TEN ESTATE MANAGEMENT HINTS

Ralph E. Hepp
Extension Economist
Department of Agricultural Economics
Michigan State University

1. All property owners, regardless of age or size of estate, can benefit from having an estate plan. Due to the fact that a wife frequently is younger than her husband and will likely outlive him, as a widow she must assume the responsibility of settling the estate and making a good life for herself and the family. Therefore, your wife is more concerned about getting an estate plan than you. A man must plan, with his wife, for the distribution of the property and implementation of the plan. A sound estate plan should take into consideration the income and security needs for you and your wife during your lifetime and the financial demands on your estate immediately after death. The extensive period of family adjustment for the survivors including the income needs for the spouse and eventual equitable distribution of property to the children or other heirs should also be considered.

2. Develop personal and family objectives of what you and your spouse want done with the property and with the business. These will act as a guide to selecting among alternative estate transfer plans. Saving death taxes is only one of many objectives. Develop objectives to satisfy the needs of the survivors. Your spouse and children helped you accumulate the property. Therefore, develop a property transfer arrangement that is flexible so that the heirs have use of the property for their life's needs.

3. A will is an important document in an estate plan, but is only one of many documents possibly needed if you have a medium or large estate. A medium-sized estate is defined as 1/4 to 1/2 million dollars and a large estate is over 1/2 million dollars.) Consider the use of trusts, jointly held property, lifetime transfers through gifts or sale, business transfer agreements and other tools.

4. Jointly held property (tenancy by the entirety or joint tenancy with rights of survivorship) is an inexpensive and easy way to transfer property if the estate is small. It becomes an expensive transfer plan if a medium or large estate is transferred. For large estates, a combination of lifetime and death time transfers can benefit the heirs earlier in their career and save estate transfer costs.

5. If a family member will continue the business, transfer of business capital and development of management experiences and knowledge should be started early in the joint business venture. A process to transfer business ownership and control from one generation to another should be continued. Consider using a partnership or corporation business organization to aid the intra-family farm transfer process.

6. The federal estate and gift-tax reform has been structured to bring tax relief to small and medium-sized estates. For decedents dying in 1981 and thereafter, a married couple can transfer a $425,000 estate between them before a federal estate tax is paid. In the case of a widow, widower or single person a $175,000 estate can be transferred to heirs without a federal estate tax.

7. The federal estate and gift tax reform bill has removed some of the tax incentive for making lifetime gifts. However, there still are tax advantages in making gifts. The $3,000 ($6,000 jointly with your spouse) per donee gift tax

annual exclusion remains unchanged so that such annual gifts continue to escape gift and estate taxes. Making lifetime gifts still saves estate taxes, especially for gifts of appreciating property. The future capital appreciation accrues in the receiver's estate. Earnings from the gift property are income to the receiver and the gift taxes paid are removed from the donor's estate.

8. Planning becomes more important for the large estate for minimizing federal estate taxes. The federal estate and gift tax reform has limited the advantages of some common estate planning tools. Although the estate exemptions and deductions have been raised, the federal estate and gift tax rates have also been raised. Lifetime and death time transfers have been unified into a common rate schedule and unified credit (exemption equivalent). Generation-skipping transfers are now subject to an additional tax upon distribution of the trust assets to the generation-skipping heir or termination of an intervening interest. The income tax cost basis (basis is purchase price plus improvements minus depreciation on improvements) on appreciated property inherited by an heir receives only a partial "stepped up" cost basis at the decedent's death. The income tax cost basis for property held by the decedent will be carried over to the heir. A sale by the estate heir would be gain, to the extent the selling price exceeds the decedent's basis before death, adjusted for the fair market value of the property on December 31, 1976.

Federal estate taxes for large estates can only be minimized by having a larger share of the property escape the tax (gifts before death) or reducing the number of times the property can be taxed (transfer property to younger family members).

9. If certain conditions are met, the executor of farm and closely held business estates may elect to value real property. This is devoted to farming or the business, on the basis of such property's value rather than its fair market value determined on the basis of its highest and best use. If a farm qualifies for this special valuation, its value is determined by this formula: divide the average annual gross cash rental for similar land in the locality, minus the average annual state and local real estate taxes for such comparable land, by the average annual effective interest rate for all new Federal Land Bank loans. For example, a farm will be valued at $800 per acre if cash rents are $70, property taxes $6, and the Federal Land Bank loan rate 8 percent ($70 - 6 = $64 ÷ .08 = $800 per acre). For purposes of this rule, the computation is to be made on the basis of the five most recent calendar years ending before the date of the decedent's death.

If the special evaluation method is used to value farms and if within 15 years after the death of the decedent, the property is sold or ceases to be used for farming, any tax benefits obtained by virtue of the reduced valuation are recaptured. Full recapture is provided for the first 10 years with a phase in of the amount subject to recapture during the remaining 5 years. If the qualified heir dies without having disposed of the property or converting it to a non-qualified use or a period of 15 years from the decedent's death lapses, the potential liability for recapture ceases.

10. Utilize professional counsel in developing an estate plan. Do not expect or allow professionals to determine your estate planning objectives or estate transfer alternative. You need to understand the implications for your family and business situation of suggested transfer plans, and decide which alternative estate plan best satisfied your objective.