INTRODUCTION TO ESTATE PLANNING

by Al Lundstrom

Is estate planning really for me? This question was presented to you in last month's article.

It is important to note that there is no such thing as "no estate plan." It is possible not to have a will, but everyone has an estate plan. People who do not have a *personal plan* are provided with one by the state in which they live. Within your state, the same set of legal rules applies to everyone regardless of occupation, age, income or social status.

The law regarding estates and estate taxation can work for you as well as against you. Fortunately, if you have the foresight to plan and to identify your objectives, the law, with its flexibility, can be used to accomplish those goals. In most cases where legal restrictions are imposed, a great deal of latitude may exist; even with restrictions, there are exceptions.

Life's Economic Stages

Your life contains four economic stages—a learning period, an earning period, a conserving period and a time of distribution.

During the learning period, you work for wages and try to acquire a few assets which may be considered the basics of life's needs. Ideally, you are working to learn and gain experience so that you can eventually establish a business and work for yourself.

The earning period represents the time in your life when you are willing to take the chance on the knowledge you have gained. It is the time when you acquire assets, putting to work all your previous experiences in hopes that the newly acquired assets produce a cash flow, not only to meet financial requirements but to provide a profit.

The conserving period represents the time in your life when you leave the speculating to the younger generation and are concerned with the security of the assets you have acquired, those assets that will produce the income to maintain you during your retirement years.

The fourth phase is unfortunately enjoyed only by the few who have successfully accomplished their lives' goals. It is a period when they are distributing assets that are in excess of the amount needed to provide financial security for the rest of their lives.

Consider Two Points

Little thought is given to the acquisition, control and personal ownership of the assets acquired during the formative years of the learning period or in the early years of the earning period. Few people, if any, consider it the time for estate planning. Time and consideration should be given to (1) an examination of how property is owned, i.e., joint tenancy, tenancy-in-common, sole ownership and corporation, (2) under what form of business you will operate, i.e., sole proprietership, partnership or corporation.

By raising these questions, additional thoughts should be taken into consideration. What effect will each type of property ownership have on disposition of that property during life—such as sale by cash, installment sale, private annuity or gift giving sales transactions? How will the form of business affect record keeping, tax rates, cash flow and control?

Inevitably, in most farming and ranching situations, the wife/mother is involved helping with management and labor during the formative years of the business. Little consideration is given to the organizational structure of the operation at this stage. Shouldn't the wife/mother have the opportunity to build assets in her own name while working side by side with her husband? If the wife's contribution to the overall farm or ranch business needs to be recognized, is she a partner, officer, shareholder or employee? Being concerned about these matters and the underlying effects of good estate planning, a lot of time, tax dollars and worry can be eliminated if reasonable steps are taken.

Family Business Plans

What about the family business plans? Can a family have financial objectives just like the parents? Decisions and objectives must also be made for the family business that continues from generation to generation.

One of the most difficult problems in estate and business planning is the process of deciding objectives. Most farm families are very close and involved, making it more difficult for the parents to distinguish between personal objectives and family objectives. Since parents and children alike have different personalities, it is difficult for the parents to maintain an equitable division of assets for the benefit of each child. On the other hand, where physical and mental handicaps may exist in their children, then the necessity for unequitable sharing becomes a difficult task to accomplish.

Efforts to minimize or eliminate entirely death taxes and estate settlement costs would mean losing control or assets in the estate for the eventual benefit of the children or favorite charities. On the other hand, to provide financial security to the parents means important decisions on property ownership and disposition of property during life and at the death of the first spouse. Individually, parents are always concerned about property disposition. The question arises, after the first to die, what happens if the surviving spouse remarries? What happens if the surviving spouse is disabled, unable to work or make management decisions concerning the inherited assets?

Basic Levels of Concern

There are basically three levels of concern in family estate planning. The first level involves decisions about the disposition of property if one parent should die, survived by the other parent and children. The second problem exists when both parents are deceased, leaving surviving children. Of the surviving children, what if there are minor children who by law are not competent to manage their own assets? We are concerned with not only the custody of the children but what happens if the entire family should die in a common accident.

Seldom, if ever, do ranchers and farmers focus their attention on estate planning when they go out to buy land, livestock, machinery or other property. Nevertheless, the method by which titles are held can have important implications. There are six factors which influence the choice of ownership: (1) Financial and legal performances on sole ownership or co-ownership, (2) income tax liabilities, (3) the desired disposition of property during life or at death, (4) state and inheritance tax facts, (5) gift tax implications, (6) differences in estate settlement costs.

Second in a series of articles offering ANGUS JOURNAL readers a systematic procedure they can use in designing their own estate plans.

There are economic rights and powers that you possess as property owners. Property can be defined and divided into two classes. First is real property, which is basically land or the soil and everything attached to it (trees, water, houses, barns, buildings, fences, etc.), things of a permanent nature that cannot be moved readily from place to place. The second is personal property, those objects and possessions that *can* be moved. They include such things as livestock, money, crops, machinery and equipment, things that are easily transferable.

The most widely used form of ownership between two or more persons is joint tenancy or tenancy-in-common. In the eight community property states—Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas and Washington—community property is also an important co-owner concept. Details vary in these states, but as a general rule all property acquired during marriage becomes community property and is owned essentially half by each spouse. Property acquired by gift or inheritance is not included.

Size of the estate may have a great deal to do with the choice of co-ownership methods. As the estate increases in size and becomes potentially subject to death taxes, joint tenancy may become less satisfactory as a means of holding title. Thirty years ago, relatively few estates were subject to federal estate tax, but times have changed. The average farm estate is now more than 20 times larger.

Major Difference

In discussing joint tenancy and tenancy-in-common, the major difference becomes apparent with the disposition of property at death. At the death of a tenant-in-common, that individual's undivided interest passes to the decedent's heirs under state law or by will. Joint tenancy, however, has the right of survivorship, meaning that when one joint tenant dies, the survivor immediately becomes the full owner. In this case, a will is not necessary to transfer the property at the time of death.

Joint tenancy ownership of property by husband and wife may accomplish their goals, but the same type of ownership applied to a father and a son or unrelated person can produce unexpected problems. Take, for instance, a father and son who have farmed together for several years and all the real property is in joint tenancy under the assumption that the father will die first and the son will become sole owner. If the son would be accidently killed before his father's death, leaving a wife and children, what would happen to his equity in the farm? The son's wife and children are left without the financial security of that asset.

Creating and changing co-ownership is not a simple matter. Much thought should be given to each of the individual's goals and their joint goals, taking into consideration that state's applicable laws and the type of property to be owned.

In some families, there is no one in the younger generation who is interested in continuing on with the farm/ranch. What is to be done with assets in a case like this? Will the assets be sold, transferred or gifted away? For those families with younger members to carry on, are the goals of the younger generation the same as those of the older generation? What are the objectives of the "on-farm heirs" and what consideration has been given to the "off-farm heirs"?

Financial planning, business planning, tax planning, retirement planning and estate planning become increasingly more important in making decisions today when we realize that federal estate taxes take the largest slice from a decedent's estate. It is extremely important to estimate what the federal estate tax will be and what must be available in liquid assets to pay that tax.

In the next article, we will discuss the meaning of gross estate, adjusted gross estate or taxable estate and how to estimate the federal estate tax. Through proper planning, we will also suggest steps available to reduce that *tax* burden. It would be extremely unfortunate to work a lifetime accumulating assets only to give the federal government as much as 50-75% of your estate.

Financial security for you, your family and heirs depends on good planning.