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ESTATE PLANNING for NORTH DAKOTA FARMERS

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ESTATE PLANNING FOR THE NORTH DAKOTA FARMER*

Have You Asked Yourself:

What would happen to my property if I should die in my sleep tonight?

Would my wife and children be taken care of?

Would the children be able to finish their education?

Who would ultimately receive the property if my wife remarried, her second husband or my children?

With a properly executed estate plan, you will be able to give specific answers to each of these and similar questions. Death is an unpleasant subject but it is inevitable and you should recognize it as such. An estate plan benefits you and your survivors. You will rest easier if you can properly answer the questions asked above.

What Is Estate Planning?

Estate planning involves more than the execution of a simple will. In disposing of your estate, a sound, comprehensive plan will insure the economic and legal consequences you desire. Ideally, it should preserve your basic unit of economic production, the farming operation, for use by your chosen successors.

Who Needs An Estate Plan? Why?

Every property owner needs an estate plan. It can save thousands of dollars if your estate is large enough to be subject to federal estate taxes. There may be an even greater need to plan a small estate, because here careful arrangement of your affairs is essential to give you adequate income during retirement, and to care for your surviving spouse and minor children.

In this publication, "large estate" refers to an estate which is subject to federal estate taxes; "small estate" refers to one which is not. This terminology is basic to a proper understanding and intepretation of the material presented. Since deductions allowed vary significantly from case to case (e.g., funeral expenses, expenses of administration, etc.) it is difficult to assess absolute valuations above which federal estate taxes will always apply. Basically, a married couple can avoid the federal estate tax by proper planning, if their assets have a fair market value of $120,000 or less. A single person will be subject to this tax if his estate is valued at $60,000 or more.

Many property owners do not realize that they have accumulated sufficient assets to place them in the large estate category. Since different legal considerations exist in the planning of small and large estates, you should inventory your assets at their present fair market value to determine which category your estate falls within.

An Inventory - The First Step

Property which is considered a part of your estate for federal estate tax purposes is listed on the inventory. To help you list the basic information required for this inventory, use worksheet FM-1-68, "Family Estate Record." It is available from your county extension agent or the Agricultural Information Department at NDSU.

To take this inventory accurately, refer first to the section in this publication entitled, "Your Gross Estate." An inventory will include not only property owned at death, but also certain property in which you may have some interest or control.

After completing the inventory you can determine whether your estate is small or large. This will help you to determine the particular benefits you may obtain from estate planning.

NOTE: It is important to list on the inventory the date on which property, particularly land, was acquired. Also, if property is in joint tenancy, the date on which it was placed in joint tenancy is important since the tax consequences differ if this was done before or after December 31, 1954.

Who Should Plan The Estate?

Various formal written statements, called legal instruments, are used as tools in estate planning. The written construction of these tools is governed by the legislative and judicial interpretation that will be given their technical legal language. Since you are not likely familiar with the legal meaning of such language, you should never attempt to plan your own estate.

Companion publications to this circular that will be useful in estate planning include (1) "Family Estate Record", NDSU Extension Service worksheet FM-1-68 and (2) Bulletin 463 "Family Estate Planning" by Johnson and White, Department of Agricultural Economics, NDSU and the School of Law, UND.

A "homemade" plan can lead to an unnecessary wasting of assets, because litigation (contesting by lawsuits) is often required to determine the legal effect of each of the legal instruments used to carry out the plan. Remember, when these instruments are being interpreted, you will not be there to explain what you intended the language to mean.

Since the only person who is qualified to create an estate plan is an attorney, you should contact your lawyer and relate your desires and all relevant information to him. He may find it necessary to consult with your life insurance agent, the representative of a bank or trust company, and other persons with a particular knowledge of the character of your estate and its proper distribution and administration.

Your attorney will draw all legal instruments needed to implement your plan. The cost of procuring his services is far less than the wasting of assets which occurs in the absence of a plan, or with the presence of a homemade plan.

Objectives of Estate Planning

There are at least three objectives in every estate plan:

1. To reserve sufficient resources to care for yourself during retirement.
2. To transfer property from one generation to the next in such a manner as to assure distribution of your assets to the person(s) of your choice.
3. To conserve as much of your estate as possible for your survivors.

Regardless of the size of your estate, the first objective of your plan is to take care of yourself during retirement or permanent disability since you are the person who has accumulated the assets which constitute your present estate. It is only logical and fair that provisions be made to care for yourself first. The retention of control over a sufficient quantity of assets to assure you of an adequate retirement income also has the practical function of avoiding family disagreements.

The second objective of an estate plan is to transfer your property to the survivors of your choice. For example, if you own farm property, and your daughter lives in the city while a son remained on the farm, you would probably prefer that your son receive the farm. This might be done by a properly executed will. Other assets could be used to equalize the distribution between the children.

If you should die without leaving a will, your property which is subject to probate will pass to your survivors in accordance with the state statutes on intestate descent. Rarely do these laws function to distribute each of your individual assets to the person(s) of your choice. They may transfer title to your heirs as tenants in common, with each receiving an undivided interest in the whole.

The difficulties involved in dividing a farm without destroying its efficiency as a productive economic unit might dictate that the only reasonable solution would be to sell the farm and divide the proceeds among the heirs. Thus, your farm may be sold out of the family. An estate plan is imperative to avoid this situation and get a son started in farming.

The third objective of estate planning, the conservation of a maximal amount of your estate for your survivors, suggests that you may want:

1. To keep the expenses of administration in probate at a minimum.
2. To keep state inheritance and federal estate taxes at a minimum.

The compensation of an executor in North Dakota can be determined in two ways. If you set an amount in the will that is to be the executor's compensation this will be adhered to unless the executor renounces all claim to such compensation. If the executor makes such a renunciation he will be entitled to the same compensation that is allowed an administrator by statute. In North Dakota the compensatory rates for administrators, based on a sliding scale, are set out in the following scale.

TABLE I

First $1,000	5%
Next $5,000	3%
From $6,000 to $50,000	2%
Excess of $50,000	what the court decides is fair, but never in excess of 2%.

THIS PERCENTAGE IS PAID ON ALL OF THE ESTATE ACCOUNTED FOR BY THE ADMINISTRATOR EXCEPT PROPERTY NOT RANKED AS ASSETS.

An attorney is normally hired by the administrator or executor to handle the legal affairs of the estate. The attorney will charge at least the minimum fee set by the North Dakota Bar Association. This fee is 4 per cent of the first 25,000 appraised value of the estate and 3 per cent of the remainder of the appraised value of the estate.

Many people are under the impression that property in joint tenancy is transferred to the survivor and therefore escapes administrator and legal fees. However, it is necessary to terminate a joint tenancy at the time of death by a formal legal proceeding and fees are charged for this service.

By multiplying the percentage figures given in Table I and in the above paragraph by the value of property which is subject to these costs will yield a fair approximation of the total expenses of administration in probate. It should also be noted that a poorly planned estate may be subject to more expenses. For example, a poorly planned estate may take longer to settle and will be subject to greater costs for managing the property in the estate while subject to the jurisdiction of the probate court. The court will also allow additional compensation to the attorney and other individuals for additional work that is often necessary in settling a poorly planned estate.

The obvious way to avoid expenses of administration is to plan your estate so that certain of your assets are not within it when it is admitted to probate. The cost of legal advice for estate planning is usually more than made up by the savings in administrative expenses which it achieves.

Tax Considerations:

Taxes may have a significant effect on achieving the third objective of estate planning. Minimizing taxes will usually maximize the value of assets transferred to the next generation. Taxes which should be considered include state estate, federal estate and federal gift taxes. There is no state gift tax in North Dakota.

The North Dakota estate tax operates basically the same as the federal estate tax. An estate tax is paid on the net estate so the tax reduces the proportionate share of the property received by each beneficiary.

Determining what your gross estate or your net estate will entail is a procedure which requires an intimate knowledge of the applicable tax laws. This can only be successfully done by a person who has been exposed to the workings of the tax laws. The only qualified person to undertake this task is your attorney.

The tax rate is figured on your net estate. It would be unduly complicated and serve little useful purpose to attempt to set out in this pamphlet the procedures necessary to arrive at your net estate from your gross estate. There are several exemptions from the gross estate and several optional methods of taking them in arriving at the net estate. Your lawyer can advise you on how to obtain the maximum benefit from these exemptions. The tax rate upon the net estate is set out in the following table:

TABLE 2 NORTH DAKOTA ESTATE TAX RATES

The tax on the net estate is:

1. 2 per cent of the amount of the net estate not in excess of $25,000;
2. 4 per cent of the amount by which the net estate exceeds $25,000 and does not exceed $50,000;
3. 6 per cent of the amount by which the net estate exceeds $50,000 and does not exceed $100,000;
4. 8 per cent of the amount by which the net estate exceeds $100,000 and does not exceed $200,000;
5. 10 per cent of the amount by which the net estate exceeds $200,000 and does not exceed $400,000;
6. 12 per cent of the amount by which the net estate exceeds $400,000 and does not exceed $600,000;
7. 14 per cent of the amount by which the net estate exceeds $600,000 and does not exceed $800,000;
8. 17 per cent of the amount by which the net estate exceeds $800,000 and does not exceed $1,000,000;
9. 20 per cent of the amount by which the net estate exceeds $1,000,000 and does not exceed $1,500,000; and
10. 23 per cent of the amount by which the net estate exceeds $1,500,000.

Federal Estate Tax

An understanding of the basic mechanics of the federal estate tax is essential to a proper interpretation of the material presented in this publication. The first step in determining whether your estate is subject to this tax is to calculate the value of your gross estate. Your gross estate includes all property owned by you at death, and certain other property over which you may have retained some interest or control. The deductions and exemptions available are then subtracted from the gross estate to yield the net taxable estate. The tax is calculated on the basis of this amount. The tax due and payable may be further reduced by subtracting available tax credits.

Your Gross Estate

Federal estate tax law is extremely complex. It is impossible to set out an exhaustive list of property subject to federal estate tax in this type of publication. Only a competent attorney can advise you whether particular assets are subject to this tax. The following summary lists some of the more common items which are a part of your gross estate (and thus, are subject to federal estate tax) under existing law.

1. Property which you own at death.

To remove these assets from your gross estate, you must completely divorce yourself of ownership and control.

2. Life insurance policies on your life over which you have any of the incidents of ownership, or which are payable to your estate.

Policies of life insurance on your life over which you have any incidents of ownership are a part of your gross estate. The incidents of ownership include the right to (1) name the beneficiary, (2) surrender the policy for cash, (3) borrow against the policy, (4) pledge it as security for a loan, and (5) assign the policy and revoke such assignments.

If you have any of these rights, you have the right to enjoyment of the policy in that you can effect a change in the disposition of its proceeds at will. You must be willing to divorce yourself of these rights if you desire to remove the policy from your gross estate for tax purposes.

Since all policies of life insurance payable to your estate are includable in your gross estate, this may serve as an inducement to change the beneficiary from your estate to blood relatives.. This, along with divorcing yourself from the incidents of ownership, may ultimately decrease the size of your net taxable estate and thereby put you in a lower tax bracket.

It may be desirable to make your life insurance payable to your estate, even though this will increase the size of your estate and the tax which will be due. For example, assume you own a 500 acre farm and a large herd of cattle, together with other assets typically found in such an operation.. Also, assume that you have little cash available for immediate expenditure, but rely rather heavily on operating credit. If, after death, no liquid funds exist to pay the funeral estate tax, it may be necessary to sell part of your cattle herd to satisfy the tax liability. Such a sale can destroy the entire efficiency of the farming operation. Under these circumstances, you may prefer to make life insurance payable to your estate, even though doing so increases taxes, because it furnishes liquid assets from which the tax may be paid. This may yield the most desirable economic consequences over the long run for your survivors.

Even greater tax savings may be accomplished by using a life insurance trust. See the trusts section under "Tools Used to Implement the Estate Plan" for more information.

3. Property transferred at death by means of a right of survivorship (less the value of any portion thereof shown to have originated in another co-owner).

In North Dakota the joint tenancy is characterized by a right of survivorship.

The full value of any property transferred at death by means of a joint tenancy is includable in your estate. However, the rules of contribution apply here, and any portion of such property which represents an original contribution of capital by another co-owner will not be within your estate, if this contribution can be proved by adequate records. It is very difficult, if not impossible, to sustain this burden of proof. Therefore, as a practical matter, the full value of the property so held is almost always included in the estate of the co-owner who dies first. For example, if you contributed 75 per cent of the cost of your farm and a son contributed 25 per cent, the full 100 per cent of this current value of your farm will probably be taxable in your estate. Since the federal estate tax is graduated, this may have the effect of putting an estate in a higher tax bracket.

However, in North Dakota where the relationship is that of husband and wife, there is a presumption that each contributed one-half.

4. The value of gifts made in "contemplation of death."

Any gifts made within three years of death are presumed to have been made in contemplation of death, and as such, are includable in your gross estate. In its simplest form, a gift made in "contemplation of death" refers to one induced by a belief that the donor does not have long to live. The taxing authorities include such a gift in your gross estate on the theory that it was made in lieu of a testamentary disposition of property.

This legal ruling or "statutory presumption" can be rebutted if your executor or administrator can prove that the motive for your gift was one essentially associated with life, rather than with death. Examples of motives for gifts from your estate when proven are when the motive is (1) to avoid income taxes, (2) to avoid property taxes, (3) to see the family continue your business in the family name, and (4) to make dependents financially independent.

Gifts made more than three years prior to death are conclusively presumed not to have been made in "contemplation of death." They are not a part of your gross estate for federal estate tax purposes.

5. The value of property previously transferred to another if there has been a reservation of:

   a. The right of use, enjoyment or income from the property; or

   b. The power to alter, amend, revoke or terminate the transfer.

Property you have disposed of during your lifetime in which you have reserved certain rights may be includable in your gross estate.. For example, suppose you give your son a farm, but retain the right to its sole use during your lifetime. Here, you are in essentially the same position as if you had kept complete ownership of the property until death and then disposed of it by will, the only difference being that you no longer have the power to convey absolute ownership.

The degree of control which you can safely retain and still legally remove a given asset from your gross estate is governed by complicated provisions of the Internal Revenue Code. Consequently, you should consult with your attorney about these matters.

6. Property which you have the power to "appoint" to yourself, your estate, your creditors or the creditors of your estate.

7. The value of property previously transferred (except by bona fide sale), if the transferor has certain reversionary interest, or if enjoyment by the transferee is possible only if he survives the transferor.

8. The value of property listed in terms 4-8, to the extent that such property was transferred for less than adequate consideration.

9. Certain joint life and survivor annuity contracts.

If you possess property or contemplate creating interests such as those found in items five through nine, you should seek legal advice as to the best manner to adapt them to your particular circumstances.

Deductions

If you are to minimize federal estate taxes and maximize the value of the estate which you pass to your survivors it is essential that you minimize the size of your net taxable estate by taking full advantage of all deductions available by law. The principal deductions are:

1. Funeral expenses, expenses of administration in probate, debts of the estate and casualty losses suffered during the settlement of the estate.

2. The amount of money or value of property left to charities.

3. The value of all property passed to the surviving spouse as a nonterminable interest, not to exceed one-half the adjusted gross estate (gross estate, less the deductions listed in item one, above).

The deductions listed under item one are, for the most part, self-explanatory. Casualty losses refer to losses caused by fire, storm, theft, etc. They are deductible only to the extent that insurance or other type of recoupment does not compensate the estate for the loss.

Certain transfers of money or property for public, charitable, or religious uses are deductible. If you contemplate making this type of bequest or legacy you should consult with your attorney to ascertain whether it will qualify for this deduction.

The deduction referred to by item three is called the marital deduction. It is the greatest single tax saver in the federal estate tax area.. Advice of a competent attorney is essential if you are to take full advantage of it. Will, inter vivos (lifetime) trusts, life insurance options, the use of jointly owned property and other dispositive arrangements must be planned with a view to taking maximum advantage of the marital deductions.

Table 3 illustrates the different tax consequences which result over the long run (i.e., the total due in the estate of both the husband and the wife) in a \$200,000 gross estate where (1) the surviving spouse is left all of your property, (2) the surviving spouse is left property which equals one-half the value of your adjusted gross estate, and (3) where there is no surviving spouse.

TABLE 3 SAMPLE OF TAXES ON AN ESTATE UNDER THREE DIFFERENT MEANS OF DISPOSAL

(A)	Property left to wife[1]	All property	One-half adjusted gross estate	No surviving spouse
1	Value of Husband's Gross Estate	\$200,000	\$200,000	\$200,000
2	Less Expense of Administration, etc.[2]	12,000	12,000	12,000
3	Adjusted Gross Estate	188,000	188,000	188,000
4	Less Marital Deduction	94,000	94,000	0
5	Net after Marital Deduction	94,000	94,000	188,000
6	Less \$60,000 Exemption	60,000	60,000	60,000
7	Net Taxable Estate	34,000	34,000	128,000
8	Federal Estate Tax due on Husband's Estate	3,720	3,720	29,100
9	Value of Wife's Gross Estate[3]	184,280	94,000	0
10	Less Expenses of Administration, etc.[2]	11,561	5,640	
11	Adjusted Gross Estate	172,719	88,360	0
12	Less \$60,000 Exemption[4]	60,000	60,000	
13	Net Taxable Estate	112,719	28,360	0
14	Federal Estate Tax due on Wife's Estate	24,515	2,770	0
15	Total Federal Estate Taxes due in both Estates Obtained by Adding Items 8 & 14.	28,235	6,490	29,100

[1]This example assumes that all property was owned by the husband, who predeceased his wife.

[2]This is item one under "Deductions." The aggregate of these expenses is assumed to be 6 per cent.

[3]Value of property actually received from husband's estate, deducting all expenses and taxes.

[4]The marital deduction will not be available here, because there is no surviving spouse to whom to leave property.

Note in Table 3 that a person can save a significant amount of tax dollars by planning his estate to take maximum advantage of the marital deduction (i.e., compare column 2 with columns 1 and 3). Since it is a virtual impossibility to predict the nature and extent of your estate at some indefinite date in the future, complicated formulas for insertion in wills and trust instruments have been worked out. They are designed to utilize the marital deduction fully by making allowances for any changes in circumstances which may occur. Compliance with the Internal Revenue Code is essential if you are to take full advantage of the marital deduction, so this formula should always be prepared by an attorney.

Many individuals leave the majority or all of their assets to their surviving spouse simply to assure themselves that she will be adequately cared for after death. Probably this will not maximize the effectiveness of the marital deduction, as shown by Table 3. Your attorney can plan your estate so that the marital deduction will be fully utilized while keeping all property available for use by your spouse.

Exemptions

Every person has a $60,000 exemption for federal estate tax purposes. Therefore after utilizing all available deductions, the first $60,000 of the sum remaining is exempt from tax. See Table 3 for an illustration of how this exemption applies to reduce your taxable estate.

Credits

After the federal estate tax has been computed, there are several credits which may be available to further reduce the amount of estate tax which must be paid. Credits should be distinguished from deduction. The latter are subtracted from the gross estate to determine the net taxable estate, while a credit is subtracted directly from the tax due.

You will recall that any gift made within three years of death is presumed to have been made in contemplation of death, and that such a gift becomes part of your gross estate unless the statutory presumption is rebutted. If gift tax was paid on this type of gift, the amount of this tax is credited against the federal estate tax due in order to prevent double taxation. That is, after calculating the estate tax, you are entitled to subtract from this figure the tax paid on all gifts made in contemplation of death.

A percentage credit is also available for estate taxes paid by a deceased transferor on property passed to you. The percentage credit allowed decreases as the period by which you survive your transferor increases, with no credit being allowed after ten years have elapsed. Therefore, the usefulness of this credit is directly dependent on how long you live after your transferor's death.

The amount of state estate tax (i.e., North Dakota estate tax) actually paid is another credit available. The credit allowed will increase as the size of your gross estate increases. However, this is usually a very small amount.

Federal Gift Tax

Since ownership at the date of death is the critical factor in determining whether a particular asset will be within your estate for federal estate tax purposes, one obvious way to avoid this tax is to give property away prior to death. The federal gift tax prevents one from avoiding taxation completely by disposing of all his property as lifetime gifts. However, federal gift tax rates are lower than federal estate tax rates (approxi-

TABLE 4 FEDERAL ESTATE TAX RATES

If the federally taxable estate is:	The tax shall be:
Not over $5,000	3 per cent of the taxable estate
Over $5,000 but not over $10,000	$150 plus 7 per cent of excess over $5,000
Over $10,000 but not over $20,000	$500 plus 11 per cent of excess over $10,000
Over $20,000 but not over $30,000	$1,600 plus 14 per cent of excess over $20,000
Over $30,000 but not over $40,000	$3,000 plus 18 per cent of excess over $30,000
Over $40,000 but not over $50,000	$4,800 plus 22 per cent of excess over $40,000
Over $50,000 but not over $60,000	$7,000 plus 25 per cent of excess over $50,000
Over $60,000 but not over $100,000	$9,500 plus 28 per cent of excess over $60,000
Over $100,000 but not over $250,000	$20,700 plus 30 per cent of excess over $100,000
Over $250,000 but not over $500,000	$65,700 plus 32 per cent of excess over $250,000

mately 75% of the estate tax rate). Since tax free gifts also can be made within the statutory exemptions and exclusions, it is possible to make lifetime gifts and save a significant amount of tax dollars.

The more important of the federal gift tax exclusions and exemptions are the annual exclusion and the specific exemption. Under the annual exclusion, you may make gifts to as many people as you choose each year, and the first $3,000 of the gifts to each person is tax free if it is a gift of a present interest. Basically, a present interest gift is one by which the donee (receiver of the gift) immediately obtains possession and enjoyment of the asset being given to him. If possession and enjoyment are postponed for a period of time, or if possession and enjoyment are subject to condition or the will of another, this will be a gift of a future interest, rather than a present one. If you have questions, your attorney can advise you as to whether a contemplated gift will create a present or a future interést.

Each individual also has a specific exemption for gift tax purposes, with gifts of both present and future interest qualifying for it. Under the exemption, every individual can give away a total of $30,000 tax free at any time during his lifetime. This is in addition to the $3,000 annual exclusion. He can use the exemption all at once, or periodically by a number of smaller gifts.

If your wife elects to join in the gift and follows the required statutory procedure, the amount of the tax free gifts under the annual exclusion and specific exemption can be doubled. This applies even though you are giving away property which you hold in sole ownership. In this case, the first $6,000 of gifts to each donee would be non-taxable under the annual exclusion, while a total specific exemption of $60,000 would be available. This election is made by showing the consent of both spouses on their respective gift tax returns.

There are other deductions available under the gift tax law which may be useful in certain circumstances. Gifts to or for the use of certain charitable organizations are exempt from gift tax, as are gifts to the United States, a state, or any political subdivision thereof if the gift is exclusively for public purposes.

A marital deduction of one-half the value of the gift is available for gifts made to a spouse. That is, one-half of the value of the gift will be exempt from tax.

The gift is assessed on the fair market value of the property being transferred at the date of the gift. The value of your original investment in the property being given away is irrelevant for gift tax purposes.

The federal gift tax is based on the cumulative value of all taxable gifts (net value of gifts after all exemptions and exclusions have been used). For example, assume you make a taxable gift of $7,000 in each of two successive years. To determine the gift tax due on the second gift, you calculate the tax due on a $14,000 gift, and then subtract the amount of tax paid on the prior gift. Since the tax is set up on a graduated scale, you will pay a greater tax on the second $7,000 gift than on the first one.

TOOLS USED TO IMPLEMENT THE ESTATE PLAN

The form of asset distribution is very important if optimal results are to be achieved by estate planning. A will, inter vivos (lifetime) or testamentary (after death) trust, gift, annuity, sale, or the creation of co-ownership interests may be used either singly or in various combinations to fit your particular situation. The form of ownership is also an important factor to consider in estate planning. Again, it is your particular circumstances which determine whether you can operate most advantageously as a sole proprietorship, a partnership, or corporation.

Wills

Most individuals do not dispose of all their property by lifetime gifts, but retain ownership and control over a sufficient quantity of assets to support themselves

TABLE 5 FEDERAL GIFT TAX RATES (up to $100,000 only)

Gift	Tax Rate
Not over $5,000	2¼ per cent of the taxable gifts
Over $5,000 but not over $10,000	$112.50 plus 5¼ per cent of excess over $5,000
Over $10,000 but not over $20,000	$375 plus 8¼ per cent of excess over $10,000
Over $20,000 but not over $30,000	$1,200 plus 10½ per cent of excess over $20,000
Over $30,000 but not over $40,000	$2,250 plus 13½ per cent of excess over $30,000
Over $40,000 but not over $50,000	$3,600 plus 16½ per cent of excess over $40,000
Over $50,000 but not over $60,000	$5,250 plus 18¾ per cent of excess over $50,000
Over $60,000 but not over $100,000	$7,125 plus 21 per cent of excess over $60,000

during retirement. As noted earlier, if you do not leave a will directing a specific distribution of these assets, state law will control their distribution. You may prefer that certain of your heirs receive specific items of your property, ranging from family heirlooms to substantial holdings of land. The desired distribution of such property may be attained by the execution of a will.

If a change in circumstances dictates a different distribution of your property after you make a will, you should not hesitate to see your attorney. The distribution of your property can be changed by executing either a codicil (addition to a will), or a completely new will which revokes the old one. Technical legal rules govern the execution, validity, and interpretation of both wills and codicils; consequently, you should always have your attorney prepare them.

Trusts

A trust is created by transferring legal title of the corpus (trust property) to a trustee, who manages the property and administers the trust for the benefit of your chosen beneficiaries. A fiduciary relationship exists between the trustee and the beneficiaries. This relationship is defined in terms of trust and confidence and requires the trustee to act in the best interests of the beneficiaries, consistent with the terms of the trust agreement.

Planning an estate for maximal long-run tax savings requires consideration of federal estate, gift, and income tax consequences which result from the creation of a trust. The tax consequences are dependent upon the type of trust that is used. Both an inter vivos (lifetime) and a testamentary (after death) trust can be employed to advantage in estate planning under the proper circumstances. Inter vivos trust can be broken down into two general categories, revocable and irrevocable.

Testamentary Trust

A testamentary trust is created by will and does not take effect until after the death of the grantor. Since the property remains under his direction and control until death, it will be in his estate for estate tax purposes.

Inter Vivos Trust

An inter vivos trust involves the transfer of property from you (the settlor) to the trustee during your life. A revocable trust is one which, by the terms of the trust agreement, gives you the power to revoke, amend, or alter the trust during your lifetime. An irrevocable trust arises whenever you completely dispose of your power to control the corpus of the trust property or the income from it.

Tax Consequences

The tax consequences of an inter vivos trust depend primarily upon the degree of control that you retain over the trust property.

(a) Federal Estate Tax: If you retain the possession or enjoyment, the right to the income, or the right to designate the persons who shall possess or enjoy the property, then it is included in your gross estate. If you retain the right to alter, amend, revoke, or terminate the trust at any time before your death, it will again be included in your gross estate. However, if you divorce yourself of these rights, it is possible to create a trust and remove the value of the trust property from your estate for estate tax purposes.

(b) Federal Income Tax: If you are treated as the owner of the trust or any portion thereof, you must report all income that comes from the portion of property attributable to you in your personal tax return.

The general rule is that you will be treated as the owner of the trust any time you can control the disposition of the trust property or the income therefrom without the approval or consent of any party who has a substantial beneficial interest in the trust. This is still true even if the control is through another party who has no beneficial interest in the trust. The theory of taxation here is much like that set forth in the estate tax situation above (i.e., as long as you retain control over the trust property, the income from it will be taxed to you).

There are a number of exceptions to this general rule which allow you to retain control and not be taxed. Among these exceptions are the retention of:

(1) the power to distribute income to persons other than those to whom you are legally obligated to support, (2) the power to affect the beneficial enjoyment of income but only after a 10 year period has expired, (3) such powers that are exercisable only by will, and (4) such control if the income is irrevocably payable to recognized charities.

(c) Federal Gift Tax: Gift tax liability often results from the creation of an irrevocable trust. If you retain no right to alter, amend, or revoke the trust, you have in effect given up all control over the property and have nothing upon which you must pay estate or income tax. When you have given up all control, the gift is deemed complete and liability for gift tax arises.

As a general rule, property subject to gift taxes will not be subject to estate or income taxes.

Exceptions--It is possible that even though gift tax has been paid on property the property will later be included in the decedent's estate for estate tax purposes under some conditions. These exceptions include:

(1) Gifts made in contemplation of death.

(2) Gifts by which you retain a reversionary interest if this interest exceeds 5 per cent of the value of the property immediately before your death.

(3) The retention by you of the right to designate who who may receive the income or corpus from the trust, or the retention of the right to alter, amend, or revoke the trust.

If you pay gift tax on property which later becomes a part of your gross estate for estate tax purposes, the gift tax previously paid is credited against the estate tax due.

A life insurance trust is often used in estate planning. By divorcing yourself of all incidents of ownership and making the policies payable to the trustee, the value of such policies can be effectively removed from your gross estate, minimizing the impact of estate taxes.

If the trustee is given discretion to pay estate taxes, assurance is given that liquid funds will be available for their payment. However, since the trustee is under a fiduciary duty to act in the best interests of the beneficiary, life insurance proceeds might not be used to pay estate taxes if the beneficiaries under the trust are not ones who will inherit the remainder of the estate. That is, if different people are involved, payment of estate taxes by the trustee might not be in the best interests of the beneficiaries.

Other types of trusts than insurance, involving either real or personal property, may be desirable in your estate plan. A trustee can be selected for them who is adept at handling the particular type of property involved, with the income from such property to be distributed to your heirs in the manner and proportions which you direct in the trust agreement. This may be done to relieve your heirs of the obligations of managing the trust property, or when your heirs do not have the training and ability to manage this type of property. It might be used, for example, when your heirs are your wife or minor children.

A warning should be entered here regarding the establishment of a trust to handle actual farming operations and the holding of farm property. A corporate trustee cannot under present North Dakota law hold farm lands. There may be some change in certain situations under the new corporate farming law; however, this law has been referred and the old law is still in effect. The only way to be sure that you are setting up an effective trust is to consult with your attorney.

You may want to use either an irrevocable or a revocable inter vivos trust, or a testamentary trust. Your selection here depends on which will most advantageously meet your needs. Study of the gift, income, and estate tax consequences of each type of trust (discussed earlier) may aid you in your selection.

Gifts

Since the federal estate tax is basically assessed on property owned at death, one obvious legal way to avoid the full effect of this tax is to give a portion of your assets away before death. A planned system of giving can save a significant number of tax dollars, if the exclusions and exemptions previously discussed are used.

Some knowledge of income tax is also helpful in determining the relative merits of making lifetime gifts of property. For ease of administration, the tax statutes have made all income taxable unless specifically exempted. When you sell property, not all of the sale price is income because the law specifically allows you to first recover your investment. More properly stated, a taxpayer is entitled to recover his "basis" in the property before any income is subject to tax. In its simplest form, the term "basis" means the original cost of the property less the amount of depreciation claimed or allowable, using the straight line method of depreciation.

For example, suppose you purchased a farm for $30,000 and correctly claimed $1,500 depreciation on the buildings. Your basis in this farm for tax purposes would be the original cost ($30,000) less the depreciation claimed ($1,500) or $28,500. If you sell the farm for $40,000, your taxable income will be $11,500, the difference between the sale price and your tax basis.

If you should give your farm to your son via a lifetime gift, he will receive your basis in the farm for income tax purposes. He is entitled to add to your basis the amount of any gift tax paid on the transaction. Therefore, using the figures in the example above, if he sold the farm for $40,000, the taxable income would again be approximately $11,500.

However, if you choose not to make a lifetime gift of your farm to your son, but rather pass it on to him after death, his basis in the farm will be the fair market value of the farm at your date of death. If this value is $40,000, and your son subsequently sells the farm for $40,000, no taxable income will result from the sale because there is no difference in his basis and the sale price. However, this $40,000 farm would be a part of your farm for estate tax purposes.

A primary objective of estate planning is to transfer the most assets possible to the succeeding generation over the long run. The income tax factors stated above must be considered if the sale of the family farm by your son or other heir can be foreseen.. The nature and extent of your assets, and the projected taxable income of your son may affect your decision of whether to make a lifetime gift of the farm to your son.

It is possible that minimizing estate taxes would not maximize the tax savings over the long run. The estate tax savings which resulted because of the gift might be more than offset by the adverse income tax consequences resulting from your son's sale of the farm.

Expert advice adapted to your particular situation, coupled with long range planning, is essential if maximum tax savings are to be achieved.

Do You Need Co-ownership of Property?

The two principal types of co-ownership are tenancy in common and a joint tenancy. They may be created in either real or personal property, and are characterized by an undivided interest in the whole asset. Other differing characteristics dictate which will accomplish your desired distribution of property.

Under the proper circumstances, co-owning property with your heirs in joint tenancy will maximize the value of assets transferred to the succeeding generation. A joint tenancy can exist between two or more persons, regardless of relationship. It is characterized by the right of survivorship; that is, when one co-owner dies, title passes automatically to the other.

There are many contingencies which should be discussed with your attorney before using this or any other type of co-ownership in your estate plan.

Any member of a joint tenancy can force the partition (physical division) of the asset among co-owners. If it is not economically feasible to divide the property, one co-owner can force its sale, with the proceeds being divided among the co-owners. This may be the very thing you want to avoid. In any event, the legal result of their creation is a co-ordinate loss of both control and the right to rents and profits.

For example, you own a farm which provides an adequate living, and create a joint tenancy with two heirs to avoid state inheritance taxes. If one of your heirs has an immediate need for cash because of personal family circumstances, he can obtain it (and destroy the tenancy) in one of three ways:

1. He can convey his undivided one-third interest to a third party (who in turn may force partition).

2. He can force the division of the farm into three tracts of equal value and sell his tract.

3. If such division substantially impairs the efficiency of each tract as a productive unit, he may be able to force the sale of the entire farm, with the proceeds being divided among the three joint tenants.

At any rate, the tract or the cash you wind up with may not be sufficient to provide you with income adequate to meet retirement expenses. If any of the circumstances above can be foreseen, the use of a joint tenancy in your estate plan may be risky.

Many property owners have created joint tenancies as part of a homemade estate plan, simply because these types of co-ownership pass title automatically at death by operation of law. It is true that this can be used legally to avoid state inheritance taxes. However, since these types of co-ownership may result in adverse federal estate tax consequences, they should be used in large estates only upon the advice of your attorney.

If you are a co-owner of property with non-related business associates, you may prefer to own such property as tenants in common. Here again, all owners have an undivided interest in the whole asset, but this type of tenancy does not have a right of survivorship. Rather than your interest passing to the surviving co-owners at death, it passes to your heirs. The use of a tenancy in common here will keep your property in the family.

Sale

Another tool which may be used to transfer property to the next generation is the simple sale. For example, after retirement, your farm could be sold to your son under terms and conditions which make it possible for him to grow with the farming operation. This assures that your son will get started in farming. It also provides cash to meet retirement expenses.

Family Annuities

A family annuity is very similar to an annuity purchased from a life insurance company. In the latter you pay the company a lump sum in exchange for their promise to make specified monthly payments to you for the rest of your life. The total of these payments may be either more or less than the sum which you paid them, depending on how long you live after purchasing the annuity.

With a family annuity you need not make an immediate cash outlay. Rather you can use a specific asset, such as your farm, to "purchase" the annuity. You can deed the farm to a family member (e.g., your son) in exchange for his promise to make monthly payments to you of a mutually agreeable amount for the rest of your life. This assures you that your son will get started in farming, and also provides you with funds to meet expenses during retirement. Your attorney can advise you of the tax consequences of a family annuity.

Partnership

A father-son partnership can be used in estate planning to accomplish desired results. It permits and encourages your son to remain on the farm. His participation in management allows him to develop his farm managerial ability under your guidance.

This form of business organization allows gradual withdrawal from the responsibilities of ownership and management as you approach retirement. It also permits the younger generation to assume a more active role in operating the farm business.

Corporations

In recent years, more and more consideration has been given to incorporating the farm business. There are cases in which creating a farm corporation can be used effectively as a tool in estate planning. For example, suppose essentially all of your assets are tied up in a large farming operation. Here it may be impractical to make lifetime gifts to remove property from your estate in an attempt to avoid federal estate taxes because gifts of assets essential to the farming operation can destroy its efficiency.

However, if you should incorporate and give away shares, you can decrease the size of your taxable estate while continuing to operate the farm at maximum efficiency. If the annual exclusion and specific exemption available under federal gift tax laws are fully utilized in a planned system of giving, a large tax savings can be accomplished without affecting the income-producing capacity of your basic economic unit.

Using the corporation as a tool in the effective implementation of your estate plan has the additional advantage of allowing you to retain control over the operation. As long as you own 51 per cent of the shares, you can elect a majority of the board of directors, which is the governing body of a corporation.

There are some costs involved in incorporating the farm business. They will be more than off-set by derived benefits, however, if the situation is favorable for its formation.

This is not possible under present North Dakota law which prohibits corporation farming. However, if the new corporate farming law which was passed in 1967 and is currently being referred to the people is approved by the people, this type of set-up will be possible and they could become an integral part of planning your estate. You should consult with your attorney before attempting to set up this type of corporation if the law is approved because of special provisions in the law which will require competent legal interpretation.

Planning the Small Estate

Since, by definition, small estates are those which are not subject to federal estate taxes, tax considerations are of minimal importance in planning this type estate. But this does not mean that estate planning is not beneficial in small estates. On the contrary, it may be that there is a greater need to plan small estates than large ones because here careful planning is required to assure that you will be taken care of during retirement.

Co-ownership of property, family annuities, and life insurance trusts are tools frequently employed in implementing small estate plans. They are usually complemented by a will which accomplishes the desired distribution of the remainder of the estate. However, it is emphasized that these are not the only tools which can or should be used in planning your estate. Under the proper circumstances, various other tools can be advantageously employed.

Since one of the primary objectives of estate planning is to care for yourself during retirement, projected benefits from social security should not be overlooked. The extent of benefits you may expect to receive can materially influence the plan for disposition of the remainder of your assets.

Planning the Large Estate

Since sufficient assets exist in the large estate to assure that you are properly cared for during retirement, planning entails a consideration of how the impact of taxes can be minimized while still achieving the desired distribution of property. It is in this case that estate planning can literally save thousands of tax dollars. It is essential that you get expert advice in long range planning to achieve inter-generation transfer of assets with maximum efficiency.

Wills, trusts, family annuities, and incorporation of the farm business, if the law is unsuccessfully referred, are used frequently to implement large estate plans. Since the nature and extent of your assets, together with your particular circumstances, often dictate the method of implementing an estate plan, the possibility of using the various other tools described should not be overlooked.

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GLOSSARY OF TERMS

ADJUSTED GROSS ESTATE--For federal estate tax purposes, this refers to the gross estate less funeral expenses, expenses of administration in probate, debts of estate, and casualty losses suffered during the settlement of the estate.

ADMINISTRATOR--A person appointed by the probate court to administer the estate of a decedent. His duties include collecting the assets of the estate, paying its debts, and distributing the residue.

ANNUITY--The periodical payment of a definite sum of money, with such payments to continue for life or for a definite number of years.

ASSETS--All types of property which can be made available for the payment of debts.

BENEFICIARY--The person who derives the primary benefit from the creation of a trust.

BEQUEST--A gift of personal property by will. A legacy.

BONA FIDE--In or with good faith; honestly, openly, and sincerely; without deceit or fraud.

CODICIL -A supplement or an addition to a will; it may explain, modify, add to, subtract from, qualify, alter, restrain or revoke provisions in a will.

CONSIDERATION--Something which has legal value in the eyes of the law; that which induces a contract (e.g., that which induces the sale of a farm; money is consideration).

CONTINGENCY--The possibility of coming to pass; an event which may occur.

CORPUS--Trust property; the principal sum or capital, as distinguished from interest or income.

CREDITOR--One who has a legal right to demand and recover a sum of money from another.

DEED--The legal instrument used to transfer title to real property.

DEPENDENTS--Those persons to whom you owe the legal obligation to support.

DONEE--A recipient of a gift.

DONOR--A person making a gift.

ESTATE--The interest which one has in both real and personal property; the dollar value of this interest.

EXECUTOR--A person appointed by will to carry out the directions and requests of the will, and to dispose of property in accordance with the provisions of the will.

FIDUCIARY RELATIONSHIP--A relationship between two or more persons in regard to business or property, or in regard to the general business or estate of one of them, of such a character that one must repose trust and confidence in the other. In return, the law raises the rule that the fiduciary must exercise a corresponding degree of fairness and good faith, and in no way take selfish advantage of the relationship.

GIFT--A voluntary transfer of real or personal property with no consideration.

GROSS ESTATE--For federal estate tax purposes, the total value of all property, real or personal, tangible or intangible, that a decedent had beneficial ownership of at the time of death.

INCORPORATION--The act or process of forming or creating a corporation.

INTESTATE--To die without making a will is to die intestate.

INTESTATE DESCENT, STATUTES OF--Laws which specify the method and manner of distributing and disposing of the estate of a person who dies without a will.

JOINT TENANCY--Co-ownership of property, either real or personal, by two or more people. One of the major characteristics of this type co-ownership is the right of survivorship.

LEGACY--A disposition of personal property by will. Modern usage sometimes extends legacy to include the disposition of interests in real property by will.

LIABILITIES--The aggregate of all debts and other legal obligations.

LINEAL DESCENDANT--One who is, by blood relationship, in the direct line of descent from an ancestor. By statute, the term now includes adopted children in some states.

LITIGATION--Lawsuit; a judicial contest or controversy.

NON-TERMINABLE INTEREST--For purposes of the marital deduction, this refers to an interest in property which will be taxable in the estate of the surviving spouse.

PROBATE--A general term used to include all matters over which the probate courts have jurisdiction. It refers to the judicial process of administering the estates of all decedents, whether they died with or without a will.

REBUTE--To defeat or take away the effect of something, as to rebut a presumption. For example, proof that a gift made within three years of death was not made in contemplation of death.

REVERSIONARY INTEREST--A future interest which remains vested in a transferor.

RIGHT OF SURVIVORSHIP--This right is present in both a joint tenancy and tenancy by entireties. With these types of co-ownership, by virtue of simple survivorship, the surviving co-owner(s) accede to the decedent's ownership interest.

SETTLOR--One who creates a trust by transferring property to the trustee.

SOLE PROPRIETORSHIP--Sole owner; one who has exclusive title to property.

STATUTE--An act of the legislature which declares, demands, or prohibits something.

STATUTORY--Relating to a statute; created or defined by a statute; conforming to a statute.

TENANCY BY ENTIRETIES--A type of co-ownership which can exist only as between husband and wife. One of its chief characteristics is the right of survivorship. There is no tenancy by entirety in North Dakota. It has been replaced by joint tenancy.

TENANCY IN COMMON--A type of co-ownership which can exist between two or more persons. Here the interest of the deceased co-owner passes to his heirs, rather than to the surviving co-owner(s).

TESTAMENTARY--Pertaining to a will; any instrument is testamentary if drafted so as not to take effect until after death.

TRANSFEREE--The person to whom a transfer is made.

TRANSFEROR--One who makes a transfer.

TRUSTEE--The person, or corporate body, appointed to execute, administer, and carry out the terms of a trust for the benefit of the beneficiary.

TRUST--The legal relationship created by virtue of one party holding legal title to property, whether real or personal, for the benefit of another.

WILL--The legal instrument used to express or declare a person's wishes and directions as to the disposition and distribution of his property after death.

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