PLANNING YOUR estate

JOSEPH G. DUNCAN, FREDERICK W. WHITESIDE, JR., and HELEN M. STEVENS

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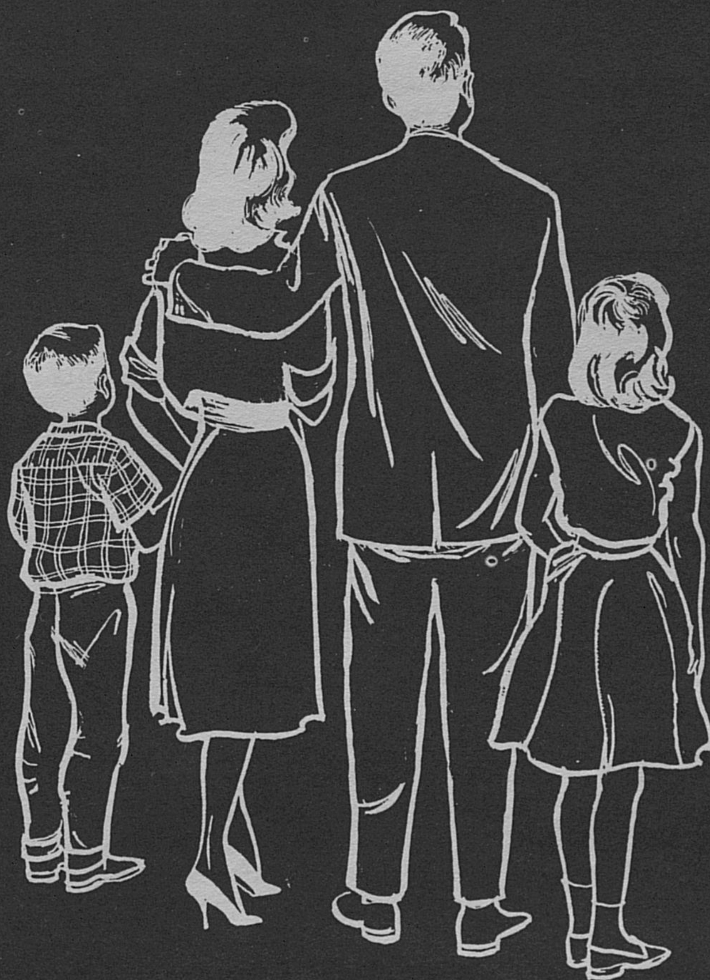

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Planning Your Estate

By JOSEPH G. DUNCAN,* FREDERICK W. WHITESIDE, JR.,**, and HELEN M. STEVENS***

Successful Kentucky farmers carefully plan their operations to maximize the return from their investment of land, capital and management to insure a good living for themselves and their families. A similar situation applies to business and professional persons—and, for that matter, to all of us, even though we may be using means different from those of the farm operator.

The planning that goes along with the acquisition and enjoyment of our property needs to be carried a step further to take into consideration the inevitable processes of aging and death—things which most of us push into the background of our daily lives, to be recalled only at intervals and then without enthusiasm.

What will happen to our property when we are gone is a matter of great importance to us all regardless of our occupation. For want of a better term, the process of the creation and use of our property and of arranging for its transfer to those persons or other beneficiaries whom we wish to succeed to it, with the least possible loss of assets, is known as estate planning.

Purpose of this publication is to emphasize the need we all have for the planning of our estates and to point out in a general way some of the means or ways by which this can be done. It is not our intention to qualify you to plan your estate without professional guidance and counsel. However, having some information on various phases of property holding and estate planning should enable you to make better use of the time spent with your attorney and other professional persons whose counsel may be required.

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PURPOSES AND GOALS OF ESTATE PLANNING

Estate planning usually involves more than the mere disposal of property after the death of the owner. If that were our only purpose, it could be effected by the terms of a relatively simple will, or by doing nothing thus allowing the disposal to be governed by the Kentucky statutes on property descent and distribution. Either course, however, in many instances would result in unnecessary financial hardship to our remaining spouse and heirs-at-law and would not be in accord with our intent or wishes.

Estate planning to be most effective should involve both the husband and wife and, as will be discussed later, the children and other persons concerned. The objectives, of course, will differ among families because of varying circumstances such as differences in assets, number of children, value judgments, and personal desires. The following purposes may be considered although they would not all apply to all estates:

1. To promote the financial security of you and your family during your working and retirement years.

A properly executed estate plan should help you arrange your financial affairs to provide an adequate income for you, your wife (or husband), and your family during your working years; for you and your wife when you retire; and, finally, for the ultimate transfer of your property to your heirs or other intended recipients. To achieve this may involve some changes in your current money management, some changes in your current farm program or your investment program, and possibly some changes in your life insurance setup, to be discussed later.

2. To minimize federal estate taxes, state inheritance taxes, and probate and settlement costs.

An estate plan will provide the means for reducing a possible large loss of assets in your estate through an unnecessarily high federal estate tax. This tax is levied by the federal government on the estate itself before your heirs receive their portions. Because of size, however, not all estates must pay a federal estate tax. On the other hand, in this era of inflation and rising property values, more and more property owners, without their being aware, have accumulated sufficient assets that, unless proper planning is done, their estates will be subject to this tax. Planning, if done in

sufficient time, may also help reduce the Kentucky inheritance tax paid by your heirs on what they may receive from you. (See pages 19-26 for a more complete discussion of taxes involved in estate settlement.)

3. To insure equitable treatment of your children.

Planning will enable you to treat all of your children equitably but not necessarily equally. Some may have already received special gifts from you, such as money for their college education or for investing in some enterprise such as a farm or a business. Thus, you may wish to compensate the other children who have not yet received any substantial funds from you. Also, you may wish to compensate one or more who have made or who may now be making special personal contributions to you and your spouse. We are all familiar with the case of the son or the daughter who never left home and who later bore the principal responsibility of caring for the parents in their declining years. Yet, because of a lack of testamentary provision (will) by the parents, when the parents died all the children shared equally in the estate with no compensation for the one or ones who did the most for the parents. Suitable planning would have prevented such an occurrence and might have prevented later bitterness or ill feeling among some of the heirs.

4. To anticipate and satisfy the need for cash in settling your estate.

Settlement of an estate always involves some costs. These include payment of the debts incurred by and for the person who has died, his unpaid federal and state income taxes and local property taxes as of the time of death, and administration or probate expenses such as fees for attorney, executor or administrator, and for court costs. Perhaps the estate will be subjected to the federal estate tax. Many times the immediate financial drain after a death may be most severe. Unless steps have been taken to provide available cash, the proceeds from a life insurance policy, or some other assets that can be readily converted into cash, it may be necessary for the executor or administrator to borrow the necessary funds, thus adding still further to the cost of settling the estate. In the case of a farmer's estate, it might even be necessary to sell some of the land or other assets which should have been kept intact. A similar situation might arise in the case of a businessman's estate.

5. To inform your heirs about your plans.

Although it is highly desirable for all of your heirs to have some idea as to what your estate plan contains, it is especially important for those who will be operating the family farm. Knowing about your plan will help them in making their own plans; accordingly, any future transfer of property can be done more smoothly, and many problems attending change of ownership can be avoided. Understandably, we often are reluctant to discuss money matters with our children and others who may be our heirs. We may still consider them as we did when they were growing up and depending on us for many of their decisions. But when a man or woman, for instance, is 25-30 years old or even older, that person is certainly no longer in the category of a dependent child. The children themselves probably are also reluctant to raise the matter of what you may have in mind for them. It's a morbid subject, they may feel, and they do not wish you to gain the impression that they are anxious for their portion of your estate. Nevertheless, if the desires and goals of both you and your children are to be fulfilled, you cannot postpone indefinitely a discussion of mutual financial matters.

6. To aid in transfer of the family farm.

The Kentucky farm family has a special need for estate planning. Here there is the problem of equitable treatment of the surviving spouse and the children in case it is decided to keep the farm in the family and ultimately to transfer ownership to one or more of the children who would be best suited to take over for its operation. Lack of planning or faulty farm transfer plans not only can cause ill-feeling among the heirs but can result in financial hardship for the surviving spouse (usually the wife) and also for the heir who takes over as owner. If he has been forced to purchase the interests of the other heirs with no extension of time and, thus, has depleted his capital, he may be deeply in debt and be greatly handicapped in operating the farm properly (see pages 26-30).

STEPS IN ESTATE PLANNING

With the exception of very small estates–and in most instances it is not wise to generalize–an estate plan must of necessity be tailored carefully to fit a particular situation. A plan suitable for

your neighbor probably would not be the best for you, any more than if you were to take medicine that had been prescribed for another person, even though your symptoms were similar.

Having decided that you should have an estate plan, you will need to make some preliminary decisions and take steps to implement your plan. As already mentioned, reading this publication is not intended to make you sufficiently expert to prepare your estate plan alone. To do so would require long study of the many details of several complex subjects and procedures. Your requirements will likely be best served by a team of professional persons whose interests encompass the areas represented in your particular situation.

CHOOSING YOUR PROFESSIONAL AIDES

You will need the counsel and services of at least your lawyer. He should be one with an interest and competency in estate planning in all aspects. As your plan progresses and as your situation becomes more clear, you and he may find it desirable to include other professional persons, such as your life insurance representative, your banker or trust officer, your securities broker, and possibly your accountant if you have been using one in your business or to prepare your income tax returns.

One good reason for including a life insurance man is that almost all estates have life insurance or annuities as a part of their assets, or there may be need for a life insurance program. Also, for many years life insurance companies have conducted intensive programs on ways to help their representatives serve their clients' financial needs.

The services of your banker and broker may be required in several ways. One might be to advise in regard to better use of your current income or to propose changes in investments as a part of your program to build your estate and to provide for financial security for you and your family.

INFORMATION YOU AND YOUR LAWYER WILL NEED

Before your lawyer can be of service in counseling with you about your estate plan, you will need to assemble some basic information for him about you and your wife (or husband), and your property. (See pages 8-11 for more details.) Having this

information, he can familiarize himself with (a) your present situation, such as your assets and liabilities, (b) the names of your heirs and others whom you may wish to benefit, and (c) your desires or what you seek to accomplish by your plan.

A. YOUR PROPERTY AND YOUR PRESENT FINANCIAL SITUATION

The information pertaining to your financial situation (and also that of your wife) includes (a) the property that you own outright and also that in which you have an interest; (b) your present income from all sources; and (c) anticipated income. Because of its importance, this information should be in writing and in a systematic form. It should be as complete and accurate as possible. It's possible that your lawyer may give you a printed form or checklist on which to record the information.

Very few of us have a policy of periodically reviewing our financial situation, such as calculating our net worth at the beginning of each year. One of the benefits that you will derive from assembling this information is that you will learn considerable about your financial picture which will be well worth your time and effort in compiling it, even if you do not proceed further.

Basically, property is anything that you own. There are two kinds: **real property** (also known as realty or real estate) and **personal property**. The two classes of personal property are **tangibles** (such as household goods, livestock, automobiles) and **intangibles** (such as bonds, common stock shares, life insurance policies, bank accounts). These, of course, are only approximate time-honored classifications, still useful for most purposes.

The general types of ownership in real property are **fee simple, life estate** and various interests in remainder. In the first, the person designated has the exclusive use, essentially, and the sole right to dispose of the realty by deed or other instrument of transfer. A life estate entitles a person to the use and benefits of the realty only for his lifetime. He is known as the **life tenant,** and he cannot dispose of the realty. His rights cease upon his death. Those to whom the property then passes are the **remaindermen.**

Co-ownership or joint ownership means that two or more persons own the same property at the same time. (More information on this type of ownership appears on pages 16-17.)

When you compile the list of your assets, indicate how the title of each is held. (Whether in your name alone or jointly owned with your wife, husband, or someone else.) In the case of assets for which you are still making payment, such as your farm, home, automobile, etc., state the mortgage terms or current payment plan.

The following checklist of some of the more common assets of an estate may help you in compiling your list. (Give the information for **both** you and your wife.):

1. Cash assets: checking accounts, savings accounts, savings and loan accounts (give location and average balance).
2. Real estate: type (home, farm, city lots), location, when purchased, cost, present market value (estimated).
3. If employed, what your retirement plan is: Social Security, profit-sharing, any other plan. What does it provide? What is your current equity in the plan?
4. Business assets: name, location, nature of ownership (whether you are the sole owner or a partner) cost, present value (estimated).
5. Livestock and farm chattels: kind, location, cost, present value.
6. Corporation stocks, bonds and other securities: name of company, type, and number of shares, when purchased, cost, present value.
7. Federal bonds (such as E-Bonds) and municipal bonds: name of agency, type and number, when purchased, cost, present value, and where kept.
8. Life insurance and annuity policies: name of company, type of policy, face amount, current cash value, date of maturity, beneficiary provisions, any loans or assignments on policies.
9. Mortgages, notes and accounts receivable: names of mortgages or debtors, amounts, when due.
10. Trusts in which you have an interest and any possible inheritance which you are likely to receive.
11. Miscellaneous assets: automobile, jewelry, antiques, personal property not already included.

Also, you will need to compile a list of all debts you owe and payments for which you are obligated, such as:

(1) Mortgages payable: farm, home, automobile. Give original amounts and the present balance, terms or payment plan, name of creditor.

(2) Notes and accounts payable: name of creditor, amount, present balance, payment plan.

(3) Obligations incurred by a former marriage, such as alimony, property settlement, duty to maintain life insurance, child support payment.

(4) Other liabilities such as unpaid taxes, unpaid judgments.

Also, you will need to furnish your attorney with a copy of your current will if you have one; he will also need to have a copy of your wife's current will.

B. PERSONAL AND HEIRSHIP INFORMATION

Under this heading include information about **yourself**; your birth date, birth certificate (where kept), birthplace, social security number, place of employment if not self-employed. Give the same type of information about **your wife.**

Also include facts on your marital status: when and where married; list any previous marriages and state when and how each terminated.

List your heirs and other intended beneficiaries, the names and ages of your children, including adopted children; if any of your children are dead, list the names of their children; names of your parents if living; names of your brothers and sisters if living; names of the children of any deceased brothers and sisters.

C. WHAT YOU SEEK TO ACCOMPLISH WITH YOUR ESTATE PLAN

As previously mentioned, estate planning includes the arrangement of your affairs to provide a satisfactory living for you and your family during your working and retirement years and for your survivor(s) after your death. What you seek to accomplish with your plan should represent the desires of you and your wife in harmony with the goals of your children.

For instance, it is possible that you have accumulated sufficient assets that you may wish to start disposing of some of them in the form of gifts while you are living. One purpose might be to avert

future death taxes* on a portion of your estate; or you might wish to aid one or more of your children in some project, such as the beginning of an ownership interest in your farm; or you might wish to make gifts to some charity or institution. If you make gifts during your lifetime you can observe and evaluate the ability of the recipients to handle money. This might influence your decision on how you may desire to provide for them in your will.

Some of your other purposes have likely already been mentioned in the previous section, "Purposes and Goals of Estate Planning," pp. 4-7, and need not be repeated here. Obviously, the purposes that you desire for your plan will be influenced greatly by the present net worth of your estate and what its potential worth may be between now and some future time, such as at the time of your death.

As a part of what you seek to accomplish by your estate plan, you will need to list your intentions regarding the disposal of the items in your estate. You will need to list the names of those persons or institutions (e.g., your church)** whom you wish to remember. This might include specific amounts of money or certain properties such as your business or farm or city property; or these bequests might be in the form of percentages of your net estates. You may wish to designate the recipients of such items as your jewelry, silverware, books, and other personal things; also, to whom the residue of your estate is to go (the remaining portion of your estate after debts, expenses, taxes and specific bequests have been taken care of).

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*"Death taxes" refers to all taxes that may be levied against an estate or its recipients following death of the property owner. Included are the federal estate tax and the Kentucky inheritance tax. Also there may conceivably be unpaid gift tax still owing at death. (Not included are federal and state income taxes that may be due on income received or earned by the decedent up to the date of his death in the current tax year.)

**In the case of an institution or a charitable organization, give the formal or complete name and address to avoid possible confusion with some other organization having a similar name.

EVALUATION OF YOUR SITUATION AND RECOMMENDATIONS

After you have presented the facts about you and your wife and your estate and have indicated what you wish to accomplish, your lawyer is in position to counsel with you regarding some of the means to be used. He can also tell you some of the likely consequences as to what can happen if you take no further action.

Based on present federal and state inheritance laws and the information you have supplied, he can estimate the approximate current cost of settling your estate, including the federal estate tax if applicable.

Several things may become apparent as the evaluation of your situation continues, for instance:

1. Some investment changes or management decisions may be indicated, either to enhance the accumulation of assets, or to preserve the assets in the case of an estate already established, or to lay the foundations for an estate of a younger individual who needs assets. Thus, you may need also the consultation and services of your life insurance representative and your banker or securities broker. If you are a farmer, you may need the services available from your county Extension office, particularly in respect to farm management practices.

2. It may be desirable for you to call on your life insurance representative for counsel also on what to do with some of your policies regarding alternatives available to your beneficiaries. In addition, the estimate of the cost of your estate settlement may reveal that your estate will likely need more cash available. This could be accomplished by having more life insurance or by changing the method of payout on a policy you already have. When buying life insurance or providing for readily available cash to insure estate liquidity, one needs to keep in mind the problems resulting from inflation. Inflation increases the value of estate assets over a period of years, and thus increases administration expenses and death taxes.

3. You and your wife (or husband) both need wills. Or, if you already have wills executed several years ago they may need to be updated to reflect all the subsequent changes in your personal and financial situation or in applicable property or tax legislation. Also, your wills may not be drawn to take advantage of certain

tax-saving features, such as the marital deduction. Thus, new wills may need to be prepared. (“Marital deduction,” a rather complex concept, is explained on pages 21-23.)

4. As for the way certain items of your property are now owned, your lawyer may suggest the desirability of making changes. For example, in one instance, he may counsel that you dissolve a joint ownership; in another instance, and under different circumstances, he may suggest that you create one. The reasoning behind such recommendations may be based on the size of your estate or some other factor apparent to one trained in property law.

The foregoing items are typical of some of the matters that may be discussed during your estate planning process.

To help you understand better some of the more common legal terms and the many problems associated with estate planning and to enable you to work more effectively with your “planning team,” we include in the sections which follow:

1. Means or tools used in estate planning;
2. Taxes involved in estate planning and settlement; and
3. Planning farm property or small business transfers.

MEANS OR TOOLS USED IN ESTATE PLANNING

With the information you gave your lawyer about yourself and your wife (or husband) he will be able to help you evaluate your situation and to make some recommendations on how to carry out your desires. In helping you prepare your estate plan, your lawyer and your other consultants will likely make use of several means or “tools.” The selection of the particular ones, of course, will be made on the basis of your situation and the goals or purposes that you have indicated.

Much of what is included here might well be labeled “How ownership is transferred,” for consideration of methods of transfer is a concern in much of estate planning. However, as previously stated, some of our efforts may need to be directed also towards the creation or building of an estate in order to have anything to enjoy and, ultimately, to pass on to our heirs or other beneficiaries.

Following are some of the more common means or “tools” used in estate planning:

WILLS

Virtually all comprehensive estate plans have as their cornerstone a will. The importance of a correctly planned and executed will, thus, cannot be overemphasized.

It may be the only instrument in a person's estate plan or it may be one of several. If a person retains the complete ownership of all of his assets, or makes no arrangements during his lifetime, such as establishing a joint ownership with right of survivorship or setting up a lifetime (inter vivos) trust or making other arrangements to keep some of his assets out of probate, then his will is essentially his estate plan. However, even though he does make such arrangements as mentioned, he will still need a will to provide for the disposal of many other items that he may own at death. Under such conditions, his will may not be of great significance but it is necessary.

The most important feature of a will is that the maker can direct the distribution of his property in the manner he most prefers. Also, if there are minor children, the parents, by their wills, may state their preference as to the custodian or guardian to be appointed by the court should either or both parents die.* By its provisions, the maker of a will not only can simplify administration of his estate but also can help preserve the value of his estate that is passed on to his beneficiaries.

(For more information regarding wills, you are directed to Kentucky Extension Circular 538-E, "Property Rights in Kentucky: How Property is Owned and How It Descends By Law or Will.")

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*In the absence of a valid will the disposal of the estate is in accordance with the Kentucky statutes on descent and distribution. When a husband or wife dies, the surviving spouse shall have an absolute estate in one-half of the surplus real estate and personal property left by the deceased person (that is, the assets remaining after the funeral expenses, charges of administration, taxes and debts have been paid). Personal property or money on hand or in the bank to the amount of $1,500 can be set aside for the use of the widow and minor children or to the orphan children until the estate can be settled or provision made to support the family. The remaining half of the real estate and personal property then descends in the following manner:

To his (or her) children and their descendants. If none,

Then, to his (or her) father and mother, equal part to each, if both are living, or all to the one living. If none,

Then, to his (or her) brothers and sisters and their descendents.

(For more information on disposal of estates not provided by will, see Kentucky Extension Circular 538-E.)

LIFE INSURANCE AND ANNUITIES

Previously mentioned was the role of life insurance in aiding estate liquidity by helping provide a source of readily available cash for paying debts and death taxes when an estate is being settled. Also, as will be explained in a later section (page 18) life insurance is sometimes used to establish a trust.

Aside from their life insurance, many individuals have no sizable asset in their estate. In such instances family protection is uppermost. A young, reasonably healthy person may be well advised by his counselors to consider increasing his coverage while his premium cost is relatively low. A short term or a family plan might also be considered.

After family protection and the provision of a sum sufficient for payment of last sickness and funeral expenses, we usually think of life insurance as one means of providing some retirement income. There are many variations among the policies offered, each of which is designed to accomplish one or more goals of the purchaser. Some may be combined with an annuity, which is a contract with a life insurance company providing for a fixed amount of money to be paid at stated intervals to a person during his lifetime.

An annuity is considered one of the safest ways for one to assure himself of income after retirement or for life. In addition, because both principal and interest are received by the annuitant (the person who receives the annuity payment), the return is higher than that from any other form of safe investment.

The two general types of annuities are the **immediate** and the **deferred** which differ in respect to the time when payments begin. As indicated, an immediate annuity starts paying when purchased and the other starts at some future time as stated in the contract or policy. Among the options available is that of continuing payments to the surviving spouse after the death of the annuitant.

In estate planning one must recognize that, like life insurance and other fixed-dollar-amount payments, an annuity of the regular type provides no hedge against inflation. In recent years, however, the variable annuity is being offered by several companies in Kentucky. In general terms, the amount of the payments made to the annuitant is based on the fluctuating value of common stocks and other assets in the investment portfolio of the insurance

company. Thus, the amount of the payments is intended to reflect changing economic conditions.

Sometimes in estate planning a so-called private annuity may be used. It usually consists of the transfer of property such as a farm by an older member of the family to a younger one in exchange for an annuity to be financed or paid for by the latter. Because of possible tax involvement on the part of the older person and for other reasons, an annuity of this type should be set up only after careful study with legal counsel.

A thorough consideration of the insurance and annuity assets of your estate will require the services of your insurance representative. Selecting the type of life insurance best suited for your situation, choosing the settlement options, coordinating your life insurance and any annuity with social security benefits are all important matters for you and him to discuss.

OUTRIGHT GIFTS

If you are in position to do so, one way of reducing death taxes and estate settlement costs is by the regular making of gifts to your beneficiaries. For economic and other reasons many persons hesitate to make such gifts during their younger years. And in many cases one may need to retain all his property to provide income for himself in later years.

If you have a sizable estate, however, during your discussion with your lawyer he may mention the possibility of your making annual gifts to your heirs as a means of saving taxes later. And, of course, there might be personal reasons for so doing; for instance, such gifts might be very useful for one or more of your adult children in furthering their own estate planning.

ESTABLISHING JOINT OR CO-OWNERSHIP ARRANGEMENTS

As previously mentioned, after studying the facts pertaining to your situation your lawyer may advise that some of your property now held in joint or co-ownership should be changed **to single** ownership. Or, in your particular situation, he may advise that **joint** ownership of certain things would be desirable. The desirable type of ownership would likely depend upon the size of your estate.

In Kentucky joint ownership usually takes one of two forms: **tenancy in common** or **joint tenancy with right of survivorship.** In

the first, each person owns a certain undivided interest in the property such as a farm, for example. The shares need not be equal nor need the owners be related. Each owner may dispose of his share by sale or by will without the consent of the others. Upon his death, in the absence of a will his share goes or descends to his heirs-at-law. In joint tenancy with right of survivorship, however, if one of the joint owners dies the remaining owner (or owners) gains title to the whole property. Neither joint owner can dispose of his interest by will.

One of the more common examples of joint ownership of personal property is a bank or a savings and loan account held in joint tenancy with right of survivorship by a husband and wife. Here again, it must be emphasized, neither co-owner can dispose of his interest by will.

Joint tenancy with right of survivorship has been a popular way of owning many kinds of property, particularly the home, and it may simplify the administration of some small estates. Such an arrangement should be made or continued, however, only after the advantages and disadvantages are carefully considered in consultation with your attorney.

TRUSTS

Trusts are being increasingly used in estate planning. A trust is an arrangement in which the legal title, control and management of property is transferred to a person or a corporation, such as a trust company, to be administered for the benefit of certain beneficiaries designated in a will or trust agreement. The person or corporation in charge of the trust is known as the trustee.

The two major types of trusts are (a) the **living** (or inter vivos) and (b) the **testamentary**. In the first type the property is transferred during the creator's lifetime, and he himself may enjoy the benefits if that is his wish. Such a trust may be designed to continue after the death of the creator, at which time other provisions become operative. A testamentary trust is created by a will, and its provisions are stated in the will. This type of trust becomes effective only after death of the creator and after his will is admitted to probate.

A living trust may be either **revocable**, which means that the creator may change the terms or revoke the trust entirely as he

desires; or **irrevocable,** which is a **permanent** arrangement. The irrevocable trust is sometimes used as a tax-saving device in estate planning but, regardless of reason for using it, it is a type of trust that a person should establish only after careful study and due consideration of possible unforeseen and undesirable consequences.

The chief usefulness of a trust is its flexibility in carrying out the wishes of its creator in meeting the requirements of various personal and family situations.

A trust is often established when the beneficiary is (a) a minor, or (b) an adult incapable by temperament or otherwise to manage property in a prudent manner, or (c) an adult incapacitated by age or disease. Also in some instances, a person who creates a trust does so to be relieved of management problems and to be assured that his affairs would be in capable hands if he were to have unexpected illness or a serious accident.

For obvious reasons, rather broad powers are usually given the trustee in respect to administrative and investment policies. This is done because of the likelihood of changing circumstances during the time the trust is in operation and to enable the trustee to be of the utmost service to the beneficiary (or beneficiaries) in faithfully carrying out the wishes of the creator. For example, one of the powers granted the trustee might include that of making payment to the creator or a beneficiary who had become incapacitated by illness or age. Another power given the trustee might be to draw upon some of the principal of the trust if the income from the trust became insufficient to meet the needs of the beneficiary. These powers and others might be incorporated in a trust agreement as your lawyer or your trust officer might suggest or deem desirable in your particular case.

Financing a trust is from the assets of the estate, such as a farm or other realty (to be discussed in "Farm Transfer Plans," pages 26-30), or from stocks, bonds, savings account, or life insurance proceeds. Life insurance is often used when sufficient other assets are lacking to establish a trust. In such case the trustee may be given discretion to invest the proceeds from one or more life insurance policies and to distribute the income–and the principal if so directed–to the beneficiary in accordance with the creator's wishes.

Unless an estate has at least $35,000-50,000 to be put into a trust, a trust arrangement probably would not be practical because there would likely be insufficient income after management fees were paid.

TAXES INVOLVED IN ESTATE PLANNING AND ESTATE SETTLEMENT

In this era of rising property valuations and high tax rates, the matter of taxes is of great importance in estate planning. We need to be aware of the federal and state taxes on estates and their corrosive effect on the assets we seek to transfer to our beneficiaries, both during our lifetime and after death.

On the basis of information which you supply your attorney, as suggested previously, he should be able to estimate the approximate cost of settling your current estate. Much of the expense which shrinks the value of the assets received by your beneficiaries comes from the so-called death taxes levied on your estate. Kentucky estates must face the possibility of both the federal estate tax and the Kentucky inheritance tax. In addition, you and your tax advisor must be aware of a gift tax levied by the federal government during one's lifetime on certain property transfers by gift. Estate planning summaries and other publications (including advertising leaflets) contain dramatic illustrations of savings possible in respect to death taxes and gift taxes. However, overall planning should steer away from mere tax saving arrangements which may in reality shortchange your heirs by scuttling worthwhile objectives. Such planning may even result in steep increases in income tax liability far offsetting any estate tax saving.

FEDERAL ESTATE TAX

The federal estate tax is levied upon your taxable estate at your death after appropriate deductions for taxes and expenses but before any division is made to your individual heirs or beneficiaries. The figure representing your **taxable** estate is arrived at by subtracting allowable deductions and a $60,000 exemption from your **gross** (or total) estate.

For federal estate tax purposes the gross estate includes all property which you own at death, such as real estate, bank accounts and securities, and any other property in which you may

have an interest. To prevent avoidance of the tax, however, Congress found it necessary to include certain other property within the statutory concept of gross estate, even though this property was not technically owned at death and was not subject to Kentucky probate or administration. For example, there **may** be included in the estate for federal tax purposes:

(1) Property which you gave away during your lifetime under certain defined technical conditions as, for example, property which you gave away but over which you retained some sort of lifetime interest or control; also, gifts you made within 3 years of death, which may be subsequently ruled to have been made "in contemplation of death," a statutory concept involving technical legal considerations;

(2) The proceeds of life insurance policies under certain conditions even though the proceeds were payable to name beneficiaries and, thus, would not need to go through probate; and

(3) Property owned jointly with your wife (or husband) even though the property passed directly to her as your survivor by operation of law and could not have passed under your will. In some circumstances, this property would not be included provided the survivor could prove that she (or he) had furnished the purchase funds.

Because of the foregoing "hidden assets" which are made part of one's estate for tax purposes, many persons underestimate the size of their taxable estates.

To arrive at your **taxable estate**, there is subtracted from your **gross** estate:

(1) Your debts, funeral and burial expenses, costs of administering your estate such as court costs and compensation paid the executor (or administrator) and attorney, and all unpaid taxes including property taxes and federal and state income taxes owing up to the date of death*;

(2) Money or property left by you to qualifying educational, religious, or charitable organizations;

(3) A specific exemption of $60,000; and

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*If you customarily file on a calendar year basis, the current income taxes owed would be based on your net income from January 1 to the date of your death.

(4) Amounts passing from you by will or by the laws of intestate distribution to your wife under conditions qualifying for the **marital deduction** limited to 50 percent of your "adjusted gross estate." This term means roughly the gross estate minus the debts, costs and expenses (but before subtracting the charitable and similar gifts), and the $60,000 specific deduction.

THE MARITAL DEDUCTION

Having just mentioned this term, we feel it desirable to present some general information on the **marital deduction.** This concept, first contained in federal tax legislation in 1948, offers the possibility of substantial saving for those estates of a size that would make them subject to the federal estate tax.

The marital deduction permits you to leave a maximum of one-half of your **adjusted** gross estate to your wife (or husband) free of federal tax. The deduction is allowed for certain types of property which pass from you to your surviving spouse either outright or in trust under certain technical rules. These requirements, roughly speaking, are designed to allow the deduction only with regard to property which the survivor receives as her (or his) own and which therefore may be subjected at a later time to the federal estate tax when her (or his) estate is being settled.

This deduction is frequently lost entirely by do-it-yourself efforts of planners without adequate understanding of complicated statutory provisions, regulations, and current judicial decisions. It is important that your wills, trusts, and estate plans be periodically reviewed to make sure that all legal instruments are properly drafted to take advantage of the law. If there should be no will, the half which goes outright to the surviving spouse by intestate distribution would qualify for the marital deduction.

To illustrate, in a very general way, the federal estate tax saving accomplished by proper use of the marital deduction, assume that you leave a gross estate totaling $145,000, which incidentally is not considered a very large estate by today's standards. Also, assume that your allowable deductions total $15,500 (debts, $5,000; funeral and burial expenses, $1,500; estate administration expenses, $7,000; unpaid property and income taxes, $2,000) and that you made no provision for charitable gifts.

The following computations show the tax saving possible:

	Case No. 1: With Marital Deduction	Case No. 2: Without Marital Deduction*
Gross estate	$145,000.00	$145,000.00
Debts and expenses	-15,500.00	-15,500.00
Adjusted gross estate	129,500.00	129,500.00
Specific exemption	-60,000.00	-60,000.00
Marital deduction	-64,750.00	none
Taxable or net estate	$ 4,750.00	$ 69,500.00
Federal Estate Tax	$ 142.50	$ 11,160.00**

The computations compare a case (No. 1) taking full advantage of the marital deduction with one (Case No. 2) of complete failure to take any advantage of the marital deduction. If, on the other hand, all of the husband's property in Case No. 2 had been left outright to his wife, his estate would have had maximum advantage of the marital deduction. This is because property left outright to the wife qualifies for the deduction which would be allowed up to a maximum of 50% of his "adjusted gross estate." However, it is possible, unless the wife manages to spend or give away some of such property prior to her death, that needless estate taxes would be paid at her death because then the property would all be part of her estate and there would be no marital deduction (unless she remarried and left half or all the property to her new husband).

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*This case would have to be a somewhat unusual situation—for example, if the man's will leaves his spouse only a life estate or a lifetime interest in a trust which is included in his estate; in other words, none of the wife's property is taken by her outright or is subject to certain statutory provisions that would qualify part of it for the marital deduction. In such an instance, some of the tax loss in the husband's estate would usually be compensated for when the wife died, inasmuch as *none* of the property then would be taxable in her estate. Actually, depending on the amount of property which the wife owned independently of the husband, the foregoing arrangement might have been the best arrangement possible. In other words, consideration of the estates of both husband and wife is important in attempting to plan property dispositions for married couples, where the objective is to pass as much property as possible on to the children and grandchildren free of tax.

**This illustrates the necessity of anticipating the possible need for cash in settling your estate.

There are many individual situations where it is advantageous, without sacrificing general objectives, to make maximum use of the marital deduction because of the tax savings. On the other hand, there may be situations in which the arithmetic of the case requires that maximum use of the marital deduction **not** be taken because of the total tax picture, considering the estates of both husband and wife—and taking also into account that you never know which will die first.

Competent tax counsel should be engaged to consider carefully the impact in each individual case of all these taxes upon the amount of the estate which ultimately reaches the beneficiaries. Not only must estimates be made for the amounts of probable tax liability under each of the taxes, but there are complex problems which arise concerning the relationship between the lifetime gift tax (federal) and the death taxes (federal and state). Furthermore, possible future federal and state income taxes cannot be ignored. Unlike estate and gift taxes on property, income taxes recur year after year. Sad indeed is the author of a beautiful estate plan to reduce estate taxes who, because of ignoring the income tax, creates unnecessary liability to the property owner while living or to his estate or beneficiaries after his death because of these increased income taxes.

FEDERAL GIFT TAX

The federal gift tax is really a backstop for the estate tax. It was enacted after the estate tax had been in operation for a few years and officials discovered that the wealthiest persons were avoiding the impact of the high brackets of the estate tax by making gifts during lifetime so that the taxable estate at death would be greatly reduced.

The federal gift tax is levied upon certain transfers by gift which you may make during your lifetime over and above specified amounts. You are permitted to give away $3,000 each calendar year to each of as many persons as you may desire, and you will not be taxed nor will a gift tax return be required. In addition, you have a lifetime specific exemption of $30,000 over and above the annual exclusions provided you live 3 years after making the gift. (The matter of gifts made in contemplation of death was mentioned in the section on federal estate tax, page 20.)

Even though no tax would need to be paid, if you give more than $3,000 to any one individual in any one year you must file a gift tax return.

For example, if during any year you should give $5,000 to any one person, the $2,000 gift ($5,000 minus the $3,000 per donee exclusion) must be reported as a gift. In this case, whether you actually must pay any tax depends upon whether the $2,000 plus all gifts previously made during your lifetime bring the total amount in excess of the $30,000 lifetime exemption allowed every donor.

Gifts may be made by both you and your wife (or husband) if you desire. If these are done according to a detailed prescribed procedure (the essence of which is consent of both spouses), you can double the amount of the annual exclusions and the exemption. Thus, a couple may give away **jointly** $6,000 each year to each of any number of individuals and still have $60,000 as a lifetime specific exemption. This can be done even though the entire amount was earned by only one of the spouses.

A gift may also be from one spouse to the other. This gift would qualify for a marital deduction of 50 percent of the value of the gift provided certain technical requirements were met.

Federal gift tax rates are about three-fourths those of the estate tax rates. Generally, the gift tax on a particular transfer will be much less than the estate tax would be if the property remained in the estate and was transferred at death.

An important characteristic of the federal gift tax is that it is cumulative; in other words, in calculating the tax that may be required for any current year you would need to take into account the total value of gifts made in previous years and the exclusions because the rates are on a graduated basis. By careful consideration of all the factors, it is possible by giving away a part of your estate during life to split the total property into estate tax property and gift tax property, both taxable at lower rates than would have been the case had all been left in your estate to pass at death or had all been given away. Before undertaking the making of sizable gifts, or if you wish more detailed information on the tax consequences of gifts, you are advised to seek counsel of your attorney or accountant.

KENTUCKY STATE INHERITANCE TAX

The other form of death taxes in Kentucky is the state inheritance tax. It is levied upon the amount of property that passes to a particular beneficiary and is paid normally by the recipient although you can direct in your will that the recipients

KENTUCKY INHERITANCE AND STATE DEATH TAXES[a]
RATE AND EXEMPTION CHART

Beneficiaries	Exemptions[b]	Over exemption and to $10,000	$10,00-$20,000	$20,000-$30,000	$30,000-$45,000	$45,000-$60,000	$60,000-$100,000	$100,000-$200,000	$200,000-$500,000	Over $500,000[d]
Class A		%	%	%	%	%	%	%	%	%
Wife	$10,000		2	3	4	5	6	7	8	10
Infant child	10,000		2	3	4	5	6	7	8	10
Incompetent child	10,000		2	3	4	5	6	7	8	10
Husband	5,000	2	2	3	4	5	6	7	8	10
Adult child	5,000	2	2	3	4	5	6	7	8	10
Stepchild	5,000	2	2	3	4	5	6	7	8	10
Adopted child[c]	5,000	2	2	3	4	5	6	7	8	10
Parent	5,000	2	2	3	4	5	6	7	8	10
Grandchild	5,000	2	2	3	4	5	6	7	8	10
Class B										
Brother										
Sister										
Half brother										
Half sister										
Nephew										
Niece	$1,000	4	5	6	8	10	12	14	16	16
Half nephew										
Half niece										
Daughter-in-law										
Son-in-law										
Aunt										
Uncle										
Institutions—educational, charitable, or religious	Entire Transfer									
Class C										
All others	$500	6	8	10	12	14	16	16	16	16

[a] (1948). In addition to the inheritance tax, an estate tax is levied when the federal estate tax credit exceeds the Kentucky inheritance tax.

[b] K.R.S.140.030 provides, in effect, that insurance proceeds are tax free if they are made payable to a named beneficiary or to a trustee other than the assured or his estate.

[c] Exemption granted only if adoption occurred during infancy.

[d] On net estates of $3,000,000 or more the inheritance tax is not applicable but an estate tax equal to the federal credit is levied.

are to receive their portions tax free. In that case the tax would be paid out of your residuary estate (the assets remaining after specific bequests have been paid). The amount that can go to a particular recipient free of tax and the rate of the tax on the excess vary according to the degree of relationship of the recipient to you. For example, your wife (or husband) would pay a smaller inheritance tax on a particular amount than would your neice or nephew.

From the accompanying table (page 25) you may estimate the Kentucky inheritance taxes that might be due on the portions of your estate going to your wife (or husband) and to other recipients.

PLANNING FARM PROPERTY TRANSFER

One of the most important matters to be considered in estate planning by the Kentucky farmer and his wife is the disposal of their farm in accordance with their desires and those of their beneficiaries.

If there is no particular reason for keeping the farm in the family–and sometimes that is the case–the problem is less complex, and a satisfactory plan for the farm's disposal can usually be made with a minimum of effort and time. However, if conditions are such that it would be desirable to keep the farm in the family, then much more effort will be required in the estate planning process to insure fulfillment of the goals desired. Making a decision whether to keep the farm in the family will be based on a number of factors some of which are highly personal.

The goals or purposes of estate planning in general, already discussed on pages 4-6 apply equally to intra-family farm transfers, including:

(a) To insure the financial security of the parents, and, later, to insure adequate income for the surviving parent;

(b) To insure equitable treatment for all of the children; and

(c) To minimize taxes and transfer costs;

To these should be added:

(d) To promote the financial security of the son or sons who will be operating the farm; and

(e) To maintain the farm as an efficient, operating unit.

The other information already presented—for instance, necessity of obtaining legal counsel, the means or tools used in estate planning, and the taxes to be considered—also applies to intra-family farm transfers.

METHODS OF FARM TRANSFER

Probably in no other transfer of an asset is there a greater variety of ways by which it can be done than those applicable to an intra-family farm transfer. There is a method or combination of methods best suited to each family situation provided that sufficient thought is given and expert counsel obtained.

Essentially, the principal purpose of the method or methods chosen is to pass on the land as an operating unit to one or more persons, such as the son and his wife, and to provide a financial return for other persons, such as the father and mother or others in the family. At the same time, the transfer needs to be accomplished with minimum expense for all parties concerned.

Many times it is possible for the parents to help one or more of their sons to get started in farming even before the matter of transferring ownership is seriously considered. This can be done by such an arrangement as (a) a wage or work agreement, (b) a father-and-son partnership, or (c) a rental agreement. If the arrangement operates satisfactorily, then as soon as feasible a decision about a transfer plan can be considered.

A. TRANSFER BY WILL

Even though the parents and the son (or perhaps the son-in-law) may agree on the desirability of a transfer of ownership, circumstances may be such that the transfer should not be attempted during the father's lifetime. One reason might be the difficulty in guaranteeing financial security to the parents. Thus, the transfer would be made by terms of the parents' wills. In this way they would retain control over their property while anticipating transfer at the time of death. One disadvantage of this method is that it fails to provide sufficient certainty or security for the son (or son-in-law). There have been instances in which a son did not acquire title to the farm until he was past his most productive age and the farm was showing the consequences of poor management because of the father's unwillingness to change time-honored, outmoded practices.

Although not frequently used in Kentucky farm transfers, a trust might be provided under the husband's will which would be beneficial to both the widow and to the farm-operating son for whom it was designed. (See pages 17-18 for a discussion of trusts in estate planning.)

B. TRANSFER DURING PARENTS' LIFETIME

Some of the methods of transfer during the lifetime of the parents include: (a) sale for cash or other consideration, (b) sale with a deed and mortgage, (c) sale with a land contract, (d) outright gift, (e) sale and gift combined, (f) partnership with a buy and sell agreement and (g) incorporation in form of a closely held corporation.

An outright sale of the land is a common method of transferring title. Usually, however, sufficient money is not available for full payment, but an arrangement can be made for the sale of the land for a definite price to be payable in installments for a certain specified number of years. Such a sale has advantages for both the parents and for the son or son-in-law who is the buyer.

The parents are relieved of the burden of management and are provided with steady income during their retirement years. The buyer has the opportunity of operating his own business and can make permanent improvements and management changes to increase his income and build his future. In addition, the other children are not omitted from consideration for possible future benefits. The balance due under the terms of the sale contract would become a part of the parents' estate to be disposed of by their wills.

In an installment sale by land contract there are opportunities to include stipulations pertaining to the particular circumstances and desires of the parents and the son. For instance, because of the son's need for immediate operating capital it would be possible to scale down the amount of the payments for the first few years and then to increase the amount as, perhaps, the productivity of the land increased. As for the parents, they might wish to continue living on the home farm if housing were sufficient or could be arranged for two families; they also might wish to reserve a small area for raising a garden or for some other purpose.

Selling their farm on an installment basis may help the parents to reduce the federal and state income taxes levied on their capital gain by their being able to pro-rate the net gain over the installment period.

Transfer of the farm by a gift or by a combination sale and gift has also been used in some instances. Sometimes, a farm has been transferred by a deed subject to a life estate retained by the parents. The parents, as life tenants, then lease the farm during their lifetime to the son who holds the deed. Because of possible complications arising from the use of these methods, including the matter of gift taxes incurred and the taxes resulting from any capital gains–as well as the possibility of future family dissension–these methods should be used only after careful consideration on your part and with the counsel of your attorney.

A **farm partnership** with a buy-or-sell agreement is an effective and flexible arrangement that can be planned and set up to suit the needs of your family situation. One advantage is that it provides for an easy method for two or more persons, such as a father and his son or son-in-law, to pool their assets and conduct a joint farming operation. Being less formal than a corporation, a partnership is flexible enough to permit adjustment to changing or unforeseen conditions. A partnership provides a method for the father to transfer ownership of the farm, and after his retirement, to be assured of income. The partnership may also be used to effect some income and death tax savings.

A disadvantage of a partnership is that, unless the agreement provides for continuation, it will terminate upon the death of a partner. In addition, each partner has unlimited liability, and all partners are liable for the acts of each other while carrying on the business of the partnership. If you feel that a partnership holds attraction for you in your situation you will need to get legal assistance in preparing a partnership agreement to insure yourself adequate protection and to promote the success of your venture. By this agreement you can provide for the continuation of the partnership after death of one of the partners and for a buy-or-sell arrangement to aid in your farm transfer plans.

The farm corporation, a more formal arrangement than a partnership, might offer advantages in certain situations. Such an arrangement may be applicable to your situation as a means of

carrying out your wishes. Kentucky farmers have incorporated their farming businesses for such reasons as: (a) to reduce income taxes, (b) to reduce risks, such as are inherent in a partnership, (c) to provide the farm business with continuity of operation, and (d) to facilitate intrafamily and intergeneration transfer of property.

Whether incorporation of your farm would help you to achieve your purpose in transferring farm ownership at a minimum expense is a matter that would require thorough consideration of your situation. You will need, in addition to legal counsel, competent farm management and accounting advice. Certainly the corporate form of farm organization has merit in some cases; in others, it would likely create problems and prove unsatisfactory. One advantage, however, of the farm corporation in the facilitating of intrafamily transfer is that it makes possible the easy transfer of shares of stock from the parents to the children either as outright gifts or by will.

Finally, if you contemplate the use of any of the foregoing methods of farm transfer, try to anticipate some of what the future may hold for you and your family. In respect to financial matters involving one's family, the best way to insure continuing harmony among all members of the family is to conduct family farm affairs on a businesslike basis. Thus, any agreements regarding transfer and other matters should be reached only after full discussion, and any plan agreed upon should be made out as a written, legal document. Before signing the document each party should fully comprehend the meaning of its terms and be prepared to accept them.

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