, and the family of the deceased would receive a flexible, liquid asset, i.e., cash. In order to be responsive to the needs of both the family and the corporation, the buy-sell agreement should be carefully developed.

There are three tasks that a well developed buy-sell agreement should accomplish: (1) an orderly transfer of ownership interests upon death and retirement, (2) funds and income to survivors who are not active in the business, and (3) stability and continuity of the business enterprise (27,44).

These tasks are accomplished within the structure of the agree-

ment, and such structure should include the following sections: (1) introduction or preamble to state the purpose and intent of the agreement, (2) the conditions or events (i.e., death, retirement, etc.) to which the agreement will apply, (3) the method of determining the value of the stock or other interest, (4) the method, terms, and time-frame of payment, and (5) restrictions on the transfer of the stock or other interests (35,44).

The above items are self-explanatory in nature, but probably the most important sections are: (3) the method of determining the value of the stock or other interest, and (4) the method, terms, and time frame of payment. Several methods are available for valuing the stock and a competent farm estate planner can help with this decision. The method, terms, and time-frame of payment are important in that the family needs payment as quickly as possible without crippling the efficient operation of the business (28,44).

The type of business organization under which the business is structured can be an important consideration when determining how to develop an appropriate estate plan. Competent, professional assistance can be utilized to help structure the estate plan to the existing business organization, and can point out deficiencies which may need to be addressed if certain estate planning objectives are to be achieved.

The use of the buy-sell agreement can be an important tool for an estate plan where a corporation or a partnership is involved. Again, professional assistance can be utilized to develop a flexible, functional agreement that meets the unique needs of the particular estate circumstances.

Other Tools

In addition to the major tools available for planning the farm estate that have been identified and briefly explained, there are six less utilized aids to the farm estate transfer process that, for specific situations, could be just as important. These six tools are: (1) the private annuity, (2) the power of appointment, (3) the disclaimer, (4) the "Series E" or "flower" bond, (5) the charitable deduction, and (6) the installment sale.

The Private Annuity

A private annuity can be utilized by estates which have foreseeable liquidity problems. It is probably best utilized by larger estates,

since it involves the complete transfer of property, usually to a specific heir or heirs. A private annuity is defined as a "contractual arrangement whereby an individual (the transferor) transfers property, usually that which is illiquid in nature, to another party (the transferee) whether that party is a corporation, a trust, or another individual, in exchange for the transferee's promise to make periodic payments of a specified sum to the transferor for the remainder of the transferor's life" (29). The annuity is termed "private" as opposed to "commercial" because the transferor is not in the business of selling annuities (29).

The definition of the private annuity reveals two areas that are important in utilization of this tool: the size of the annuity payment and the length of the payment period. The size of the annuity payment is determined by treasury regulations, where an "annuity factor" for the age of a particular transferor is divided into the fair-market value of the property in question to yield the size of the annual payment. Thus, the actual size of the payment is arbitrarily determined from guidelines set by the U.S. Treasury. Concerning length of payment period, the payment is to be made at least annually for the length of the transferor's life. While life expectancy itself is measurable statistically and is somewhat definable, actual life-in-being for a given individual is highly uncertain. This is why life or private annuities are usually not considered until after the transferor reaches 55 years of age.

From the transferor's perspective, the most important aspect of the private annuity is the potential estate tax savings. "The transferred property is removed from the transferor's gross estate even though the transferor receives a benefit from the property for the remainder of his life" (29). The transaction itself is treated by the IRS as a sale, becoming effective the moment the agreement is signed (29). The private annuity therefore removes not only the current value of the property from the transferor's gross estate, but also any appreciation that may accrue to the property. The tool serves to immediately reduce the transferor's gross estate without any transfer tax liability; this is the most compelling advantage of the private annuity (29).

The major disadvantage of the private annuity has already been identified, the uncertainty of the transferor's life-in-being. If the transferor lives beyond life expectancy, payments for the transferee could become excessive (29). However, this may not be a great burden, especially when consideration is given to the current provisions of the annual gift exclusion and the unified credit provision.

The private annuity can be a useful tool in estate planning if properly structured. "The unique feature of the private annuity is that it offers the owners of non-liquid estates the opportunity to pass such estates to desired heirs free of transfer tax" (29). There are other aspects of the estate situation that need consideration in determining if the private annuity is to be utilized, such as implications concerning the property basis. However, competent estate planners can help with these aspects.

The Power of Appointment

The power of appointment is a tool whereby a donor of property allows the receiver of the property to "appoint" or designate whom the property is to vest at the transferee's death. The one giving the power of appointment is usually referred to as the "donor" and the one holding the power of appointment, the "donee" or "holder." The person or entity that is the receiver of the property upon the exercise of the power of appointment is called the "appointee" or "taker" and the person or entity that receives the property upon failure of the power to be exercised is the "taker in default" (43).

The power of appointment can be categorized under two classifications: the general power of appointment and the special power of appointment. These two classifications differ on the basis of the scope of the appointee. Under a general power of appointment, the holder can name anyone, including himself, to be the beneficiary or taker of the property. Under a limited power of appointment, the holder is limited in whom he can name as taker, since the number of takers is limited (43). Concerning estate taxes, only property subject to a general power of appointment is includable in the holder's gross estate. Property subject to a special or limited power of appointment is not generally included in the holder's estate for estate tax purposes (43).

Probably the most important feature of the power of appointment is that it serves to add flexibility to an estate plan. For example, if the wife is the holder of a life estate, a special power of appointment will allow her to designate the specific beneficiary in whom the property will vest, either during her life or at her death. The flexibility is present because, as the surviving spouse, the wife can take into consideration circumstances that might not have been in existence at the time of the donor's death. And, because the power is limited to a specified class of appointees, the property interest is not included in this surviving spouse's (donee's) estate (10).

The power of appointment can add flexibility to an estate plan if properly utilized. Care should be exercised to avoid unwanted tax consequences in the donee's estate.

The Disclaimer

Disclaimers are instruments that can be used to reject transfers of property or property interests. A disclaimer can be defined as "an unqualified refusal to accept a transfer or attempted transfer of property" (37). The disclaimer can be used to reject both in-life (inter vivos) and at-death (testamentary) transfers of property.

For a disclaimer to be effective, four tests must be passed: (1) the refusal must be in writing, (2) the refusal must be received by the transferor, his legal representative, or the holder of legal title to the property not later than 9 months from the date of the transfer, or the date on which the recipient of the property became 21 years of age, (3) the disclaimant must not have accepted the interest or any of its benefits, and (4) the interest must pass, without any direction on the part of the disclaimant, to someone other than the disclaimant (37). If these tests are passed, the disclaimed property is treated as if it never passed to the disclaimant and thus the property is excluded from the estate of the disclaimant (37).

Why would an individual utilize a disclaimer? Probably the main reason would be for tax purposes. For example, with the current unlimited status of the marital deduction, a husband may unnecessarily "stack" assets in the wife's estate by leaving her all his property in order to "fully utilize" the marital deduction. While the estate might thus escape taxation at his death, the estate at her death could become excessively large, with the potential for serious tax problems. If the wife in this instance could reject or "not accept" some of this property, the stacking problem could be avoided and the potential estate tax liability at her death could be reduced. The property, in lieu of vesting in the wife, could then vest in the children who would probably be the natural recipients of the property at the wife's death anyway. A disclaimer can thus be used as a corrective device for an over-funding or under-funding of the marital deduction (11,37).

Other reasons for utilization of the disclaimer include the following (37):

1. "To adjust distribution of property in response to changed conditions or special circumstances and to set up alternatives for distribution with pre-death planning, i.e., achieve 'built-in flexibility'.

2. "To achieve larger charitable deductions.
3. "To add assets to trusts, including family trusts with income to the surviving spouse.
4. "To avoid double taxation and ease probate problems in cases of rapid successive deaths.
5. "To avoid generation-skipping tax traps.
6. "To modify trusteeship powers or other powers which would cause adverse tax consequences.
7. "To insulate property from creditors."

Disclaimers can be useful in the estate planning process, especially in helping reduce the tax consequences of estates that may have been improperly planned or that, because of a sudden severe change of circumstances, have a plan with reduced efficiency (11).

The "Series E" Bond

"Series E" U.S. Savings Bonds, or "flower" bonds as they are sometimes called, are government securities that can be purchased for the purpose of paying the estate tax liability that might be incurred by an estate. The provision for these bonds was repealed in March 1971, but obligations issued before that date can still qualify for this treatment (43).

The advantage of flower bonds is that they can be purchased at about 25 to 30 percent below their "par" value, the value at which the bonds may be redeemed at the time of death (22). However, the bonds have a fairly low yield associated with them and, therefore, the time between the date of purchase and the date of redemption should be relatively short for the most efficient utilization of this particular tool. The bonds will lose some of their effectiveness if they are held for an extended time (22,43).

Flower bonds may or may not be a viable alternative for utilization in an estate plan. Under current situations with the amount of unified credit available, the unlimited marital deduction, current-use valuation, and other major estate planning alternatives, the usefulness of flower bonds may be somewhat limited. Flower bonds are designed to help with liquidity problems since their cost is generally 70 to 75 percent of their redeemable value. However, if liquidity is a problem, a good insurance program may be more useful to an estate owner, especially if implemented early, than these low yield bonds. If flower bonds are to be a consideration for an estate plan, the ex-

pertise of professional estate planners is needed to properly advise relative to these matters.

The Charitable Deduction

With respect to farm estate planning, the charitable deduction is probably the least utilized minor tool. For certain situations, however, utilization of this deduction can afford opportunity for enhancement of the estate position that might otherwise be unavailable. A charitable deduction, if properly structured, can be quite beneficial to an estate plan.

The charitable deduction is simply a deduction allowed for gifts, bequests, or devises to charitable institutions. However, restrictions exist concerning what organizations qualify as charitable institutions; the existence of an organization under a tax-exempt status does not necessarily mean the organization can qualify as a charitable institution. Types of organizations that could qualify as charitable institutions include the following (43):

1. "Government entities, if the gift is exclusively for public purposes.
2. "Certain corporations, trusts or foundations if such organizations are created within the United States, organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals, not utilized for the benefit of any private shareholder(s) or individual(s) and, not used in an attempt to influence legislation or promote certain political candidates.
3. "Certain organizations of war veterans.
4. "Certain fraternal societies if such contributions are to be exclusively used for religious, charitable, scientific, literary or educational purposes, or for the prevention of cruelty to children or animals."

The preceding guidelines serve to broadly define the type of organization that can qualify for the deduction. Churches and most educational institutions would also qualify. However, because regulations do exist, it would be advisable to make sure the organization is qualified before making the transfer.

There are many ways in which charitable transfers may be structured. One potentially useful structure for farms or farm-related businesses might be one involving a transfer of property to a charitable trust, with the charity holding a remainder interest in such trust

which would consist of the trust corpus. In this instance, the heirs could receive the income interest which the trust corpus might produce. Or this entire situation might be structured in reverse order where the heirs would hold the remainder interest and the charity receive the income interest. In either case, the grantor or transferor would receive a charitable deduction (although different in each case) for the estate to help reduce the tax burden. Another idea might involve use of a private charitable foundation. A foundation is somewhat advantageous in that the donor of the property can be allowed an immediate deduction without having definitely determined what organization will be the recipient of the funds or property. The foundation thus allows some flexibility in planning with respect to time (43).

In summary, the charitable deduction is probably not a tool that most farm estates would need to utilize; however, for certain situations, it can be successfully employed in an estate plan.

The Installment Sale

The installment sale is similar to the private annuity in several respects, yet differences do exist which help distinguish between the two tools. Like the private annuity, the installment sale has specific uses for specific circumstances in farm estate planning.

Both the installment sale and the private annuity are probably best utilized by estates that have foreseeable liquidity problems. The installment sale, like the private annuity, involves the transfer of property from a transferor or "seller" to a recipient or "buyer," with payments of a set amount to be made over a number of years to the "seller" of the property. The installment sale is flexible in that either a land contract or a deed and mortgage can be utilized as the instrument of conveyance, as long as the requirements for installment reporting are met. Both the installment sale and the private annuity can also be used to exclude property from the transferor's gross estate.

Probably the most unique aspect of the installment sale is flexibility; it can be structured in a variety of ways to meet the specific needs of the "buyer" and "seller." For example, under the installment sale, the seller can retain title to the property until all or part of the payments have been made. This is different from a private annuity where title is transferred when the annuity contract is signed. Also, the amount and schedule of payments under an installment contract are flexible and totally at the discretion of the parties involved, while

in a private annuity, payments are a definite amount as determined by U.S. Treasury regulations, due at specific stated intervals.

There are also other aspects of the installment sale that differentiate it from the private annuity. Payments in an installment contract are specified for a given time or stated number of years; the time period is definite and certain. For a private annuity, payments are to be made for the life of the transferor—an indefinite or uncertain period of time. Also, the interest associated with the payments for an installment sale is income tax deductible. The interest in a private annuity is not tax deductible (43). However, a private annuity may have an advantage over an installment sale in that the transferred property is immediately removed from the transferor's gross estate, thereby immediately reducing the value of the gross estate. Under an installment sale, the property is removed from the gross estate, but this value is replaced by the value of the installment obligation, the down payment, and any payments received to date of death, since the seller has retained title (43). Therefore, care should be exercised when using the installment sale to avoid adverse estate tax consequences which may result since the value of the gross estate is not immediately reduced under the terms of this arrangement.

Finally, in utilizing the installment sale, as with the private annuity, attention needs to be given to the incoming payments so that these do not accumulate in the gross estate and thus thwart the purposes for which the installment sale was utilized, that purpose being to provide liquidity while at the same time reducing the value of the gross estate.

The installment sale, as well as the other five minor tools, is designed to lend assistance in solving specific estate problems. If these tools are properly structured, they can be utilized to accomplish specific objectives, while at the same time helping reduce the tax liability.

SUMMARY AND CONCLUSIONS

This study sought to identify and explain various provisions ("tools") that can be employed in the farm estate transfer process. The major tools available for use in farm estate planning included considerations of property ownership (property deeds), the will and marital deduction, current-use valuation, the annual gift exclusion and the unified credit provision, the installment payment of the federal estate tax, life insurance, trusts, and considerations of business organization. Several minor tools were also examined in the study, in-

cluding the private annuity, the power of appointment, the disclaimer, the "Series E" bond, the charitable deduction, and the installment sale. All tools were examined individually in an attempt to provide the prospective estate owner with an understanding of how these can currently be applied to the estate transfer process.

Historical aspects of the estate transfer process were examined. It was discovered that two major pieces of legislation were basically responsible for the current estate tax laws: the Tax Reform Act of 1976, effective January 1, 1977, through December 31, 1981, and the Economic Recovery Tax Act of 1981, effective January 1, 1982, and currently in existence.

Each of the tools examined in this study was found capable of being incorporated into an estate plan to meet various needs. Some of the tools examined have a broad range of application; for example, the will and marital deduction, along with lifetime gifts, can be applied to almost every estate. It was found that other tools are highly specific in their design and apply only under specific circumstances; the qualified terminable interest property trust is an example.

When consideration is given to the tools available to the estate owner for planning the transfer of the estate and their flexibility for application to a wide variety of estate circumstances, the findings seem to indicate that most farm and small-business estates should be able to eliminate most inter-generational transfer tax and non-tax problems. The tools of estate planning, as currently structured under existing legislation, appear adequate to avoid excessive tax liability while aiding the estate owner in his non-tax objectives for the estate transfer process. Conservation and proper distribution of the estate can 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

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:

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APPENDIX C

The Alabama Probate Code; Selected Sections, Code of Alabama, 1982

43-8-40. Intestate Estate Generally

"Any part of the estate of a decedent not effectively disposed of by his will passes to his heirs as prescribed in the following sections of this chapter." (Acts 1982, No. 82-399, 2-101)

43-8-41. Share of the Spouse

"The intestate share of the surviving spouse is as follows:

1. If there is no surviving issue or parent of the decedent, the entire estate;
2. If there is no surviving issue but the decedent survived by a parent or parents, the first \$100,000 in value, plus one-half of the balance of the intestate estate;
3. If there are surviving issue all of whom are issue of the surviving spouse also, the first \$50,000 in value, plus one-half of the balance of the intestate estate;
4. If there are surviving issue one or more of whom are not issue of the surviving spouse, one-half of the intestate estate;
5. If the estate is located in two or more states, the share shall not exceed in the aggregate the allowable amounts under this chapter." (Acts 1982, No. 82-399, 2-102)

43-8-42. Share of Heirs other than Surviving Spouse

"The part of the intestate estate not passing to the surviving spouse under section 43-8-41, or the entire intestate estate if there is no surviving spouse, passes as follows:

1. To the issue of the decedent; if they are all of the same degree of kinship to the decedent they take equally, but if of unequal degree, then those of more remote degree take by representation;
2. If there is no surviving issue, to his parent or parents equally;
3. If there is no surviving issue or parent, to the issue of the parents or either of them by representation;
4. If there is no surviving issue, parent or issue of a parent, but the decedent is survived by one or more grandparents or issue of grandparents, half of the estate passes to the paternal grandparents if both survive, or to the surviving paternal grandparent, or to the issue of the paternal grandparents if both are deceased, the issue taking equally if they are all of the same degree of kinship to the decedent, but if of unequal degree those of more remote degree take by representation; and the other half passes to the maternal relatives in the same manner; but if there be no surviving grandparent or issue of grandparent on either the paternal or the maternal side, the entire estate passes to the relatives on the other side in the same manner as the other half." (Acts 1982, No. 82-299, 2-103)

43-8-43. Requirement that (the) heir survive decedent for five days.

"Any person who fails to survive the decedent by five days is deemed to have predeceased the decedent for purposes of homestead allowance, the exempt property and interstate successions, and the decedent's heirs are determined accordingly. If the time of death of the decedent or of the person who would otherwise be an heir, or the times death of both, cannot be determined, and it cannot be established that the person who would otherwise be an heir has survived the decedent by five days, it is deemed that the person failed to survive for the required period. This section

is not to be applied where its application result in a taking of intestate estate by the state under section 43-8-44." (Acts 1982, No. 82-399, 2-104)

43-8-44. When estate passes to state.

"If there is no taker under the provisions of this article, the intestate estate passes to the State of Alabama. (Acts 1982, No. 82-399, 2-105.)"

43-8-45. Division of Estate where representation is involved.

"If representation is called for by this chapter, the estate is divided into as many shares as there are surviving heirs in the nearest degree of kinship and deceased persons in the same degree who left issue who survive the decedent, each surviving heir in the nearest degree receiving one share and the share of each deceased person in the same degree being divided among the issue of such deceased heir in the same manner. (Acts 1982, No. 82-399, 2-106.)"

43-8-46. Inheritance by relatives of half blood.

"Relatives of the half blood inherit the same share they would inherit if they were of the whole blood. (Acts 1982, No. 82-399, 2-107.)"

43-8-47. Inheritance by after born heirs.

"Relative of the decedent conceived before his death but born thereafter inherit as if they had been born in the lifetime of the decedent. (Acts 1982, No. 82-399, 2-108.)"

Source: *Code of Alabama*, Volume 22, Title 43, Chapter 8 Article 3, 1982 Replacement Volume. The Michie Co., Charlottesville, Va.

APPENDIX D

Steps in Developing an Appropriate Will

A. The Basic Process

1. Determine your goals and intentions, the objectives you want to accomplish for your family and business, your family situation, the condition of your estate and business, and your own personal desires? These facts will serve as guidelines.

2. Select your personal representative—the person (or institution) who will administer your estate at death. Your estate will save money if you appoint or name this individual in your will. If you fail to name an executor, the State will appoint one for you. It is also good to name a contingent executor, in case the original executor should fail in or be prevented from performing his duties. This individual needs to be someone you trust as being mature and competent, with a working knowledge of your estate.

3. Prepare information—organize and develop a basic plan yourself before you visit an attorney. The following are items to have that will aid you and your attorney in developing your will:

- a. Your developed (and written down) estate planning objectives and intentions.
- b. An inventory of all personal and real property you own, or everything you desire to distribute.
- c. A description of how your property is owned; the deeds.
- d. An explanation of any transfer provisions already in existence, and any lifetime gifts you have made or are in the process of making.
- e. Your plans for continuation of your farm or other business, if any.
- f. A description of your financial situation, particularly any indebtedness against your property.
- g. A description of your immediate family, including names, ages, and addresses of your spouse, children, parents.
- h. A list of beneficiaries, those you wish to receive your property; their names, addresses, and relation to you. Completely describe what you want each to have.
- i. Names and addresses of the desired guardians and contingent guardians. This will be needed only if there are minor children involved.
- j. The names and addresses of your desired executors and contingent executors.
- k. An idea or statement of how your property should be distributed if you and your spouse should die simultaneously in an accident.

4. Obtain professional counsel—choose an attorney you like and trust. Strong consideration should be given to an attorney who specializes completely in estate planning. Your insurance agent, broker, or accountant could recommend someone. Certain states have formal requirements for executing a valid will, and a competent estate lawyer will know these.

5. Preserve your will. Your will is like an investment, and it needs to be kept along with other important papers (i.e. deeds, insurance policies) in a safe storage box of some type (i.e. home safe, safety deposit box, etc.).

6. Keep your will up to date. The circumstances of life are constantly changing. It is good to review the will on a regular basis to account for changing business circumstances, family situations, and various provisions in the law.

B. Basic Legal Requirements of a Will (Alabama)

1. Minimum age of 18 years, no maximum age limit.
2. An individual must be of sound mind at the time the will is drawn.
3. The will must be in writing and readable.

4. The will must be dated and signed by you, or by someone for you in your presence and under your direction.
5. The will must be signed by at least two persons, each of whom witnessed either the signing or the testator's acknowledgment of the signature of the will.
6. The will must be signed by each witness in your presence.

C. Objectives that Can Be Accomplished by a Will

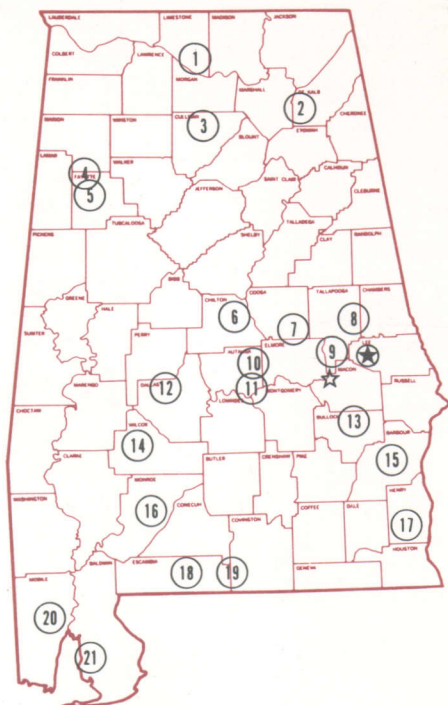
1. The distribution of property (either real or personal) according to the personal desires of the deceased. This right is inherent with the ownership of the property. Make sure the deed and the will are in agreement.
2. Designate the executor of an estate—the person desired to handle the estate. This feature saves the estate administration costs.
3. Grant the executor broad powers and discretion that would otherwise be available under state inheritance laws (probate code). This feature also saves the estate administration costs, and the estate can be administered with less “red tape.” For example, granting an executor powers without having to pay surety for a bond.
4. Nominate guardians for minor children. Guardians and contingent guardians can be nominated, thus saving the estate administration costs over these having to be appointed and approved by the probate court.
5. Establish how the estate should be distributed if the estate owner and spouse are killed simultaneously in an accident.
6. Creation of trust(s) that can be used for a wide variety of objectives or purposes.
7. Reduce the potential tax liability at death. The will is able to help reduce the potential tax liability by way of the marital deduction.

SOURCES:

1. Maddox, Charles L., *Making Your Will - Six Steps*. Ala. Coop. Ext. Ser., Auburn Univ. Cir. ANR-315.
2. Maddox, Charles L., *Making Your Will - What You Need to Know*. Ala. Coop. Ext. Ser., Auburn Univ. Cir. ANR-314.
3. Maddox, Charles L., *Making Your Will - Is It Really Necessary?* Ala. Coop. Ext. Ser., Auburn Univ. Cir. ANR-313.
4. Uchtmann, Donald L., J. W. Looney, N.G.P. Krausz, and H.W. Hannah. *Agricultural Law; Principles and Cases*, 1981, McGraw Hill Book Co., Inc., pp. 592-594.
5. *Code of Alabama*, Volume 22, Title 43, Chapter 8, Sections 130 and 131, 1982 Replacement Volume. The Michie Co., Charlottesville, Va.

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 Substation, Spring Hill.
21. Gulf Coast Substation, Fairhope.