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Planning the Farm Estate

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Estate planning is one of the most important activities you can undertake. It is important because it deals with **your property**, the estate, and **your loved ones**, who will receive the estate upon your death.

THE FARM ESTATE

Your estate includes all things of value in which you have ownership interest.[1] This includes all real property (your farm, buildings, other land, and things attached to the land), as well as all your personal property (machinery, trucks, car, livestock, stocks, notes, etc.). An estate inventory includes bank accounts, bonds, stocks, notes, mortgages, accounts receivable, life insurance, legal description of real estate, business investments, and a listing of significant pieces of personal property.

As important as what you own is how you own it. **Fee simple** is the most common form of outright ownership. It allows exclusive use and the sole right to dispose of property. Variations of this form of ownership include those that condition the use of the property (**fee simple determinable**). An important form of ownership interest is a **life estate**. A piece of land, for example, can be conveyed to another person for life. The length of the person's life determines how long rights in the property last. A **remainder** ownership interest is current recognition of who will have rights to the property when the person having the life estate interest dies. It is possible, for example, for a man to give a life estate interest in his farm to his wife and remainder interest to his children. It should be noted, however, that such an arrangement creates serious commercial transfer problems.

Under **co-ownership** of property, two or more persons share the ownership of the same piece of property at the same time. Such property can be held as **tenants-in-common** or as **joint tenants**. Property held by tenants-in-common indicates that the parties each own undivided shares of the property. Upon the death of one tenant, his share of the property is transferred to his heirs. Joint tenants, on the other hand, have an agreement to transfer the property in its entirety to the surviving tenants.

All real and personal property (including life insurance proceeds and joint tenancy property) is considered the gross estate of a deceased person. The concept of gross estate is used in determining tax liability. The probate estate usually is less than the gross estate. The probate estate, for example, does not include life insurance proceeds[2] and joint tenancy property. Although a list of nonprobate items must be filed with the probate court, the probate court transfers ownership of only certain property. Insurance and joint tenancy property are transferred by means of contract. The means whereby other components of an estate can be transferred or distributed can be selected or modified according to your goals.

PLANNING GOALS

Estate planning is a complex process because it involves satisfying multiple goals, usually with sophisticated legal and business instruments. You will need professional advice in developing your estate plan.

You may have several goals. You may want to provide one or more of your survivors with income security. You may wish to provide maximum opportunity to a son to continue operating the farm or to get started in farming. You may want to assure that the farm will stay in the family and be operable as a single unit over time. You may want to treat your children equitably, but not necessarily equally. You may want one son to have specific items of your real or personal property upon your death.

All specific estate planning goals usually reduce to three major objectives:

"1. Transfer the largest amount of property to the heirs;
2. Provide income and capital security for the parents; and
3. Direct the distribution of the estate assets."[3]

However, no two people are likely to attach the same weight to their goals, so estate planning is a highly individualized process. It is usually individual enough, in fact, to cast doubts on anyone advocating a single estate plan as best.

COMMON ESTATE PLANS

You have an estate plan even if you haven't overtly developed one. The state legislature has a plan for each citizen that will be your plan unless you developed a contrary, legally acceptable alternative.

The plan provided you by the state can be regarded in two parts: estate settlement procedures and the distribution formula (intestate succession).

Estate Settlement. The legal procedures for settling an estate are prescribed by the probate code, a group of statutes detailing the authority of the probate court and the steps it follows in handling an estate. Additionally, probate court rules have been drafted to guide probate judges in their responsibilities. Each county has a probate court. It deals with estates of persons residing in that county. Probatable property physically located in other states is probated in the state where it is located.

At your death, your estate will need to be managed. If you have an operating farm, a farm manager may need to be designated. In any circumstance, your representative will be appointed by the probate court. If there is a will, the representative is called the **executor** (if a man) or **executrix** (if a woman). If there is no will, the representative is called the **administrator** or **administratrix.**

If there is a will, someone must start the proceedings by offering the will for probate. This is done by filing a written petition with the court. If there is no will, the procedure is similar. The surviving spouse, next of kin, or creditors may apply to the court for an administrator to take charge of the deceased's property.

Where a will is involved, the court will set and publish a date for "proving up" the will. Witnesses who originally signed the will may be called to the court. If they are dead or unobtainable, other ways of proving a will are used. Objections may be made and, if they are, the court may establish a time to determine the validity of the will. Once proven, the will is recorded in the clerk's office and an official copy is given to the executor.

The representative may be asked to file a bond to guarantee faithful per-

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* The author anknowledges the helpful comments of Professor Robert Stein of the University of Minnesota Law School; George Kerr, Rochester attorney; and Steven Dokken, Faribault attorney. All errors are the author's. Matters of law should be checked with your attorney before you initiate estate plans.

[1] Minn. Statutes 525.13: ". . . the word estate includes every right and interest of a decedent in property, real or personal, except such as are terminated or otherwise extinguished by his death." Also see page 4, U.S. Estate Tax Return, Form 706, U.S. Treasury Department, Internal Revenue Service.

[2] Except where the beneficiary named is the estate itself.

[3] M. D. Boehlje and L. M. Eisgruber, "Estate Management for Indiana Farm Families," Agricultural Experiment Station manuscript (processed), Purdue University, Lafayette, Indiana, August 1970.

formance of his duties in handling the estate. Upon appointment, the representative takes possession of all personal property owned by or belonging to the decedent at the time of his death. The representative's first important job is to inventory the estate and file this with the probate court. He collects all debts owed the deceased, pays all creditors, and even may sue to recover money or property due the deceased person.

The estate is held open for a period to permit all persons owing or owed by the estate to register claims. Some early distributions of the estate may be made to heirs if the court decides that creditors' interests are protected. After an appropriate notice, the representative must distribute the property in accord with the will or provisions of the law, whatever the case may be.

The executor or administrator makes reports to the court on his progress in settling the estate, including proof of tax payments. After he has finished his prescribed duties, he files a final report and petitions for discharge. When his report is accepted by the probate court, the estate is considered settled.

Intestate Succession. When a person dies without a will, he is said to have died **intestate.** Probate assets owned by him at the time of his death will be distributed according to a fixed plan provided by the statutory law of Minnesota. The plan is referred to as intestate succession. This plan can be complex, depending upon the family situation involved. Ask an attorney how it fits your special circumstances.

The general pattern of estate distribution under state law is characterized in figure 1. Property distributed by the probate court for the person dying without a will goes to his wife (husband), children, and grandchildren first. If there is no spouse, children, or grandchildren, the estate goes to the deceased's parents. Where there is no spouse or children and the parents are dead, the estate is distributed to brothers, sisters, and/or nephews and nieces. Beyond these, distant relatives have an interest in the estate. Where no heirs can be identified, the property reverts to the state.

If you do not have a will and if all or part of your estate will be distributed by the state law of intestate succession, you should learn exactly who will get what. The best way to learn how this law would operate in your case is to contact your attorney and have him explain it to you.

Social Security. The survivors' benefits program administered by the Social Security Administration is another estate plan that most people have. Most farmers qualify for this program. It provides a modest lump sum payment to a surviving heir to aid in burial expenses. Additionally, certain income is available to a surviving spouse and/or children, depending upon their ages.

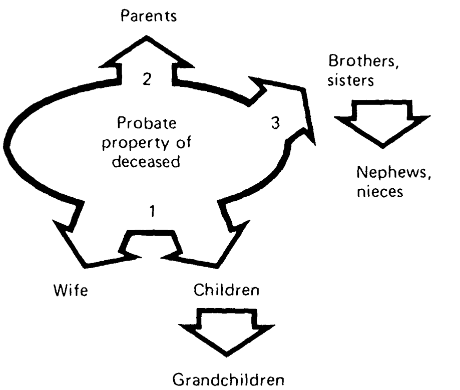

Figure 1. Patterns of estate distribution under Minnesota law.

This program was not intended to provide adequate income for survivors of a bread winner. It was developed to provide some income and to serve as a base for a more comprehensive estate plan. Such a plan would involve the use of wills, joint tenancy, insurance, trusts, gifts, sales, and business organization.

ESTATE PLANNING TOOLS

An entire estate plan frequently involves several subplans. If you have no will and have done no planning, your complete estate plan consists of your social security (a subplan) and the state laws of intestate succession (a subplan). A person who has a will has replaced the state subplan with one of his own. Other subplans can be developed using form of ownership (joint tenancy), insurance, trusts, gifts, sales, and business organization as your tools.

Wills. A will is a legal instrument you can use to direct the probate court in distributing your estate. If the will is properly drawn and doesn't violate the law, it will be accepted by the probate court to replace the law of intestate succession.

Any person of legal age and sound mind can make a will.[4] By making a will, a person can decide who'll receive his property, how much they'll get, how they'll own it, and, to some extent, what they can do with it. A person making a will is called a **testator** and is said to have died **testate.**

The restrictions of the testator are few. The most important limitation prevents a person from depriving a spouse of his (her) share of the property. If a will gives a spouse less than he (she) is entitled to under state law, the spouse can reject the will and take the share provided by state law. The amended will would still operate in disposing shares to other heirs. Other than his spouse, the testator can disinherit anyone, but he must express his intent in the will.

Most people should have a will. The unusual cases where a will is not needed may include (1) where the state plan exactly conforms to your desires, (2) where the probate estate is only personal property and amounts to less than $3,000 in value, and (3) in very large or complex estates that more favorably employ other legal tools. Buying the services of an attorney to draw a will is still the best buy of all legal services.

Joint Tenancy. Husband and wife frequently own their home as **joint tenants** (with right of survivorship). Upon the death of one tenant, the property automatically transfers to the other. Several people can hold property in joint tenancy. If, for example, a father holds land with his three sons, all four as joint tenants, and the father dies, the sons will continue to hold the property as joint tenants.

Many people see the advantages in holding property in joint tenancy, but not the disadvantages. For example, all joint tenancy property does not avoid estate taxes. All of the property is subject to taxation upon the death of one joint tenant, unless rebutted. Further unique situations may arise to form results not intended by the parties to the ownership form. A lawyer can explain which parts of your property should be held in joint tenancy and why.

Insurance. Life insurance, of course, is a contract that offers a sum of money paid to designated beneficiaries upon your death for a series of smaller money payments (premiums) during your life. Policy types vary by the amount of investment and protection built into each contract. **Term** insurance represents protection only. No recoverable (face) values are accrued during the premium paying period. **Endowment** contracts are at the other end of the spectrum. Substantial accrual values (investment) are built up over the policy period, with limited protection offered. Between these extremes are such popular policies as whole life.

Life insurance probably should be part of your complete estate plan. Life insurance can be used to assure income for parents (retirement), for achieving special objectives with children (educational funds, trust funds, etc.), and for providing liquid assets available in settling the estate. Life insurance also has the virtue of immediate estate creation for a young man. Life insurance has proven to be a flexible estate planning tool. You should discuss your insurance needs with a reputable life insurance professional and other estate planners.

Trusts. A **trust** is an arrangement whereby you give up manangement con-

[4] Minn. Statute 525.18, Subdivision 1: "Every person of sound mind, not a minor, may dispose of his estate, or any part thereof, or any right or interest therein, by his last will in writing, signed by him or by some person in his presence and by his express direction, and attested and subscribed in his presence by two or more competent witnesses."

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trol of property to achieve specific estate planning, personal, or business goals. In effect, you entrust some of your property to a **trustee**, asking him to use the principal or proceeds to benefit a **beneficiary** of your designation. Depending on the type of trust you put into effect, you may be able to avoid certain estate taxes and probate costs. The nature of the trust and what it can do for you are complex areas. A person shouldn't try to develop a trust without competent professional guidance.

One kind of trust is called a spendthrift trust. A sum of money is placed in trust with stipulations to the trustee that the beneficiary can not deplete the principal except at a prescribed maximum rate. A variant of this type is where large sums are involved and a wife does not feel confident in her ability to invest it wisely. A trust may be created upon your death if you outline its provisions in your will and direct property to it. This type is called a testamentary trust. Other types are available. Trusts are flexible legal instruments that deserve your consideration.

Gifts. Gift giving is a useful way of transferring portions of your estate to your heirs while you're still alive. Estate transfer is used by persons who want to see the benefits bestowed upon their heirs or persons who want to avoid substantial estate tax payments.

Gifts that are not taxed (either income or estate taxes) must meet certain legal specifications. Gift giving must be an established and varifiable practice. For example, gifts given less than 3 years prior to death may be regarded as gifts made in contemplation of death and could become subject to estate taxes. Gifts cannot exceed prescribed limits without incurring a gift tax liability. Each person has a single exemption of $30,000 and $3,000 per year per donee (gift receiver). Thus, a farmer could give $60,000 over a 10-year period to one son without incurring estate or gift taxes.[5]

Gifts can be valuable as an estate planning tool. But they also can be improperly used. Children may say "give it to me now when I need it most." But parents, unable to foresee possible medical and living expenses, may be wise to keep gift giving to a minimum. As in all estate planning situations, general advice is of limited value.

Sales. The simplest way to transfer property and to obtain a money return is a sale. Your son, for example, could buy the farm from you. The money paid can be used for your income and capital security. Several variations can be developed using this popular estate planning tool.

The sale method can be combined with the gift idea. You could sell your farm to your son, having him pay only $7,000 of an annual payment of $10,000. The other $3,000 could be regarded as a gift.[6] Another technique would be to transfer a **remainder** (ownership) interest in the farm to the son, retaining a **life estate** interest for you and your spouse. A life estate interest allows you the right to use the property as you wish during your lifetime and the right to income from the property (in the form of rent). Income received by your son from operating the farm business would be his unless you made some other arrangement. Such an arrangement, however, would not save on estate taxes. And, as indicated earlier, this can create transfer problems.

A sale while you are living also can prevent a major family squabble. If you have two sons who both want the home farm and that farm is not big enough to support two families, you might be wise to sell it, even to someone outside the family.

Business Organization. How your farm business is legally organized affects your estate plan. If, for example, you are a sole proprietor and wish to leave the farm to your son, you may want to develop a **father-son partnership.** You should make such an arrangement formal by putting it in writing. Too frequently, partnership arrangements are not in writing and agreements reached between partners are lost upon the death of one partner.

Putting the agreement in writing also forces partners to stipulate what each partner will contribute to the business (capital, labor, management), how profit and losses will be shared, if salaries will be paid, and how decisions will be made. Shifting management responsibilities over time by drafting new agreements may be a way for a father to ease out and a son to take over the farm operation.

Incorporating the family farm business is becoming increasingly popular.[7] It has many estate planning advantages. With such a business organization, shares of stocks can be divided and transferred easily, joint ownership problems can be avoided, the farm can continue to operate as an undivided unit, gift arrangements can be facilitated, and preferred stock can be issued to the wife to assure some income for her. There are some disadvantages too. Much formality and red tape are involved, good accounting is needed, corporation meetings must be held, etc. You should consult an attorney when weighing this alternative.

ESTATE TAXES

Two taxes are levied upon property passing at death: the federal estate tax and the Minnesota inheritance tax. Other taxes important in estate planning include the federal and state gift and income taxes.

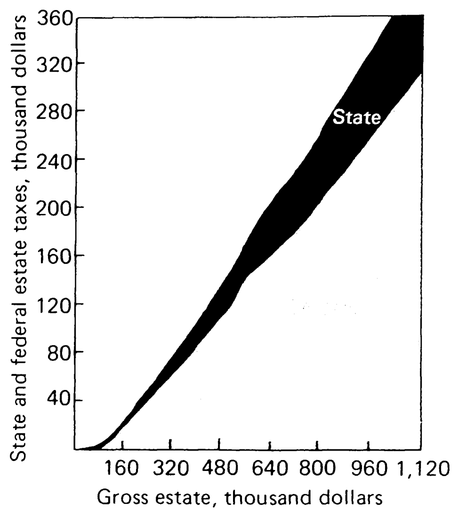

Figure 2. State and federal estate taxes in relation to size of gross estate.

The Federal Estate Tax. The federal estate tax is levied upon the value of property owned by the decedent at his death and other property transfers during his life in which he retained interest or control. As with the more familiar income tax, it is progressive (the rate goes up as the size of the estate increases). Also, certain deductions and exemptions are allowed. Items that can be deducted include debts, funeral expenses, costs of estate administration, certain losses, and amount of property left to charitable organizations. This includes property left to the surviving spouse (but not more than 50 percent of the adjusted estate).

An exemption of $60,000 also is provided for all estates. This means that the first $60,000, after all deductions, passes free of tax. With the deductions and exemptions taken together, a taxable estate transferred to a spouse is only taxed after $60,000 and then on less than half the remaining amount. A larger tax bite is felt when the surviving spouse dies, leaving the property to the children.

The federal estate tax rate starts at 3 percent for a taxable estate of $5,000 and ranges up to 77 percent for a taxable estate of $6 million (see figure 2). Obviously, large estates should be planned to minimize tax liability.

The Minnesota Inheritance Tax. The Minnesota inheritance tax also is progressive, ranging from 2 percent on a $30,000 taxable estate for a surviving wife to 10 percent on a $1 million estate. Minnesota's inheritance tax rates and exemption levels vary depending upon the kinship of the heir to the decedent. Wives receive a $30,000 exemption; minor children, $15,000; husbands, adult children, and their descendants, $6,000; and down to $500 for nonspecified beneficiaries.[8]

As with the federal tax, certain deductions are allowed. These include debts, certain taxes, funeral expenses, and es-

[5] It may be possible to give double this amount without incurring tax liability. See your attorney about the use of gift giving in your estate plan.

[6] The income tax consequences of such a method should be discussed with your tax accountant or attorney.

[7] Paul Hasbargen et al., *Corporate Farming*, Department of Agricultural and Applied Economics Staff Paper P70-7, St. Paul, Minnesota, May 1970. P. M. Raup, *What Policies Should We Have Toward Corporations in Farming?* Department of Agricultural and Applied Economics Staff Paper P69-25, St. Paul, Minnesota, December 1969.

[8] A wife also receives a homestead exemption of up to $30,000.

tate settlement costs. The total tax levied, both federal and state, is shown in figure 2. **Do not** use this graph to assess your personal situation. Certain assumptions were made in presenting it that may not fit your case. It is included to suggest rate changes and general magnitudes only.

Other Taxes. Other important taxes to consider in estate planning are gift taxes and income taxes. As noted previously, a planner should consider the possible advantages of paying a gift tax now over an estate tax later. Similar alternatives exist for income taxes. Your tax accountant or lawyer will consider these alternatives when he offers you advice. Gift taxes may be less familiar to you than income taxes.

There are both federal and state gift taxes. These taxes are levied on gift transfers made during your lifetime. The tax is due in the year the gift is given. And the gift must be a true gift. If a person gives $30,000 of land to his son, but retains control and use of it, the value of that land will be subject to an estate tax upon the death of the gift giver.

Gift tax rates are less than for estate taxes, thus encouraging gift giving as a means of minimizing tax liabilities. As indicated earlier, exemptions are provided in these laws. At the federal level, a single $30,000 exemption is provided to anyone and a $3,000 exemption for each gift receiver (a person could give $3,000 each to five people in a year without incurring a tax and without losing his $30,000 exemption privilege). The state gift tax allows an annual exemption. This, however, varies, depending upon kinship.

Taxes are an important consideration in estate planning, especially for large estates. More farmers are affected by estate taxes now than before because of increased land values and major capital items required in farming. It is important to stress that tax minimization is only one goal of an estate plan.

YOUR ESTATE PLAN

Estate planning involves at least four steps: estate inventory, goal specification, plan development, and re-evaluation.

Inventory. You should spend some time inventorying your estate now. You may be the only person who knows for sure the composition of your estate. Upon your death, your personal representative will be required by the probate court to develop an inventory. But he will not be sure he has a complete inventory, no matter how well he pieces things together.

Your attorney probably can provide you with estate planning inventory sheets for this purpose. If not, request a copy from the author.

Goal Specification. You must decide what, given the size and composition of your estate, you want to achieve, what income levels are needed for your surviving wife and minor children. What does your present plan provide? Do you want your son to take over your farm? How does he feel about it? Should your oldest son have the deer rifle? Should your niece have the set of china?

Consider not only what you want to do, but what you can do. The difference between what you want to provide and what you can provide may encourage you to develop a plan of estate creation, a matter not considered here.

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Plan Development. If you decide that your present plan is inadequate, you should seek planning help. Professional estate planners include lawyers, accountants, insurance agents, social security representatives, and bankers. If your estate is large or complex, all of these experts should be involved.

Act **now** to develop your plan. Too many problems have been created by the fellow who was going to write a will or change a deed but never did. Do it today.

Re-evaluation. Plans are made to fit a set of circumstances. When circumstances change, plans may need changing too. Your estate will change in size and composition. Your goals and family situation will change too. Be sure to evaluate your estate plan periodically. Your estate plan is important. It deserves your continued attention. ■

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