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FAMILY ESTATE PLANNING

LAST
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by
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Joint Agricultural Law/Economics Research Program Report

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FAMILY ESTATE PLANNING

By

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I. General Information

A. What Is Family Estate Planning?

A person's estate includes all property rights owned and transferable to others either during one's lifetime or upon one's death. It includes all property you own which can be measured in dollars either now or in the future.

Family estate planning is often thought of as the preparation and maintenance of your affairs to provide for and protect your family both now and in the future. A major concern is the transfer of your property to the next generation. This requires a study of the transfer method or combination of methods best suited to you and your family.

Estate planning also may be thought of as resource planning of the assets you control or own to accomplish your objectives. Estate taxes are paid on the value of assets owned or controlled at the time of your death. The fewer assets owned or controlled at death, the less tax that will be levied. Estate planning is an opportunity to regulate the amount of assets in your estate at death and, hence, the amount of estate taxes your estate must pay. A variety of legal instruments and concepts, such as insurance, deeds, wills, and trusts, are useful for planning purposes. In addition to estate taxes, gift, income, and capital gains taxes also must be considered.

B. Objectives of the Estate and Gift Taxes

Generally stated, the objectives of estate and gift taxes are: to break up large concentrations of wealth and limit the extent to which wealthy parents can confer unearned advantages on their children; to provide a backup for the income tax and prevent avoidance of it; and to provide more progressivity in the overall tax system. These objectives have been drastically undercut, however, by current federal and state estate and gift tax rates and the availability of sophisticated tax avoidance techniques. It should be noted however, that many do not exploit tax avoidance opportunities. Some reject tax avoidance for reasons of principle; others give low priority to engaging in complicated maneuvers solely for tax purposes; some die inopportunistly; others simply have no natural or trustworthy heirs. Whatever the desires of the property owner, family estate planning is a complicated process.

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C. When Should You Plan?

Planning should start as soon as you begin acquiring assets, are married, or have children. The plan should be regularly updated as long as you live. A widow or widower who has not remarried and has acquired a considerable estate from the deceased spouse or others without a two-trust, life estate, or similar estate plan should create an estate plan to pass the property to designated heirs to avoid an excessive tax burden.

D. Who Should Plan?

All property owners need to plan for their retirement and the eventual transfer of their estates.

Because estate planning can be an involved process, the advice of several specialists should be sought to tailor the estate plan to a particular family's needs. Such specialists should include an attorney, an accountant, an insurance agent, and a banker or other financial specialist.

One can minimize financial or familial conflicts by having all family members participate in establishing the objectives of the estate plan. This will help ensure that the finished plan is smoothly accepted and implemented. Even your tentative estate plan should be discussed with family members and estate planning specialists.

E. Why Plan?

There are three major reasons why property owners plan for their retirement and eventual transfer of their estates.

First, property owners plan so their own retirement needs are adequately met while their specific estate transfer plan is implemented.

Second, planning helps tailor estate transfers to the interests of the property owner and the needs of his or her beneficiaries. The transfers should be clearly understood by all concerned before they take place to avoid bitter and costly family conflicts and hardships. Lack of a workable transfer plan for the courts or personal representatives to follow can result in transfers according to state statutes which may not be satisfactory to the owner's or the beneficiary's desires.

Third, although today's federal estate and gift taxes apply only to a small percentage of the population, sophisticated estate planning can be used to largely avoid most federal and state estate taxes. Despite the 1976 and 1981 estate and gift tax reforms by Congress, tax experts have concluded that the current generation of multimillionaires as well as persons of lesser wealth need not pay any more gift and estate taxes than did previous generations.

Estate planning is important for several other reasons:

1. To transfer property in which survivors have interests and to assure equal treatment of children.

2. To reward children for specific contributions given to parents.
3. To provide financial support for surviving spouse and children in case of untimely death when young.
4. To let heirs know what to expect so that they may plan accordingly.
5. To avoid economic hardships for spouse and heirs from lack of money available for living expenses while waiting for settlement of the estate.
6. To avoid unexpected problems created by the lack of a will, by a will being successfully challenged, or by failure to understand the nature of joint tenancy and life estates.
7. To minimize or avoid waste of the estate in legal costs or transfer fees.
8. To compensate the farm or business operating heir for his contributions by avoiding settlement under state descent and distribution laws.
9. To avoid a loss of income and depreciation of the estate from the uncertainty over who will become eventual owner(s) upon death of present owner(s).
10. To keep the farm or business in the family while helping one or more children to get established in farming or business.

Among those most in need of an effective estate plan is the young family farmer or businessman. Often heavily indebted and with young children, his untimely death can be very financially burdensome. Yet he can avoid much of the later suffering and misery by being responsible now.

There are many advantages to good estate planning. It is your decision whether you and your family shall enjoy them. By planning now you can effect an orderly transfer of the farm or business to your children while they are still interested and best able to pay for it, and at the same time provide yourself with a steady income to enjoy during retirement.

F. Probate

Probate is an orderly passing of your assets through a probate court to your heirs. Property owners generally cannot avoid probate, although one option under the new Uniform Probate Code is the "no-action option." Probate of a properly planned estate usually is not costly, taking only 2 to 4 percent or so of the taxable value of the estate. Costs may be much higher if your estate planning team does not consider all asset transfer costs. There are many situations where it is more desirable for the property owner to subject his estate to probate costs rather than risk failure to reach his goals due to poor planning.

G. Estate Planning Costs

If tax avoidance and maximum financial security for survivors are the property owner's primary objectives, then good estate planning usually saves more than it costs. The reduced estate shrinkage and the increased peace of mind of all those involved more than offset the cost of planning. Reduction in death taxes alone can be a major saving and may be critical to the heirs.

Administrative costs also can be reduced by good planning. The choice of an administrator or trustee can be important in carrying out an estate plan over a long period of time. For example, one might consider a bank trust department where charges vary according to the size of the principal balance within the trust each year. In a \$100,000 trust the administrative cost would be about \$700. However, charges vary from bank to bank and according to specific services that the bank would be required to provide.

The cost of not planning can be a substantial "waste" of your properties. Long delays before your heirs get reduced shares, hardships due to the delays, and failure to reach some life-long objectives may be the results.

II. Property Ownership

The decision on how and what property may be transferred depends on the types and amounts of property involved. There are two kinds of property: real and personal. Real property consists of land and the fixtures attached to it. Personal property consists of movable items, either tangible or intangible. Tangible objects are such things as livestock, machinery, and household goods. Intangible property includes bank accounts, bonds, shares of stock, and mortgages.

A. Ways of Owning Property

There are numerous ways of owning property. The way in which title to property is held generally determines if it will become a part of the estate upon its owner's death. The type of ownership also indicates the degree of control the owner has over the use and disposition of property. Sole ownership is having the full title to the farm in one person's name only. By holding the property in this manner the owner has an almost unrestricted right to sell, mortgage, or dispose of the property during or after life. This property will become a part of the owner's estate upon his death.

The owner of a life estate has a right to use the real estate during his lifetime but not to dispose of it at his death. Consequently, a farm held under a life estate does not become a part of the owner's estate upon his death, except under certain circumstances where it may be included for tax calculation purposes. Upon the death of the life tenant, the holders of the remainder interest, which includes all rights not held by the life tenant, acquire the right to possession of the property.

Co-ownership of farm property exists when two or more persons hold legal title to a farm. About 70 percent of the farm titles in North Dakota are held in co-ownership. Co-ownership is "an undivided" interest in the jointly held

property. The co-owners do not have separate rights to any given part of the land. The two usual types of co-ownership are tenancy-in-common and joint tenancy.

Tenancy-in-common exists when two or more people each own an undivided interest in the same property. Tenancy-in-common may be created by deed or will and usually results from the operation of state inheritance laws. For example, tenancy-in-common arises when two or more children inherit undivided fractional interests in a farm. Each can sell his share during life or devise it by will. If not sold or devised, upon his death his interest in the property will pass to his heir(s). The heir(s) will then become a tenant or tenants-in-common with the surviving tenants-in-common.

Joint tenancy usually exists where two or more people own the real estate with the "right of survivorship." When one joint tenant dies, his undivided interest is extinguished, and each surviving joint tenant owns a larger fraction. The property does not pass to the joint tenant's heirs as would be the case if he were a tenant-in-common. This characteristic generally is peculiar to joint tenancy and is called the "right of survivorship." While a joint tenant may sell his interest in the property before death, he may not dispose of it by will. If husband and wife own a farm as joint tenants and the husband dies, his wife would have full ownership to the exclusion of the children. Joint tenancy usually involves a much shorter settlement procedure than regular probate.

The law in North Dakota is very specific about the wording of a title in joint tenancy. The usual form is "To John Doe and Mary Doe, husband and wife, as joint tenants, and not as tenants-in-common." It may be advisable to have an attorney examine the title if there is any question about the form of co-ownership presently existing. An attorney will ordinarily want to do this as part of his estate planning services.

Thus far, we have spoken about co-ownership of real property only; however, such ownership of personal property also is possible. Both checking accounts and savings accounts may be held individually or in co-ownership either with or without the right of survivorship. Joint accounts with survivorship rights become the property of the survivor. Individual accounts may be transferred to another only by way of gifts, trusts, or wills. Similarly, bonds, shares of stock, and other personal property may be held either individually or in co-ownership with or without rights of survivorship.

The joint tenancy right of survivorship feature is frequently pointed out as a device to pass property at death without the necessity of a will and the required probate administration. This general statement is no longer necessarily true. Under the Uniform Probate Code there will be certain times when property held in joint tenancy will be included within the administrative activities of the estate. Also, possible adverse estate tax consequences from receiving property through joint tenancy are so great that this factor must be evaluated carefully in any estate plan.

B. Deeds and Importance of Delivery

A deed is written evidence of ownership of real property. It is the written instrument by which a person transfers real property to a new owner.

Deeds should be recorded in the Register of Deeds Office of the county in which the land is located. The purpose of recording is to inform all others of the recorded holder's rights in the property. To record it, the grantor must declare before a competent officer that he has executed the deed.

Two kinds of deeds ordinarily are used to convey land: warranty deeds and quit-claim deeds.

A warranty deed is a written instrument containing five or six covenants or assurances of title which impose contractual liability upon the person transferring the title. One covenant assures the grantee that the grantor has the right to convey the title. Another assures that he actually possesses the land. He also assures that the title is not limited, defective, or in any way encumbered. If the assurances are broken, the grantor may be personally liable for damages to the grantee or he may have covenanted to give further assurances. Finally, the warranty deed usually contains the clause "and warrants the title thereto," meaning the grantor will defend the title and quiet enjoyment of the grantee against all claims through a superior title.

A quit-claim deed conveys only whatever interest in the property the grantor has at the time of transfer. If he has no interest, none is conveyed. A quit-claim deed can be used to release one's present or future rights, title, or interest to another person without providing a guarantee or warranty of title. This type of deed is useful when the grantor is unsure of his interest in the property.

Delivery is necessary to accomplish a conveyance by deed. Delivery generally is the transfer of a deed from the grantor to the grantee or some third person, such as a trustee, during the lifetime of the grantor. Delivery demonstrates the grantor's intent that the deed become effective immediately. As a general rule, unless the deed is actually delivered to the grantee or his agent during the lifetime of the grantor, the transfer is not effective. For example, if the grantor, after completing the deed, puts it in his own safety deposit box or among his private papers instead of delivering it directly to the grantee, it is very likely that at the grantor's death the deed would be considered undelivered, and as a result would transfer no interest to the intended grantee.

III. Property Ownership and Transfer Methods and Uses

This section presents and evaluates various ways of transferring property ownership from one person to another. The more popular methods of transfer are described in some detail along with their advantages and disadvantages. Selection of the one best suited for the particular circumstances of a family requires careful analysis and should be made with the help of an experienced and competent estate planning attorney.

A. Planned Methods of Transferring Property

Legal ownership of property may be transferred from one person to another by one of several methods. In the event that the decedent has failed to provide a plan of transfer, the state will transfer the property for him.

Ownership of property may be transferred by means of sale, gift, co-ownership, wills, insurance, or annuities. Each method is discussed below and its use in estate planning evaluated.

1. Transfer by Will

Everyone should have a will. A will is a written instrument telling how its maker wants his property distributed upon his death. The person who makes the will is called the testator (if a woman, the testatrix). A will permits you to retain after death a degree of control over the property you owned before death. The will guides the court in distributing your property.

A will should be prepared by an attorney to avoid errors and ambiguities that may result in an expensive lawsuit to determine the decedent's intent. A farm's assets consist of both real and personal property and a going business. In preparing to transfer a farm by will, you must be careful to consider the following due to their different treatment by law: land, buildings, machinery, equipment, livestock, accounts receivable, bank accounts, insurance policies, crops, real estate mortgages, and so forth.

A will may be prepared in North Dakota by any person of sound mind over the age of 18. Also, a married woman may dispose of all of her separately owned property by will without consent of her husband.

A properly executed will must be signed by the testator or in the testator's name by some other person in the testator's presence and by his direction. The will also must be signed by at least two other persons, each of whom either witnessed the testator's signing or acknowledged his signature on the will. A will may be revoked by a subsequent will which revokes the prior document expressly or by inconsistency. A will also may be revoked by destroying the original when such destruction is intended by the testator to act as a revocation.

A person may write his own will and it will be a valid document, whether or not it is witnessed, if the signature and the "material provisions" of the will are in the handwriting of the testator. However, only an attorney has the necessary training and experience to properly prepare a written will. This can be done at a very reasonable cost. An attorney will use the proper language to carry out your intentions, whereas an untrained person is likely to use inaccurate or ambiguous language making an accurate interpretation of the will's meaning difficult. The attorney also will assure that all legal formalities are observed.

A person prepares to make a will by taking a complete inventory of all property owned and decides just how he wants his property distributed. This is best accomplished through a thorough discussion with all family members and your estate planning team.

a. Advantages:

- * Transfer by will keeps full control of the property with the owner until her/his death.

- * The will permits the owner to distribute his property as he sees fit.
- * By including carefully selected and drafted provisions in the will, it may be possible to reduce the amount of estate tax that will be due. Tax savings, however, may not be as important as equitable treatment of all family members or other objectives.
- * A will may be changed easily when conditions warrant.
- * Parents with young children can designate the surviving spouse as both guardian and personal representative.
- * The maker may select the personal representative or executor of the estate and save the cost of a surety bond by specifying that the executor shall serve without bond. Otherwise, some courts are hesitant to let one serve in this capacity without first securing an expensive surety bond.

b. Disadvantages:

- * A poorly prepared will usually fails to carry out the wishes of its maker.
- * Changing economic and family conditions may outdate the will. The maker may fail to revise the will periodically and die with a will which may harm rather than help the family estate plan.
- * The testator may plan to transfer property by will without telling heirs. Farming heirs may experience uncertainty as to their future on the farm and may neglect it. This uncertainty may be avoided by transfers during the lifetime of the owner, or by arranging other definite agreements with the farming heirs.

2. Transfer by Insurance

Insurance has many uses in estate planning. It gives liquidity to the estate, qualifies for the marital deduction, and also provides considerable flexibility in its use. It may be given as a gift.

Proceeds from life insurance policies are an important part of most estates. The entire amount of the decedent's life insurance, under the present federal and North Dakota law, is part of his taxable estate if he had the "incidents of ownership" of the insurance policy. These "incidents" include the right to change the beneficiary, to borrow against the policy, to select the method of settlement, and the right to the cash surrender values. A complete transfer of these rights removes the insurance proceeds from the decedent's estate, thus relieving it of federal estate tax liability. This transfer may be accomplished by making either your spouse or children the owner(s) of the policies. At death the policy owners can lend the proceeds to the personal representative, or estate. Preferably, policies should be purchased originally by the spouse or the children. If existing policies are used as gifts, the possibility of an adverse tax result exists. A gift tax may

be levied on gifts in excess of the annual exclusion. These gifts also may be added to the gross value of the estate at death, making them subject to estate tax.

Another way to avoid inclusion of life insurance proceeds in an estate is to create an irrevocable trust to hold the policy, with the trustee authorized to lend the proceeds to pay estate settlement costs.

Life insurance policies should be reviewed often (at least every five years). Since through savings, inheritance, inflation, or otherwise, the size of an estate is likely to have increased, additional insurance may be required to meet liquidity requirements. Life insurance retirement income should be planned for both husband's and wife's needs. Coordination of policies and wills can result in better estate planning and considerable tax savings.

Insurance alone or in combination with annuities can yield retirement income as well as payment to a beneficiary. It can be used to pay off the house mortgage, educate the children, or support the spouse. In partnerships the surviving partner must terminate the partnership or buy out the heirs of the deceased partner, which can be very expensive. A partnership-purchased insurance policy can help the surviving partner in this situation.

a. Advantages:

- * Life insurance proceeds go to the beneficiaries specified in the policies.
- * Life insurance proceeds escape most or all estate taxes by prior transfer of the policy and all incidents of ownership.
- * The proceeds are received income tax free.
- * A life insurance trust can be set up to take care of minor children, with secondary beneficiaries named in addition to the primary beneficiaries.

b. Disadvantages:

- * The insured often fails to rename beneficiaries even though great changes have occurred since he first bought the policy.

3. Transfer by Means of Co-Ownership

Co-ownership provides a method of transferring property upon the death of a co-owner. The form of co-ownership in which the property is held determines how it will be distributed upon death.

a. Joint Tenancy

Joint tenancy, meaning joint tenancy with right of survivorship, is a means by which two or more people co-own an undivided interest in the entire

property. Farm property may be owned in joint tenancy. Upon the death of any co-owner, his undivided interest is extinguished and the surviving joint tenant(s) share the full ownership. Property owned by joint tenancy cannot be disposed of by will, except by the last survivor.

Property owned in joint tenancy is usually excluded from the probate estate. Upon the death of a joint owner, the survivors may obtain full ownership with a minimum of expense, trouble, and time. Costs of administration may be reduced if the estate is of modest size, and the time necessary to clear the title for the survivor may be reduced to a few weeks. Under certain circumstances, such as the spouse taking his or her forced share, the property owned in joint tenancy is brought in to probate administration.

While owning the property by joint tenancy might eliminate some costs of estate administration, it will not avoid federal and state estate taxes. Under current federal law, the total value of property held in joint tenancy by joint tenants other than spouses is taxed in the estate of the first joint tenant to die, with the exception of that portion which a survivor can prove he or she paid for, unless the creation of the joint tenancy was initially a gift and gift tax was paid at that time.

Property held in joint tenancy by husband and wife, however, is treated differently. When property is jointly owned with the right of survivorship by spouses, the estate of the first spouse to die will include one-half of the value of the property regardless of which spouse furnished the money to purchase the property. As a result, as between joint tenant spouses, the survivor, who is usually the wife, will not have to prove that he or she paid for one-half the value of the property to be included in the estate of each spouse.

The current unlimited marital deduction permits joint tenancy property to pass to the surviving spouse free of estate and gift taxes. However, the value of the joint tenancy property remaining at the survivor's death will be included in the survivor's estate and will be taxed to the extent the value of the estate exceeds the allowed exemption.

Both creation and termination of joint tenancies have serious gift, estate, and income tax consequences, many of which are not readily apparent. If you have created any joint tenancies, seek competent legal advice to determine first whether or not they should be unraveled, and then if appropriate, how they should be terminated.¹ Some people who have considered their consequences have applied the misnomer "poor man's will" to describe the joint tenancy, but a better description would be a "poor man's trap." Although the new tax law mitigates some of the harshness of previous law, an attorney should be consulted to determine if it would be advantageous for a particular estate to retain, sever, or create joint tenancies.

Many joint tenancies are filled with inevitably tragic consequences. For example, when a living trust has been created, it is often wise for title in a few assets to be kept outside the trust (i.e., a car and/or a house). To

¹Incompetent termination of a joint tenancy may create gift tax liability except between husband and wife.

avoid probate, the assets external to the trust may be held jointly by the husband, wife, and trustee.

(1) Advantages:

- * Property held in joint tenancy usually is not a probate asset and hence is not subject to the delays and expenses of probate.
- * Joint tenancy is a relatively easy method of transferring property. It is easy to create a joint tenancy, but care must be used to meet the legal requirements.

(2) Disadvantages:

- * Few owners have all their property in joint tenancy; thus a probate of the remainder of the estate is likely anyway.
- * Once a farmer has put his property into joint tenancy, even if the other joint tenants are his wife or children, he cannot get more than half of it back without their permission.
- * Property held in joint tenancy is not subject to a will. If a surviving widow remarries and places the property in joint tenancy with her second husband, it becomes the second husband's property if she dies before he does.
- * A joint tenant usually can sever the joint tenancy by transferring his undivided interest to another person. The new co-owner will become a tenant-in-common with the other co-owner (the joint tenancy would have been severed or destroyed). Thus, if A and B were joint tenants, and A conveyed his undivided one-half interest to C, B and C now would be tenants-in-common.

b. Tenancy-in-Common

Tenancy-in-common is frequently used and is probably what most people mean when they speak of "joint ownership." The courts usually will assume this form of co-ownership was intended unless the proper wording for joint tenancy has been used. Tenancy-in-common is frequently created when land is inherited among several heirs. However, the tenants need not be related. If one tenant dies, his share descends to his heirs instead of to the surviving tenant(s). Each tenant has the right to sell, assign, mortgage, or convey his undivided share of the property. Only the decedent's actual share of the tenancy-in-common property is taxable in his estate, whereas in joint tenancy the entire jointly held property is taxable in his estate, unless it can be proven that some portions were acquired by inheritance or by money originally belonging to the surviving joint tenants.

(1) Advantages:

- * If one of the tenants dies, his share is distributed to his heirs.

- * Several persons can own the same land in unequal and undivided shares.
- * Only the interest of the deceased tenant-in-common is included in the value of his estate.

(2) Disadvantages:

- * A tenant-in-common can have the property physically divided or force it to be sold so that he can receive his share of the money.

c. Tenancy-by-the-Entirety

This is another form of co-ownership with the right of survivorship, but the parties must be husband and wife. At the death of either spouse, the survivor will own the whole estate. Neither husband nor wife alone can dispose of his or her interest to a third party. It costs no more to hold property in either joint tenancy or tenancy-by-the-entirety. In some states, including North Dakota, tenancy-by-the-entirety is not recognized and is now construed to be the same as tenancy-in-common unless specifically stated to be joint tenancy. North Dakota residents who own real property in other states should be aware of this form of ownership.

d. Partnership

A partnership is an association of two or more persons to carry on a business as co-owners for profit. A partnership can be used to transfer property from one generation to another. It is possible for a child to secure an interest in the farm by gift, purchase, or by an operating agreement in the real property, the personal property, or both. It is important that the partnership transaction be entered into by a written agreement so that a permanent record exists. If desired, it can be arranged for the child to later purchase the parent's share. The partners may wish to purchase a partnership insurance policy which enables the surviving partner to buy out the interest of the deceased partner. It is important in transferring farms that the interest of children other than those who will continue farming be carefully considered as well. A properly prepared and executed estate plan involving a farm property transfer by partnership (where a specific child buys the partnership business initially and later, either at some agreed upon time or at the death of the surviving partner, the real property) will protect the interests of all the children. A partnership in North Dakota must be established according to North Dakota partnership laws, and the formal agreement should be written by an attorney.

4. Transfer by Sale

A simple and direct method of transferring farm ownership before death is by sale to a member of the family. The sale may be outright or subject to a mortgage or by a contract for deed. This latter method of transfer is ideally suited to situations where the buyer, usually a child, has only a limited amount of capital and the parent, who wishes to help the child begin

farming, desires the income from the sale of the farm distributed over a number of years. Under another plan, the parents can transfer the title to the child in return for a token cash payment and either a lifetime support contract or reservation to themselves of a life estate. But under such an agreement the estate will be construed as belonging to the parents and will be fully taxable in their estate, thus negating any transfer benefits.

a. Direct Sales with Mortgage Back

The simplest means of selling the property involves the childrens' purchasing the farm "outright" when they start to farm. The seller simply deeds the farm title to the buyer who makes a suitable down payment and gives the seller a mortgage to the property to secure the balance of the payments due.

(1) Advantages:

- * Direct sale is a businesslike way of making the transfer.
- * Equitable treatment of all children is separated from the transfer of the farm.
- * Direct sale lets the buyer operate the business or farm during his most productive years.
- * Direct sale lets the buyer make early permanent improvements to the business or farm.

(2) Disadvantages:

- * Parents lose control of property.

b. Conditional Sales with Contract for Deed

A contract for deed can be used as a method of sale when the child does not have a sufficient down payment. The seller in this arrangement agrees to convey the business or farm to the buyer for a certain price. Equitable title to the property passes to the buyer, but the deed is not delivered until the future date specified in the contract. This method of transfer is called a contract for deed and is very popular among both related and unrelated parties. The particular advantage of a contract for deed is the low down payment by which the buyer secures control of the business or farm, and possible tax savings to the seller.

The contract for deed may utilize various methods of payment adapted to fit the particular family situation. Also, the payment plan can be flexible. It may consist of a fixed money price for the business or farm and fixed annual payments, or the annual payment may be based upon a share of each year's proceeds, as in crop-share contracts.

(1) Advantages:

- * The contract for deed helps the young person with limited funds purchase a farm or business.
- * The seller may save on capital gains and estate taxes.
- * The payment schedule can be arranged to encourage building of equity during the buyer's most productive years..

(2) Disadvantages:

- * The seller takes a substantial credit risk during the early years of the contract.
- * The farm or business may unexpectedly default back to the seller if payments are not made.
- * The buyer may have less control of the land or business than under a mortgage since he does not have legal title.
- * It is often easier for the buyer to obtain credit or to sell his equity in the property if he has a mortgage rather than a contract for deed.

c. Transfer with a Life Estate

Parents may reserve to themselves a life estate in the farm and deed the remainder interest to the child. This assures the parents of income since they have the right to use the land during their lifetime. The child actually owns a future interest in the land and is thereby assured that he will eventually receive the farm. Additionally, the parents may give their child a lifetime lease of their life interest in the farm.

This method of property transfer is not without disadvantages. The child may sell her/his remainder interest to an uncooperative person. Moreover, where the parents reserve a life estate, the full value of the property will be included in their gross estate upon death. The life estate is not necessarily a technique to avoid federal and state estate taxes.

As an alternative to a transfer with a retained life estate, the parents might transfer the farm outright to their child, requiring a fixed annual payment to them for their lives or the life of the survivor. The income and gift tax consequences of such a transfer are identical to the taxation of annuities. If the transfer is for less than a full consideration (that is, the child pays less than full market value of the property over the expected useful lives of the parents), the balance will be considered a gift. However, unlike a life estate, upon the death of the parents, no portion of the land value will be included in their gross estate. In many situations, the same result that is desired by parties seeking to transfer property by retaining a life estate can be accomplished by selling the land for a private annuity, but the child is obligated to make the annuity payments regardless of the income the property may produce.

5. Transfer by Gift

Transfer of property (money, stocks, real estate, etc.) by gift to the younger generation is important in estate planning. Many small gifts may be given without being taxed. Transfer by gift can be a valuable tool in estate planning but it must be used carefully to achieve all your estate planning goals.

The legal transfer of property ownership by gift is very easy to accomplish. A valid gift requires that there be (1) an intent on the part of the donor to give a nonrevocable gift, (2) an acceptance of the gift by the donee, and (3) a delivery of the deed or the property itself to the donee. If the donor is giving a number of gifts, it is advisable to maintain a written record of these gifts (including their dollar value) for estate planning purposes.

Effective for gifts given after 1981, gift tax returns are to be filed, and any gift tax paid on an annual basis. In general, the due date for filing the annual gift tax return will be April 15 of the following year. However, for the year in which a donor dies, the gift tax return must be filed no later than the date of filing of the donor's estate tax return.

Although gifts may reduce tax burdens, this should not be the primary objective in giving gifts. Contributing to the happiness and security of a donee should be the foremost reason for giving. The unified tax credits should not preclude parents from enjoying the pleasure of seeing children and grandchildren enhance their life styles. However, before giving any substantial gift, you should consider more than tax consequences and the happiness of others.

First, you should not give gifts that will reduce your estate below the level needed to support yourself and your spouse. Depending upon the size of the estate, tax savings from gifts in excess of annual exclusions are likely to be inconsequential.

Second, if tax avoidance is desired, you as a donor can achieve great tax savings using the annual exclusion. Each person has an "annual exclusion" from gift taxes in which he may give gifts of up to \$10,000 (\$20,000 for husband and wife) each calendar year to each of as many donees as he wishes, without paying a gift tax. The donor before 1977 could give away another \$30,000 without the burden of any gift tax, but under the Tax Reform Act of 1976 this specific exemption of \$30,000 and the death tax exemption of \$60,000 were abolished and a dollar-for-dollar tax credit called the "unified gift tax credit" and the "unified estate tax credit" was created. Under this unified transfer tax, the combined exemption is \$175,625 during 1981, which is equivalent to a tax credit of \$47,000. Beginning in 1982 the combined exemption will gradually increase to \$600,000 by 1987 and the unified credit will be raised to \$192,800. The schedule for achieving this is as follows:

<u>Year of Death</u>	<u>Combined Exemption</u>	<u>Unified Credit</u>
1981	\$175,625	\$ 47,000
1982	\$225,000	\$ 62,800
1983	\$275,000	\$ 79,300
1984	\$325,000	\$ 96,300
1985	\$400,000	\$121,800
1986	\$500,000	\$155,800
1987 and after	\$600,000	\$192,800

Third, in addition to the annual exclusions and unified gift tax credit, transfers between spouses after 1981 of an unlimited amount of property during life or at death are tax free. This is due to the unlimited marital deduction imposed by the new tax law.

Finally, after the exclusions have been used, the unified gift tax credit remains and can be used anytime during life. However, taxable gift value will be included in the donor's estate for estate tax calculation purposes.

a. Advantages:

- * The annual gift tax exclusion is \$10,000 per donee. Spouse-to-spouse gifts can be given during life or at death without incurring any federal gift or estate tax liability.
- * There is no state gift tax in North Dakota, but there is an estate tax.
- * A donor can reduce his own income tax liability by disposing of income producing property.
- * Although gifts in excess of exclusion equivalents are taxable, increases in the value of the property which occur after the gift has been given will not be included in the donor's estate.

b. Disadvantages:

- * Under North Dakota law the taxable estate does not include the value of any gift given by the decedent. This differs from the federal law which excludes gifts given under the annual exclusion from the federal taxable estate even if given within three years of death.

6. Transfer by Annuities

Commercial annuities are contracts usually sold by insurance companies. A life annuity guarantees an income for as long as the annuitant lives. Payments stop when the annuitant dies. A refund annuity provides an income for as long as the annuitant lives, but also provides that the total payment to the annuitant and his beneficiaries will be at least equal to the purchase price of the annuity. A joint life and survivorship annuity guarantees an income to continue as long as either of two annuitants may live. Deferred annuities are bought on the installment plan like life insurance policies instead of in a lump sum. A single life annuity expires at the decedent's death leaving nothing to be included in her/his gross estate.

One method of transferring farm or business property using an annuity is to sell the farm or business to a child, with the child purchasing a commercial annuity for the parents equal to the farm's purchase price. The insurance company then pays a guaranteed income to the parents upon their reaching retirement age.

Private annuities also can be used to transfer property. The private annuity may be used whenever one person desires to transfer property for a consideration. It is a device whereby the giver transfers property to the recipient in exchange for the latter's promise to pay him a certain annual income for life. The parent can sell the farm to the child in return for an unsecured promise to pay a yearly income to his parents. It is similar to a lifetime support contract or "bond of maintenance" agreement and has many of the same problems. Alternatively, the parents may use a contract for deed or reserve a life estate in the farm and transfer the remainder interest to the child.

a. Advantages:

- * An annuity assures a definite level of income to the parents while reducing the value of the estate subject to tax.
- * There is no age limit with regard to when this plan can be started.

b. Disadvantages:

- * Value of the annuity remainder becomes part of the decedent's estate and thus is subject to estate taxes and probate expenses.
- * Guaranteed income payments usually are not hedged for inflation.

B. Unplanned Methods of Transferring Property

1. Laws of Descent

What happens when one fails to leave a will (i.e., dies intestate)? North Dakota laws state that the property of one who dies intestate passes to his heirs subject to the control of the county court and the court-appointed personal representative.

The order of succession to this property by the heirs is clearly spelled out in the North Dakota Century Code, Chapter 30.1-04:

Intestate estate. Any part of the estate of decedent not effectively disposed of by his will passes to his heirs as prescribed in the following sections of this title.

Share of the spouse. The intestate share of the surviving spouse is:

1. If there is no surviving issue² or parent of the decedent, the entire intestate estate.
2. If there is no surviving issue but the decedent is survived by a parent or parents, the first fifty thousand dollars, plus one-half of the balance of the intestate estate.

²The term "issue" means offspring or children, including those adopted.

3. If there are surviving issue all of whom are issue of the surviving spouse also, the first fifty thousand dollars, plus one-half of the balance of the intestate estate.
4. If there are surviving issue, one or more of whom are not issue of the surviving spouse, one-half of the intestate estate.

Share of heirs other than surviving spouse. The part of the intestate estate not passing to the surviving spouse or the entire intestate estate if there is no surviving spouse, passes as follows:

1. To the issue of the decedent. If they are all of the same degree of kinship to the decedent they take equally, but if of unequal degree, then those of more remote degree take by representation.
2. If there is no surviving issue, to his parent or parents equally.
3. If there is no surviving issue or parent, to the issue of the parents or either of them by representation.
4. If there is no surviving issue, parent or issue of a parent, but the decedent is survived by one or more grandparents or issue of grandparents, half of the estate passes to the paternal grandparents if both survive, or to the surviving paternal grandparent, or to the issue of the paternal grandparents if both are deceased, by representation; and the other half passes to the maternal relatives in the same manner. If there be no surviving grandparents or issue of grandparent on either the paternal or maternal side, the entire estate passes to the relatives on the other side in the same manner as the half.

No taker. If there is no taker under the provisions of this title, the intestate estate passes to the state for the support of the common schools and an action for the recovery of such property and to reduce it into the possession of the state or for its sale and conveyance may be brought by the attorney general or by the state's attorney in the district court of the county in which the property is situated.

Representation. If representation is called for by this title, the estate is divided into as many shares as there are surviving heirs in the nearest degree of kinship and deceased persons in the same degree who left issue who survive the decedent, each surviving heir in the nearest degree receiving one share and the share of each deceased person in the same degree being divided among his issue in the same manner.

Requirement that heir survive decedent for one hundred twenty hours. Any person who fails to survive the decedent by one hundred twenty hours is deemed to have predeceased the decedent for purposes of homestead allowance, exempt property, and intestate succession, and the decedent's heirs are determined accordingly. If the time of death of the decedent or of the person who would otherwise be an heir, or the times of death

of both, cannot be determined, and it cannot be established that the person who would otherwise be an heir has survived the decedent by one hundred twenty hours, it is deemed that the person failed to survive for the required period. This section is not to be applied where its application would result in a taking of intestate estate by the state.

The last statute quoted is a limited version of a common type of clause put in wills to take care of the "common accident" situation, in which several members of the same family are killed or injured and die within a few days of each other. This section avoids multiple administrations which could require more than one probate proceeding and duplicate payments of estate tax on the same property in the space of a few days. A similar statute exists to deal with the situation where a will is involved.

Two examples may help explain what happens when one dies without a will and his property passes through the statutory laws of descent. In each example, the value of the shareable estate which remains after paying all of the decedent's creditors is \$250,000.

Farmer Smith dies leaving his wife and his father. No children have been born. Smith's wife would get the first \$50,000 plus one-half of the \$200,000 balance (i.e., \$100,000) for a total of \$150,000. Smith's father would receive one-half of the balance (i.e., \$100,000) after the first \$50,000 had been paid to Smith's wife.

Rancher Jones dies leaving his wife, a son, and two grandsons by his previously deceased daughter. His wife would receive the first \$50,000 plus \$100,000 (one-half of the \$200,000 balance). The remaining \$100,000 would be divided between the son and the two grandsons. Jones' son would get one-half or \$50,000; his two grandsons would split the share that would have gone to their mother (Jones' daughter) if she had lived (i.e., \$50,000). The two grandsons take \$25,000 each under the right of representation.

2. Homestead Survivor Rights

The surviving family of a decedent who owns real estate in North Dakota may be entitled to a homestead estate. The homestead estate is dependent upon the existence of a homestead. The homestead consists of the land upon which a claimant resides and the dwelling house on the land, with all its appurtenances and other improvements. Total value of the homestead cannot exceed \$80,000, over and above liens or encumbrances or both. In no case shall the homestead include different lots or tracts of land unless they are contiguous. While the homestead includes the land and the house, the homestead estate includes the right to the possession, use, control, and income from the real property held or occupied by the decedent as a homestead at death. The importance of a homestead is that it cannot be sold to satisfy decedent's or family's debts existing prior to the death, or debts incurred by the family after the death. There is an exception to this general rule for mortgages existing on the homestead premises signed by both spouses, and for liens for work done on those premises.

The surviving spouse receives the homestead allowance in addition to the share given him/her by the state's intestacy laws. The purpose of the

homestead allowance is to insure that the surviving spouse can retain the home as her/his residence after the other spouse dies. Homestead rights may be exercised even if the spouse has inherited property under a will, and/or the home has been willed to someone else.

3. Exempt Property Entitlement

The spouse, or children if there is no surviving spouse, of the decedent may take certain types of personal property from the estate which do not exceed \$5,000 in value. This personal property exemption is designed to relieve the personal representative (PR) of the duty of selling household goods when there is a spouse or children who want the property. This \$5,000 exemption is in addition to any benefits or share passing to the surviving spouse or children by the will or the decedent unless otherwise provided by intestate succession or as part of the spouse's elective share.

4. Family Allowance

In addition to homestead rights and exempt property, if the decedent was domiciled in North Dakota, the surviving spouse and minor children whom he/she was obligated to support and children who were in fact being supported by her/him are entitled to a reasonable allowance in money out of the estate for their maintenance during the period of administration. However, the allowance may not continue for longer than one year if the estate is inadequate to pay the allowed claims. The allowance may be paid as a lump sum or in periodic installments. It is payable to the surviving spouse for use by the surviving spouse and minor and dependent children. If there is no surviving spouse, the allowance is payable to the minor and dependent children, or persons having their care and custody. In case any minor child or dependent child is not living with the surviving spouse, the allowance may be paid partially to the child or his guardian or other person having his care and custody, and partially to the spouse as their needs may appear. The family allowance is exempt from and has priority over all claims except the homestead allowance.

The family allowance is not chargeable against any benefit or share passing to the surviving spouse or children either by the will of the decedent unless otherwise provided, by intestate succession, or by way of elective share. Death of any person entitled to family allowance terminates his right to allowances not yet paid.

It is clear that if a property owner fails to write a will, the state provides for an orderly distribution of his property. However, the state's method of distribution and/or the recipient's share might not be what the decedent had intended. Even if a will is written, the spouse and children receive additional benefits if they claim homestead rights, the exempt property entitlement, and/or the family allowance.

5. Protection of the Spouse--The Augmented Estate

Numerous statutory schemes have been enacted throughout the United States to prevent the disinheritance of the spouse. The surviving spouse, under the North Dakota Uniform Probate Code, has a right of election to take

one-third of the augmented estate in lieu of any benefits to be received under the decedent's will or intestate succession.

The augmented estate can include more than the property covered by the will of the decedent. The Comments to the Probate Code explain that essentially two separate groups of property are added to the net probate estate to determine the augmented net estate for purposes of computing the one-third elective share:

- (1) Gratuitous transfers (gifts), which are essentially will substitutes, given by the decedent to any person except the surviving spouse during the marriage. These would include:
 - a. Any transfer under which the decedent retained at the time of his death the possession or enjoyment of, or right to income from, the property.
 - b. Any transfer to the extent that the decedent retained at the time of his death a power, either alone or in conjunction with any other person, to revoke or to consume, invade, or dispose of the principal for his own benefit.
 - c. Any transfer whereby property is held at the time of the decedent's death by decedent and another with right of survivorship.
 - d. Any transfer given to a donee within two years of death of the decedent to the extent that the aggregate transfers to any one donee in either of the years exceed three thousand dollars.
- (2) Gratuitous transfers to the surviving spouse given by the decedent. These would include, for example, all property held in joint tenancy, life insurance benefits, etc.

The purpose of establishing the augmented estate as the basis for determining the spouse's elective share is two-fold: (1) to prevent the decedent from transferring any property to other persons by means other than probate in an effort to deliberately defeat the right of the surviving spouse; and (2) to prevent the surviving spouse from electing a share of the probate estate when the spouse has received a fair share of the total wealth of the decedent either during the lifetime of the decedent or at death from life insurance, joint tenancy assets, and other nonprobate arrangements.

The surviving spouse has nine months after the date of death or within six months after the probate of the decedent's will, whichever occurs last, within which to elect to take one-third of the augmented estate. Any property in the augmented estate that the surviving spouse has received during the life of the decedent, or by will if he or she chooses not to renounce the will, will be deducted from the one-third to which he or she is entitled. And, even if the spouse takes the one-third elective share of the augmented estate instead of taking under the will, the spouse also may receive homestead rights, family allowance, and exempt property entitlement.

IV. Additional Tools in Estate Planning

Five additional tools of considerable importance are available to estate planners to reduce tax liability, help conserve assets, and create retirement and asset distribution plans desired by the property owner. They include marital deduction, trusts, powers of appointment, insurance, and life estate.

A. Marital Deduction

Federal law, and indirectly North Dakota law, recognizes a marital deduction in computing estate taxes. Beginning in 1981, the marital deduction is unlimited. That is, unlimited amounts of property, except for certain terminable interests, may be transferred between spouses free of estate or gift taxes.

The marital deduction is available only if there is a surviving spouse. When there is no surviving spouse, a modest adjusted gross estate may incur substantial federal and state estate tax liability.

B. Trusts

A trust can be a useful tool in estate planning by providing flexibility. A trust is an arrangement whereby title to a property right (usually money or real property) is held by one party (trustee) for the benefit of another (beneficiary). The trustee manages, controls, and has legal title to the property while the benefits go to the beneficiary. The trust offers flexibility to meet changing conditions after the death of its creator which could not be foreseen. Use of trusts can avoid probate, save income taxes, protect beneficiaries, provide the grantor personal security, and keep the farm intact. It is a separate tax-paying entity which can avoid income taxes, if desired, by paying out all of its income to the beneficiaries. Two types of trusts are the living trust and the testamentary trust.

A person creates a living trust any time during his lifetime by placing funds or property under the care of a trustee. The trust creator thus does not have to administer or manage trust property, nor risk the possibility of having property contested if transferred by a will. A corporate trustee, such as the trust department of a bank, can be selected to protect the spouse when he/she lacks sufficient business skills to handle money. Also, a corporate trustee may be more skilled at administering a large estate or trust plan. The living trust may be especially helpful to its creator when beneficiaries are incapacitated or are minors. The life insurance trust is a form of living trust.

A testamentary trust is created by a will with directions given on how the property is to be handled and distributed. This trust takes effect as soon as the decedent's property has been delivered to the trustee. Testamentary trusts may be used to reduce both income and estate taxes when used in conjunction with the marital deduction. A testamentary trust includes all property which the will transfers to it. However, property in joint tenancy with right of survivorship is not testamentary (transferable by will).

A husband can use the trust device as a method of transferring property to qualify for the marital deduction. One such trust is the power of appointment trust whereby a wife gets all of the trust income for life, plus the power to transfer the principal to anyone including to herself. Another way is by the estate trust, in which a wife receives all of the trust income for life, and on her death the principal becomes part of her estate.

The two-trust plan uses a "marital deduction trust" which is a form of testamentary trust. A husband directs in his will that his estate should be divided into two equal parts. He directs that one part be placed in trust for the benefit of his wife. Usually, he directs that all estate settlement costs are to be paid from the second half of his estate, with the remainder of that half transferred to a second trust. Often he directs that the income from the second trust also go to his wife with the property to be distributed to his children upon his wife's death. The remainder interest of the second trust goes directly to the children to keep it out of his wife's taxable estate. An important reason for placing one's property in trust is to subject it to fewer taxing instances. If the decedent places his property in trust, with the income to his wife for her life, to his children for their lives, and the principal to the last of his grandchildren then living who reaches the age of 21, the property will be taxed only upon transfer of his estate and will not be included in the estate of his wife or children. However, in larger estates, where more than \$250,000 would be left to each grandchild, it is likely that the excess will be subject to the generation skipping transfer tax imposed by the 1976 federal law. Generation-skipping trusts created by wills or revocable trusts in existence on June 11, 1976 are, however, exempt from the generation-skipping transfer tax if such wills and trusts were not amended after that date to create or increase the amount of the generation-skipping transfer, and the testator or trust grantor dies before January 1, 1983.

Lifetime trusts can be revocable, revocable under certain conditions, or irrevocable. Whether income, gift, or estate taxes will be applicable depends upon these and other important elements in forming the trust. There are so many variations of the trust that only an attorney can determine the best type of trust for each particular situation.

1. Advantages:

- * A living trust results in reduced estate taxes and less estate shrinkage since funds pass directly from the father to his children, thereby eliminating their inclusion in and taxation as part of the wife's estate. A trust is a separate tax-paying entity. Income to the trust is usually taxed at a lower rate.
- * Skillful management can be obtained with increased welfare for the children. A trustee can be selected who is trained in the efficient management of property and securities for others.
- * A living trust is a private, confidential contract, not a public probate. It protects inexperienced beneficiaries from business worries and investment responsibilities.

- * The creator's instructions on use of the property will be faithfully followed so that he is able to direct how his property shall be used long after his death.

2. Disadvantages:

- * Almost complete control of the trust property must be given up during the creator's lifetime if he wants to save estate and income taxes.
- * Trust property in a testamentary trust is included in its creator's estate for estate tax purposes.

C. Powers of Appointment

It has been said that, "The power of appointment is the most efficient dispositive device that the ingenuity of Anglo-American lawyers has ever worked out." A power of appointment is a means by which the owner of property, or one with the right to dispose of property, reserves to himself or grants to another person or persons the power to designate, within such limits as the person granting the power may prescribe, the persons who shall receive the property or the shares which they may receive. A power of appointment may be created by will or deed and may be either a general or a special power created for some particular purpose.

The power of appointment adds flexibility to an estate plan. The future cannot be clearly foretold, so this power helps the owner avoid rigidity in her/his estate plan. It is a way for the creator to view the future through the eyes of the recipient (donee) of the power. It is a way of allowing for adjustments in the distribution of the remainder interest of the estate many years in the future to meet then existing circumstances, such as a child being severely handicapped in an accident or children having different financial success and responsibilities.

One use of the power of appointment is as a guide or safety measure. It permits the owner to specify in her/his own will the ultimate beneficiaries of the trust principal if her/his spouse fails to use the power to appoint. The owner indicates his wishes and his wife can, if she wishes, abide by them merely by doing nothing.

Ownership of a general power of appointment is now treated as the equivalent of ownership of the property subject to the power for federal estate tax purposes. Estate taxation can be escaped only by a valid inter vivos exercise or release of the general power, but these are subject to the gift tax. Furthermore, if the power is exercised before death of the holder of the power of appointment in a testamentary fashion, the value of the property subject to the power will still be included in the gross estate.

If the husband leaves one-half of his adjusted gross estate to a trust, with the income of his wife, and to his wife the power to appoint by will the principal to such person as she may desire except her estate or its creditors, the power will not be taxable to the wife's estate. Such special limited power

of appointment is nontaxable if it specifies that the holder cannot appoint to herself, her creditors, her estate or its creditors the remainder interest of a trust over which she has a power of appointment. The purposes of limiting the power are to make the trust remainder nontaxable and to assure that the trust remainder goes to your descendants or to members of your family and their wives or husbands.

Power of appointment can be a very useful and valuable estate planning tool. There are many potential uses for this power, but considerable skill is required to analyze its usefulness. It may result in sizable gift and estate tax savings. Each situation must be analyzed to determine whether it should be created and, if created, the nature and extent of the power.

1. Advantages:

- * A power of appointment provides a very efficient distributive device that adds flexibility and guidance to the estate plan and may yield tax savings.
- * It gives a surviving spouse income from trust property during life with the remainder going to a selected group of recipients on her/his death.
- * It may prevent property in a power of appointment trust from becoming a part of surviving spouse's estate at her death and thus not subject to her creditors or claims.
- * It may prevent trust property from becoming subject to the costs and shrinkage of a second probate.

2. Disadvantages:

- * The holder of a power of appointment must possess some business skills and understanding of owner's objectives in creating the estate plan.
- * The holder of a power of appointment may permit personal preferences and emotional prejudices to affect her/his distribution.

D. Insurance

Insurance is our most widely held estate-creating asset, and it has many uses in estate planning. It immediately increases its owner's estate and adds to the security of his family. It provides cash to give the estate needed liquidity to pay debts, taxes, and living expenses during the settlement period and may enable the family to continue farming. It also can provide retirement income.

Term insurance policies are written for a definite number of years--1, 5, 10, or 15. Only if death occurs during this term is the face value of the policy paid. A term policy has no cash or surrender value if the insured lives

beyond the term. It is an inexpensive form of short-term life insurance and is especially useful to the young family man buying a home or farm. Costs per thousand of insured value rise with increases in age, especially after age 50 when insurance needs are usually declining. These policies are frequently required of borrowers of installment sales contracts.

Ordinary life insurance, straight, or "whole life" insurance policies, whose terms are for life, usually require the same size (level) annual payments for the life of the insured. "Whole life" gives lifetime protection and creates an insurance estate regardless of whether the insured dies early or lives to an old age.

Limited-pay life insurance policies provide the same benefits as an ordinary life insurance policy but are fully paid for in a limited number of years, commonly 20 years, rather than throughout the life of the insured. Policies typically have level annual premiums for the agreed-upon pay period and pay their face value upon death of the insured.

Endowment insurance policies require payment of a fixed premium for a specified number of years during which time the policyholder is insured for the face amount of the policy. If the insured lives to the end of the premium paying period, he receives the face amount and the insurance involved stops.

Disability or accident and health insurance is a potentially vital source of income where the insured suffers lengthy sickness or injury. Many people insured today have plenty of life insurance but little or no disability insurance, which indicates a need to re-evaluate and rebalance the insurance program in light of changing policy offerings and family needs.

Family life insurance policies insure all family members in one contract. Typically the head of household is insured under an ordinary life plan, and the wife and children are insured with "convertible" term insurance. Additions to the family are typically included 15 days after birth, with the cost per thousand the same regardless of the number of children.

Group life insurance policies provide insurance protection to a group of employees or unit members. Expectation is that the age composition of the insured group will remain about constant over time as new and younger members enter the plan and older members leave. The policy usually provides the employee with a rather limited amount of protection. It is an inexpensive form of protection, with no cash or surrender value, and usually it is not transferable if the employee leaves the employer's hire.

Burial insurance policies are no longer easily obtained, but the limited face value of some group life insurance policies often serves the same function, which is to pay all burial expenses. In some areas, funeral directors operate burial companies which offer a complete funeral, but bad experiences with some of these have led to state and congressional investigations. These investigations and other sources have pointed up the success of the many cooperative funeral associations operating in the Midwest and the memorial associations operating on the West and East Coasts. These associations reflect a movement toward prearranged funerals and a widespread interest in funerals priced as low as reasonably possible. In contrast, legislative action in some

states to require embalming or the cremation of a casket as well as the body are unnecessarily increasing the costs of funerals in those states.

A convertible policy is one that permits changing from one form of insurance contract to another, such as term insurance into ordinary life or 20-pay life into whole life.

Most insurance policies provide a choice between lump-sum payment of the face value of the policy to the beneficiary upon the death of the insured and settlements featuring a periodic income or a combination of settlements. The insured chooses the method of settlement, and his choice usually cannot be changed by the beneficiary.

In addition to the lump-sum payment plan, five options are frequently offered: (a) life income, payable monthly or otherwise, with proceeds paid for the life of the beneficiary; (b) limited installment option which pays the face value with interest in equal installments for a fixed number of years with the amount of the installments determined by the number of years selected; (c) payment of installments in a somewhat smaller amount periodically for a guaranteed number of years, but paid only as long as the beneficiary lives; (d) payment of equal installments until the amount of the policy and interest are exhausted; and (e) periodic payment of the interest earned by the principal with or without the right of the beneficiary to receive a part of the principal each year and with the remaining principal to go to the children.

E. Corporation

A corporation is a body of persons granted a charter legally recognizing it as a separate entity having its own rights, privileges, and liabilities distinct from those of its members. Shareholders contribute capital or services to the corporation in return for shares in the corporation. Corporate profits are used in a manner that will benefit the corporation or are paid to the shareholders as dividends.

In 1981 the North Dakota Legislature authorized certain family-type corporations to engage in farming and ranching. To create such a corporation, however, the statutory requirements must be strictly met.

1. Statutory requirements include:

- * A maximum of 15 shareholders who must be related to each other by specified degrees of kinship.
- * Each shareholder must be an individual, with the exception of certain trusts and estates, who is a United States citizen or a permanent resident alien.
- * Officers and directors must be shareholders and actively engaged in operating the farm or ranch.
- * At least one shareholder must reside on or operate the farm or ranch.

- * At least 65 percent of the corporation's gross income must be derived from farming or ranching; income from rent, royalties, dividends, interest and annuities cannot exceed 20 percent of gross receipts.

2. Advantages of the corporate form include:

- * Limiting of each shareholder's liability for corporate acts and transactions to the amount of each shareholder's agreed upon investment in the corporation.
- * Ability to transfer the farm or ranch business intact from one generation to the next without loss of control by the majority owners after transfer of minority interests.
- * Ability to transfer an interest in the business to minors, thereby reducing the overall family income tax burden and decreasing estate taxes due upon death of the parents. Gifts of stock are eligible for transfer to minors, whereas interests in land, machinery, and livestock are not.
- * Simplified estate settlement for deceased shareholders.
- * Continuation of the farm business after death of a shareholder.

3. Disadvantages of the corporate form include:

- * A corporation must be created in strict compliance with the statute, which requires much paperwork.
- * A corporation is costly to create and maintain.
- * Decisionmaking may be complicated and time consuming if all shareholders must participate.
- * The possibility of multiple income taxation by the state and federal governments if the corporation pays dividends. Since the corporation is considered a separate legal entity, its profits are taxable to the corporation. These same profits, when paid to shareholders, will again be subject to taxation as shareholder income. The problem can be reduced, however, by having the corporation pay salaries, interest and rent to its shareholders (which, if reasonable, will be deductible by the corporation as ordinary business expenses) rather than dividends, or by qualifying as a Subchapter S corporation, whose income is taxed at the shareholder level only.
- * Withholding of additional Social Security tax by the federal government.

F. Cooperative/Corporation

A cooperative/corporation is an association of members who contribute either capital and/or labor and receive stock or membership in the organization. It distributes all of its profits to its members or stockholders.

Although family farm corporations are now permitted in North Dakota, the cooperative/corporation business form will probably remain popular, especially to unrelated persons who wish to form a business organization. The cooperative/corporation form of business organization provides many advantages of the until recently forbidden corporate organization.

1. Advantages of the cooperative/corporation form include:

- * Limited liability to members; the risk of loss is limited to the amount of a member's investment in the association.
- * Simplified property transfer before or at death. A member may be able to transfer his shares without affecting continuity of the farm business.
- * Attracting more capital into the farming operation, due to its perpetual life and larger size.
- * Reduced costs when purchasing larger quantities of fertilizers and other farming inputs, often in bulk forms.
- * Possible tax advantages.

2. Possible disadvantages may include:

- * The cooperative/corporation must follow formal operating rules, which can be both time consuming and expensive.
- * Complications in decisionmaking because of the voting format. Each member has one vote regardless of the amount of capital invested or stock owned.
- * Loss of absolute control of the family farm by the father, when other family members control shares or capital invested.
- * Seventy-five percent of the members must be actual farmers residing on farms or depending principally on farming for their livelihood. This ratio must not fall below 75 percent or the land may be subject to forced sale.

V. Retirement Income Planning

Complete family estate planning considers a combination of ways to provide retirement income. Social Security retirement benefits are included in

the family estate plan. Consideration is given to insurance and annuities. Annuities help the property owner assure his own future financial security. Consideration also must be given to income, estate, and gift tax consequences.

The retirement income plan has at least three long-term goals:

1. It must assure that the farmer and his wife do not outlive the sources of their income.
2. It must provide protection against inflation.
3. It must provide some cash or liquid reserves for emergencies.

The first consideration in estimating future retirement income needs is the time period for which income is going to be needed. Life expectancy tables suggest these answers.

These estimates indicate the vital importance of careful planning. People with adequate retirement incomes live longer. As persons in good health grow older, they still have many good years ahead, which places greater emphasis on good family estate and retirement income planning.

The amount of retirement income needed has risen in recent years. In 1940 it was estimated that an average of about \$150 a month would provide an adequate retirement monthly income, but today the minimum is three to five times that amount. In another 20 years it may take an additional three to five times as many lower-valued dollars to live on. Medical bills usually increase in the later years. Any plans to travel or visit family and friends will increase retirement income needs, as it takes more to maintain a home and travel about.

Inflation has been the ruin of many a retirement plan. Inflation averaged about 1-1/2 percent a year up to 1960, 4 to 6 percent annually in the 1960's, and reached "double digit" rates in the 1970's. The result is that the 1940 dollar was worth only 21 cents in 1977; the 1967 dollar was worth only 55 cents in 1977; and the 1977 dollar was worth about 72 cents in 1980. Take care to "inflation-proof" your retirement income.

Most retirement income plans use a combination of income sources to supplement the monthly social security payments. You must consider the monthly income sources and how each is likely to be affected by inflation. In general, all fixed monthly income payments will be reduced by inflation. Social security monthly payments are now in indexed dollar amounts, cannot be outlived, and may be affected by inflation. Congress has changed the size of payments, but inflation continues to be a problem. Most annuity payments are in fixed monthly amounts and are adversely affected by inflation. Stocks or other investment funds are more commonly a hedge against inflation.

The retirement income plan must include some cash or liquid assets for emergency needs. Most commonly used are the easily converted government bonds, savings accounts, or certificates of deposit. These assets usually yield a lower return as an investment but are necessary for liquidity. A study of selected North Dakota estates showed that many estates of all sizes had a high percentage of their assets in low yielding forms, with the consequent smaller income earnings to the property owner.

Life Expectancy

EXPECTATION OF LIFE AND EXPECTED DEATHS, BY RACE, AGE, AND SEX

AGE IN 1978 (years)	EXPECTATION OF LIFE IN YEARS					EXPECTED DEATHS PER 1,000 ALIVE AT SPECIFIED AGE				
	Total	White		Black and other		Total	White		Black and other	
		Male	Female	Male	Female		Male	Female	Male	Female
All birth.....	73.3	70.2	77.8	65.0	73.6	13.79	13.37	10.58	23.25	19.90
1.....	73.3	70.1	77.6	65.9	74.0	.04	1.01	.71	1.35	1.18
2.....	72.4	69.2	76.7	64.6	73.1	.73	.75	.58	1.13	.85
3.....	71.5	68.3	75.7	63.7	72.1	.58	.59	.46	.94	.77
4.....	70.5	67.3	74.8	62.8	71.2	.46	.49	.38	.79	.62
5.....	69.5	66.3	73.8	61.8	70.2	.42	.43	.33	.67	.49
6.....	68.6	65.4	72.8	60.8	69.3	.37	.40	.29	.57	.38
7.....	67.6	64.4	71.8	59.9	68.3	.33	.37	.26	.50	.32
8.....	66.6	63.4	70.8	58.9	67.3	.30	.33	.23	.44	.27
9.....	65.6	62.4	69.9	57.9	66.3	.26	.28	.21	.41	.25
10.....	64.6	61.5	68.9	57.0	65.4	.23	.24	.19	.40	.24
11.....	63.7	60.5	67.9	56.0	64.4	.24	.24	.18	.43	.25
12.....	62.7	59.5	66.9	55.0	63.4	.26	.33	.21	.49	.27
13.....	61.7	58.5	65.9	54.0	62.4	.40	.51	.26	.60	.31
14.....	60.7	57.5	64.9	53.1	61.4	.56	.77	.34	.75	.36
15.....	59.7	56.6	64.0	52.1	60.4	.74	1.06	.44	.82	.42
16.....	58.8	55.6	63.0	51.1	59.5	.91	1.33	.52	1.10	.48
17.....	57.8	54.7	62.0	50.2	58.5	1.05	1.55	.58	1.33	.56
18.....	56.9	53.8	61.1	49.3	57.5	1.15	1.69	.61	1.61	.64
19.....	56.0	52.9	60.1	48.3	56.6	1.22	1.78	.61	1.83	.72
20.....	55.0	52.0	59.1	47.4	55.6	1.28	1.85	.61	2.26	.82
21.....	54.1	51.1	58.2	46.5	54.7	1.34	1.93	.61	2.59	.91
22.....	53.2	50.2	57.2	45.7	53.7	1.38	1.96	.61	2.85	.98
23.....	52.2	49.3	56.2	44.8	52.8	1.38	1.93	.61	3.07	1.06
24.....	51.3	48.4	55.3	43.9	51.8	1.37	1.87	.62	3.21	1.12
25.....	50.4	47.5	54.3	43.1	50.9	1.34	1.79	.62	3.35	1.18
26.....	49.5	46.5	53.3	42.2	49.9	1.32	1.72	.62	3.49	1.24
27.....	48.5	45.6	52.4	41.4	49.0	1.31	1.66	.62	3.60	1.30
28.....	47.6	44.7	51.4	40.5	48.1	1.30	1.62	.64	3.67	1.34
29.....	46.6	43.8	50.4	39.7	47.1	1.31	1.61	.66	3.72	1.38
30.....	45.7	42.8	49.5	38.8	46.2	1.32	1.60	.69	3.78	1.42
31.....	44.8	41.9	48.5	37.9	45.2	1.34	1.60	.72	3.82	1.46
32.....	43.8	41.0	47.5	37.1	44.3	1.38	1.63	.76	3.95	1.56
33.....	42.9	40.0	46.6	36.2	43.4	1.44	1.68	.80	4.16	1.69
34.....	41.9	39.1	45.6	35.4	42.5	1.52	1.76	.85	4.44	1.85
35.....	41.0	38.2	44.6	34.5	41.5	1.61	1.86	.90	4.74	2.03
36.....	40.1	37.2	43.7	33.7	40.6	1.73	1.99	.98	5.08	2.22
37.....	39.1	36.3	42.7	32.9	39.7	1.87	2.13	1.07	5.43	2.43
38.....	38.2	35.4	41.8	32.0	38.8	2.03	2.29	1.19	5.85	2.66
39.....	37.3	34.5	40.8	31.2	37.9	2.22	2.47	1.33	6.33	2.91
40.....	36.4	33.6	39.9	30.4	37.0	2.43	2.68	1.49	6.87	3.19
41.....	35.5	32.6	38.9	29.6	36.1	2.68	2.93	1.68	7.43	3.49
42.....	34.6	31.7	38.0	28.9	35.3	2.93	3.22	1.85	7.92	3.80
43.....	33.7	30.8	37.1	28.1	34.4	3.21	3.58	2.08	8.29	4.12
44.....	32.8	29.9	36.1	27.3	33.5	3.53	3.99	2.28	8.60	4.45
45.....	31.9	29.1	35.2	26.5	32.7	3.87	4.44	2.52	8.88	4.79
46.....	31.0	28.2	34.3	25.8	31.8	4.25	4.93	2.78	9.26	5.18
47.....	30.1	27.3	33.4	25.0	31.0	4.67	5.46	3.06	9.89	5.63
48.....	29.3	26.5	32.5	24.3	30.2	5.13	6.06	3.34	10.85	6.18
49.....	28.4	25.6	31.6	23.5	29.3	5.64	6.73	3.65	12.07	6.75
50.....	27.6	24.8	30.7	22.8	28.5	6.20	7.48	3.99	13.45	7.40
51.....	26.7	24.0	29.8	22.1	27.6	6.80	8.25	4.35	14.83	8.07
52.....	25.9	23.2	29.0	21.4	27.0	7.42	9.05	4.73	16.15	8.76
53.....	25.1	22.4	28.1	20.6	26.2	8.03	9.85	5.11	17.33	9.45
54.....	24.3	21.6	27.3	20.1	25.5	8.66	10.68	5.52	18.41	10.15
55.....	23.5	20.8	26.4	19.5	24.7	9.29	11.53	5.94	19.43	10.82
56.....	22.7	20.1	25.6	18.9	24.0	10.01	12.40	6.42	20.57	11.56
57.....	22.0	19.3	24.7	18.3	23.3	10.92	13.70	7.01	22.05	12.47
58.....	21.2	18.6	23.9	17.7	22.5	12.06	15.25	7.75	24.04	13.62
59.....	20.5	17.9	23.1	17.1	21.8	13.40	17.06	8.61	26.39	14.95
60.....	19.7	17.2	22.3	16.5	21.2	14.91	19.07	9.58	29.14	16.54
61.....	19.0	16.5	21.5	16.0	20.5	16.43	21.13	10.57	31.84	18.11
62.....	18.3	15.8	20.7	15.5	19.9	17.85	23.15	11.50	33.91	19.20
63.....	17.6	15.2	19.9	15.1	19.3	19.05	25.04	12.31	34.94	19.58
64.....	17.0	14.6	19.2	14.6	18.6	20.13	26.80	13.05	35.17	19.45
65.....	16.3	14.0	18.4	14.1	18.0	21.21	28.75	13.84	34.89	19.05
70.....	13.1	11.1	14.8	11.0	14.8	31.10	42.64	20.92	48.43	30.33
75.....	10.4	8.6	11.5	8.8	12.5	49.21	65.20	36.03	73.92	55.04
80.....	8.1	6.7	8.8	6.8	11.5	75.09	98.30	60.22	98.60	74.33
85 and over.....	6.4	5.3	6.7	7.8	9.9	1,000.00	1,000.00	1,000.00	1,000.00	1,000.00

SOURCE: U.S. National Center for Health Statistics, unpublished data, 1978.

You must consider the income, estate, and gift tax consequences of your retirement income plan. State tax laws vary, so that these tax consequences will differ according to where you maintain your permanent retirement residency. An estate planning attorney will help you to consider the various tax consequences and tax liabilities arising from different family estate plans.

Annuities often are used by retired persons to provide a fixed income. The annuity contract states that an individual pays a given sum to the life insurance company and in return receives an income or annuity for as long as he lives. Annuity payments may be received annually, semiannually, quarterly, or monthly. The purchase price of annuities for women is usually greater than for men, because on the average the life expectancy for a woman is somewhat longer. Usually no medical examination is required for an annuity.

Annuities may be purchased via a single premium or on an installment basis to suit the convenience of the buyer. An immediate annuity provides income to the buyer beginning one year or some agreed-on period after purchase. A deferred annuity is more likely to be purchased by a younger buyer with income returns to commence at some specified future date. Income from a straight-life annuity terminates with the death of the annuitant. A refund annuity provides that should the annuitant die before the total amount of annuity payments received by him equals or exceeds the purchase price, the difference shall be paid to a named beneficiary either as a cash lump sum or as a continuation of the regular installments. A life income on a joint-life-and-survivorship annuity basis may be advantageous for a married couple, but it has disadvantages as well as advantages which indicate that it should be carefully analyzed. Social Security benefits can form an integral part of the family estate and be an important source of after-retirement income. They are very important and good estate planning includes periodic checks during one's employable period to assure accurate recording of benefits earned. These checks are welcomed by the Social Security Administration. As retirement nears, you should again contact your local office to see that their records are up to date. At least three months before retirement, complete an application for benefits to permit processing and straightening out of any problems to assure the immediate flow of benefits when retirement starts.

VI. Estate and Gift Taxes

This section briefly explains and illustrates the calculation of federal and North Dakota estate and gift taxes. Family estate planning may minimize these taxes, but sometimes not without some sacrifice to the welfare of the children. Family estate planning involves more than just tax saving.

A. Estate and Gift Taxes

1. Federal Estate Tax

The federal estate tax is a tax on the privilege of transferring or shifting relationships (financial interests) to property at death. It is not levied on the property itself.

The importance of the federal estate and gift taxes can be viewed from the number of these tax dollars paid by North Dakotans in recent calendar years.

<u>Year</u>	<u>Estate Tax</u>	<u>Gift Tax</u>
1974	\$ 8,738,000	\$ 472,000
1975	11,950,000	1,086,000
1976	18,100,000	1,443,000
1977	18,731,000	2,244,000
1978	14,484,000	406,000
1979	17,838,000	386,000

a. Filing Requirement

An estate tax return is required if the decedent's gross estate exceeds the annual exemption.

b. Farm Property--Payment of Estate Tax

It is fairly easy to obtain 12-month extensions for payment of estate taxes. Merely showing that the executor needs time to collect liquid assets or to convert liquid assets to cash is enough to obtain an extension.

Estates with a value of a farm or other closely held business of at least 35 percent of the adjusted gross estate can have the estate taxes of the farm or business deferred for up to 14 years. The estate will only pay interest for the first four years. Thereafter, the balance must be paid in 10 annual installments of principal and interest. Interest is payable at a rate of 4 percent on the estate tax attributable to the first \$1,000,000 of the interest in a farm or business. Deferred payment of estate taxes may be advantageous due to today's high interest rates.

c. Farm Property--How to Value

Gross value of the estate is usually its fair market value as of the date of death. But, if the real property included in the decedent's gross estate was and is used for farming or other closely held business use, the property may qualify for special current use valuation as a farm or business rather than the normally higher fair market valuation. A farm owner is relieved of the excessive burden of a fair market valuation, for example, where agricultural land is in high demand for housing. This special valuation may be used to lower the "highest and best" value (i.e., the fair market value of the decedent's gross estate) up to \$750,000 for estates of decedents dying in 1983 and thereafter.

Several considerations must be met to qualify for special current use valuation as a farm:

- (1) The decedent must have been a citizen or resident of the United States at the time of death.

- (2) The real property must be located in the United States and be used at the decedent's death for a qualified use.

The Internal Revenue Code defines qualified use as a "farm" for farming purposes or use in a trade or business other than farming. The mere passive rental of property will not qualify. However, where a related person leases and conducts farming on the property, the real property may qualify for special-use valuation.

The term "farm" includes "stock, dairy, poultry, fruit, furbearing animals; and truck farms, plantations, ranches, nurseries, ranges, greenhouses, or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands." The activities engaged in on the real property help decide whether it is used as a farm for farming purposes. The term "farming purposes" not only includes cultivation of the soil and raising or harvesting of agricultural or horticultural commodities, and preparing such commodities for market, but also the planting, cultivating, caring for or cutting of trees, and the preparation (other than milling) of trees for market.

- (3) Adjusted value of the farm (or other closely held business) real or personal property must be at least 50 percent of the adjusted value of the gross estate, using fair market value figures.

Adjusted value of the gross estate means the gross estate less allowable unpaid indebtedness attributable to the property.

- (4) Property must pass to a qualified heir.

A qualified heir is any member of the decedent's family who acquired the property from the decedent. This includes the decedent's lineal ancestors and descendants, a lineal descendent of a grandparent, the individual's spouse, or the spouse of any such descendent.

- (5) At least 25 percent of the adjusted value of the decedent's gross estate must be qualified farm real property that was acquired from or passed from the decedent to a qualified heir.
- (6) The real property must have been used, or held for use, as a farm at the time of the decedent's death. It cannot be merely held for investment.
- (7) The decedent or a member of the decedent's family must have been participating "materially" in the operation of the farm for five of the last eight years preceding the earliest of: (1) the date of the decedent's death; (2) the date the decedent became disabled; or (3) the date that the decedent retired.

The Economic Recovery Tax Act of 1981 provides an alternative to the material participation requirement for qualification of real property for special use valuation. Under the new law, active management by a surviving spouse who acquired the property from a decedent in whose estate it was

included at its special use value will satisfy the material participation requirement. Active management means making of business decisions other than daily operating decisions of the farm or closely held business and therefore requires less activity than actual material participation. Additionally, if the surviving spouse dies within eight years after the decedent, the surviving spouse's period of material participation can be aggregated with the decedent's to allow the spouse to fulfill the material participation requirement.

Material participation is not a precise concept. It generally includes participation in management decisions, regular inspection of production activities, sharing in revenue and expenses, furnishing equipment, residing on the farm, and working on the farm or in the business.

Where the material participation requirement is satisfied, the real property which qualified for special use valuation includes the farmhouse or other residential buildings and related improvements located on qualifying real property, if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use. However, elements of value which are not related to the farm or business use (such as mineral rights) are not eligible for special use valuation.

- (8) Each person with an interest in the property must sign an instrument consenting to the payment of additional tax if the real property is disposed of in such a way as to trigger recapture of part or all of the benefits of use valuation.

Two methods can be used to determine the special use value of the gross estate: The rent capitalization method and the multiple factor method. To use the rent capitalization method, first determine the average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm (R). Subtract the annual state and local real estate taxes for such comparable land (T) to obtain net cash rental. Divide the net cash rental by the average annual effective interest rate for all new Federal Land Bank loans (I). In other words: $(R - T)/I$.

Each average annual computation is based on the five most recent calendar years ending before the date of the decedent's death.

However, this rent capitalization method is not applicable where:

- (1) It is established that there is no comparable land from which the average annual gross cash rental may be determined, or
- (2) The executor elects to have the value of the farm determined by applying the multiple factor method.
- (3) The realty is held by a non-farm business.

Example: Assume a landowner died on December 31, 1977. Also, assume the decedent's estate met all requirements necessary to qualify for special use valuation. The following hypothetical example may be what Congress intended:

Year	Average Annual Gross Cash Rental (per acre)	No. of Acres	Average Annual State and Local Real Estate Taxes per acre	Average Annual Effective Interest Rate for All New Federal Land Bank Loans
1977	\$25.00	1,000	\$1.70	8.6%
1976	25.70	1,000	1.50	8.7
1975	20.50	1,000	1.35	8.0
1974	17.50	1,000	1.32	7.5
1973	11.50	1,000	1.27	7.4

Average annual gross cash rental per acre is \$20.04 ($\$100.20 \div 5 = \20.04). Average annual state and local real estate taxes per acre are \$1.43 per acre ($\$7.14 \div 5 = \1.43). Average annual effective interest rate for all new Federal Land Bank loans is 8.04 percent ($40.2 \div 5 = 8.04$). Excess of average annual gross cash rental is \$18.61 ($\$20.04 - 1.43 = \18.61). The excess is divided by 8.04 percent, giving a value of \$231.47 per acre. Because the decedent landowner had 1,000 acres, total value of his farm under the special use valuation method is \$231,467. Such valuation, however, cannot result in a value more than \$750,000 less than the highest and best use value. For example, if the highest and best use value of the farm were \$2,500,000, the special use value would have to be increased from \$1,000,000 to \$1,750,000 in order not to reduce the decedent's gross estate by more than \$750,000.

Once the farm value has been calculated, the gross value of the estate is determined by adding to the farm value the value of all gifts given within three years of death (except gifts given under the \$3,000 annual exclusion) plus the gift taxes already paid on those gifts.

d. Recapture

Disposition of the property or cessation of qualified use may result in the recapture of use valuation benefits. If within 10 years after the decedent's death and before the death of the qualified heir the property is disposed of to persons who are not family members or ceases to be used for farming, then all or a portion of the federal estate tax benefits obtained by virtue of the special valuation may be recaptured by the federal government. Recapture will not occur, however, on death of the qualified heir because death of the qualified heir appears to terminate the possibility of recapture of use valuation benefits on the property involved.

For purposes of "cessation of qualified use," the Economic Recovery Tax Act of 1981 provides a two-year grace period immediately following the decedent's death in which failure by a qualified heir to use the property in a qualified use will not result in recapture of the tax. The recapture period of 10 years will be extended by the part of the two-year period that expires before commencement of the qualified use. If special use valuation property is involuntarily converted and replaced with qualified replacement property, the two-year period is extended until the qualified heir begins qualified use of the replacement property.

Active management of property that qualifies for special use valuation will constitute material participation for eligible qualified heirs. As a result, no recapture tax will be imposed on these heirs solely because their involvement with the property is not full material participation.

Payment of any recaptured tax benefits is the responsibility of the qualified heir. But a bond can be posted to avoid personal liability.

e. Determining the Taxable Estate

A standard deduction is no longer used for determining the taxable estate. Deductions may be claimed for funeral costs, costs of administering the estate, debts of the decedent and losses from fire, storm, or other casualty or theft during settlement of the estate. In general, expenses are deductible if deductible under local law and if they are reasonable and necessary administrative expenses.

The monetary ceiling on the estate and gift tax marital deduction has been eliminated for estates of decedents dying after 1981. Unlimited amounts of property, except for certain terminable interests, can be transferred between spouses free of estate and gift taxes. This unlimited marital deduction exempts many estates and gifts from federal taxation.

f. Determining the Tax Payable

The tax payable is determined by first applying the appropriate rate schedule (Table 1) and then reducing that amount by the unified tax credit (page 24). The estate includes "taxable" gifts given after 1976 for estate tax computation purposes. The tax credit replaces the standard exemption. The tax credit will be \$192,800 in 1987 and thereafter. The credit will be phased in over a five-year period beginning in 1982 and, when fully effective, will be equivalent to an exemption of \$600,000.

There are other allowable credits, including a credit for: state estate taxes paid, foreign death taxes paid, and a sliding scale for federal estate taxes paid for property transferred to the present decedent from a person who died within 10 years before or within two years after the decedent whose estate is claiming a credit. The latter provision lessens the impact of federal estate taxes paid on the transfer of the same property when owners died within 10 years of one another.

TABLE 1. UNIFIED FEDERAL TRANSFER TAX RATE SCHEDULES

1982

If the amount is:		Tax	Tentative tax 'is:	
Over	But not over		+	%
0	\$ 10,000	0	18	\$ 0
10,000	20,000	1,800	20	10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,800	32	150,000
250,000	500,000	70,800	34	250,000
500,000	750,000	155,800	37	500,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	780,800	49	2,000,000
2,500,000	3,000,000	1,025,800	53	2,500,000
3,000,000	3,500,000	1,290,800	57	3,000,000
3,500,000	4,000,000	1,575,800	61	3,500,000
4,000,000	.....	1,890,800	65	4,000,000

1983

If the amount is:		Tax	Tentative tax 'is:	
Over	But not over		+	%
0	\$ 10,000	0	18	\$ 0
10,000	20,000	1,800	20	10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,800	32	150,000
250,000	500,000	70,800	34	250,000
500,000	750,000	155,800	37	500,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	780,800	49	2,000,000
2,500,000	3,000,000	1,025,800	53	2,500,000
3,000,000	3,500,000	1,290,800	57	3,000,000
3,500,000	.....	1,575,800	60	3,500,000

1984

If the amount is:		Tax	Tentative tax 'is:	
Over	But not over		+	%
0	\$ 10,000	0	18	\$ 0
10,000	20,000	1,800	20	10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,800	32	150,000
250,000	500,000	70,800	34	250,000
500,000	750,000	155,800	37	500,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	780,800	49	2,000,000
2,500,000	3,000,000	1,025,800	53	2,500,000
3,000,000	.....	1,290,800	55	3,000,000

1985 and Thereafter

If the amount is:		Tax	Tentative tax 'is:	
Over	But not over		+	%
0	\$ 10,000	0	18	\$ 0
10,000	20,000	1,800	20	10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,800	32	150,000
250,000	500,000	70,800	34	250,000
500,000	750,000	155,800	37	500,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	780,800	49	2,000,000
2,500,000	.....	1,025,800	50	2,500,000

g. Joint Tenancy

Estates of decedents dying after 1981 will include one-half of the value of property held in joint tenancy between spouses in the value of the estate of the first spouse to die regardless of which spouse furnished the consideration. For property held in joint tenancy between the decedent and another person, the gross estate of the decedent will include the value of the property minus the portion of the property originally belonging to a joint tenant and not received from the decedent for less than adequate and full consideration. If the property was received from the decedent for less than full consideration, only the amount received in excess of the consideration will be included in the decedent's estate.

2. North Dakota Estate Tax

The 1979 North Dakota legislature changed the state estate tax computation law to read as follows:

The amount of tax imposed upon the transfer of the North Dakota taxable estate shall be equal to the maximum tax credit allowable for state death taxes against the federal estate tax imposed with respect to a decedent's estate which has a taxable situs in this state. If only a portion of a decedent's estate has a taxable situs in this state, such maximum tax credit shall be determined by multiplying the entire amount of the credit allowable against the federal estate tax for state death taxes by the percentage which the value of the portion of the decedent's estate which has a taxable situs in this state bears to the value of the entire estate. For the purposes of this section, "federal estate tax" means the tax imposed on transfers of estates of decedents pursuant to the United States Internal Revenue Code of 1954, as amended, and "North Dakota taxable estate" means all property in a decedent's federal gross estate that has a situs in North Dakota.

The North Dakota estate tax law was written to reduce the total federal and state estate tax as low as possible. If the North Dakota estate tax were further reduced without a change in the federal estate tax law, then the total federal and state estate tax would remain the same but the federal portion would be greater. The North Dakota legislature intended the state estate tax to have as little overall impact as possible on any given estate and at the same time provide revenue for North Dakota.

Calculation of the North Dakota estate tax follows completion of the federal estate tax form, and involves two steps:

- (1) First, the percentage of the federal gross estate with situs in North Dakota is determined; and
- (2) Second, the amount of credit allowed for state death taxes on the federal estate tax return is multiplied by the percentage of the federal gross estate with situs in North Dakota to yield the North Dakota estate tax. This step uses Table C.

TABLE C. COMPUTATION OF MAXIMUM CREDIT FOR STATE DEATH TAXES (BASED ON FEDERAL ADJUSTED TAXABLE ESTATE WHICH IS THE FEDERAL TAXABLE ESTATE REDUCED BY \$60,000)

Adjusted taxable estate equal to or more than--	Adjusted taxable estate less than--	Credit on amount in first column	Rate of credit on excess over amount in first column
-----dollars-----			-----percent-----
0	40,000	0	None
40,000	90,000	0	0.8
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	-----	1,082,800	16.0

For example, assume a decedent died in 1982, left \$250,000 to his spouse, gave no gifts, and left a federal gross estate of \$600,000 and federal adjusted gross estate of \$550,000 because of bills, attorney's fees, and funeral expenses. The computation of the federal and North Dakota estate tax would be:

Federal

Adjusted Gross Estate	\$550,000
Less Bequest to Spouse Qualifying for the Marital Deduction	<u>250,000</u>
Federal Taxable Estate	\$300,000

Tentative Tax:

70,800 + (300,000-250,000) x .34	\$ 87,800
Less Unified Credit	<u>62,800</u>
Federal Estate Tax Due	\$ 25,000

North Dakota

Percentage of Federal Gross Estate in ND . . .	100%
Federal Adjusted Taxable Estate	\$300,000
Maximum Credit for State Death Tax 3600 + (.032 x 60,000)	5,520
ND Tax = 1.0 x 5520 =	<u>5,520</u>
TOTAL ESTATE TAX	\$ 30,520

B. Federal Gift Tax

The federal gift tax is imposed on outright gifts given during life. Not all gifts are subject to the tax. The first \$10,000 worth of gifts to each donee during a calendar year are excluded from the total amount of taxable gifts for that calendar year. A person may give each of his children \$10,000 per year without filing a gift tax form. Gifts given by both the husband and wife together can total \$20,000 to each beneficiary each year tax free.

One of the underlying themes of the Tax Reform Act of 1976 is to treat lifetime transfers of property (gifts) the same as death time transfers (estates). The same rate schedule is used in determining the tax due on gifts and estates and the person making the gifts is liable for the tax.

The unified tax credit is a lifetime credit for all gifts given. The credit may be used in a single year or over a number of years as the donor wishes. However, it appears that it must be taken against a taxable amount at the earliest opportunity and cannot be "saved" for later use by paying a tax now. The credit for gift taxes, as with the estate tax credit, has a larger effect on donors with moderate incomes than the old law. But, consistent with the theme of treating gift and estate taxes the same, where there has been a taxable gift, whether the credit is applied to the gift taxes due or not, that taxable value will be included in the donor's estate for estate tax computation purposes.

The unified tax credit was \$47,000 in 1981. Beginning in 1982 the unified credit will be increased over a five-year period to \$192,800 (see page 15). The unified credit applies only to taxable gifts.

"Exclusions" allow many gifts to be given before a taxable gift arises. There is an unlimited marital deduction exclusion in addition to the \$10,000 per donee annual exclusion. As a result one spouse may make unlimited gifts to the other spouse without incurring gift tax liability. Also, gifts to charitable, religious, and educational institutions are deductible.

C. The Impact of the Economic Recovery Tax Act of 1981
on Estate Planning: Gift and Estate Taxes

The following examples further show the interrelation of gift and estate taxes under the new law and the effect of gifts in reducing the total tax liability in most situations. For the sake of computational ease, the \$10,000 exclusion per donee is not included in these calculations.

It will be assumed in all these situations that the decedent died in 1987, after the new tax law has taken full effect. It is also assumed that the decedent is married when he dies, and that all gifts were given in 1981. Effects of the new law vary only in degree for larger estates.

The table below shows how the new law affects estate taxes where no lifetime gifts were given to the surviving spouse:

Death in 1981 (Old Law)

Decedent's Estate		At Surviving Spouse's Death Five Years Later		At Surviving Spouse's Death 10 Years Later	
Adjusted Gross Value	Taxes Due	Adjusted Gross Value	Taxes Due	Adjusted Gross Value	Taxes Due
\$ 600,000	\$ 40,800	\$ 600,000	\$121,320	\$ 600,000	\$145,000
750,000	66,300	750,000	161,520	750,000	201,000
1,000,000	108,800	1,000,000	233,520	1,000,000	298,000

Death in 1987 (New Law)

Decedent's Estate		At Surviving Spouse's Death Five Years Later		At Surviving Spouse's Death 10 Years Later	
Adjusted Gross Value	Taxes Due	Adjusted Gross Value	Taxes Due	Adjusted Gross Value	Taxes Due
\$ 600,000	0	\$ 600,000	\$ 0	\$ 600,000	\$ 0
750,000	0	750,000	55,500	750,000	55,500
1,000,000	0	1,000,000	153,000	1,000,000	153,000

The above tax table contains the gross value of the decedent's estate and the corresponding taxes due for the three estate sizes. Because the decedent has given no gifts, the estate tax will have its full effect. Because the decedent was married when he died, if all property passes to the surviving spouse, no tax under the new law will be due as a result of the unlimited marital deduction. Property passing to persons other than the decedent's spouse, however, will be subject to taxation.

Assume that one-half of the estate passes to the decedent's spouse upon the decedent's death. The tax due at decedent's death will be determined by subtracting the marital deduction from the gross estate and applying the tax schedule (Table 1) to the remaining sum. This will yield the tentative tax. The tax payable then is determined by subtracting the unified tax credit from the tentative tax.

If we assume that five years later, after having paid the estate tax and other expenses, the estate has returned to its original value (this is not *unlikely* given the effects of inflation) estate taxes will again be due on the same size estate when the surviving spouse dies. This is called the second tax. The second tax is usually greater than the first tax since, if the spouse does not remarry, there can be no marital deduction. There is a special tax credit for this situation. If the spouse dies within 10 years of the decedent, a certain percentage of the first tax is allowed as a credit to reduce the second tax liability. This is a sliding credit, and it decreases the longer the spouse survives the decedent. There is no credit after 10 years. The sliding credit for taxes paid on prior transfers is computed as follows:

Spouse dies in first or second year after decedent's death	credit is 100% of taxes paid on decedent's estate
Death in third or fourth year	80%
Death in fifth or sixth year	60%
Death in seventh or eighth year	40%
Death in ninth or tenth year	20%
Death after tenth year	0%

In the second major column, entitled "Spouse's Death Five Years Later," is shown the estate tax on the same estates after the spouse's death five years later. There is no marital deduction, therefore, the tax due is computed on the full \$600,000. This yields a tentative tax in 1981 of \$192,800, which is reduced by the unified tax credit of \$47,000 to \$145,800. The tax credit allowed for the estate tax paid when decedent died (60 percent of \$40,800) is \$24,480, which reduced the tax due to \$121,320. If the spouse dies 10 years later, no credit is allowed for estate taxes paid upon decedent's death, so the tax due is \$145,800. As the above table illustrates, the \$600,000 estate has been subject to full estate tax liability twice within a relatively short time. The total amount of estate taxes paid is either \$162,120 or \$185,600, depending on when the surviving spouse dies. Some of

this tax liability, however, could have been avoided by distributing some of the property during life in the form of gifts.

The Economic Recovery Tax Act of 1981 effectively exempts smaller estates from federal estate taxation by increasing the amount of the Unified Tax Credit. In the above example, however, because no taxes were paid on the property at the decedent's death due to the large unified credit of \$192,800, no tax credit will be permitted for it in calculating the second tax. As a result, the tax to be paid if the spouse dies either 5 or 10 years later will be the same. In addition, less tax will be owed under the Economic Recovery Tax Act of 1981 than under prior law on all estates of equal value.

The increase in the unified tax credit and the unlimited marital deduction may make it advantageous to give large lifetime gifts to the spouse. Although the part of the estate not passing to the surviving spouse will be taxable at the decedent's death, the large unified credit will effectively exempt taxable estates of less than \$600,000 in value after 1987. The large unified credit also will prevent estates smaller than \$600,000 from being subject to the second tax when the surviving spouse dies.

The 1981 increase in the annual gift tax exclusion and the unlimited marital deduction for gifts to a spouse now make it possible to greatly reduce the size of an estate prior to death. The new tax law does, however, place certain restrictions on the time period before death in which the gifts must be given to be excluded from the gross estate. Transfers made within three years of death, other than gifts qualifying for the annual exclusion, are includable in the gross estate for purposes of determining the estate's qualification for special use valuation, deferral of estate taxes, and stock redemptions.

Tax results of giving certain gifts within three years of death can be harsh. These results emphasize the need for lifetime estate planning. Estate planning should be a continuous process, begun in middle-age or earlier. Property owners should not wait until their old age before making estate plans. These results also suggest that trusts may be useful estate planning devices.

VII. Estate Settlement Procedures and Costs and the Personal Representative

The Uniform Probate Code (UPC), as adopted in North Dakota, provides more family protection and allows for an informal administration of the estate. The greater family protection comes from provisions in the UPC concerning homestead survivor rights, exempt property entitlement, family allowance, and the augmented estate.

A. Five Settlement Procedures

Five settlement procedures are available in North Dakota: formal, supervised, "no-action," informal, and closings. They differ in the amount of court involvement and protection available to heirs, creditors, and property recipients. These proceedings can be combined, or one procedure may be used throughout the administration of an estate.

A formal testacy proceeding is initiated by a petition to the probate court and involves formal notices, hearings, and court dispositions of the issues concerning the estate. It is used primarily to determine whether the decedent left a valid will. The formal procedure ends with a hearing before the court to close the estate to further claims or challenges. Once all the formal requirements are fulfilled, court involvement ends.

Supervised administration is a single proceeding to secure complete administration and settlement of a decedent's estate under the continuing authority of the court. The court's authority extends until entry of an order approving distribution of the estate or a decree of distribution or other order terminates the proceedings. A supervised personal representative is subject to directions of the court concerning the estate on its own motion or on the motion of any interested party.

Under the so-called "no-action" option, no application seeking either an informal or formal appointment is filed within three years of death; thereafter, administration is barred by a three-year statute of limitations. Once administration is barred, creditors also are barred. Thus, an estate is seemingly settled by three years of inaction. The major reason why this process may not be practicable is that during the three-year period the property will be unmarketable. This results from the fact that it may be possessed at any time by a personal representative who may be appointed at the request of any interested person (e.g., an unsecured creditor). However, if the heirs assume and pay all known debts of the decedent, are willing to assume the risk that a disinheriting will may be found and probated, and are content to simply possess and enjoy the decedent's estate without marketing it, they may find settlement by inaction useful.

The informal proceeding also uses the three year statute of limitations for protection against other beneficiaries, heirs, or creditors. This proceeding allows probate of a will and the appointment of a personal representative. A will is final if it is not challenged during the statutory period; after the statutory period has run, good title for any assets passes to the devisees. The informally appointed personal representative has all the power and authority of one formally appointed but her/his right of appointment may be challenged in a later formal proceeding.

The informal proceeding can be started within five days of death by filing an application with the probate court to appoint a personal representative and by filing the will as a public document. The surviving spouse or a close relative may become the personal representative, who then collects the assets, sells the assets or distributes them to heirs, passing valid title or a deed with the property. These acts can be challenged by creditors or heirs, so liability to the personal representative and heirs may be created. The personal representative can obtain legal protection for all parties and assure marketable property titles by obtaining a formal closing proceeding.

The legislature intended the informal proceedings to be used in the administration of small, undisputed estates. The owner who plans his estate with the help of his attorney, accountant, and financial advisers, and helps his family understand his estate plan, is more likely to achieve his estate planning goals. The attorney should help both husband and wife understand the

estate settlement options and steps in each while formulating the estate plan. A well-planned estate should be easy to settle at a reasonable cost. The UPC permits the survivors to use only as much court administration as they feel necessary. They use a formal probate closing to terminate the informal procedures, obtain legal protection for all parties, and assure marketable property titles.

The closing may be initiated by the personal representative to obtain protection and court approval of her/his administration accounts and/or distribution of assets. This action is a separately authorized proceeding, although it can be a part of either informal or formal proceedings.

Some factors to consider in determining which procedure(s) to use in settling an estate are: (1) the value of the decedent's estate; (2) the applicable statute of limitations; (3) the degree of trust, cooperation, and agreement among the persons interested; (4) the decedent's expressed testamentary wishes; (5) the complexities of administration; (6) the degree of protection from liability needed by the successors and by the personal representative; and (7) proof of title to property requirements.

Competent legal advice is necessary in selecting the proper procedure to ensure that the best alternative is followed to protect all interests and eliminate any procedural steps not necessitated by the particular estate. Both the cost and time required to settle an estate will decrease the more a decedent has planned her/his estate before death. A person can do much before death through estate planning to eliminate possible legal contests between relatives which would require continuous court involvement in the probate proceedings. Also, when an estate requires a federal tax return, administrators often keep the estate open until the return has been audited and the taxes finally agreed to by the government. This may delay final distribution by several years.

B. What the Personal Representative Does

The Uniform Probate Code (UPC) permits estate settlement with or without administration. Probate with administration involves appointment of a personal representative (PR) while probate without administration does not. A personal representative is a person or legal entity appointed by a court, either in formal or informal proceedings, to administer an estate. The term personal representative includes "executor," who is a personal representative indicated by the decedent in a will.

The UPC substitutes an unsupervised personal representative for the close supervision previously required. It assumes that the PR will honestly administer the estate since he/she was selected by the decedent, by those who control a majority of the estate, or by the creditors of an insolvent estate.

The court may formally or informally appoint a special administrator of the estate. The duties of an informally appointed administrator include collecting and managing, preserving, and delivering the assets of the estate to the PR. The power of an informally appointed special administrator is the same as a PR. A formally appointed special administrator has powers similar to a PR except as they are limited by the court. In an emergency a special administrator can be appointed without notice or hearing.

The PR must be appointed by a court. The UPC sets the following priorities among persons seeking appointment: the person nominated in the will, the surviving spouse who will receive via the will, other devisees, surviving spouse (not a devisee), other heirs, and any creditor if no PR has been appointed after 45 days of death of the decedent. The PR must be at least age 18.

The PR must execute an acceptance of his appointment. No bond will be required unless specified in the will or by the court. The PR must notify all heirs and other interested parties within 30 days of his appointment and indicate the name of the court appointing him, his or her name, address, and whether a bond has been filed.

The PR is required to inventory the property of the estate and report a fair market value of the estate within three months of appointment. Appraisers may be hired. The inventory and appraisal may be filed with the court or sent to all heirs, devisees, and others requesting a copy. The PR is expected to take possession or control of the decedent's property, except as provided in the will. The PR shall pay any taxes due and take all steps reasonably necessary to manage, protect, and preserve the estate. The PR should publish, if such notice is not given, notice(s) to inform creditors to present their claims within three months or to be forever barred. Such claims against the estate will not be barred by the statute of limitations until three years after the decedent's date of death.

The PR has the same power over title to the estate property that an absolute owner would have. He must, however, hold the property in trust for benefit of the creditors and others with interests in the estate. His power to dispose of property may be exercised without notice, hearing, or order of court. The breadth of this power is accompanied by the absolute responsibilities of a fiduciary. If any one is hurt by actions of the PR, such party can petition the court for an order to remove the PR.

The PR pays taxes, creditors, and prepares the distribution of the remainder of the estate. The PR may prepare the distribution plan and notify the distributees, and if there is no objection within 30 days, can so distribute the residue. Or, the beneficiaries may suggest a plan and the PR may follow that plan.

The PR, after completion of his duties, may present a final account to the court fully reporting all his actions and intended final distribution. This report can be part of the informal or formal closing proceeding. The informal closing proceeding uses a verified report, and if no one objects within a year, the matter is closed and the appointment is terminated. The formal closing proceeding shows the intended final distribution, directs the court to approve the accounts and approve or order the final distribution, and discharges the personal representative from further claims or demands by heirs or creditors.

C. Settling Small Estates

Estates of \$15,000 or less, consisting solely of personal property, may be collected by affidavit 30 days after death without court action. If the

inventory and appraisal show that the value of the estate, less liens and encumbrances, does not exceed the homestead, plus exempt property, family allowance, costs and expenses of administration, reasonable funeral expenses, and the expenses of last illness, the PR may distribute the estate to those entitled without giving notice to creditors. The PR can file a verified statement of his actions. The PR's appointment terminates if no action is pending a year after filing the closing statement.

D. Time To Settle

It takes several months to administer an estate through the settlement procedure. The time required should be considered in planning for the needs of the family following the death of the estate owner.

The time period required to settle an estate varies with the type of estate being settled, age of decedent, desire of family to continue farming the estate property or to immediately settle it, and so forth. The family in joint tenancy estates often sees no reason to settle the estate immediately. This is reflected in the average number of months to settle joint tenancy estates found in a 1975 eastern North Dakota study of 996 selected estates. The overall averages were 17.4 months from date of death to the start of settlement procedures and 20.3 months from date of death to final settlement. The shortest period from date of death to settlement was one month and the longest in the survey was 198 months. One-fourth of the estates were settled within four months of death, one-half within eight months, and three-fourths were settled within 14 months of date of death.

The average time for probate estates from date of death to entering probate was 5.3 months and from date of death to final settlement was 17.5 months with a range of one month to 16 years and 5 months. Nearly one-half entered probate within one month of date of death, 70 percent within two months of death, and about 95 percent within one year of death. Only 10 percent were fully settled within seven months from date of death, 39 percent within one year, 71 percent within 18 months, and 87 percent within two years of date of death. The settlement period was longer in the more rural areas of the study. Settlement costs were usually higher in cases with longer settlement times. But it should be noted that often the farm is the only earning asset of the estate and the survivors may prefer to operate it instead of selling it to pay costs or distributing it to individuals.

The above statistics were gathered for estates settled under North Dakota law which has been superseded by the Uniform Probate Code that went into effect July 1, 1975. It is expected that both the cost and time required to settle estates have been reduced by the new UPC procedures.

Since many decedents now own property in more than one state at the time of death, an increasing number of estates are being probated in more than one state. This dual-probate situation is probably more expensive to the estate than if all the property were located in one state. The situation may be avoided through the timely use of the methods of property transfer presented above. The result will be to maximize the net amount of property passed.

E. Estimating Estate Planning and Settlement Costs

Estate planning and estate administration and settlement require the skilled services of an attorney. His/her role in our society is to provide these needed services. The compensation paid reflects the special training he/she has acquired and the special efforts he/she puts forth for his/her clients. The attorney must fully inquire into the nature and form of assets, the family situation, and the wishes of the individual. The amount of time required to do this is largely determined by the size of the estate and the complexity of questions involved.

The attorney's fees listed here should only be taken as a rough indication of what minimum costs might be. Each lawyer must be consulted to find out what he/she would charge. The matter of attorney's fees should be settled before legal consultation begins.

1. Performing legal services in estate planning for a:

a. Simple will	\$ 35-\$ 50
b. Simple will with trust for minor children	\$ 60-\$100
c. Complex will	\$ 75-\$100
d. Will with trust provisions	\$150-\$250
e. Will with two trusts	\$200-\$300
f. Establishing single trust during lifetime of testator	\$150-\$200
g. Simple will modification (codicil)	\$ 30-\$ 50
h. Complex codicil	\$ 50-\$ 75

2. Performing estate administration and settlement legal services:

a. Estate administration and settlement costs:

(1) Probating estate is based on 4 percent of the first \$25,000 of taxable value; 3 percent of taxable value between \$25,000 to \$200,000; and 2 percent of value in excess of \$200,000. Normal fee where taxable value is less than \$8,850 is \$350.

(2) Summary administration, with or without will where estate value is under \$5,000 . . . \$250 or hourly

(3) Summary administration by affidavit where estate value is under \$500 \$ 50 or hourly

b. Handling estate tax proceedings on joint tenancy transfers, and on lifetime transfers and trusts which are effective and/or taxable at death:

- (1) Where appraisal and federal estate tax returns are necessary, use percentages for probating estate but applied to one-half the taxable values.
Where no federal estate tax form is needed
. \$300 or hourly

c. Fees of an executor or administrator: In 1970 the law stipulated these charges at 5 percent of the first \$1,000 of value, 3 percent of next \$5,000, 2 percent of the next \$44,000, and a fee not in excess of 2 percent of the value above \$50,000 as allowed by the court; plus charges for extraordinary services and out-of-pocket expenses as allowed by the court. Current law provides only that "reasonable compensation" will be provided for such services. The supervising court may look to previous statutory guidelines in determining whether the fee is reasonable.

3. Guardianships:

- a. Securing appointment and filing inventory . . \$200 or hourly
- b. Sale of real estate \$150 or hourly
- c. Filing of annual or final account, hearing and its approval \$100 or hourly

Many attorneys charge for the above services on an hourly basis. It is therefore imperative that the client discuss fees to determine what his/her attorney will charge.

VIII. Conclusion

Transferring assets from one generation to the next can be costly. Estate planning can reduce these costs, but more important, it will yield more retirement income and achieve your other goals. The avoidance of probate by itself is not necessarily good estate planning. Probate is concerned with ownership and to avoid probate requires prior establishment of the correct title to your assets, naming a beneficiary, or creating a living trust. Each of these will require careful planning and the services of an attorney to set them up and to see that certain documents are prepared in order to meet state and federal tax laws.

The goal of this report is to help you achieve your retirement income and estate planning objectives. One aspect of this is the awareness of the fact that you need to plan, to prepare a will, and to openly inform your family of your estate plan. Another is to prepare you to better use your attorney and your team of estate planning experts. They will treat your affairs confidentially, but they can only best serve you if you are completely honest with them. Start now to prepare your "Family Financial Report," an outline for which is presented on the last page of this bulletin.

IX. Basic Requirements for Orderly Estate Settlement

The following is a summary of the basic requirements for orderly estate settlement.

1. Location of Valuable Family Records--Prepare an inventory of all valuable family records and make sure that your survivors know where these records are kept. Include such documents as deeds, wills, leases, marriage and birth certificates, citizenship papers, social security records, nonfarm investments, stocks, bonds, insurance policies, and so forth.
2. List of Valuable Consultants--Prepare a list giving the name, purpose or use, and telephone number of people usually consulted on legal, personal, and business matters. These should be people whom your survivors may turn to for assistance in times of stress and in family estate planning in your absence.
3. Discuss Your Family Estate Plan With the Persons Concerned--These proposals affect the interest and welfare of the entire family and therefore should be discussed with those involved. It is important that if the child is to take over the family farm that he understand your plans, and that other members of the family also are aware of these plans.
4. Provide Your Estate With Liquid Reserves--It takes money to settle estates and debts, and taxes must be paid. On the average, plan that it will take 7 to 25 percent of the gross value of the estate for estate settlement expenses.
5. Provide for Your Survivors During Estate Settlement--It requires money for your survivors to live during the estate settlement period. It takes several months to more than a year to settle an estate; and depending upon the size of your family, the amount of money necessary to live in this period will vary.
6. Keep Your Family Estate Plan Up To Date--The estate plan should be revised due to changing family composition, in-laws, changing financial conditions, changes in the name of the administrator, changes in beneficiaries, and so forth.
7. Keep Your Financial Affairs in Order--Many estates studied have had large unpaid taxes due, mortgages due, and other financial obligations that seriously reduced the amount of assets available for transfer. These substantial obligations or debts sometimes require the sale of the estate assets to pay them or impose financial hardship upon the survivors, which could have been avoided by using term insurance and/or keeping things in good order.

The combination of retirement income and estate planning requires financial planning, with an emphasis on the investment specialist. He/she may need the help of your accountant and your insurance agent to bring about the best financial plan to achieve your goals, and your attorney to put your

estate plan into the framework of the law. Expect to change your financial plan from time to time, and update your estate plan as situations change. Plan to enjoy your well-earned retirement. Now is the time to start planning.

X. Glossary

Administrator--A person authorized to manage and distribute the estate of an intestate; a person appointed by the court to manage and distribute the estate of one who has not appointed an executor or whose executor has not qualified.

Beneficiary--One who receives something, such as the income of a trust.

Codicil--An amendment to a will. It is treated as a part of the will. An addition to a will executed with traditional formality.

Conservator--A person appointed by the court to manage property and affairs of another person who is unable to do so.

Decedent--A deceased person.

Distributee--A person entitled to share in the distribution of an estate.

Donee--A recipient of a gift; one to whom a gift is made or bequest is given.

Donor--One who makes a gift or voluntary transfer.

Equitable--Just; conforms to the principles of justice and right.

Estate--One's property; also, specifically, the interest which anyone has in real property.

Estate Tax--A "death" tax payable by the estate of the decedent, not by the heirs.

Executor--A person to whom a testator by his will commits his last will for execution.

Fiduciary--(Person of trust or faith) executor, trustee, guardian, conservator. The trustee named in the will or trust agreement.

Forced Share--A percentage of an estate which must be given by law to the spouse if the spouse wants it.

Gift--A voluntary transfer of personal property or the conveyance of real property without consideration.

Half Blood--A term indicating the degree of relationship which exists between those who have the same father or the same mother, but not both parents in common.

Heir--The person who, by law, is declared to be the person who will take the property of the deceased if the deceased makes no other provision. Also, the person who does, in fact, succeed to the decedent's property.

Holographic Will--A will written by the testator in his own hand.

Inheritance Tax--A "death" tax assessed against the heir(s) or person(s) inheriting the assets.

Intestacy--The state of having died without making a will.

Intestate--Having no valid will.

Joint Tenancy--When two or more people hold undivided interest in the same property which was conveyed under the same instrument at the same time; a joint tenant can sell his interest, but he cannot dispose of it by will; upon his death his undivided interest is distributed among his surviving joint tenants.

Lifetime Gift--A gift properly delivered during the lifetime of the donor and donee.

Liquid Assets--Assets readily converted into cash.

North Dakota Century Code--Name given to the 1960 codification (classification) of the North Dakota statutes (laws) and amendments thereto.

Personal Representative--Refers generally to the person who carries out the duties of an executor or an administrator, in the distribution of property via a will or under the laws of intestacy. The appointment of a personal representative is made by the court. If a specific person is named as the personal representative (executor) in the will, the court will usually agree to appoint that person.

Per Stirpes--(By branches of families) by right of representation. Example: father had three children. One child has died leaving two sons. Father dies leaving his estate to be divided per stirpes, so that his two surviving children each receive one-third share, and the two orphaned grandsons each a one-sixth share.

Probate--Action to establish that a will is genuine and valid. The procedure by which the property of a decedent is passed from the estate to his heirs in the general sense.

Probate Courts--County court that handles estates and guardianships and sometimes other duties.

Real Property--Land and things that are attached thereto.

Tenancy-By-The-Entirety--A type of cotenancy between husband and wife, in some states, which is characterized by the fact that neither party can sever it and destroy the other's right of survivorship. Upon the death of one, survivor acquires title to the property. It does not exist in North Dakota.

Tenancy-In-Common--Two or more persons holding undivided interest in the same land as tenants-in-common with no right of survivorship, but each tenant-in-common can sell or divide his share. A tenant's portion passes to his heirs upon death.

Testate--Deceased leaves a valid will.

Testator--One who makes or has made a will.

Testatrix--A woman who makes or has made a will.

Trust--A property interest, real or personal, held by one person for the benefit of another.

Trustee--A person to whom property is legally committed in trust with the understanding it is to be administered for the benefit or use of another.

Trustor (Settlor)--The person making a trust.

XI. Additional Information

Additional information on estate planning may be found in the following books. These books may be in your local library or may be purchased from the publisher cited. Books like these are updated frequently to reflect changes in the law. Always ask for the most recent edition. Some of the specific books listed here, for example, may not contain the most recent changes in estate tax law.

Estate Planning

- Ashley, Paul P., *You & Your Will: The Planning & Management of Your Estate*, rev. ed., 1978, \$13.95 (ISBN 0-07-002415-4), McGraw.
- Clifford, Denis, *Planning Your Estate*, 1979, paper, price not indicated (ISBN 0-917316-24-X) Nolo Pr.
- Covey, Richard B. *The Marital Deduction & the Use of Formula Provisions*. 2nd ed. 1978, with 1979 suppl \$17.50 (ISBN 0-672-83719-4 Bobbs-Merrill Law); suppl \$5.00 (ISBN 0-672-83718-8). Michie.
- Denhardt, J. G., Jr., *Everyone's Guide to Estate Planning*, 1979, \$7.95 (ISBN 0-8092-7329-2), Contemp Bks.
- Dixon, Lawrence W., *Wills, Death & Taxes: Basic Principles for Protecting Estates*, rev. ed., (Quality Paperback No. 228) (Orig.), 1979, pap. \$2.95 (ISBN 0-8226-0228-8), Littlefield.
- Douglas, Paul. *Guide to Planning the Farm Estate, With Checklists and Forms*. 2nd ed. (IBP In Estate Planning & Administration) 1979, \$29.95 (ISBN 0-87624-172-0) Inst Busn Plan.
- Estate & Financial Planning for the Closely Held Corporation 1979 Course Handbook* (Tax Law & Estate Planning Course Handbook Ser. 1978-79; Vol. 97). 1979. pap. \$20.00 (ISBN 0-686-50961-7). PLI.
- Faberty, Patrick F. & Richard S. Ziegler, *Estate Planning for Everyone*, rev. ed., 1979, \$14.95 (ISBN 0-308-10346-7), T. Y. Crowell.
- Ford, Curtis B, *How to Establish an Estate Analysis Practice*, 1978, looseleaf, \$21.50 (ISBN 0-87218-001-8), Nat'l. Underwriter.
- Fundamental Concepts of Estate Planning Nineteen Seventy-Nine Course Handbook* (Tax Law & Estate Planning Course Handbook Ser., 1978-79: Vol. 97), 1979, pap. \$20.00 (ISBN 0-686-50969-2), PLI.
- Gargan, John J., *The Complete Guide to Estate Planning*, (Spectrum Reference Shelf Ser.) 1978, \$10.95 (ISBN 0-13-159996-8, Spec), P. H.
- Hinckley, Clive, *Settling and Safeguarding Estates in California Without an Attorney-with Forms*, 1979, pap. \$8.95 (ISBN 0-686-11165-6), C. Hinckley.
- Hoffman, William H. *Annual Edition of West's Federal Taxation*. 1979. Corporations, Partnerships, Estates, & Trusts.

- Holzman, Robert S. The Complete Book of Estate Planning. rev. ed. 1979, \$50.00 (ISBN 0-685-53354-9). Boardroom Rept.
- How to Beat the Money Grabbers: The Essentials of Estate Planning, 1979, \$14.95 (ISBN 0-87000-442-5), Arlington Hse.
- How to Save Taxes Through Estate Planning, 1979, pap. \$7.95 (ISBN 0-87128-576-2), Dow Jones.
- Hower, Dennis R. Wills, Trusts, & Estate Administration for the Paralegal (Paralegal Ser.). 1978 text ed. \$16.95 (ISBN 0-8299-2012-9). West Pub.
- Institute for Paralegal Training. Introduction to Estates & Trusts. Stern, Steven and Caroline S. Loden, eds. (Paralegal Ser.). 1979 text ed. \$16.95 (ISBN 0-8299-2025-0). West Pub.
- Kirby, Jack A., Estate Planner's Kit, (Estate Planning and Administration Ser.), 1978, \$39.50 (ISBN 0-87624-140-2), Inst. Busn. Plan.
- Lane, Laura, ed., Farm Journal's Estate Planning Idea Book, 1978, \$16.95 (ISBN 0-89795-000-3), Farm Journal.
- Lewis, James B. The Estate Tax, 4th ed. 1979 text ed. \$45.00 (ISBN 0-685-94307-0). PLI.
- Lippett, Peter E. Estate Planning, What Anyone Who Owns Anything Must Know. (illus.) 1979, \$14.95 (ISBN 0-8359-1778-9). Reston.
- Looney, J. W. Estate Planning for Farmers. 3rd ed. Tom Corey, ed., 1979, pap. \$8.25 (ISBN 0-932250-06-8). Doane Agricultural.
- Lynn, Robert J. Introduction to Estate Planning in a Nutshell. 2nd ed. (Nutshell Ser.). 1978, pap. text ed. \$5.95 (ISBN 0-8299-2011-0). West Pub.
- McNulty, John K. Federal Estate & Gift Taxation in a Nutshell, 2nd ed. (Nutshell Ser.). 1979 pap. text ed. (ISBN 0-8299-2043-9). West Pub.
- Milam, Edward E. and D. Larry Crumbley, Estate Planning: After the 1976 Tax Reform Act, new ed., 1978, \$14.95 (ISBN 0-8144-5468-2), Am Mgmt.
- Ninth Annual Estate Planning Institute, (Estate Planning & Administration Course Handbook Ser. Vol. 92), 1978, \$20.00 (ISBN 0-685-63715-8), PLI.
- Plutzer, Louis. Estate and Gift Tax Provisions (Fourth Ser.). 1979. pap. write for info. (ISBN 0-917126-07-6). Mason Pub.
- Plutzer, Louis. Estate and Gift Tax Provisions Update. 1978. pap. write for info. (ISBN 0-917126-06-8). Mason Pub.
- Post Mortem Estate Planning 1978, (Tax Law & Estate Planning Course Handbook Series 1978-79: Vol. 94), 1978, pap. \$20.00 (ISBN 0-685-90314-1) PLI.

Practical Will Drafting 1978, (Tax Law & Estate Planning Course Handbook Series 1978-79: Vol. 93), 1978, pap. \$20.00 (ISBN 0-685-90307-9), PLI.

Spiro, Herbert T., Financial Planning for the Independent Professional, 1978, \$23.95 (ISBN 0-471-03111-9, Pub. by Wiley-Interscience).

Sterling Swift Publishing Co. Co-Op East Law Outlines: Wills and Estates. (Co-Op East Law Outlines Ser.). (Orig.). 1976. \$6.95 (ISBN 0-88408-086-2). Sterling Swift.

Stoeber, Edward A. How to Use Life & Health Insurance In Business & Estate Planning. 2nd ed. 1979. pap. \$15.00 (ISBN 0-87218-402-1). Natl Underwriter.

Taubman, Eph & Max K. Lerner eds. In the Matter of the Estate of Mark Rothko. 1978. pap. \$8.00 (ISBN 0-88238-087-7). Law Arts.

Retirement Income

Barnes, John. More Money for Your Retirement. 1978. \$9.95 (ISBN 0-06-010228-4). Harper-Row.

Hardy, C. Colburn. ABC's of Investing Your Retirement Funds. 1978. \$22.50 (ISBN 0-685-67909-8). Med Economics.

Knoles, Jere J. Individual Retirement Accounts Handbook. 1978. \$29.95 (ISBN 0-87624-256-5). Inst Busn Plan.

Marcus, Bruce W. The Prudent Man. 1978. \$49.95 (ISBN 0-9601610-0-7). ESP Corp.

Melnick, Jack. Step-by-Step Guide to Your Retirement Security. 1978. \$8.95 (ISBN 0-8129-0752-3). Times Bks.

Retirement Dollars for the Self-Employed. pap. \$3.95x (ISBN 0-686-05669-8). Dun.

Swartz, Melvin J. Don't Die Broke! A Guide to Secure Retirement. rev. ed. 1978. pap. \$3.95 (ISBN 0-525-47499-4). Dutton.

Unthank, L. L. & Harry M. Behrendt. What You Should Know About Individual Retirement Accounts. 1978. \$12.95 (ISBN 0-87094-156-9). Dow Jones-Irwin.

XII. Family Financial Report

Net Worth Statement as of _____, 19____.

Assets	Husband's Name	Wife's Name	Held Jointly	Annual Income
	-----Dollars-----			
A. Fixed Dollar				
1. Cash: a. on hand	_____	_____	_____	_____
b. in checking accounts	_____	_____	_____	_____
c. in savings accounts	_____	_____	_____	_____
2. U.S. Savings Bonds	_____	_____	_____	_____
3. Other bonds and preferred stocks	_____	_____	_____	_____
4. Cash value of life insurance	_____	_____	_____	_____
5. Money owed you	_____	_____	_____	_____
B. Equities (assets whose value is subject to inflation)				
1. Farm real estate (current market value)	_____	_____	_____	_____
2. Other real estate (rural and urban)	_____	_____	_____	_____
3. Business interests	_____	_____	_____	_____
4. Common stocks	_____	_____	_____	_____
C. Other Assets Owned				
1. Household furnishings	_____	_____	_____	_____
2. Farm personal property	_____	_____	_____	_____
3. Other personal property (car, boats, jewelry)	_____	_____	_____	_____
4. Current cash value of pension plans	_____	_____	_____	_____
TOTALS	_____	_____	_____	_____
				Annual Interest Charges
Liabilities				
1. Amounts owed to banks	_____	_____	_____	_____
2. Mortgages and land contracts payable	_____	_____	_____	_____
3. Loans on life insurance	_____	_____	_____	_____
4. Installment payments	_____	_____	_____	_____
5. Other loans and notes payable	_____	_____	_____	_____
TOTALS	_____	_____	_____	_____
(assets minus liabilities)	_____	_____	_____	_____
Net Worth	_____	_____	_____	_____

