Farm Transfers and Estate Settlements – Taxes, and Legal Costs
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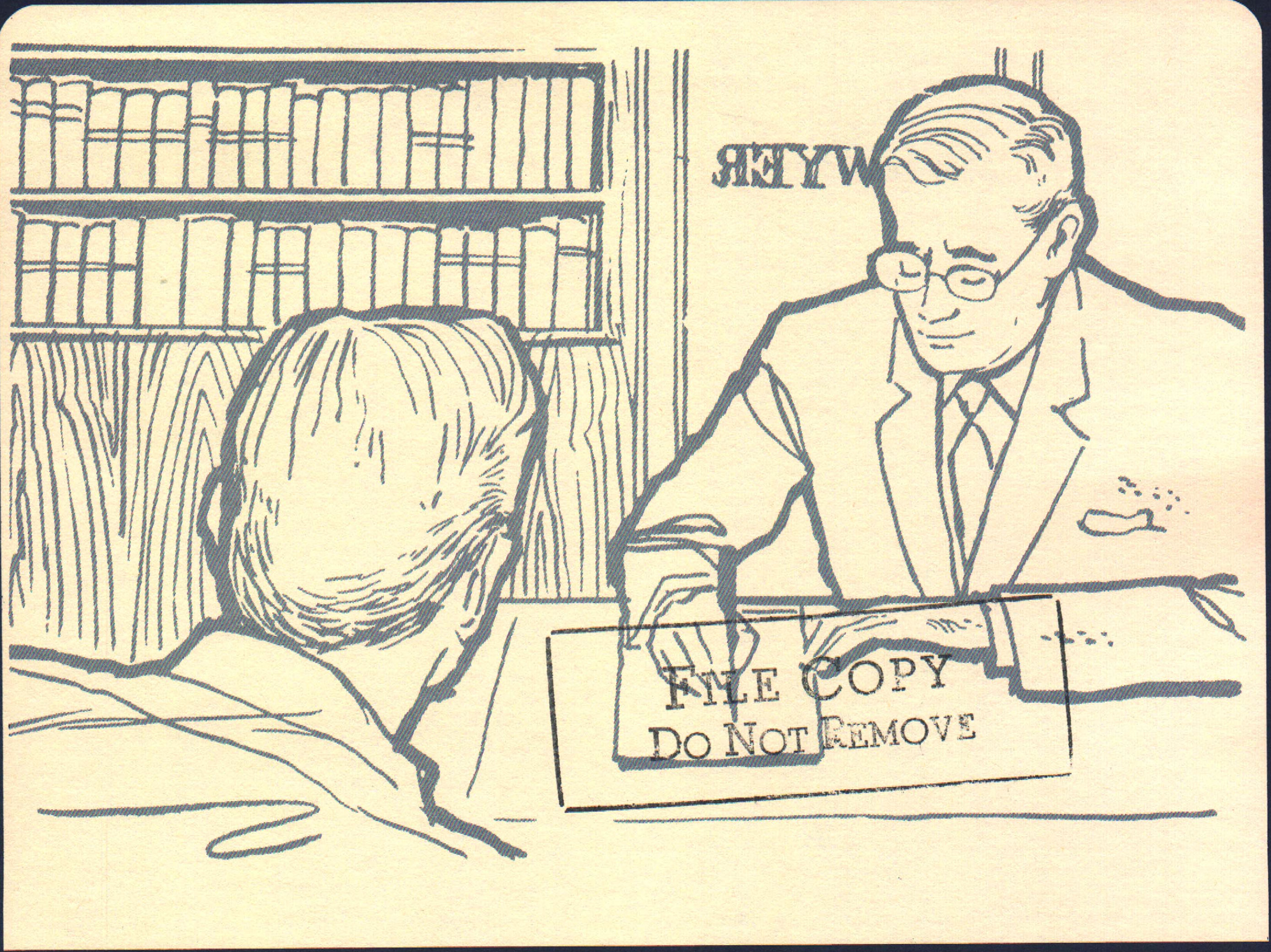

Farm Transfers and Estate Settlements—Taxes, and Legal Costs

THE QUESTION OF HOW taxes, legal fees, and court costs may be minimized in estate settlements is in the minds of many farm fathers and mothers. The transfer of the home farm to a son or son-in-law often poses a problem.

Farm families may have heard of cases where it appeared as though taxes and legal costs took much of the estate in the transfer process. In an attempt to avoid excessive costs to their heirs, many farm parents make property transfer arrangements which may greatly reduce their own security and happiness during retirement.

In many instances, farmers and other people are poorly informed about tax and legal costs in settlement of estates and in intra-family farm transfer arrangements. This bulletin was prepared to provide farm owners with practical information on these subjects.

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Farm Transfers and Estate Settlements—Taxes, and Legal Costs

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The author, however, assumes full responsibility for the content of this bulletin which contains many changes from the manuscript submitted to the reviewers. Changes in the 1969 Tax Reform Bill have been updated by Myron Kelsey.

*Mich. Agrl. Exp. No. Spec. Bul. 424 "Impact of Taxes and Legal Costs on Farm Transfers and Estate Settlements" 1959, pp. 32.

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Intra-family Farm Transfer Arrangements

The transfer of the home farm from one generation to the next is one of the most important features of any farmer's estate management plan. One of the first questions to be answered is the desirability of keeping the farm in the family. Conditions under which it would seem desirable to keep the home farm in the family are:

1) Where there is a capable son or son-in-law who wishes to own and operate the farm;

2) Where the farm is in a rural area;

3) Where the farm is an adequate farm unit or can be made so;

4) Where the family really wishes to keep the farm in the family; and

5) Where a reasonably early transfer or plans for the transfer of the farm to the farm operating heir or heirs is possible.

GOALS TO BE ATTAINED

Among the major goals to be attained in the farm transfer and estate settlement process are the following:

1) A reasonable degree of security for the parents, consistent with the size of the parents' estate.

2) A reasonable degree of security for the farm operating son or sons.

3) Equitable (not necessarily equal) treatment of the other children.

4) Minimizing taxes and legal costs.

5) Maintenance of the home farm as a going concern and on an efficient basis.

HOW TO MAKE THE TRANSFER

From the standpoint of time, the transfer of the farm and other portions of the parents' estate may be made as follows:

1) **Transfer Plans Made During the Life of the Owner but Which do not Take Place Until After the Owner Dies** — The best example of such an arrangement is a will. If the will is still in effect at the death of the owner, state inheritance and federal estate taxes will be involved if the estate is large enough to exceed allowable deductions and exemptions.

2) **Transfer of Ownership Either in Whole or in Part During the Life of the Owner** — This may be done in several ways:

(a) by sale on an installment basis, either by a land contract or by deed and mortgage;

(b) by a combination of sale and gift, that is a gift of a portion of the farm and sale of the rest or by selling the farm to the son at less than market value. In the latter case, the transaction would be regarded as a gift and possibly subject to a gift tax to the extent that the sale price is below the market value;

(c) by an outright gift of a portion of the farm;

(d) by gift of deed with reservation of a life estate;* or

(e) by establishing a joint tenancy, or a tenancy-in-common, of all or a portion of the farm by gift or by sale.

If the transfer is by sale, the owner or owners may be concerned with the capital gains section of the income tax, both state and federal. If the transfer is by gift, the federal gift tax may be involved.

3) **Transfer by the State Laws of Descent and Distribution** — This is what happens when the decedent leaves no effective will or has made no previous arrangement for the disposition of his property during his life time. State inheritance and federal estate taxes are involved in this situation if the value of the estate exceeds the exemptions and legal deductions. See the Appendix for statements as to the major provisions of the Michigan laws of descent and distribution.

WILLS

The question often arises among farm families as to the desirability of making a will. Does a will help in the farm transfer process? Does it provide for better continuity on the home farm? Will it tend to increase or decrease "death" taxes, court costs, attorney fees, etc.?

A will is a plan for the transfer of the farm and other property and for the settlement of the estate in case of the death of the owner. It serves an excellent purpose as a farm transfer plan until some other more permanent or perhaps more desirable plan, such as a transfer of ownership either in whole or in part during the life of the owner, can be arranged.

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*The gift of the deed to a farm with the reservation of a life estate is not recommended unless the parents have sufficient other property or income from other sources to provide for reasonable comfort and security during their old age. If, for example, there are two farms involved or if the one farm is suitable to be divided, then the gift of a deed with the reservation of a life estate may be an acceptable transfer device for one or a portion of one of the farm units involved.

It is recommended that every farmer and his wife each make a will. In most instances the primary purpose of the husband's will is to protect the wife, and a will is necessary for this purpose. Otherwise she will receive only that part provided for by the state laws of descent and distribution. There are many other reasons for doing so. One of the children may be handicapped and need a larger share, or one child may have received considerable financial aid in attaining a college education while another stayed home and helped on the farm. Still another may have given other valuable assistance to the parents.

For the young farmer

A will is as necessary for a young farmer and his wife as it is for an older couple. This is particularly true if there are minor children. Unless there is evidence to the contrary, Michigan law assumes that the husband owns all the farm personal property, such as livestock, machinery and equipment, feed, crops, and supplies. Thus, upon his death, unless he has left a will to the contrary, the farm personal property is distributed to his heirs in accordance with the state laws of descent and distribution. In case of minor children and no will, the law requires a guardian to be appointed to represent the interests of the children. This often is the mother, and she must post a surety bond and make annual reports to the court. Some very unfortunate situations for the surviving farm widow have resulted from the husband's death where there are children and he left no effective will.

Common accident clause

Another good reason for making a will is the possibility of the death of both parents in the same accident or disaster. The will should include, therefore, a "death in common accident" clause. This is particularly important for a husband and wife who have no children. Suppose, for example, a husband and wife were on a trip and became involved in a serious accident. The husband was killed instantly. The wife survived him by an hour. By law (if there were no will to the contrary) she inherited all jointly owned property and the widow's share of his other property even though she lived for only an hour. Upon her death, one hour later, such property would go to her heirs. If desired, this situation could be avoided by having wills with clauses stating how property should be divided in case both husband and wife die as a result of the same accident or disaster.

Tax savings

Making a will does not necessarily reduce time and cost of probate, but may provide for some tax savings. In addition, the testator (one making the will) may name an executor of his choice (a person or a trust company to accumulate and temporarily manage the estate).

Property owned in joint tenancy with the right of survivorship cannot be disposed of by will, but most persons own some property that is not so owned and thus a will is highly advisable.

It is important also that the wife make a will. If a wife survives her husband, her will not only controls any separate property she may have owned, but also all property that she acquired upon the death of her husband. In many cases, the absence of a will upon the death of a surviving wife has resulted in an unfortunate and unintended distribution of property.

Joint and mutual wills

In some instances, married persons wish to make joint and mutual wills with irrevocable clauses and sign a separate supporting contract. Probate court experience indicates, however, that many joint and mutual wills are poorly drawn. Such wills and contracts provide for the distribution of property as the two persons mutually agree. If properly drawn, the survivor is bound by the will and contract and, thus cannot subsequently make beneficial changes to accomplish the initially desired results, or a later and better result. For example, suppose the joint and mutual will indicated that the oldest son was to receive the farm when the mother died. Then the son dies with the father in an automobile accident. The mother might now wish to change the will but is unable to do so because it is a joint will. Thus, when the mother dies, the property will go to the son's heirs.

In general, lawyers' experiences with joint and mutual wills have not been satisfactory. Such an arrangement should not be entered into except after the most careful consideration of the possible results. It is probably more often used in second marriages. In such cases, a pre-nuptial agreement might more easily accomplish the same result.

In any event, the services of a lawyer should always be retained in making a will. The maker then has the best assurance that it will be legally effective. It should be remembered that a verbal agreement, handwritten note, or any proposed will not executed according to the statutes of the state is not a valid will, and therefore ineffective.

In completing the will, two witnesses to the maker's signature are required by Michigan law. Neither witness should be a beneficiary to the will, because by serving as a witness, he would prevent his later participation as a beneficiary of the will. The witnesses should preferably be younger than the maker of the will. The purpose of the witnesses is only to witness the signature of the will maker. They need know nothing of its contents.

Furthermore, the will should be kept up to date as changes in the family and in the property assets may occur. However, never make any changes in your will without the aid of a lawyer and the presence of two witnesses, and never sign more than one copy of a will. The will should be filed either with the Probate Court or with your trust officer.

Information Needed in Making a Will — In making a will and an estate management plan, the maker should make (1) a list of the names and ages of all members of his family and any other persons and institutions to be provided for, (2) a list of the kinds and values of all his property assets, both real and personal, including his insurance, and (3) a list of the major items of his indebtedness. The maker of the will should then prepare a tentative statement of his plan and wishes for the distribution of his estate upon his death. He should then take this information to his lawyer for the preparation of his will.

The guide on page 6 shows the information needed in making out a will, and an estate management plan as discussed in the preceding paragraphs. This information should be written or typed out in logical order in a statement form and made available to your lawyer.

TRANSFERRING THE HOME FARM

The transfer of the home farm to the younger generation is one of the most important lifetime decisions of many farm families and it needs to be done with a good deal of care and thought. The following proposals are suggested as a good procedure to follow in making the farm transfer:

a. Give early consideration to ideas about how and when to make the transfer.

b. Consult with the son, sons, or son-in-law who would like to own and operate the home farm.

c. Develop a plan which best meets the family's goals.

d. Study the impacts of the state and federal income tax on capital gains, the federal gift tax, the state inheritance tax, the federal estate tax, court costs, and attorney fees on the proposed plan.

e. Consult a lawyer and have him put the plan into written, legal form.

Factors Involved in Minimizing Estate Settlement Costs

KINDS OF PROPERTY

In general, there are two main classes of property: real property (real estate); and personal property, both tangible and intangible.

By the use of suitable wording, the ownership of certain intangible personal property, such as stock certificates, bonds, and promissory notes, may be on a joint ownership basis, whereby the survivor takes all. Bank accounts, savings and loan accounts can also be owned jointly and withdrawn on the basis of the signature card — for example, John R. Doe and/or Mary Doe, or the survivor of them. By this arrangement, the survivor can quickly resume use of the account.

Personal tangible farm property in Michigan, such as livestock, machinery and equipment, feed, crops, and supplies, is considered to be owned by the husband unless there is evidence to the contrary. Such property could be transferred from husband to wife by a bill of sale. However, this practice is not approved by credit agencies since it jeopardizes a farmer's credit and complicates his doing business in his own name.

WAYS REAL PROPERTY IS HELD

The amount of property and the way it is held at the death of the owner have an important bearing on the impact of state inheritance, federal estate taxes and legal costs. Thus, one must

INFORMATION NEEDED IN ESTATE PLANNING

Personal Information Date ______________ 19______

Your name and age ...... ______________________________
Spouse's name and age ... ______________________________
Childrens' names and ages ______________________________
Other persons to be considered, names and ages______________________________
Institutions to be considered, e.g., church, etc.______________________________

Property Information

The farm: Size, acres: Total ________ Tillable ______________________________
Present market value .... $____________
Legal description ______________________________
Type of ownership, (fee simple, joint tenancy, etc.) ______________________________
Co-owner, if any; name and property involved ______________________________

Other real estate: Kinds ______________________________
Present market value .... $____________
Legal description ______________________________
Type of ownership, (fee simple, joint tenancy, etc.) ______________________________
Co-owner, if any; name and property involved ______________________________

Personal, tangible property:

Livestock, kinds and values .... $____________
Feed and growing crops, average value .... $____________
Machinery and equipment .... $____________
Automobile .... $____________
Other .... $____________

Personal, intangible property:

Cash on hand or in bank .... $____________
Stocks and bonds .... $____________
Life insurance, types and amounts .... $____________
Real estate mortgages, balance due .... $____________
Land contracts, balance due .... $____________
Chattel mortgages, balance due .... $____________
Unsecured notes, balance due .... $____________
Other .... $____________

Assets, total value .... $____________

Indebtedness:

Real estate mortgages, balance due .... $____________
Land contract, balance due .... $____________
Chattel mortgage, balance due .... $____________
Unsecured notes, balance due .... $____________
Other major accounts due .... $____________
Total indebtedness .... $____________

Net worth, assets less indebtedness .... $____________

first consider in what ways the real property is owned. The following paragraphs provide some information on this important subject.

1. **Fee Simple Ownership:** This is ownership of real estate by one person who has an unrestricted right to sell, mortgage, or otherwise dispose of it. A man's interest is subject to his wife's dower and homestead rights. However, a woman owns property clear of any claim by her husband.

2. **Tenancy in Common:** This is one type of co-ownership. Two or more persons may each own an undivided share in the real estate. One of the co-owners may sell his share or dispose of it by will; if it is not previously sold, it becomes a part of his estate upon his death. Tenancy in common often occurs among heirs of an estate in which the actual division or settlement of the real estate has not been completed. In situations of this kind, the farm-operating son may feel a greater sense of security than actually exists. All of the other co-owners have equal rights and may sell or otherwise dispose of their shares at any time. They also have equal rights to residence on the farm unless such rights have been transferred by lease. However, the son operating the farm may be able to work out an agreement with the other heirs regarding the operation or transfer of the farm that may help to avoid such difficulties.

Capital improvements would be the responsibility of all the co-owners.

3. **Joint Tenancy with Rights of Survivorship.*** In this type of co-ownership, where survivorship is expressly provided for, the real estate upon the death of one of the joint owners goes to the survivor or survivors with but little legal formality. This is true even though the deceased joint-tenant has directed by will that his equity on the property should go to someone else. This type of co-ownership may be between related or unrelated persons and cannot be broken without the consent of the parties concerned.

4. **Tenancy by the Entirety:** This arrangement is a joint tenancy (joint-ownership) of real estate between husband and wife. This type of tenancy cannot be broken by either the husband or wife without the other's consent.

JOINT TENANCY—PROS AND CONS

There are both advantages and disadvantages to joint tenancy with the rights of survivorship and to tenancy by the entirety. Once entered into, the arrangement cannot be revoked or changed except by the written consent and participation of all the co-owners. Therefore, persons contemplating such an arrangement should do so only after considering all the "pros and cons" of the idea, and only with the aid of a lawyer.

Disadvantages — Many authorities look with disfavor upon joint tenancies between husband and wife for more than half of the husband's estate because of (1) the uncertainties of life whereby the intended chain of inheritance may be broken, and (2) because of the high federal estate taxes which may result from large jointly-owned estates. If all the husband's property is held in joint ownership with his wife, it destroys the flexibility of estate management needed to minimize federal estate taxes to the surviving beneficiary.

A disadvantage of joint-tenancies between parents and their children is that parents needing funds in their old age could not obtain the funds by selling or mortgaging the property without the written consent of the other co-owner or co-owners.

Similarly, a father, mother, and the farm-operating son may work out a joint-tenancy arrangement with the logical assumption that the father and mother would die first and that the son would thus automatically receive the parents' real estate. However, should the son die first, the ownership of the property would revert to the surviving parent or parents and the son's wife and family would be left without a share of the estate. Such unexpected and unfortunate sequences have prompted some lawyers to advise against joint tenancies between parents and their children.

Advantages — The main advantage of a joint tenancy with the right of survivorship, or of a tenancy by the entirety, is that the real estate so held automatically goes to the survivor or sur-

*Legal wording is often as follows: "As joint tenants and not as tenants in common, and to the survivor thereof." Precautions and care should be used to avoid confusing the term "joint tenancy with rights of survivorship" with the simpler term "joint tenancy" (Common Law Joint tenancy) in the preparation for and in consideration of co-ownership of farm real estate. The distinguishing feature between the two is that, in Common Law Joint tenancy, either joint tenant during his lifetime can break the joint tenancy by selling, deeding, or otherwise disposing of his interest in the property either with or without the written permission of the second party. In such an event, the new owner becomes a tenant in common with the other joint tenant or tenants. Common Law Joint tenancy is not common in Michigan.

vivors and does not require going through extensive probate court procedure. Thus, estate settlement costs, such as court and legal expenses as well as the time needed to clear the title of the property are greatly reduced.

When real estate is held in joint tenancy at the time of death, there is no Michigan inheritance tax levied. In many farmer estates, however, the exemptions and deductions are large enough and the Michigan inheritance tax rate is low enough to make it appear to be inadvisable to create a joint tenancy of any kind for more than one-half of one's property simply to avoid having to pay any Michigan inheritance tax.

TRUSTS

A trust is an arrangement whereby a person, bank, or trust company, as trustee, holds title to and administers money or other assets for the benefit of designated beneficiaries in accordance with the provisions of a will, agreement, or other paper creating a trust and setting forth its provisions.

A modern trust (1) may save on death taxes, both state and federal; (2) may save on estate settlement and administration expense; (3) protects capital for financially inexperienced or incapable beneficiaries; (4) provides investment management; and (5) is as flexible as a family situation demands.

When one first considers the pros and cons of a trust plan, it can be somewhat confusing. In addition, a farmer's situation is different than that of many other persons because most of his estate may be real estate and farm personal property, as compared with stocks and bonds, as with many urban persons. This presentation may be of some help to the reader previous to his meeting with his lawyer and trust officer.

TWO KINDS

There are two major types of trusts: (1) the **living trust** and (2) the **testamentary trust.** In all trust arrangements, the person creating the trust transfers title of ownership of the property to be included in the trust to the trustee for estate settlement and management; for example, to the ____________ Bank as trustee for Gerald L. Jones. Such a transfer is not a gift, since the trustee acts as a custodian of the property for the period specified in the agreement.

In a living trust, such ownership is transferred during a person's lifetime. In a testamentary trust, such ownership is transferred by will to the trustee at the death of the testator (the person making the will).

Living

A living trust may be either **revocable** (that is, the maker may change it or revoke it completely at any time) or **irrevocable** (that is, it may be a permanent, unchangeable transfer of ownership of property to a trustee for purposes of management and eventual transfer to a beneficiary.) The living trust may be set up to last for your lifetime only, or it may be worded so as to continue after your death and during the lives of certain persons you may name. When the last beneficiary dies, the trust ends and the remaining assets are paid over to those the maker has selected.

The revocable living trust is frequently suggested as a means of avoiding probate and minimizing estate settlement expense. Obviously, if you have transferred title to some or all of your assets to a trust company for management and eventual transfer to named beneficiary or beneficiaries, such assets will not be included in your estate for probate. This is the route often taken to avoid probate and to minimize estate settlement expense.

However, such assets are a part of your estate from the standpoint of the state intangible taxes, the state inheritance tax, and the federal estate tax. The administrator or executor of your estate must still (1) prepare and file income and intangible tax returns for the part of the year that the deceased lived; (2) settle and pay Michigan inheritance taxes, if any are due; (3) prepare, file and pay the federal estate tax return; and (4) obtain final acceptance and releases from proper authorities on the foregoing named taxes.

Testamentary

A testamentary trust is usually created by a will which outlines the provisions of the trust and designates the name of the trustee. It becomes effective as an irrevocable trust upon the death of the testator.

For example, if a farmer held his estate in his own name in fee simple ownership, he could leave half of it in a trust by means of his will in such a form that this one-half qualifies for the full marital deduction and so passes free of the federal estate tax. His wife gets the income for life and has a general power of appointment; that is, unlimited power to designate to whom the principal is to go at her death. Then the farmer could leave the balance of his estate in a second trust which provides that his wife is also to receive the income during her life but which gives to her only limited or no power to designate to whom the principal is to go, or else directs its payment to the children. This portion of his estate would be included in the federal estate tax calculations.

This same arrangement could be accomplished by will without setting up a trust arrangement; for example, see the illustration under the federal estate section in the latter part of this bulletin.

TRUST DEPARTMENTS

Most major banks now have trust departments. The trust officials in a bank or trust company, however, do not draw wills creating the trust. The services of a lawyer are necessary for the testator's (maker of the will) protection in making the will creating a trust. Banks and trust companies are preferred over individual persons as trustees since they operate under national or state laws, have great financial strength and are incorporated, thus being assured of longer life. Trust officials usually offer both estate settlement and estate management services. They will gladly inform you as to their charges and types of services available. For administrative and management services of an estate after it has been settled, the yearly charge of most trust companies is from 0.5 to 0.6 percent of the value of the estate, depending on the size of the estate and the type of management services rendered.

Changes in tax laws over the last decade which permit certain tax advantages, plus the inherent usefulness of the trust device, have made the use of a trust much more common now than in the past in estate management plans. The marital deduction, one of the usual federal estate tax savers, is often put in the form of a trust for a surviving spouse. The balance of the estate may be set up in a residual trust which may have quite flexible provisions.

A trust under a husband's will may provide for greater security, freedom, and convenience for a wife than could be achieved through out-right transfer of the husband's estate to her. The trust may help in reducing the widow's income tax. It may also help in reducing the "second" federal estate tax that may be incurred at the time of the wife's subsequent death. The trust plan may be particularly advantageous in reducing federal estate taxes with estates in excess of $100,000.

The transfer of title of the farm itself or of the total farm business assets to a trustee may make it easier:

1) to continue to operate the farm as a business unit;

2) to permit a farming son to manage or lease the farm and avoid partition by the heirs, or to let him buy on special terms, or to give him time to exercise an option to buy;

3) to reduce conflicts between a life tenant and the remainderman (the one who gets possession of the farm in fee simple upon the death of the life tenant);

4) to provide a means of sale or a method of mortgaging the property to provide funds for farming operations, or for the welfare of the surviving spouse;

5) to hold the operating unit until a family member is ready to take over.

Modern trusts now may provide for much greater flexibility in handling estates than in the past. Detailed information on trusts can be obtained from your local trust company and your attorney. Ask them to explain the purpose of a trust, how it operates, and its advantages.

Taxes and Legal Costs

In some instances farm parents, in their efforts to minimize legal costs and "death" taxes, make property arrangements, such as either giving away or giving away control of much of their property. This may greatly reduce the security and happiness which their estates should afford them in retirement. Farm parents should give first consideration to their own welfare in making plans for the distribution of their estate. They thereby retain such independence of action as their estate may afford.

Control of property may be given away by, (1) entering into a joint-tenancy with the right of survivorship with a son or some other member of the family; (2) giving a deed to a son or daughter with the reservation of a life estate to the donor; or (3) giving away property by placing a deed-in-escrow in the hands of a third party. This deed is to be recorded in the office of the Register of Deeds after the death of the donor.

In these situations, the owner loses control of his property to the extent he is unable to sell or mortgage such property without the consent of the other person or persons involved. Thus he is unable to raise funds in case of a serious illness or some other misfortune requiring money in excess of the income from such property.

WHEN TO BE CONCERNED

One of the first questions often asked by farm parents is, "How can we make our intra-family farm transfer and plan our estate settlement so our heirs will not have to pay so much in taxes and legal costs?" In this connection, it is of first importance to know when to be concerned about the impact of taxes and legal costs on intra-family farm transfers and estate settlements.

In situations where the estate is less than, say, $70,000, farmers and others would be well advised to disregard the impacts of legal costs, federal and state income taxes on capital gains, federal estate and gift taxes, and the Michigan inheritance tax in working out their estate management plan.

Legal Costs — It is difficult to enumerate the legal and administrative expenses that may be incurred in making out a will and in the settlement of an estate. Much depends on the size of the estate, the type of will to be prepared and the amount and kind of services to be performed. Inquire of your attorney as to the probable charges for the type of services that may be involved before requesting such services.

The administrator or executor of an estate is entitled to a commission in proportion to the value of the property included in the estate. The fee (as of 1967) is 5 percent on the first $1,000, 2½ percent on $1,000 to $5,000 and 2 percent on anything above $5,000. These fees may be expressed in different ways, such as two percent of the value of the estate plus $50. These are the fees that most trust companies charge for performing the duties of an administrator or executor of an estate. The administrator or executor is entitled to additional commission on the proceeds of any real estate sold under the license of the court.

Taxes — The federal and state income taxes on capital gains apply only when the property is sold. The federal gift tax applies only to gifts made during one's lifetime.

The Michigan inheritance tax allows a $30,000 exemption for the surviving spouse and $5,000 for each child. If the total estate is left to the wife, she is allowed $30,000 plus $5,000 for each of the children not receiving any distributable share. Above that exemption, the tax, which is a graduated tax, starts at 1½ percent on real estate and 2 percent on personal property.

The federal estate tax allows an individual exemption of $60,000. A married person, through a combination of his individual exemption and a "marital deduction," has a $120,000 exemption if one-half or more of the estate is left without any reservations or in trust with power of appointment at death, to the surviving spouse.

Farm families, and especially single persons, with estates much in excess of $70,000, for example, could well consider various types of estate settlement, so as to minimize the legal and tax costs which may be involved.

Among some of the devices that may be used during one's lifetime in minimizing legal and tax costs in estate settlement are: (1) an outright gift, (2) a gift of a portion of the real estate with the reservation of a life estate, (3) the sale of real estate on an installment basis, (4) setting up a trust arrangement, and (5) by the incorporation of the farm business.

The formation of a tenancy-by-the-entirety in only one-half of one's estate permits taking advantage of the marital deduction, and at the same time permits flexibility in making plans which will greatly minimize federal estate taxes on the balance of the estate. The use of a trust plan should also be considered in plans to minimize probate settlement costs, taxes for the owner on any capital gains resulting from the sale of property, and also federal estate taxes for the surviving heir or heirs.

A farmer might also wish to consider making a gift to his wife of the farm home, separate from the farm, including an area of an acre or so. This may help to reduce the size of the husband's estate to be considered for estate taxes at the time of his death.

Federal and State Taxes on Capital Gains

If the intra-family farm transfer involves a sale of property used in the farm business which results in a gain, all or a portion of the gain will come under the provisions of the capital gains section of the income tax, both state and federal. Thus, some farmers may hesitate in making the transfer of the home farm by sale because of the incidence of the income tax on any capital gains that might be involved.

In many situations, however, the tax may not be as burdensome as it may appear. This is especially true if the owner is 65 years of age and is thereby entitled to two deductions, or four deductions if his wife is also 65 years of age or over. Added advantage may be gained if the farm is sold on an installment basis (land contract or a deed and mortgage) in which 30 percent or less of purchase price is paid during the year of sale.

Thus, in making a decision as to the transfer of the home farm by sale, gift, or by will, a person may wish to make comparisons as to the impacts of (1) the income tax on capital gains, (2) the federal gift tax, (3) the state inheritance tax and (4) the federal estate tax that may be involved in the different procedures. In addition, the parents should also consider the advantages to the farm-operating son and his family of being able to attain and pay for ownership of the farm during the years of his maximum debt-paying ability.

COMPUTING CAPITAL GAINS

The capital items that may be involved in setting up a father-son farm partnership or in making an intra-family farm transfer are the following: Livestock held for dairy or breeding purposes; depreciable property used in the farm business such as farm machinery, trucks, tile drainage, soil conservation structures and fences; farm real estate, and unharvested crops on the land sold. Cattle and horses acquired after Dec. 31, 1969 must be held for 24 months, other livestock for 12 months and other farm property for over 6 months to qualify for the long-term capital gain treatment.

If depreciable property (for example, farm machinery and equipment) is sold at its remaining value after depreciation, there would be no capital gain or loss or tax in such a transaction. If there is a gain on depreciable property some of the gain may be treated as ordinary income due to depreciation recapture. Only 50 percent of the remaining net long-term capital gain is considered as taxable income, subject to Internal Revenue Sections 1245 and 1250.

The amount of the capital gain or loss from the sale of property used in the farming business is (1) the selling price plus depreciation allowed or allowable during ownership less (2) the adjusted basis (cost) and selling expense. The farm dwelling occupied by the owner-operator is not subject to depreciation in computing the capital gain or loss resulting from a sale. However, the farm owner and his wife should keep in mind the exclusion from tax of such a sale, either because of re-investment in another home or the exclusion because of age.

The basis for determining the gain or loss on the sale of inherited property is the fair market value at the decedent's death, plus improvements less depreciation. If property were obtained by gift, the basis for determining the gain is the cost at the time of purchase, or the value at time of inheritance, to the last person who had not acquired it by gift, plus the remaining or undepreciated value of capital improvements.

The tax on capital gains does not apply to any property until it has been sold, traded, or involuntarily converted by condemnation or other means. This should be of interest to those persons who have inherited property, and are thinking of selling since the basis for determining capital gain or loss, when such property is sold, is the fair market value at the decedent's death or the value used in the estate tax return. Thus, property gets a new, present market basis of cost for federal income tax purposes at the time of the death of the owner.

The interest payments received on the land contract or on the mortgage would be ordinary income in computing the seller's income tax, whether or not an installment type sale is used. However, the interest qualifies for retirement income credit if the seller is 65 or over. Should the seller die before completion of the installment payments, the buyer would continue making payments to the estate or to the heirs as designated in the estate settlement. The balance of the tax due on the sale would be paid by the estate.

In accomplishing savings on state inheritance and federal estate taxes, the installment type of sale has another feature to commend it. The contract or mortgage payments become easy units for gifts. The parents may refund as gifts such portions of the contract payments as they wish.

This in effect is comparable to the tax savings involved in giving away shares of stock in a farm corporation.

FEDERAL TAX

Sale of Your Personal Residence — If you are 65 years of age or older before the date of the sale or exchange, and you had owned and used the property as your personal residence for at least 5 years within the 8-year period ending on the date of such sale or exchange, you can elect to exclude the entire gain if the adjusted sale price is $20,000 or less. If the adjusted sale price is over $20,000 an election may be made to exclude part of the gain.

Sale of a Farm — The accompanying illustration shows an example of the procedure involved in computing the federal income tax resulting from the sale, on an installment basis, of a $60,000 farm with a capital gain of $32,000 with a payment of $3,000 during the year of sale.

Sale of Your Personal Residence — An Example

Your personal residence is a capital asset and not property used in the business of farming. Thus in the sale of a farm you may separate the sale of the residence for tax purposes. If you have a gain on the sale of your residence, you may postpone the tax on the gain if within one year before or after the sale you buy and occupy another residence which you purchase at a cost equal to or in excess of the adjusted sale price of your old residence. The same applies if you start construction on a new residence within one year before or one year after the sale of your old one and occupy it within 18 months after the sale. Your residence includes the immediate surroundings and outbuildings related to the dwelling.

If you do sell your personal residence separately from your farm, you must then determine (1) the portion of the selling price and (2) the portion of the cost (or other basis) which are allocable to the residence. An example of the procedure is as follows:

1. Allocation of cost (or other basis) to the farm dwelling

(a) Cost basis of farm $25,000

(b) Apportionment of cost to —
- Land, an estimate $14,000
- Buildings, an estimate 11,000
  - Dwelling, estimate $4,000
  - Farm buildings, estimate ... 7,000

(c) Capital improvements on the dwelling since date of acquisition $2,000

(d) Total cost (or other basis) of dwelling .... $ 6,000
($4,000 plus $2,000 of improvements)
(Personal dwelling not eligible for depreciation.)

2. Determining the capital gain resulting from selling residence separately

Item	Farm including residence	Residence only	Farm, not including residence
Sale price	$60,000	$10,000	$50,000
Cost (or other basis) plus expenses of the sale and minus depreciation allowed or allowable during ownership	$28,000	$ 6,000	$22,000
Capital gain	$32,000	$ 4,000	$28,000

The tax on the $28,000 gain from the sale of the balance of the farm may not be postponed except as it may be partially postponed through sale on an installment basis with total payments on principal during year of sale of 30 percent or less of the gross sale price. This is true even though you invest part or all of the selling price in another farm.

Sale of Your Farm — An Example

1. **Items that may be included:**
   Real estate, if held over 6 months
   Machinery and equipment, if held over 6 months .... Provided total sale of such livestock and machinery is more than $1,000.
   Cattle and horses held for breeding and draft purposes, held over 24 months and other livestock held over 12 months. Treatment of capital gains in machinery, equipment, livestock and real estate is subject to Internal Revenue Code Section 1245 and 1250.

2. Type of property sold .... real estate

3. Date property was acquired .... March 3, 1950

4. Date property was sold .... Dec. 28, 1968

5. **Gross sale price** .... $60,000 } $67,000

6. Depreciation allowed or allowable during ownership .... 7,000 }

7. **Cost or other basis:**
   Original purchase price if purchased or
   Established value if inherited or
   Cost to last purchaser if acquired by gift } .... $25,000 } $35,000
   Cost of improvements* capitalized during ownership 9,000
   Expense of sale: Lawyer's fees, seller's commission, etc. .. 1,000

8. **Capital gain** ($67,000 minus $35,000) $32,000

9. Gross sale price $60,000

10. Less: Mortgage or lien assumed by purchaser 10,000

11. **Adjusted sale price** $50,000

12. **Gross profit percentage:** $\dfrac{\text{Gain } \$32{,}000}{\text{Adjusted sale price } \$50{,}000} \times 100 =$ 64%

13. Total payment on principal during year of sale (includes down payment). Must not exceed 30% of the gross sale price, $60,000, if the transaction is to be considered an installment sale. In actual practice, a 29% figure is often used in order that the use of the installment basis can be assured. } .... $ 3,000

14. **Net long-term capital gain** for the year of sale. This equals the percentage figure determined in item 12 (64%) multiplied by the payment on the principal during the year. Thus 64% of $3,000. } .... $ 1,920

15. **Computation of "ordinary income" for the year** to be transferred to the individual's income tax Form 1040 (assuming the seller has no other taxable gains or losses from the sale or exchange of capital assets). Use 50% of the $1,920 long-term capital gain (see Schedule D Form 1040) } .... $ 960

16. **Information** similar to that presented in this example should be filed with Schedule D (1040) along with your individual income tax Form 1040 for the year of sale.

17. **In subsequent years,** the taxpayer would only provide information similar to that shown in items 12, 13, 14 and 15 and make reference to the information filed by the taxpayer relating to the sale of the assets for the tax year of sale.

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* Buildings, orchards, tiling, well and water system and fencing.

MICHIGAN TAX

The procedure for determining the Michigan income tax on capital gains is the same as for federal tax, except that the capital gains from the sale or exchange of property in the federal tax calculations is reduced by the amount of gain prior to October 1, 1967, the effective date of the Michigan income tax law.

Computations for Michigan's individual income tax start with the "Federal Adjusted Gross Income" figure from the federal income tax return (line 15c, 1969 Federal Form 1040). The federal "Total Income" figure for the year is then adjusted by specific *Additions* and *Subtractions*. The *Subtractions* include the taxable gain for the year from the sale or exchange of capitol assets as shown in the individual's Federal Form 1040D. After subtracting the federal income tax gain, the portion of the gain from the sale or exchange of capital assets subject to the Michigan income tax, that is the gain since September 30, 1967, is now added. Instructions for determining the portion of the federal taxable gain that is subject to the Michigan income tax are given on page 2 of MI - 1040D, the Michigan form.

In the example of computing the federal income tax gain on capital assets previously shown, the Michigan portion of the $960 federal taxable gain for the year would be for 15 months (October 1, 1967 to December 28, 1968) of the 226 months (March 3, 1950 to December 28, 1968) federal gain or 15/226 of $960 which equals $63.71.

Federal Gift Tax

The federal statute relating to gift taxes imposes a tax upon the transfer of property by gift. A tax is levied whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. The tax also applies to sales and exchanges for less than an adequate and full consideration in money or money's worth.

EXEMPTIONS

Under this statute each taxpayer has an exemption of $30,000 during his lifetime and one exclusion of $3,000 per year per person which he may give away without paying a gift tax. These amounts may be doubled if the gift is to a spouse or is a joint gift by a husband and wife. This double exemption is allowed, even though the property is held entirely in the husband's name.

A farmer may wish, for example, to transfer all or a portion of his real estate by gift to a son over a period of time. This could be done by 1) the father refunding payments or certain amounts of payments on an installment type sale of the farm, or 2) by incorporating the farm business, including the real estate, and giving shares of stock. In this manner most or all of the farm may be transferred to a son at the rate

TABLE 1 — Federal gift tax rates on taxable gifts in excess of annual exclusions, lifetime exemption, and authorized deductions, as of 1970.

Net gifts in excess of deductions*	Amount of tax and rate on next bracket
$ 0 to 5,000	2.25% on excess up to $ 5,000
5,000 to 10,000	$ 112.50 plus 5.25% on excess up to 10,000
10,000 to 20,000	375.00 plus 8.25% on excess up to 20,000
20,000 to 30,000	1,200.00 plus 10.5% on excess up to 30,000
30,000 to 40,000	2,250.00 plus 13.5% on excess up to 40,000
40,000 to 50,000	3,600.00 plus 16.5% on excess up to 50,000
50,000 to 60,000	5,250.00 plus 18.75% on excess up to 60,000
60,000 to 100,000	7,125.00 plus 21% on excess up to 100,000
100,000 to 250,000	15,525.00 plus 22.5% on excess up to 250,000

*Gifts from a husband to his wife or vice versa are taxed on only half their value. A husband and wife can elect to give a gift made by either to a third person and have it taxed as though each gave half.

of $3,000 a year by one parent (or $6,000 by both) during the father's life without being subject to gift or inheritance or estate taxes. Like amounts could also be given tax free to the son's wife and to any number of other persons. If the whole farm or a portion of it were to be transferred by gift at one time, a total gift tax exemption of $33,000 (or $66,000 if married) is allowable, assuming no part of these exemptions have been used for other gifts. The three-year "contemplation of death" rule in the federal law needs to be taken into consideration in connection with federal gift taxes.

Transfers to joint ownership are important with respect to gift tax considerations. In the Common Law type of joint tenancy where there may be a severance of joint holding, the placing of a $100,000 parcel of property jointly between the donor and a donee, regardless of age, would be a gift of one-half or 50 percent. However, if the other type of holding, joint tenancy with rights of survivorship, is used, the gift would be based on the respective ages of the donor and donee.

It should be pointed out, however, that a gift of a future interest, such as a deed with the reservation of a life estate, does not qualify for the $3,000 annual exemption.

Gift Taxes are Cumulative. The gift tax computation for each year is based upon all of the accumulated gifts made over prior years. For example, if the first year's gifts (in excess of the exclusions, exemption and deductions) were $10,000, the gift tax for the first year would be $375. If the next year's taxable gifts were also $10,000, the tax for the year would be $1,200 (tax on $20,000 of gifts) less $375 (tax on the prior gifts) or $825. The gift tax is payable by the donor, but the donee may need to file the information form and pay the tax if it is not done by the donor.

Michigan Inheritance Tax

The Michigan inheritance tax is a tax on the transfer of property at death. There have been no major changes in this tax since its enactment in 1899. The tax is on the fair market value of the property received by each recipient, less exemptions and deductions. The value is determined by the appraisers appointed by the Probate Court in the county of residence of the decedent. It is customary in most counties in Michigan for the court to appoint one appraiser of its own choosing and to appoint the other appraiser from a list of one or more persons submitted by the executor or administrator of the estate.

The value of the estate as established by the two appraisers appointed by the Probate Court is either accepted or rejected by the State Department of Revenue. Usually an appraisal is accepted unless it is considerably out of line.

There have been cases where the appraisers have, for one reason or another, appraised the property of a deceased person at much less than its fair market value. For example, take the case of a farmer leaving all of his property to his widow, most of which is real estate and not bringing in much income. The appraisers, knowing that the widow has very little money, may try to keep the inheritance tax as light as possible through a lower appraised value.

Very often, at a later date, the recipient of an estate decides to sell. Then the value of the estate as established by the appraisers, if accepted by the Probate Court and the Michigan Department of Revenue, becomes the "cost or other basis" on which the federal capital gains tax is computed when the property is later sold. Since the federal capital gains tax rate is much higher than the Michigan inheritance tax, it usually is to the interest of everyone concerned to appraise the property, for estate settlement purposes, at its fair market value.

WHAT IS TAXABLE?

1. If a decedent had real property in Michigan and died as either a resident or non-resident, the transfer is taxable.

2. Exempt from the payment of the Michigan inheritance tax are intangible property items such as: (a) bank accounts in the names of two persons, payable to either, and (b) government bonds registered in two persons' names as co-owners. If bank accounts are placed in the above manner of ownership within two years before death, provisions of paragraph 4 of this section hold, according to the Michigan law. Real estate, the title to which is held in joint tenancy by two or more persons and which passes immediately

to the survivor or survivors at the time of death, is also exempt.

3. There is no Michigan inheritance tax on the proceeds from life insurance policies on the life of the decedent payable to named beneficiaries or to a trust for the benefit of named beneficiaries. Life insurance proceeds payable to the estate of the deceased, however are taxable.

4. If a resident or non-resident of Michigan makes a transfer of property within Michigan by deed, grant, bargain, sale, or gift in contemplation of death or intended to take effect in possession or enjoyment at or after such death, the transfer becomes taxable. Any transfer made within two years of death, except if by sale for a fair price in money or money's worth shall be considered to have been made in contemplation of death unless proven otherwise and the tax applies. However, with the contemplation of death rule, it is necessary for the state to make a reasonable showing that contemplation was involved before the state inheritance tax would be upheld by the courts.

5. In all cases, except between spouses, where property is conveyed reserving a life estate, such property will be taxable for the state inheritance tax at the time the beneficiary comes into complete possession of the property, which is upon the death of the surviving party holding the life estate. Property conveyed by a deed in escrow is also subject to the state inheritance tax upon the death of the grantor.

EXEMPTIONS

Persons taxed by the Michigan inheritance laws fall into three classes:

Class I beneficiary includes: Husband or wife and has a $30,000 exemption.

Class II beneficiary includes: Grandfather or grandmother; father or mother; child; any lineal descendants (grandchild or great grandchild); brother or sister full or half-blood; wife of son or husband of daughter despite remarriage; legally adopted children or children to whom the deceased acted in the relation of a parent, provided this responsibility was assumed before the child's seventeenth birthday and continued until such parent's death. Transfer of property up to $5,000 to any one in Class II is exempt from inheritance tax. If no property is left to a minor child or minor children, their exemption of $5,000 each will also go to their mother, provided she is the surviving spouse. If the husband is the surviving spouse, he receives only the $30,000 exemption despite disinheritance of surviving child or children.

Class III beneficiaries includes all other persons, corporations, and associations and they pay taxes on receipt of property valued at $100 or over, at the rate of 10 percent on the first $50,000, 12 percent on the next $450,000 and 15 percent on the balance, if any.

Where the estate inherited by an heir consists of both real and personal property, the amounts of such property carrying the different tax rates is determined according to the proportion of each to the total inheritance. For example, in an estate of $40,000 with $30,000 in real estate and $10,000 in personal, 75 percent of the authorized exemption will be deducted from the value of the real estate and 25 percent from the personal property. Likewise 75 percent of the taxable inheritance will carry the real estate tax rate and 25 percent will carry the personal tax rate.

Table 2 — Rate of the Michigan inheritance tax on different sizes of estates left to persons in Classes I and II as of 1970

Value of the estate	Rate of tax on personal property (percent)	Rate of tax on real estate (b) (percent)
$ 0 to 49,999 (a) .	2	1½
50,000 to 249,999 ...	4	3
250,000 to 499,999 ...	5	3¾
500,000 to 749,999 ...	6	4½
750,000 and over	8	6

(a) If there are exemptions, they are subtracted from the first $50,000 and the 2 and the 1.5 percent rates apply to the difference between the exemption and the first $50,000.

(b) Real estate is taxed at 75 percent of the rate on personal property.

Federal Estate Tax

The federal estate tax is a tax levied at death on all the property of a decedent whether real or personal, tangible or intangible and wherever situated, except real property situated outside of the United States. The total value of the items is called the "gross estate." The tax is imposed upon the taxable estate (gross estate less allowable deductions and exemption) of a decedent and not upon the share received by a particular beneficiary.

Property Included in the Gross Estate — The major items included in the gross estate are as follows:

(1) all property in which the decedent, at death, owned a fractional or entire interest (except real property outside the United States);

(2) insurance on the life of the decedent payable to his estate;

(3) insurance on the life of the decedent payable to other beneficiaries if the decedent had any rights of ownership in the policy such as the power to borrow on the insurance or to change the name of the beneficiary;

(4) property "given away" by the decedent during his lifetime in which he kept a life estate for himself; for example, a deed given with the reservation of a life estate, or property "given away" by means of a deed-in-escrow to be delivered and recorded after his death;

(5) the full value of property owned in joint tenancy less any portion that did not originate, directly or indirectly, with the decedent;

(6) transfers by gift or by sale at less than full market value or its equivalent made within three years prior to the decedent's death, according to the federal law. Such transfers are presumed to be made in contemplation of death and hence are included in the taxable estate unless a system of annual gifts has been established. Such presumption, however, may be overcome with evidence to the contrary;

(7) included in a wife's estate would be property over which she had the power of appointment.

The procedure of determining the taxable value of the gross estate for the federal estate tax is essentially as follows: the administrator or executor of the estate has the duty and responsibility of providing the Federal Internal Revenue Service with a list of values of all property items, real and personal, of the decedent. The appraisal value of the decedent's estate as reported by the executor or the administrator is either accepted or rejected by the Internal Revenue Service as a basis for the tax. Usually an appraisal is accepted unless it is clearly out of line.

EXEMPTIONS AND DEDUCTIONS

Deductions — Deductions include the following:

(1) debts, funeral expenses, costs of administering the estate and losses from fire, storm and other casualty or theft during the settlement of the estate;

(2) the amount of money or property left to charitable, religious, and educational organizations;

(3) the amount of money or property passing without reservation to a surviving spouse, but this deduction cannot be more than 50 percent of the adjusted gross estate (gross estate less the deductions listed in item 1 above), even though more than one-half actually goes to the spouse. This is the "marital deduction" which permits a person to leave roughly half of his estate to his spouse free of tax.

Taking advantage of the marital deduction allowance as a deduction from the adjusted gross estate in determining the taxable estate does not, however, change the requirement for the filing of an estate tax return when the gross estate exceeds $60,000. The return is filed on Internal Revenue Service Form 706 and is due on or before 15 months from the date of the death of the decedent.

Exemption — If the adjusted gross estate (appraised value of the decedent's estate minus authorized deductions) is $60,000 or less, no federal tax is levied. This $60,000 exemption is sometimes called the "decedent's exemption." Thus, if a decedent had an adjusted gross estate of $120,000 and had left at least half of it outright to his wife, there would be no tax because the marital deduction would reduce the taxable estate to $60,000 and the estate exemption would offset that amount.

Computation of the Tax — The gross estate reduced by (a) the deductions and (b) the $60,000 estate exemption equals the taxable estate. See Table 3 for the tax rates on the taxable portion of the estate.

Assume for example, a gross estate of $150,000. If the deductions listed in items 1 and 2

Table 3 — Federal Estate Tax Rates, 1970*

Adjusted gross estate before the $60,000 exemption	Tax and rate, nothing left to the surviving spouse	Total exemption and marital deduction when one-half or more of estate is left to the surviving spouse
$ 60,000 or less	None	All
$ 60,000 - 65,000	3% on excess above $60,000 and up to $65,000	All
$ 65,000 - 70,000	$150 plus 7% on excess above $65,000 and up to $70,000	All
$ 70,000 - 80,000	$500 plus 11% on excess up to $80,000	All
$ 80,000 - 90,000	$1,600 plus 14% on excess up to $90,000	All
$ 90,000 - 100,000	$3,000 plus 18% on excess up to $100,000	All
$100,000 - 110,000	$4,800 plus 21.2% on excess up to $110,000	All
$110,000 - 120,000	$6,920 plus 24.2% on excess up to $120,000	All
$120,000 - 150,000	$9,340 plus 27.2% on excess up to $150,000	Exemption $120,000 and up to $135,000. Tax on the balance now starts at the 3% rate
$150,000 - 160,000	$17,500 plus 26.4% on excess up to $160,000	Exemption $135,000 and up to $140,000
$160,000 - 200,000	$20,140 plus 28.4% on excess up to $200,000	Exemption $140,000 and-up to $160,000
$200,000 - 300,000	$31,500 plus 27.6% on excess up to $300,000	Exemption $160,000 and up to $210,000

*Effect of the federal estate tax on different sizes of estates. Tax shown is the federal estate tax as reduced by the maximum credit for state inheritance or estate taxes, 1970. Decedent's exemption and marital deduction are also shown when one-half or more of the estate is left to the surviving spouse.

In taxable gross estate brackets above $100,000, a credit is authorized against the basic Federal Estate Tax for estate, inheritance, legacy, or succession taxes actually paid with respect to the estate of the decedent to any State or Territory or the District of Columbia. The federal credit for state taxes paid is limited to 80 percent of the tax as levied in 1926. This is commonly known as the "80 percent basic credit." The 1954 code changed this credit to a percentage of the gross federal tax paid. The computation works out to be the same as the "80 percent basic credit." If there is no indicated Michigan tax but there is a federal estate tax then a payment must be made to the State of Michigan in the amount allowable by the Federal government as a deduction.

under "deductions" on the previous page were $20,000, the adjusted gross estate would be $130,000. If 50 percent or more of the adjusted gross estate is left to the surviving spouse, the marital deduction and the estate exemption would be $125,000; that is the $60,000 exemption for the estate plus the deduction of ½ of $130,000, or $65,000, for property passing to the surviving spouse. The taxable estate would then be $5,000. The federal estate tax would thus be $150.

At the death of the surviving spouse, assuming the remaining taxable gross estate to still be about $130,000, there would be a federal estate tax on $70,000 ($130,000 less the $60,000 estate exemption) or about $12,060 according to the tax schedule shown in Table 3. Thus, it is at this "second stage" that the impact of the federal estate tax is of real importance and that tax planning when both spouses are alive is essential.

SOME ILLUSTRATIONS

Many persons have much if not all of their real estate in some form of joint-tenancy, usually tenancy-by-the-entirety. This arrangement is satisfactory from the standpoint of the federal estate tax on modest sizes of estates; for example, under $70,000. However, when the estate is over $70,000, parents should give serious thought to some other plan which would provide the flexibility in estate management needed to minimize federal estate taxes.

The disadvantage of having all or most all of your property in joint tenancy with the right of survivorship or by tenancy-by-the-entirety is clearly shown in the following illustrations. The plans are designed as an example to show how federal estate taxes may be minimized for a $200,000 estate. For purposes of illustration, the family is assumed to consist of the husband, wife, and three children. The parents' intention is for the remaining property eventually to go to the children. The figures in the illustration are for the basic federal estate tax less the authorized credit for the Michigan inheritance tax. See Table 3.

PLAN 1

All Property ($200,000) Held in Tenancy-by-the-Entirety.

At husband's death (assume husband dies first)
Widow, as surviving tenant, receives all by right of survivorship
Estate exemption, $60,000, no tax
Marital deduction, $100,000, no tax
Balance, $40,000, subject to federal estate tax of .... $ 4,800

At widow's death, assuming she still has $195,200 ($200,000-$4,800)
Estate exemption, $60,000, no tax
Balance, $135,200 subject to federal estate tax 30,137*
Total federal estate tax, Plan 1 ......$34,937*

PLAN 2

Husband Owns All Property ($200,000) In Own Name or One-Half is Held in Tenancy-by-the-Entirety.

In this plan, the husband uses the "life-estate-remainder" tax saving device. At husband's death, one-half the property is to go outright to the widow, either by will or by the right of survivorship, to qualify for the marital deduction. The other one-half is conveyed by will to the children with reservation of a life estate to the widow.

At husband's death (assume husband dies first)
Estate exemption, $60,000, no tax
Marital deduction, $100,000, no tax
Balance, $40,000, subject to federal estate tax of .... $ 4,800

At widow's death assuming she still has the $100,000
Estate exemption, $60,000, no tax
Balance, $40,000, subject to federal estate tax of 4,800
Total federal estate tax, Plan 2 ......$ 9,600
Remainder, or the other ½ descended to children under husband's will.
Federal estate tax paid on death of husband.

Summary: Federal estate tax, Plan 1 ..$34,937*
Federal estate tax, Plan 2 ..$ 9,600*
Saving on a $200,000 estate $25,337*

*Computations are made from rates and amounts shown in Table 3.

Appendix

Michigan Laws of Descent and Distribution

Where there is no effective will
and for property not held in joint tenancy

USUAL SITUATIONS

1. **Unmarried Person: Man, Woman, Widower, Widow — No Children**
   a) If parents survive: All to father and mother or survivor
   b) No parents surviving: All to brothers and sisters divided equally, and children of deceased brothers and sisters, by right of representation
   c) No parents or brothers or sisters: All to next of kin of equal degree divided equally
   d) No kin: All to the state (escheat)
2. **Married Man or Woman With Child, Children or Descendants**

   Real Estate —
   a) Wife or husband, 1/3 subject to wife's right to take dower and homestead instead.
   b) Child, 2/3; or children, 2/3 divided equally. Grandchildren take their deceased parents' share.

   Other Property —
   a) Wife or husband 1/3
   b) Children 2/3 divided equally. If only one child, the child gets ½ and wife or husband ½. Grandchildren take their deceased parents' share.
   c) Widow is allowed all wearing apparel, ornaments, household furniture and $200 of other personal property. She is also entitled to one year rent free occupancy of husband's dwelling and reasonable subsistence for one year.
3. **Married Man Without Child, Children or Their Descendants**

   Real Estate —
   a) Wife, ½ subject to wife's right to take dower and homestead.
   b) Father and mother or survivor, ½

   Other Property —
   a) Wife $3,000 plus ½ the residue
   b) Father and mother or survivor, ½ the residue

If no parents survive, this share of both real and personal property goes to brothers and sisters, divided equally. Nieces and nephews take their deceased parents' share.

If no brothers or sisters, nieces, or nephews or parents, all property goes to surviving wife.

4. Married Woman Without Child, Children or Their Descendants

Real Estate —

a) Husband, ½
b) Father and mother or survivor, ½

Other property —

a) Husband, ½
b) Father and mother, or survivor, ½
If no parents survive, this share goes to brothers and sisters, divided equally. Nieces and nephews take their deceased parents' share.

If no parents, brothers, sisters, nieces or nephews, all property goes to surviving husband.

5. Widow or Widower With Child, Children or Descendants

All property, real and personal, to children divided equally. Grandchildren take their deceased parents' share.

WIDOW'S SPECIAL RIGHTS

Dower: By dower is meant the right of a widow under common law to a use for life one-third of the lands beneficially owned by her deceased husband during the marriage.

Homestead: Under the Constitution and related Michigan laws, an area of land legally defined as a homestead, when owned and occupied by a Michigan resident, may be exempt from any forced sale to satisfy his or her debts (except, as with dower, for any mortgage incurred in purchasing the property). A homestead in rural areas would consist of a dwelling and not more than 40 adjoining acres of farm land with an exempt property value of not more than $2,500.

This homestead exemption continues after the owner's death during the minority of any minor children, or during the life or until the remarriage of the widow, so long as the widow or minor children occupy the homestead.

Dower and homestead rights provide the widow with no more than a life estate and usually have relatively little sale value. Accordingly, it is ordinarily not to the widow's advantage to claim these rights in place of her share as an heir, unless the estate is nearly insolvent or the real estate is likely to be sold to pay debts and the expenses of administering the estate.

In addition to real estate owned by her husband on death, a widow may have dower and homestead rights in lands previously deeded away by him during their marriage without her signature or a later release of her interest.

Widow's Quarantine — In addition to her dower and homestead rights, the widow is entitled to remain in the dwelling house rent free for one year by virtue of what is commonly called "the widow's quarantine."

ORDER OF NEXT OF KIN

In the settlement of an intestate estate, that is, one with no effective will, one of the early decisions to be made is the determination of the legal heirs. In deciding on whether or not to make a will, a person should understand very clearly who will receive the property if no will is made.

If a deceased unmarried person leaves neither father, mother, brother, sister, nor child of a brother or sister, his estate descends to his next of kin. The next of kin is listed in the order in which the various relatives inherit in any usual situation.

Class 1. Grandparents
Class 2. Uncles and aunts
Class 3. Great-grandparents
Class 4. Grandnephews and nieces
Class 5. First cousins
Class 6. Grand uncles and aunts
Class 7. Great great-grandparents
Class 8. Children of grandnephews and nieces
Class 9. Children of first cousins
Class 10. Children of granduncles and aunts
Class 11. Great-granduncles and aunts

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