ESTATE PLANNING

The Estate Inventory—How To Go About It

by Al Lundstrom

Estate planning is often a lengthy process. Keep in mind that estate planning is the development of ideas, in a systematic way, in order to accomplish the goals and objectives you have established. Estate planning is not a science.

The first and most important step in the estate planning process is to decide what is to be accomplished. The estate assets you have worked a lifetime to accumulate will pass on to those persons or institutions you designate. In order to make decisions, certainly adequate information must first be available.

Preparing an inventory is the first step in successful estate planning. The inventory of assets should include all the property you own individually or jointly. Inventory forms are generally available through your accountant, attorney, public library or extension agent. A printed form can be most helpful but is not necessary. One can do an excellent job with a pencil and a pad of ruled paper. Start by describing every item of property, giving location, value, indebtedness, if any, and tax investment in the property.

Key Points

Following are some of the key points to look for in every asset.

(1) Description. Describe fully each asset—the legal description for land, serial numbers of bonds, certificate numbers on corporate stocks, the number of shares of corporate stock, the exact number of head of cattle, the exact quantity of stored grain, the description and manufacturer of machinery and equipment.

(2) Ownership. A clear description of the ownership of each asset is critical. Check back to the actual documents of title; don't trust your memory. Look for deeds, signature cards at the bank, certificates of deposit, government bonds and be sure to copy the names of the owners exactly as they appear, whether it be husband alone, wife alone, husband and wife, joint tenancy or tenants-in-common.

(3) Location. The inventory should give the location of the assets as well as the permanent storage place of any documents or titles.

(4) Indebtedness. Liabilities should be characterized according to duration, rate of reduction and interest rates. Determine which specific property is encumbered and which items are free of debt. If an asset is encumbered, where is the encumberance filed or recorded? Be specific.

(5) Value. It is very necessary to place a current value on each asset or group of assets. The valuation of assets is the biggest controversy between Internal Revenue and most taxpayers. We will spend more time on this subject later.

(6) Holding period. Record the date of each purchase and purchase price of each of your assets. Keep all purchase documents intact for reference and be able to substantiate this information. These documents become extremely important in computing tax as well as depreciation and depletion.

(7) Improvements. Establish the dates of any substantial improvements to any property, be it buildings, machinery or equipment.

Now that the inventory has been completed, you are in a position to review the values of each of the assets and try to establish alternative acceptable valuations.

Determining Value

The aspects of establishing valuation on personal property can easily be obtained through bids of willing buyers, quotes from your local equipment dealer, and market prices for livestock and grain. Trying to establish valuation on real property becomes a little more difficult.

It is necessary to pay estate tax on a theoretical value submitted by the executor of your estate, and that is either fixed by the Internal Revenue Service, arrived at as a result of compromise or litigated in a costly court action.

Real estate valuations are arrived at in several ways. One way often used by Internal Revenue is to establish the highest and best use of the land, especially where good farm or ranch acreage is in or around a community or possibly a road intersection that has the potential for commercial or residential use. Another method of evaluating is to compare other properties that have sold at a fair market value in and around the area.

Since the Tax Reform Act of 1976, another alternative is available. It is called special use evaluation. This permits the executor to elect a value of the real property included in the estate that is being used for farming or in a closely held business at its value as a farm or in that business rather than at a value determined on the basis of highest and best use. This special use evaluation, however, cannot be used to reduce the decedent's gross estate more than $500,000 below the value of the estate determined under the old evaluation method.

Qualifications

Certain qualifications are necessary in order to be able to use the special use evaluation. For instance, the value of the ranch or farm or business included in the estate must be at least 50% of the gross estate; the property must pass to a qualified heir; the property must have been owned by the decedent or family member and have been used as a farm or closely held business for five of the last eight years prior to the decedent's death; and at least 25% of the value of the gross estate must be a qualified farm or closely held business real property.

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

If the special use evaluation is used, special attention should be given to the recapture of the tax benefits involved. Recapture will occur if, within 15 years after the death of the decedent, the property passes to non-family members or ceases to be used for farm or other business purposes. The family heirs must also complete a material participation qualification. If, for any reason, the special use evaluation is disqualified, the IRS will go back to the original date of death and value the property at the highest and best use and impose taxes accordingly.

Other Considerations

Other considerations should be given when valuing the real estate since the time of purchase. You may have depleted some of the natural resources such as timber or mineral deposits that could establish an entirely different value. When you purchased real property, there may have been certain water rights, mineral rights or leases that have since been depleted or are no longer valid. This would also affect the valuation of your property.

The executor of your estate has the opportunity to establish the estate assets and values at the time of death or the alternate valuation date of six months after the date of death. This may be a significant factor with regard to livestock prices, grain prices or stocks and bonds on a recognized stock exchange.

The most common technique of valuation with real property is comparable sales within the area. In other cases, they have used the income method. The income method determines the net income that the property produces and then assigns a multiplication factor to arrive at a price a buyer would be willing to pay.

Stipulate Ownership

Determining ownership of assets is important in estate planning. In searching for the correct owner through title policies, abstracts and deeds, you may find that the ownership is not what you originally wanted or thought it to be. It may prove beneficial to establish joint ownership in cases where individual ownership now exists. Frequently, it is possible to document the fact that a spouse contributed to the down payment for the purchase of the original land either through income from outside employment or possibly assets that were inherited.

For example, assume a husband and wife purchased a piece of property 40 years ago. This property was a farm adjacent to a small 40-acre piece inherited by the wife. During the negotiations for purchase of this new land, they were able to finance it 100% but had to use the collateral of the 40 acres in order to complete the purchase. If, in fact, the land was in the spouse's name and she signed it over as collateral, it was definitely a material participation in the purchase of the new farm. On the other hand, it might have been cash that she would have contributed.

Ownership of personal property also becomes very important because, in most cases, it is the husband who shows all the feed, grain, livestock and machinery in his estate. For instance, if the spouse (wife) had inherited property that she was currently renting out for cash or shares and the income derived from that land was used for the purchase of new farm machinery, livestock and the like, and if this can be documented, it is possible that part of the personal property could be owned by the wife. Unfortunately, despite all the time and labor the wife (spouse) contributes to the success or failure of the ranch or farm operation, she is not considered a partner unless she has materially contributed financially in some respect or another.

The time, patience and determination necessary to establish ownership in some cases can make the difference of many thousands of tax dollars. It would definitely pay to examine the possibilities and alternatives available in ownership.

A comprehensive inventory of farmer or rancher assets and liabilities is the fundamental step in the estate planning process. You cannot tell where you are going unless you know where you currently are. Inventory forms are available by writing Lundstrom & Associates, P.O. Box 1077, Janesville, Wis. 53545.

Next month's article will discuss the transfer of property through the use of wills, trusts or gifts.