ESTATE PLANNING

Property Subject to Estate Taxes

by Al Lundstrom

Estate planning and tax strategy become increasingly more important in making business decisions today, since federal estate taxes will take the biggest slice from the decedent's assets. It is extremely important to estimate what the federal estate taxes will be and what must be available in liquid assets to pay them.

Ranch and farmland values are skyrocketing because of the demand for land and because of inflation. This means that ranch or farm estates that would not have been large enough to qualify for estate taxation a few years ago may now be subject to a considerable amount of tax at the death of the owners.

It is unfortunate that many ranchers and farmers do not realize the impact estate taxes are likely to have upon their estates at death. Frequently they are misinformed about estate tax laws and how the tax is calculated. While tax evasion is illegal and bears with it punishment under law, planning in advance to reduce taxes is simply a practical management decision. With the proper use of estate planning tools, the proper impact of taxes can be reduced considerably.

Although inheritance taxes or estate taxes imposed by individual states are important, most of the problems caused by taxes at the time of death are brought about by imposition of the federal estate tax.

Gross Estate

The tax law defines the gross estate to include all property wherever situated in which the decedent had an interest. Estate tax will be payable on all property the decedent owned outright as well as his fractional or other interest in property owned with others wherever in the world that property might be. This sweeping statement is a result of our early history of estate tax. Legal and constitutional law defines estate tax as an excise tax on the privilege of leaving property to one's heirs at death.

Federal estate tax is payable from the assets of the deceased's estate and is levied on the value of all property considered to be in the deceased's estate at the time of death. The tax is progressive and graduated, ranging from 18% to 70%. (See Example I.)

What is considered the *gross estate?* For federal estate tax purposes, the gross estate would include all property owned by the decedent at the time of death such as ranch or farmland, checking accounts, savings accounts, machinery, livestock, grain, accounts receivable, stocks and bonds. Other assets included in the gross estate would be gifts from others and life insurance policy proceeds payable to the estate or policies in which the decedent retains ownership.

Form of Ownership Important

The death tax consequences of property held in joint tenancy and tenants-in-common are treated very differently for the purpose of federal estate tax and state inheritance tax. Be careful that the form of ownership created eventually will not become a burden to the surviving owner.

Adjusted gross estate is described as the gross estate minus all allowable deductions. These deductions include all debts of the decedent; funeral costs; losses from fire, storm or other casualty or theft during settlement of the estate; medical expenses incurred; income tax deductions claimed; legal expenses and administration costs such as fees during probate court and related filing fees.

If the estate qualifies, there is also a *marital deduction,* assuming there is a surviving spouse. Where there is no surviving spouse, there is an orphan's deduction. Addition-

EXAMPLE I

UNIFIED GIFT AND ESTATE TAX SCHEDULE

If tentative taxable estate is more than:	but not over:	tentative tax is: + %	of excess
0	$ 10,000	18% of such amount	
$ 10,000	20,000	$ 1,800 + 20%	$ 10,000
20,000	40,000	3,800 + 22%	20,000
40,000	60,000	8,200 + 24%	40,000
60,000	80,000	13,000 + 26%	60,000
80,000	100,000	18,200 + 28%	80,000
100,000	150,000	23,800 + 30%	100,000
150,000	250,000	38,800 + 32%	150,000
250,000	500,000	70,800 + 34%	250,000
500,000	750,000	155,800 + 37%	500,000
750,000	1,000,000	248,300 + 39%	750,000
1,000,000	1,250,000	345,800 + 41%	1,000,000
1,250,000	1,500,000	448,300 + 43%	1,250,000
1,500,000	2,000,000	555,800 + 45%	1,500,000
2,000,000	2,500,000	780,800 + 49%	2,000,000
2,500,000	3,000,000	1,025,800 + 53%	2,500,000
3,000,000	3,500,000	1,290,800 + 57%	3,000,000
3,500,000	4,000,000	1,575,800 + 61%	3,500,000
4,000,000	4,500,000	1,880,800 + 65%	4,000,000
4,500,000	5,000,000	2,205,800 + 69%	4,500,000
5,000,000		2,550,800 + 70%	5,000,000

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

ally, there are charitable deductions if they can qualify.

How does one determine what property is to be taxed at a person's death? The deceased person's estate includes *all* property, real or personal, tangible or intangible, and wherever located. This means that your *gross estate* as indicated in Example II, column B, generally would include the following: Real property assets, such things as the ranch or farmland or other business properties, gas or mineral leases. Also included would be joint ownership arrangements of similar assets. The personal property would include machinery, equipment, livestock, vehicles, stocks, bonds, mutual funds, bank balances, notes secured by mortgages, household furnishings, jewelry and many other items. Other items to be considered would be taxable gifts, life insurance proceeds and revocable trusts.

Estate Deductions

Deductions, as indicated in Example II, would include all valid claims against the state such as debts on unpaid mortgages, funeral expenses, administration costs, administers fees, executor fees, attorney fees and other necessary expenses for the probation of the estate that are subtracted before the tax is imposed.

The *marital deduction* is one of the most important tools in estate planning. The marital deduction is limited to either $250,000 or 50% of the adjusted gross estate, whichever is greater. If this tool can be used, it would be deducted from the adjusted gross estate, leaving the *taxable estate.*

This, then, is the figure on which the *tentative federal estate tax* is computed and the unified estate tax credit then applied. The unified estate credit was a result of the 1976 Tax Reform Act and has been on a graduated basis since that time and will maximize at $47,000 in the year 1981.

After the *unified tax credit* is deducted from the tentative tax, an additional credit is given for state death tax. The resulting figure is the *federal estate tax due.*

Devastating Consequences

If the surviving spouse were to inherit all of the decedent's assets as in Example III, the tax consequences can be devastating.

Smaller estates as in Example II, column A, are not subject to federal estate tax upon the first death of a spouse. However, at the death of the surviving spouse, federal estate tax is due.

Examine your own situation to determine the practical possibilities of reducing this type of tax burden. Keep in mind the dollars needed at the time the estate is probated. Include the deductions (i.e., outstanding short-term debts, executor fees, administrative and legal fees), state death tax and federal estate tax.

There are certainly ways that can reduce this kind of loss to your estate. Consideration should be given to the type of property ownership, the use of marital deduction, gifts, orphan's exclusion and the use of wills and trust. Do not jump to conclusions before consulting with a qualified estate planning team. The team members would include your attorney, your accountant and a professional estate planner.

Practical Approach

A practical approach to your estate planning is to start with your most recent financial statement. Depending on who helped prepare that statement or depending on its purpose and use would largely determine whether the figures accurately reflect the fair market value of your assets. The valuation of property included in the gross estate is extremely important. Accurate evaluations depend upon the precise facts surrounding the particular asset or piece of property. The majority of disputes between taxpayers and the IRS are a result of over-evaluation of those assets.

The Internal Revenue's standard for evaluation is fair market value, which is legally defined as the price a willing buyer will pay a willing seller if neither of them is under any obligation to the other to buy or sell.

Next month's article will describe the estate planning process and how to go about it. Preparing an inventory, establishing acceptable valuations and determining ownership are the requirements necessary to start your estate planning. Your estate plan can be referred to as your lifetime economic map. Do you know where you are going or how to get there?

An estate asset inventory organizer is available upon request. A charge for postage and handling is required.

If you have specific questions or comments, contact ANGUS JOURNAL or write directly to me at P.O. Box 1077, Janesville, Wis. 53545.

EXAMPLE II

Federal estate tax calculations for death of property owner in 1981, leaving all remaining assets to surviving spouse outright.

	A	B
Gross Estate	$700,000	$1,500,000
Deductions	320,000	550,000
Adjusted Gross Estate	$380,000	$ 950,000
Marital Deduction	250,000	475,000
Taxable Estate	$130,000	$ 475,000
Tentative Tax	32,800	147,300
Unified Tax Credit	47,000	47,000
		$ 100,300
Credit for State Death Tax	-0-	9,200
Federal Estate Tax Due	-0-	$ 91,100

EXAMPLE III

Federal estate tax calculations for death of surviving spouse in 1991.

	A	B
Gross Estate	$380,000	$858,900
Deductions	19,000	42,945
Adjusted Gross Estate	$361,000	$815,955
Marital Deduction	-0-	-0-
Taxable Estate	$361,000	$815,955
Tentative Tax	108,540	274,022
Unified Tax Credit	47,000	47,000
	$ 61,540	$227,022
Credit for State Death Tax	5,552	23,566
Federal Estate Tax Due	$ 55,988	$203,456