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ESTATE PLANNING FOR NORTH CAROLINA FARM FAMILIES

W. P. PINNA, R. C. WELLS and
D. G. HARWOOD, JR.

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FOREWORD

> A farmer in Cabarrus County, North Carolina, died intestate in 1927, leaving one minor child, five grown children, and a widow. Under North Carolina law then, the widow received a dowry of 25 acres of land. The remaining land was sold and the proceeds distributed among the children. The widow desperately needed income until she died. At her death, friction developed among the heirs over estate settlement. Consequently, her estate has not yet been settled -- the land has grown up into scrub timber, and the buildings have long since fallen down. Today, property taxes owed on the 25 acres amount to over $800. At the death of the farmer, this was a productive, efficient farm.

This, and many somewhat similar examples of poor estate planning by farm families, illustrates the need for increased awareness of the problems associated with transferring property between generations.

Estate planning is the process of choosing among many alternatives that are available to a property owner for the disposition of his assets both before and at death in order to maximize the satisfaction of the property owner. Usually a property owner will want his limited estate managed in such a way that his own security is preserved, and so that his heirs receive the residual with a minimum of tax liability.

This publication is designed to furnish basic information about the concepts of estate planning, and the reasons for developing estate plans. Although this publication is slanted toward estate planning for farm families, the principles are applicable to non-farm estates as well.

The process of estate planning is a highly specialized area which requires the expertise of a competent attorney. Under no circumstances should the reader consider this publication a substitute for legal assistance. Farm families are encouraged to study the general principles

discussed in this publication in order to become better informed, and then consult their attorney for advice and assistance.

Despite the fact that one of the authors is a graduate of the Duke University Law School and one of the reviewers is a practicing attorney before the North Carolina Bar, readers are cautioned that state and federal laws may change after this publication goes to press. In addition, because of the need to keep the volume of the publication within reasonable limits, comprehensive coverage of all aspects of law relating to estate planning has been sacrificed.

ESTATE PLANNING FOR NORTH CAROLINA FARM FAMILIES

W. P. Pinna, R. C. Wells and
D. G. Harwood, Jr.*

INTRODUCTION

All farmers should decide how their property is to be eventually distributed to their heirs and/or other beneficiaries. The thoroughness of the decision in practice, however, varies widely among individuals. Some farmers, perhaps overwhelmed by the complexities of estate planning, simply ignore the problem and hope it will go away. In the absence of a property transfer plan, the decision is rigidly made for them by the Intestate Succession Laws of North Carolina. The resulting distribution of property may be inconsistent with the wishes of the deceased, impose undue hardship upon the family and result in costly taxes and fees. The experience of some families in a community, who made no estate plan, should be adequate warning of the results of poor planning. Other farmers carefully develop property transfer plans that will meet the future needs of their families and preserve a maximum amount of property for their welfare. An important part of the planning procedure is to thoroughly inform the spouse about the location of all property, whom to rely upon for advice, and estate settlement procedures.

Every farmer has an obligation to himself and to his family to acquire some knowledge of estate planning and develop a satisfactory plan. After spending a lifetime in acquiring and developing his property,

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a farmer has the right to decide how it will be distributed after his death, rather than leaving the decision to others. The development of a satisfactory plan should be based upon considerations of the property owned and the needs and future plans of the family. Some common objectives of a property transfer plan include: (1) providing security for the surviving spouse, minor children and incompetents, (2) providing an income for the widow for the rest of her life, (3) treating all children equitably, (4) helping a son get started in farming, (5) preserving the farm unit for future generations, and (6) minimizing estate and income taxes along with general estate settlement costs.

Obviously no one plan is the "best" for all families. However, an understanding of the principles, methods and procedures of property transfers and estate settlements will enable the individual to develop a satisfactory transfer plan consistent with his family situation. The development of any plan should be made with the aid and advice of a competent attorney.

The topics discussed in this publication are designed to give the reader a general understanding of the following areas of planning property transfers under the framework of North Carolina law:

(1) Property distribution in the absence of a plan

(2) Last will and testament

(3) Settling an estate

(4) Property transfers made before death

(5) Estate and inheritance, gift and income taxes

A hypothetical farm situation is presented near the end of the publication to illustrate some of the principles and methods of property transfer

discussed in previous sections.

A glossary of terms is provided to familiarize the reader with legal terminology used in planning property transfers.

PROPERTY DISTRIBUTION IN THE ABSENCE OF A PLAN

When a person dies without making a valid will, he is considered to have died intestate. The property owned by him is distributed to his spouse and heirs according to the rigid specifications of the North Carolina Intestate Succession Laws. In almost all cases, a properly prepared last will and testament will more effectively distribute property than the statutory laws.

In cases of intestacy, all real estate within the State of North Carolina is subject to the North Carolina Intestate Succession Laws regardless of the owner's residence. In such cases, all personal property, wherever it is located, is subject to the North Carolina laws of distribution if the deceased was a resident of the state. Similarly, personal property located in the state is distributed under the same rules.

In North Carolina the decedent's personal property is primarily liable for the payment of his debts and expenses of administering his estate. The decedent's real property is secondarily liable for his debts and can be sold only if there is insufficient personal property to meet these debts and expenses. The remainder is available for distirbution to the heirs. Upon distribution, the property will be delivered in its present form if it can be distributed fairly. Every effort is made to avoid selling an intestate's property and distributing the proceeds. In North Carolina, in case the wife takes the elective life estate, neither the household furnishings in the dwelling nor the wife's elective life estate itself is subject to debts (see page 24).

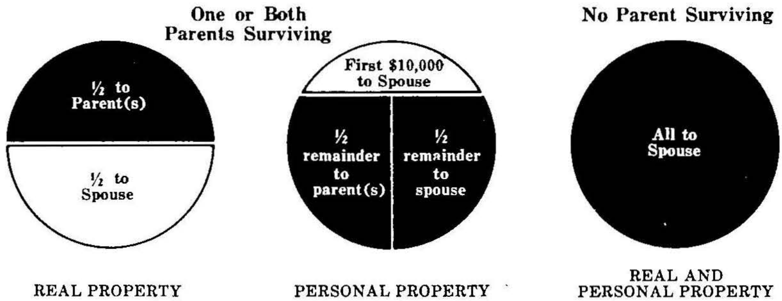
Property or money may be given to an heir by the intestate during his lifetime as an advance payment or "advancement" on the heir's share

of the estate. In North Carolina there is a statutory presumption that a gratuitous lifetime transfer is an absolute gift and not an advancement. Therefore, it is wise to make your intentions clear if an outright gift is intended. No gift of property to a spouse is considered an advancement, however, unless so designated in writing by the intestate at the time of the gift. If the advancement equals or exceeds the heir's share of the estate, he is barred by law from receiving any more of the estate and no refund can be obtained from such beneficiary if he received more than his distributive share. When the amount of advancement is less than the heir's distributive share, he is entitled to receive an additional amount so that he will, in total, receive his fair share. Under the North Carolina Intestate Succession Laws, an heir can renounce his share of the estate of an intestate, if he does so within the time specified by the statute. The renunciation must be signed and formally acknowledged.

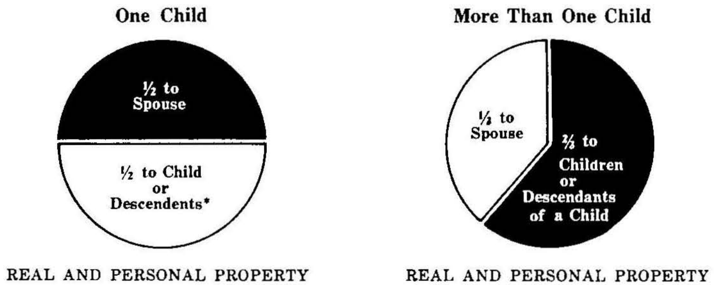
The North Carolina Intestate Succession Laws, in general, set up a specific order of preference for the distribution of property as follows: surviving wives and husbands, children and their lineal descendants, parents, brothers and sisters and their lineal descendants, grandparents, uncles and aunts and their lineal descendants, etc. The right to inherit is contingent upon survivorship of the intestate beneficiary at the time of death of the intestate. Thus, it is necessary to determine which relatives are alive before the intestate's property can be distributed to them according to law. Figure 1 graphically illustrates how real and personal property are distributed under the North Carolina Intestate Succession Laws.

North Carolina Property Distribution
If You Do Not Have A Will

Married Person—Spouse Surviving
No Children and No Descendents Surviving



Married Person—Spouse Surviving and
Children or Descendents also Surviving

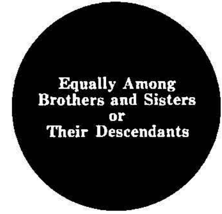


Single Person (Unmarried or Spouse Deceased) No Children or Descendants

Parent Surviving

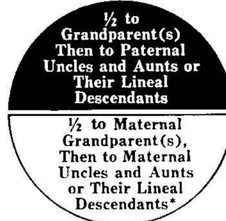
REAL AND PERSONAL PROPERTY

No Surviving Parent Brother or Sister Surviving



REAL AND PERSONAL PROPERTY

No Children, No Lineal Descendants, No Parents, No Brothers or Sisters, No Lineal Descendants of Brothers or Sisters Surviving



REAL AND PERSONAL PROPERTY

In the event there is a party on one side who can inherit under the above but not on the other side, such side shall take the whole.

Single Person (Spouse Deceased) Children or Descendants Surviving

REAL AND PERSONAL PROPERTY

No Relatives

If there are no children, no parents, no grandparents, no brothers or sisters, no aunts or uncles and no descendants of any such persons, the estate escheats to the Consolidated University of North Carolina.

* *DESCENDANTS SHARE. G.S. 29.16—In all cases where descendants take the share of a predecessor, the children of such predecessor take the share that such predecessor would have taken if the predecessor were living at the time of death of the intestate. The same principle applies to each succeeding generation.*

Spouse Surviving, but No Children

When a husband or wife dies intestate and leaves a surviving spouse, but no children, the spouse receives all of the net real and personal property if neither of the parents of the intestate are alive.

If the intestate should be survived by a spouse and by one or more parents, then one-half of the real property passes to the spouse and the other one-half is distributed equally among the parents or all to the one surviving parent. In lieu of the intestate share provided by law, the surviving spouse can elect to take an estate for life in one-third of the value of the real property the deceased owned. If the real property is such that it cannot be divided to obtain the proportionate shares, or unless the interested parties can otherwise agree upon a method of jointly using the property, it will be sold and the distribution made in cash. When one or more parents survive, but no lineal descendants survive, then the first $10,000 of personal property passes to the spouse and the remainder is divided equally between the spouse and the parent(s).

Spouse Surviving with Children

Upon the death of either spouse, the surviving spouse is entitled to a share of the intestate's net estate dependent upon the number of surviving children. If there is but one child, then the spouse takes one-half of the real and personal property and the other one-half passes to such child or his descendants. When the intestate is survived by two or more children, the spouse takes one-third of the real and personal property.

The remaining two-thirds is divided equally among the children or the descendants of each child. An adopted child, whether adopted in North Carolina or in any other state, is entitled to inherit from his parents as if he were the natural child of the parents. In case of an intestate succession, an illegitimate child is treated as if he were the legitimate child of his mother. Thus, the illegitimate child and his descendants are entitled to inherit from his mother. The Intestate Act also provides that lineal descendants and relatives of an intestate born within 10 lunar months after the death of the intestate shall inherit as if they had been born during the intestate's lifetime and survived him.

Children Surviving, but No Spouse

If a person dies leaving children and no spouse, the property passes to the children in equal shares. If any of the children are dead, then their shares pass to their descendants.

Relatives Surviving, but No Spouse or Children

If the intestate is survived only by his parents, then all of the property goes to the parents in equal shares. If only one parent is alive, he receives all the property. In cases where the intestate is survived only by brothers and/or sisters, then all of the property is divided equally among them or their descendants. If there are no parents or brothers or sisters of the intestate alive, then one-half of the property passes to the maternal and paternal grandparents, respectively,

and in turn to the related aunts and uncles if such grandparents are deceased.

No Surviving Relatives

If there are no relatives to receive the property as described above, then the property passes to the Consolidated University of North Carolina. The University can then use or dispose of the property as it sees fit.

Disadvantages of the Intestate Succession Act

Property distribution according to the North Carolina Intestate Succession Laws is rigid and inflexible. It establishes a definite pattern of property distribution as a result of a default on the part of the property owner to do so. Therefore, it is a rare situation when the statute provides the best property transfer plan. The statute cannot anticipate the true intents of the decedent or consider the special circumstances or needs of his family.

> Example 1. In many cases, distribution under the Intestate Succession Laws can place a hardship on the spouse. For example, a husband died without a will and was survived by an invalid wife and several grown children who lived in other states. One-third of the intestate's $40,000 estate passed to the wife and the remaining two-thirds to the children. It is clear that undue hardship could be imposed upon the wife since rising medical and living expenses may rapidly deplete her small share of the estate. Furthermore, what guarantee is there that the children will provide for the mother?

Example 2. Another example of the hardship the Intestate Succession Laws can create occurs when a man dies without a will and leaves a wife and two minor children. He expects his wife to receive all of the property but instead she receives only one-third. In addition, a guardian has to be appointed to manage the children's property until they become of age. Usually the court gives preference to the surviving spouse in appointing a guardian. The court has a great deal of control over the property and must be consulted every time there is a need to deal with the property or spend any of the children's money. If the mother is appointed guardian, she is still under a legal duty to account to the court for the children's shares.

Example 3. If a person dies intestate without a surviving wife or children, then North Carolina will distribute the property equally to all brothers and sisters. Suppose this person had been estranged from two of his three brothers for most of his life. If he wanted to compensate the one brother who had helped him for many years, he could have made a will leaving the brother all the property.

TRANSFERRING PROPERTY WITH A WILL

What is a will? A will is a legally enforceable declaration of how a person intends his real and personal property to be distributed at his death. A will is revocable during a person's lifetime and doesn't take effect until after his death. A will allows a person to decide before his death, who shall receive his property and what interests they will receive. It seems logical to plan for the distribution of one's property considering the effort that has been expended to obtain it. By not making a will, a person loses the opportunity and right to designate who will receive his property.

A person who makes a will disposing of his property is called a testator. When he dies, he is said to have died "testate." If a person dies without a will, he is said to have died "intestate." Under the statutes of North Carolina any person of sound mind and 18 years of age or over may make a will.

Kinds of Wills

There are two general types of wills -- written and oral. Written wills are divided into two classes -- those which are witnessed and those which require no witnesses. Wills which require no witnesses are called "holographic" wills. To be valid in North Carolina, a holographic will must be entirely in the decedent's handwriting and signed by him. In addition, it must be found among his personal effects or else in the hands of a person or bank, etc. entrusted with its safekeeping. Oral

wills, called "nuncupative" wills, are valid to convey personal property but not real property. They are spoken during the testator's last illness before at least two witnesses who are simultaneously present. The North Carolina statute requires that an oral will be converted to writing within ten days from the speaking of the will or be probated within six months from the date of making the will. In addition to the customary wills described above, North Carolina recognizes wills of members of the Armed Forces, joint wills and mutual wills. Wills executed by a person while in the Armed Forces must be admitted to probate upon the oath of at least three persons who attest to the authenticity of the testator's signature on the will. A joint will is executed by two or more persons as their separate wills. The will can dispose of property owned jointly by them, or it can dispose of their separate property. When one of the testators dies, the will is probated as if it was his own will. When the other testator dies, the will can be probated again as his will. Mutual wills are the separate wills of two or more persons in which the provisions made by each testator are substantially the same. Mutual wills are usually made by husbands and wives and are prepared by the same lawyer.

Making a Will

To safeguard against the possibility of an invalid will, it is important to meet with an attorney and have him draft the will. The fact that an attorney drafts the will does not change the specific intentions you may have as to how the property is to be distributed. You are the ultimate judge of this distribution within certain limits described later

in this section.

Before meeting with an attorney it would be wise to prepare for the meeting. A list of your property and liabilities -- residence and real estate, checking and savings accounts, business interests, securities, U.S. Savings Bonds, personal property, life and disability insurance, trust funds and personal debtors and creditors, etc. -- needs to be compiled. Also a list of the persons to be provided for, their needs and their future plans should be developed. For example, in the case of a farm, should it be kept intact? Who will take it over? What provisions should be made for children who have left the farm? What will the wife's needs be? What provisions should be made for her? Are there aged parents or sick or crippled children to be provided for? All ideas should be carefully thought out and the conclusions put down in writing.

A person should be designated to carry out the directions of the will. This person is called an executor -- the person who will execute or carry out the plans of the will after the testator's death. The executor can be an individual or the trust department of a bank. Customarily, preference is given to the spouse, then next of kin, and then others. In any event, a contingent or successor executor should be appointed if the first one named is unable or unwilling to serve. The executor should be carefully selected since he will act as the family advisor and manage property during the estate settlement period. The powers given to an executor are important. If he can be trusted, he should have nearly the same powers to deal with and manage property as

the testator had while alive. A more thorough discussion of the executor's functions follows on pages 27-36.

The nomination of a guardian for minor children should be considered in the event both parents were to die. Under North Carolina probate code, the surviving spouse, if qualified, is preferred over other persons for appointment as guardian. However, if there is no surviving spouse, the person nominated by the will shall have first preference for appointment as guardian. In the absence of such a preferred person, the court may appoint anyone who is qualified and willing to serve as guardian. However, a minor over 14 years of age may request the appointment of a certain individual to act as his or her guardian. It may be necessary to have one person as guardian of the minor and another as guardian of the property of the minor.

After the attorney has drawn up the will, he will have the testator sign the will in the presence of three persons. These persons are witnesses to the fact that the individual signed the papers as his will. Each witness will then attest to the individual's signature by signing his name on the will. This procedure results in a formally executed will. The choice of witnesses is left up to the testator. It is advisable to select younger, reliable persons who have no interest in the will and who will be alive when it comes time to probate or prove the will. Generally, a beneficiary of a will is not a suitable witness.

Restrictions on Contents of a Will

Generally, the author of a will has the right to disinherit persons, including children, who would otherwise inherit his property if he had died

intestate (without a will). However, North Carolina has enacted legislation which prohibits the surviving spouse from being entirely disinherited. A surviving spouse, either a husband or wife, may dissent from the will if the total value of all property received under the will, plus the value of property received outside of the will as a result of the testator's death, is:

(1) Less than the intestate share as shown in Figure 1 or

(2) Less than one-half of the deceased spouse's net estate

in those cases where the deceased spouse is not survived by a child, children, or any lineal descendant of a deceased child or children, or by a parent.

If the dissenting spouse is the second or successive spouse of a decedent, he or she takes only one-half of the amount provided by statute for the surviving spouse where the testator has surviving him lineal descendants by a former marriage, and there are no lineal descendants surviving him by the second marriage.

In lieu of an intestate's outright share in the decedent's property, the dissenting spouse can elect to take an estate for life of one-third the value of all real property the deceased owned as well as complete ownership in the household furnishings located in the dwelling house. Such life estate includes the dwelling, outbuildings and improvements and the land upon which these facilities are located -- even if the value of these items exceeds the one-third limit stated above. The life estate replaced "curtesy" and "dower" in 1960. Whereas "dower" gave the widow an estate for life in only one-third of the husband's real property, the elective life estate extends to both the husband and wife. North Carolina

law provides that neither the household furnishings nor the elected life estate shall be generally subjected to the debts due from the estate of the deceased spouse. This life estate election is advantageous when the estate is insolvent.

In addition to the right to dissent from the will the North Carolina Statute provides that every surviving spouse of an intestate or of a testator, whether or not he has dissented from the will, shall be entitled to an allowance of $2,000 cash or property out of the personal property of the deceased spouse for his support for one year after the death of the deceased spouse. This allowance applies to both husbands and wives and such allowance is exempt from any lien acquired against the property of the deceased spouse. Generally, if a spouse dies or fails to exercise his or her right of dissent within 6 months of the issuance of "letters testamentary," the right is deemed waived. The dissent must be written and filed within the specified time provided by law. When a spouse dissents and takes his intestate share, the will isn't entirely upset since the residual estate is distributed according to the testator's wishes.

Changing a Will

A will needs to be periodically reviewed and changed if the property owned or family circumstances change. One of the persons named in a will may have died, or some property specifically transferred by the will may have been sold. Changes in tax laws or the birth or adoption of another child, particularly if no mention is made of them in the will, are other reasons to review a will. In any event, a will should be reviewed from time to time or after each change in family circumstances.

There are certain ways that a will can be changed. It is not sufficient to draw a line through a paragraph or write the word "omit." Writing extra words on lines will not accomplish the desired changes either. Such actions may make the will invalid. If changes are to be made, a "codicil" needs to be prepared by an attorney. This document is formally executed and attested with the same formalities required of a will. If substantial changes are to be made, a new will is advisable.

In summary, the importance of a will can never be overemphasized. This document should be placed in a safe deposit box or some other known and safe place where it is not subject to being lost or destroyed. Unexecuted copies may also be filed with the attorney and the Clerk of the Superior Court. The executor of the will should be aware of the existence and location of the original will and all copies.

Probate of Lost or Destroyed Will

The probate proceeding is a judicial process by which a court tests the validity of the document and ascertains whether or not it is a last will and testament. In North Carolina the Clerk of the Superior Court has the power to probate a lost will or one destroyed by some person other than the testator. The contents of the will may be proved by the testimony of only one witness provided the evidence is clear and satisfactory.

If the widow is not familiar with the provisions of her husband's will, it should be examined as soon as possible after his death to determine what instructions it may contain concerning burial and funeral arrangements. Prompt request for release should be made to each bank in which there is an account in joint tenancy between husband and wife. This is a necessary preliminary to the widow's obtaining any funds from the account. If the widow needs funds from life and accident insurance policies, the insurance companies should be notified immediately and requested to send the necessary forms. Reliable companies will usually offer every assistance possible in preparing and processing the forms.

The Personal Representative

North Carolina law provides that the decedent's personal representative offer the will for probate within 60 days after the decedent's death. The will is filed with the Clerk of the Superior Court of the county in which the decedent lived. However, if the personal representative fails to probate the will within 60 days after death, any named beneficiaries in the will or interested persons may submit an application for probate. The person having custody of the will is responsible for filing the will and can be held in contempt and liable if he intentionally fails to do so.

The appointment of a personal representative will depend on whether the decedent has left a will and if so, if he has named a person to handle his affairs. If a will names this personal representative, the representative is called an executor (if a man) or executrix (if a woman), after

qualifying for this position before the Probate Court. If there is no will and the court appoints the representative, he or she is called an administrator or administratrix, respectively. Once this person has been appointed he has the overall responsibility for paying claims against the estate, paying taxes and distributing the property according to the will or intestate laws of North Carolina.

The Personal Representative's Duties

The person seeking authority to act as executor or administrator petitions the court, in required form, for "letters testamentary" or for "letters of administration." The Clerk of the Probate Court holds a hearing in which the will's validity is ascertained. The Clerk is required to notify by mail all who are named beneficiaries, or those persons who would have inherited property if there was no will, to appear at the hearing. Affidavits are obtained from witnesses to attest to the validity of the will to probate, if there is one. Before "letters testamentary" or "administration" can be issued to the personal representative, he must give bond if required by law. The requirement of a surety bond can be waived by the testator in his will or by a specific statutory provision.

Much work still remains to be done. Whether or not an attorney should be hired needs to be considered. If the estate is large, if the will is complicated, if the bequests are numerous, if a trust is to be established, if insolvency or litigation is likely, then the services of an attorney will be needed. Protective measures for estate property are

often imperative immediately after the decedent's death. All fire, casualty, automobile and other insurance policies should be examined promptly to make sure all premiums have been paid and to determine when they expire. Immediate knowledge of the decedent's business interests are required to protect them.

The executor should carefully examine all account books, bank books and recent bank statements, broker's statements, income-tax returns, records of receipts and expenses, and other memoranda that may help locate assets of the estate. Careful planning and listing of where assets are located can make the executor's job much easier and less costly.

Once the executor has examined the decedent's records he should begin assembling the inventory of assets. While there is no set order to assembling assets, the following is listed merely to serve as a guide.

1. Checking and savings accounts should be placed in the executor's custody since it is necessary for him to pay the debts of the estate.

2. Stocks and bonds should be located and all interest and dividends collected.

3. It should be determined whether the decedent has any interests in other estates.

4. Open accounts receivable should be verified and collected if possible.

5. Other debts due to the decedent should be verified and collected if possible.

6. Deeds to all real estate owned by the decedent should be examined to determine the status of the taxes, mortgages and rental collections.

7. Required forms and proof of death should be filed with the insurance companies in order to collect insurance proceeds.

All of the above assets along with any other personal property (jewelry,

furnishings, etc.) should be inventoried and valued as of the date of death of the decedent.

At this point, the executor needs to check the cash requirements of the estate to pay claims, taxes, legacies, etc. He will have to check assets carefully to determine whether to liquidate some of them, taking into consideration the testator's wishes and the authority granted him in the will. He may need to seek expert counsel in properly handling business interests, securities and real estate. For example, whether to continue or sell a farm business might be a difficult decision to make for an executor with no farming experience.

Along with the duty of assembling assets the executor is responsible for the payment of all the decedent's debts. For this purpose, the law prescribes for advertisement of the decedent's death so that creditors and debtors of the deceased may come forth. The executor lists these claims (holds doubtful claims until an audit is made) according to their priority specified by law. If there is a possibility of inadequate property or funds to meet all claims, then the following order of priority is observed:

1. The surviving spouse's year's allowance or the children's year's allowance
2. administrative expenses
3. preferred debts (funeral, medical, wages, rent, etc.)
4. bills for current expenses
5. pledges, family settlements, etc.
6. taxes

The payment of any debts should be deferred until it is certain that all claims have been presented and that adequate funds are available to meet

these debts. The claims are then paid in the statutory order of priorities. If funds are insufficient, personal property first, then real property may have to be sold to raise funds. An attorney should be consulted in this matter.

The problem of tax liability of the decedent's estate can be highly technical and may need to be handled by a tax expert. Such a person will be familiar with tax laws and will be aware of recent court decisions and law changes that may help in reducing taxes. It will be necessary to file both federal and state income tax returns for the preceding year if not already filed and for the year in which the individual died. It may also be necessary to pay income tax if the estate has reportable income of its own during the administration period. Any unpaid local property taxes and intangible taxes due the State of North Carolina for prior and current years and for the administration period will have to be paid as debts of the decedent or as expenses of administration.

The state's valuation of property should be compared with the inventory prepared by the executor and considered before filing the 90 day inventory or filing estate or inheritance tax returns. An itemization of debts and expenses, which will be deducted from the gross estate value, must be prepared. If the estate is subject to federal estate tax (see pages 59-63 for conditions), a preliminary notice on Form 704 is required promptly after qualification of the executor or administrator. The North Carolina inheritance tax return is computed and paid 15 months after death (Form A-100). The federal estate tax return (Form 706) is prepared and accompanied by an affidiavit as to property values together with a detailed list of appraisals, debts and expenses. A claim for partial credit for the North Carolina inheritance tax paid is made on

the federal estate tax return.

The executor next prepares an accounting which is a detailed statement of receipts and disbursements of the estate and submits it to the interested beneficiaries and to the Probate Division of the Superior Court for approval. The distribution of the estate remaining after the payment of debts and expenses follows. Legacies are paid and specific bequests are carried out in accordance with the will or intestate law and submitted to the court for approval. The executor should obtain a final receipt and release from each of the legatees (beneficiaries). If the decedent's will specified the establishment of a trust, the necessary cash and/or securities must be set aside in accordance with the authority conferred in the decedent's will. The executor arranges for the proper management of the funds and securities held in trust and for the accumulation or for regular payments of income to the beneficiaries of the trust, as provided in the will.

In summary, the executor may need competent advice in fulfilling his duties. It will be worthwhile for an individual, while still alive, to assist his executor in selecting the attorney, or other competent advisors to consult during the administration of the individual's estate. It will be especially important for the executor to disregard advice given by "new-found" friends and even well-meaning family members. Unless the individual makes such arrangements for his executor, his estate plan can easily go awry after his death.

Costs of Settling the Estate

Expenses of the last illness, funeral and burial costs, outstanding debts and claims, taxes and costs of administration must be paid before

the property transfer to the beneficiaries can be completed. This section discusses some of the common administration costs that may be required in an estate settlement.

North Carolina law provides that the personal representative of the estate (executor or administrator) can receive compensation for his services. This expense is charged as a part of the administration costs of the estate. Generally, the executor's allowance is limited to 5 percent of receipts, including the value of personal property received by the estate, plus expenditures made by the estate. For example, if the personal property received in the estate by the executor amounted to $15,000 and estate expenditures amounted to $1,500, the executor's maximum compensation would be 5 percent of $16,500 or $825. The court considers the time involved and the responsibility and skill required in determining whether the executor shall receive the maximum compensation.

In many cases, the executor will require the services of an attorney in settling the estate. Although the Clerk of the Superior Court does not fix the fees to be paid to the attorney, the Clerk must review all petitions by the executor for disbursements from the estate for such fees. Generally, the attorney's fees may not exceed 5 percent of the value of personal property in the estate plus expenditures made by the estate.

Before letters testamentary can be issued to the personal representative, a bond may be required. A bond guarantees that the personal representative will exercise good faith, diligence and care in the performance of his duties. An executor who is resident of the state is not required to give bond unless the will requires it or unless he must sell real property for the payment of debts. All administrators must give bond except banks

and trust companies. If the bond is executed by an authorized surety company, the sum required is fixed at not less than 1.25 times the value of the personal property of the decedent. Bonding companies typically charge $20 for the first $2,000 and $5 per $1000 thereafter. If the decedent's personal property was valued at $15,000, then the bond cost would be $85. A like bond is required when it becomes necessary to apply for the sale of real estate in order to pay debts. When the bond is executed by an individual's surety, the bond must be double the value of the decedent's personal property. In lieu of a bond, the executor may execute a mortgage on real estate equal to the value of the required bond. The mortgage is made payable to the State of North Carolina and must contain a power of sale.

On occasion, the personal representative may need to hire an appraiser to assist him in valuing the assets of the estate for inventory purposes. Appraisal fees are approximately $250 per day. Such services include inventorying property, locating deeds, studying comparative sales data and preparing reports.

The Liquidity Problem

The payment of funeral expenses, debts, administration fees and taxes, etc. will require cash or liquid assets, i.e. assets that can be readily converted into cash. If readily convertible assets are not available to meet the cash requirements, it may be necessary to make forced sales of property for considerably less than the property is worth. To guard against this potential loss of property value, the property owner should make some provisions in his planning for providing adequate liquidity to meet the

estate's cash requirements. These cash requirements will be forthcoming early in the estate settlement period. The federal estate taxes and the North Carolina inheritance taxes are due within 15 months after the decedent's death.

Life insurance is a common way to meet the cash requirements of an estate. In situations where tax minimization is of importance, precautions should be taken so that the insurance is not included in the decedent's taxable estate. This can be accomplished by making the insurance proceeds payble to one's spouse with the understanding that it is to be lent to the executor or else used to buy assets from the estate. But, the insured must retain no incidence of ownership in the policy (see page 59 for discussion) if it is to be kept out of his estate nor convey such incidents within 3 years of his death. Alternatively, the insured can irrevocably assign the policy to a trustee for his children and authorize the trustee to lend the proceeds of the insurance to the executor or use them to purchase assets of the estate from the executor. Still another alternative is to empower the executor to borrow money to pay taxes, debts, etc., secured by stocks, bonds or other securities. However, a court order will have to be obtained if real estate is mortgaged to secure a loan.

Cash requirements can also be met by the lifetime conversion of part of the estate into cash or readily marketable securities. U. S. Treasury bonds with estate tax payment privileges can be used to provide liquidity. For example, a man can buy certain U. S. Treasury bonds with a low yield for as little as 72 (a $1,000 face value bond thus costs only $720). If the bond contains estate tax payment privileges, you can use the bond to pay off $1,000 worth of estate taxes provided it is included in the gross estate

at face value.

Frequently, the decedent will have interests in a business that he may wish terminated at his death. These interests can also provide liquidity for the estate. For example, if the decedent is a partner in a business, he and the other partners can enter into a buy and sell agreement to obtain the decedent's share. Insurance is frequently purchased by partners on the other partners' lives to provide the cash required to buy out the deceased partner's interest. When the business interest to be disposed of consists of stock in a farm corporation, the following alternatives of providing cash are available:

1. The corporation can buy back some of the decedent's stock without incurring any additional income tax.
2. The stockholders can execute a buy-sell agreement to purchase all or a portion of the decedent's share at his death.
3. A buy-sell arrangement can be made with a son in order to insure him control of the farm corporation and provide cash for the estate to pay its debts.

TRANSFERS MADE BEFORE DEATH

A number of property transfer methods are available to property owners who wish to distribute property to future heirs or beneficiaries while they are still alive. In the case of farm families, the parents could transfer real or personal property to children to assist them in getting started and established in farming. The parents could gradually retire from the farm business but still provide the children with the benefit of their advice or experience. Whether or not lifetime transfers are possible or acceptable to the property owner depends upon his individual needs and those of the younger generation. Many of the property owner's considerations toward lifetime transfers will be economic. Will the parents be able to get along without some farm income? Will they be unwilling to reduce their standard of living? Can they get along on present income? Will they be hard pressed in the future without farm income or assets due to changes in their health and in economic conditions? Some parents are opposed to making outright gifts to children. Others think that a son should work for his property just as the parents did. There may be other reasons for not parting with property through lifetime transfers. Thus, parents must seek a plan in keeping with their desires and circumstances.

A number of property transfer methods are available to carry out a lifetime transfer. These are:

(1) Sales

(2) Gifts

(3) Life Estates

(4) Trusts

(5) Co-ownership

(6) Partnerships

(7) Corporations, and

(8) Annuities

Some of these methods can be incorporated into a will to specify how certain items of property are to be transferred to heirs and beneficiaries at the death of the property owner. Many of the methods listed above can be used in combination.

The purpose of this section is to define each particular transfer method, outline its advantages and disadvantages and specify how it might apply to particular family situations.

Sales

A simple way to provide for a lifetime transfer of farm property is by sale. A straight cash sale or an installment sale by contract are common sales methods. In many cases, the straight cash sale may be undesirable to a son since he does not have sufficient cash to make the purchase. An alternative is the use of a down payment, secured by a mortgage or note, with the balance to be paid over a stipulated time period. A straight cash sale, with payment in one lump sum, can produce large capital gains tax for the parents. The use of installment sales offers an opportunity to reduce capital gains taxes by spreading the gain over several years (see page 72).

When an installment sale is used, the buyer agrees to make a series of payments. The buyer typically obtains a deed to the property when a

final payment of the sales price has been made.

A purchase contract has a number of advantages in estate planning.

(1) The parents (sellers) are provided with a reasonable degree of financial security. They receive regular payments and hold a deed to the property until the sales price is paid. The property reverts to them in the event of default of payment.

(2) Capital gains taxes to the seller may be reduced.

(3) The young man (buyer) acquires a going farm business to operate.

(4) There is added incentive for the buyer to save money and maintain farm productivity.

(5) An installment sale of a farm may be the only way a young man can get started farming on an adequate size farm.

The disadvantages most commonly listed by buyers and sellers with installment contract experience include:

(1) The insecurity of ownership for the buyer. Legal title remains with the seller.

(2) The buyer and seller's equities are frozen. It is difficult to extract investment for other uses in the first years of contract.

(3) High risk to the seller. The buyer may be a poor credit risk.

(4) The buyer may be committed to heavy repayment schedules. Shortages of operating capital could thereby impair effective farm management.

Installment payment contracts are flexible in nature. After the purchase price is determined either fixed or variable payments can be used. In the latter case, the principal payment could be a percentage of net or gross farm income. This method provides the buyer with some protection against falling prices or crop failures, etc. Another method

is the product-payment method. A fixed sales price in dollars is determined, but the payments are made in products rather than cash. In all cases, a rate of payment should be determined which will enable the buyer to provide for his family and maintain the installment payments. Consideration should also be given to the possibility of advance payment provisions. A carefully planned and written contract will consider the policies governing the replacement of livestock and tools, and the payment of taxes and insurance.

The sale method offers flexibility as a means of property transfer even when several children need to be considered. Farm property can be sold to the son operating the farm with the proceeds to be distributed to the other children under the terms of the will. The will might specify that the farm-operating son be given first opportunity to purchase the farm from the estate under specified terms. The payments could be made to the estate for the widow's use and/or distributed to other heirs as part of their inheritance. Or the cash could be distributed by the parents to the children as gifts or as advancements on their inheritances while the parents were still alive. One difficulty with sales, as a property transfer device, is the establishment of a sale price suitable to all parties. A panel of three appraisers, one selected by each party and the third selected by the two appointed appraisers, may be helpful in arriving at an acceptable price.

Gifts

The making of a gift is another method that allows completion of a property transfer during the property owner's lifetime. A gift is

easy to make as far as legal transfer is concerned. Real estate may be given by a properly signed deed while personal property can be given by handing over the property with the intention of making the recipient the present owner. When a true gift is made, the owner turns the complete use, enjoyment and income from the property over to the recipient. Any retention of the use or income of the property by the owner may nullify recognition of the transfer as a gift for timely inheritance and estate tax purposes. As further assurance that a gift will be so recognized, a federal and state gift tax return should be filed. The transfer of any property in the form of a gift may incur a gift tax. Both the federal and state governments impose a tax upon the privilege of transferring property. A more detailed discussion of the tax aspects of gifts, as a property transfer, are discussed in a later section.

Here are some of the advantages of gifts as part of an estate plan:

(1) A gift can be made to a person of any age including minors.

(2) A gift of property may enable the recipient to use the property when he needs it most.

(3) Ownership via gift may result in more productive use of the property in the hands of the recipient than the donor.

(4) Property transferred by a timely gift will remove such property from the donor's taxable estate. Gifts of property which are likely to appreciate greatly in value will especially help reduce donor's taxable estate.

(5) Gift tax rates are less than estate tax rates.

There are also some disadvantages in using gifts as part of an estate plan:

(1) Unless the parents have other income, a gift may deplete assets and income and consequently impose financial hardships on them in later life.

(2) A transfer by gift may result in family friction if the reason for the gift is not understood by all family members.

(3) The donor has no control over subsequent use or disposition of a bona fide gift.

(4) Gifts may be subject to inheritance taxes if they are made within 3 years prior to death.

The North Carolina Uniform Gifts to Minors Act is a method of giving that may appeal to parents who wish to make gifts of cash, securities or insurance to minors. This act provides a simple, inexpensive way to make such gifts to minors. Under the act, the gift is made in the name of a custodian ("to John Smith as custodian for William Smith under the North Carolina Uniform Gifts to Minors Act"). Legal title to the property passes to the minor, but until he is 21 the custodian can use the income or sell the securities for the well-being of the minor without a court order and at his own discretion (the financing of a college education is an example). When the minor reaches 21, the custodian must pay over the money or securities to the minor.

The Uniform Gift to Minors Act has some drawbacks. Each gift is limited to one beneficiary and only securities, cash or life insurance can be so given. If the minor dies before 21, the property goes to the minor's estate. This latter provision may be contrary to the donor's intentions. Such transfer may not remove the asset from the grantor's estate if the grantor dies before the beneficiary reaches 21.

A gift and a sale can sometimes be effectively combined. For example, if a farm worth $40,000 is sold to a son for $30,000, then the $10,000 difference between the market price and selling price may be considered a gift. If a combination of gift and sale are used, an agreement should be written to prevent misunderstandings between the recipient of the gift and other children.

Life Estates

A life estate is sometimes used to transfer property during the owner's lifetime. A life tenant has undisturbed possession of property during his lifetime with ownership passing to an heir or remainderman upon the death of the life tenants. North Carolina law entitles the life tenant to sell, lease or mortgage his life estate, but he cannot sell the property since ultimate title rests in the remainderman. Profits, rents and dividends from the life estate generally belong to the life tenant. In North Carolina, life estates can be created by a will or deed and can include both real and personal property. Thus a farmer could convey a deed to farm real estate to a son with a provision that the parents retain the use of the homestead for life. Or, a life estate could be created by a will with a collateral arrangement allowing the surviving spouse to use the homestead and lease the farm to the son to obtain income for living expenses.

A life estate can be forfeited by the failure of the tenant to pay taxes. Misuse of property, referred to as "committing acts of waste," can also result in a forfeiture of the life estate. The remainderman can protect his interests in the property by obtaining a restraining order against the life tenant who misuses property.

A special type of life estate called the elective life estate is available to a spouse who dissents from the provisions of a decedent's will. The elective life estate can also be taken in lieu of the intestate share when no will is written. For a more detailed discussion of the elective life estate see page 23.

Some advantages of a life estate to a person making an estate plan include:

(1) Preserves use of the homestead or other property until death of the life tenant, whether the life tenant does or does not hold title to the property.

(2) Provides that certain property will be initially transferred within the family.

(3) Life estate may provide a source of income.

(4) It can provide an economic benefit to the grantee without death tax liability.

The disadvantages of life estates generally appear to outweigh the advantages. For example:

(1) Misunderstandings between the life tenant and remainderman can occur over property improvements.

(2) The life estate doesn't qualify for the marital deduction.

(3) The value of the life estate, where the grantor retains a remainder interest, is included in his gross estate at death.

(4) The remainder interest in the property upon which the life estate is based cannot be sold by a life tenant for income.

In general, when there is no definite need for a person to have use of a particular piece of property such as a homestead, transfer methods other than the life estate should be considered.

Trusts

A trust is a legal arrangement whereby a person called a trustee controls and manages property for the benefit of other persons called beneficiaries. Whether a trust should be used depends upon the family situation. For example, a trust can be created for the benefit of a surviving spouse. The trust can assure competent management of the farm during the surviving spouse's lifetime especially where the trustee is a bank specializing in farm management services. A steady source of income could thus be reasonably assured to the spouse. Upon her death, the property could then pass to other heirs. If the farm was left outright to the spouse, there is often no assurance that she or the children could manage it successfully. A trust can also be used to manage property for minor children until they reach an age to manage it capably themselves. Upon reaching this age, the trust property could be transferred to the beneficiaries. The trust is also useful in protecting property for imprudent or incompetent beneficiaries. Such a trust is sometimes called a "spendthrift trust." The beneficiary has no right to the possession of the property but is entitled to support from it and an equitable interest in the income. Such trusts are most frequently used to protect a young or inexperienced beneficiary.

A trust should be distinguished from a guardianship. A trustee holds title to the property and generally enjoys flexibility in managing it for the beneficiaries. In contrast, a guardian must operate within rigid limits specified by law in handling property for the benefit of a ward.

Charitable trusts may also be created for educational or charitable

purposes. To be valid, however, the number of beneficiaries must be indefinite.

Trusts are generally created by will or by a trust agreement whereby the grantor names himself as trustee for a beneficiary. If a trust is created during the grantor's lifetime, it is called an intervivos trust. A trust created by will is called a testamentary trust. A trust created by will cannot take effect until the death of the testator.

Care should be used in selecting a trustee. The trustee must invest, manage and protect the property. He must exercise good faith in his duties and do all he can to further the interest of the trust. Every trust instrument should outline the trustee's powers to assure the most effective management of the trust possible. The trustee should be named and a successor designated if the original nominee cannot or will not serve. Trustees appointed in a will probated in North Carolina must meet the same qualifications required of executors. Today, banks commonly serve as trustees for many trusts.

The taxable income of a trust is subject to federal and state income taxes. If the trust income is distributed to the beneficiaries, the beneficiaries pay the tax. Tax returns for trusts must be filed by the 15th day of the fourth month following the end of the taxable year. In addition, a copy of the will or trust agreement must be filed with the federal and state income tax returns. In cases where the grantor retains control over the trust property, a revocable trust exists. The grantor pays taxes on such trust income and can expect the value of the trust property to be placed in his gross estate for estate tax purposes if he should die.

A trust offers the following advantages:

(1) Management of farm property for minors or a spouse,

(2) Continuation of the farming operation,

(3) Income security for beneficiaries,

(4) The tax burden is allocated to more persons, which may result in lower total income tax liability,

(5) Reduced estate and inheritance taxes.

Disadvantages include:

(1) Lack of control over the property by beneficiaries,

(2) Loss of prospective income due to inefficient management by trustee,

(3) May encourage dependence upon trust income which could stifle individual initiative.

In summary, a trust provides a means of transferring property, but its main purpose is the efficient management of property for beneficiaries. The establishment and administration of trusts is a highly specialized field within law practice. For further information, a trust company, trust department of a bank or an attorney should be consulted.

Co-ownership

Co-ownership of property provides yet another means of transferring and owning property. In order to better understand the place of co-ownership in planning property transfers, it is necessary to define and explain the most common types of co-ownership allowed under North Carolina law.

Tenancy or Estates by the Entirety

Tenancy or estates by the entirety is a form of co-ownership in which real property is owned equally by married couples. The property passes to the surviving spouse upon the death of the other. North Carolina law limits this type of tenancy to married couples. One of the outstanding features of tenancy by the entirety is that real property cannot be sold to pay debts of either spouse. During the lifetime of the tenants, the husband is entitled to rents and profits from the land. He can even convey possession of the property to others during his lifetime, but he alone cannot convey title to the property. The only way the title to the real property can be conveyed is through a jointly executed deed. A married person can create a tenancy by the entirety by a direct conveyance of the property to his spouse and himself.

A tenancy by the entirety might be used in the following manner. A couple could own a farm in tenancy by the entirety with the son renting the farm from the parents. The surviving spouse would continue to hold title to the farm for his or her lifetime and could convey title to the farm to the son by will. The son, however, could never be sure that he would obtain interest in the farm or that he could develop the farm as rapidly as if he had been sole owner.

Tenancy with Right of Survivorship

Tenancy with right of survivorship allows co-ownership of property by two or more persons, whether or not they are husband and wife. Each person has an undivided interest, rather than a fractional interest in the whole property. At the death of one of the tenants, the survivors

take all and nothing passes to the heirs of the decedent. This type of tenancy can be terminated by the sale of the property by one of the co-tenants.

Tenancy in Common

Tenancy in common is a co-ownership created between two or more persons by will or deed. The tenants do not have to be related. Each tenant owns an individual interest of the undivided property. Equal shares are not necessary for a tenancy in common to function. Each tenant has the right to sell, assign or convey his share of the tenancy to others. When one of the tenants dies intestate, his share passes to his heirs rather than to the surviving tenants.

Advantages of co-ownership:

(1) At the death of one of the tenants, property passes to the survivor with a minimum of administration expense and time. (Tenancy by the entirety and joint tenancy with the right of survivorship).

(2) Property can be protected from seizure by creditors. (Tenancy by the entirety).

(3) Partial exemption of real property (50 percent) from N. C. Inheritance Tax at death of the first tenant. (Tenancy by the entirety).

(4) Ease of conveying title to others without consent of co-owners (can be a disadvantage, too). (Tenancy in common).

(5) Tenancies are easy to create.

Disadvantages of co-ownership:

(1) Heirs may be excluded from receiving property. (Tenancy with

right of survivorship).

> Example: Mr. Smith, whose first wife died, married Jane Jones. He creates a tenancy by the entirety with his new wife in all his land. At Mr. Smith's death, his land will pass outside his will by right of survivorship -- to his wife, Jane. Mr. Smith's children by his first wife will never inherit the land unless Jane leaves it to them in her will.

(2) Jointly owned property may be fully taxable in the estate of the first tenant to die unless the survivor can prove his contributions to the original purchase. (Tenancy by the entirety).

> Example: In 1968 Mr. Brown acquired real property taking title with his wife as tenants by the entirety. If Mr. Brown died in 1973, all of the land would be included in his federal taxable estate because his wife acquired her interest without contribution and for less than adequate consideration.

(3) Conveyance of property to other tenants who can disrupt the business operation (tenancy in common). Physical division of the property or sale so that the other co-owner can get his money. This could disrupt a farming operation.

(4) Costly and lengthy probate proceedings. (Tenancy in common and joint tenancy with right of survivorship).

In summary, the disadvantages of owning property as joint tenants outweighs the advantages. While co-ownership or tenancies may be useful in certain instances, careful counseling with an attorney is advised before such tenancies are created.

Partnerships

Partnerships have been successfully used by many farm families to get a son started and established in farming, and at the same time, help him acquire ownership of real and personal property. A farm partnership

is a joint farm-operating agreement in which the members share in the management and profits of the business. Management can be shared and shifted to younger members. Profits can either be shared equally or in proportion to the contributions of land, labor and capital each member makes to the business. Partnership arrangements, however, are not limited to fathers and sons. Many partnerships involve brothers or unrelated individuals.

As a way of getting the son started on the road to property ownership, the father can either give or sell the son an interest in the farm personal property -- equipment, livestock, supplies and farm bank account. A 50-50 gift or purchase is often used. If a purchase is agreed upon and the son is unable to raise the cash for his share, he can give his father a secured interest bearing note for the amount he is unable to pay. The son can then repay the note out of his share of earnings. Purchased equipment and livestock can be owned jointly or the son can purchase these items himself. Net additions to the herd can either be owned on a 50-50 basis or in some other proportion.

The father, for a time at least, normally owns the real estate. If the son decides to build a house, it should be built on land the son owns. New tracts of land can be purchased by the son as sole owner or jointly by the partners. Title to the real estate can be conveyed to the son by will or the will can give the son the option to buy the farm from the estate with the proceeds to go to the mother or to be divided among brothers and sisters. Failure to provide for the conveyance of real estate to those

operating the farm at the father's death has terminated many successful farm businesses. Other brothers and sisters may want their share of the estate immediately. This can place the farm-operating son in the position of seeing the farm divided and sold to satisfy other heirs, or else he may have to borrow heavily to meet the immediate demands of the other children.

Father and son partnerships would be well advised to establish such buy and sell agreements or other adequate plans to provide for continuation of the business. In addition to giving the son the option to buy his father's share, a price or procedure for establishing a price on the property should be specified. Life insurance policies upon each partner's life are sometimes used as a source of funds to buy out the other partner's share. Such insurance is used less frequently when there are large age differences between a father and son.

Partnerships as such are not subject to state or federal income taxes, but are required to fill out and file an information return. Each partner is liable for income tax only on his share of the partnership income. Partnership fathers who plan to receive Social Security benefits upon reaching age 62-72 can receive full benefits as long as they earn less than $1,680 per year from the partnership and from other "earned" income sources. Between $1,680 and $2,880 of total earnings, $1.00 of benefits will be lost for each additional $2.00 earned. When earnings exceed $2,880, $1.00 of benefits is lost for each $1.00 of additional earnings.

Some advantages of a partnership are:

(1) Allows the father to retire gradually from the business.

(2) Allows the son to grow into a "going farm business" without a heavy debt load.

(3) Gives the son incentive to remain on the farm in expectation that it will be his farm someday.

(4) Transfers the farm intact if a will, buy and sell agreement or other proper arrangement is used. Distributions to the wife and other children can be made in cash, by promissory note or other property.

(5) Facilitates the operation of a business large enough to support a growing young family and provide income for retirement for the parents.

(6) Spreads income among family members at lower individual tax rates.

Disadvantages:

(1) A partnership cannot overcome personality differences or poor work habits.

(2) Partners are individually liable for business oriented debts incurred by the other partner.

(3) Adequate business records will be required. This shouldn't be a disadvantage in modern agriculture.

(4) Oral partnerships provide no security of ownership for partners.

(5) The partnership property may have to be sold to satisfy heirs unless adequate provisions are made for them.

Corporations

A corporation is a legal entity that can take, hold and transfer property and carry on business in its own name. Some of the unique characteristics of the corporation are:

(1) Limited liability which limits the loss that an owner may suffer to his investment in the stock of the corporation.

(2) Continuity of existence which allows the corporation to exist and conduct business indefinitely without regard to death or incapacity of one or more of its shareholders.

(3) Ease of transferring ownership which allows shares to be bought and sold without interfering with the operation of the business.

While farmers have been slow to adopt the corporate form of business organization, there were 18,526 active farm corporations in the United States in 1965. The increasing capital requirements for a modern farming operation, and the 1958 amendments to the Internal Revenue Code which permit certain corporations (Subchapter S) to elect partnership-type taxation have encouraged many farmers to consider incorporation of their businesses. However, the use of the corporate structure as a device for transferring ownership between generations without abruptly stopping the farming business operation and physically subdividing the assets is the advantage which is of primary interest here.

As an individual proprietorship or partnership, the farm business is frequently interrupted and often dispersed with the death of an owner. Land holdings may be divided into inefficient sized parcels. An heir wishing to assume ownership and operation of the farm may be faced with heavy debts resulting from settlements with other heirs. Uncertainties associated with an unincorporated farm business may preclude investments by potential heirs in needed improvements.

The corporate structure permits the division of ownership and management of a farm business among parents and children in varying proportions.

Parents can gradually transfer shares of stock (either by sale or gift) to a son(s) who will relieve the parents of the burden of work and management of the farm. Gifts of stock made by parents to children can reduce the parents' estates and thereby minimize estate and inheritance taxes. Under the Uniform Gifts to Minors Act, parents may transfer shares of corporation stock to minor children, whereas transfers of land to minors is difficult. Sharing ownership in a corporation also means sharing income among stockholders after managers' salaries have been deducted; this may be used to minimize income taxes.

An incorporated business can also provide owner-employees with retirement plans, hospitalization plans and other fringe benefits. Qualified payments made into these plans are tax deductible as farm expenses. Usually there is no gain or loss recognized for income tax purposes on the formation of a corporation where the owner transfers his assets to a corporation in accordance with specific tax guidelines. To assure a tax free incorporation, it is advisable to seek competent tax advice.

As long as a parent holds title to over half of the corporation's stock, he is in control of the business because he has the majority voting rights.

The disadvantages associated with corporate structure include:

(1) Legal counsel is needed to incorporate a farm business.

(2) An additional income tax burden may be incurred if the corporation does not conform to requirements of law for Subchapter S corporations.

(3) There is more formality required in the management of a corporation.

(4) A minority stockholder's interest may not be marketable, and

the minority stockholder may be unable to change management of the corporation.

(5) The initial cost of incorporating may be prohibitive on small farms.

Annuities

An annuity is an amount of money payable each year for a specified period. The annuity is one way of transferring a farm to a second generation and at the same time having reasonable assurance of a continuing income to the parents. Estate and inheritance taxes may also be reduced by use of an annuity.

There are several types of annuities:

Life annuity: This type of annuity pays a fixed income as long as the beneficiary lives. No estate or inheritance taxes are imposed on a life annuity which a deceased person had owned.

Refund annuity: This type of annuity provides an income as long as the owner-beneficiary lives, and also provides that total payments to both the owner-beneficiary or his estate will at least equal a certain total amount. Payments made after the owner's death are subject to estate and inheritance taxes.

Joint Life and Survivorship Annuity: This type of annuity provides income as long as either of two beneficiaries may live. Estate and inheritance taxes are imposed upon a portion of the payments to be made following the death of the first joint owner to die, based upon his contribution to the purchase price.

A private annuity is an arrangement whereby a father, for example, can transfer a farm to his son in return for a promise by the son to pay

a specified monthly sum to the father for life.

A commercial annuity can be purchased from an insurance company to facilitate a farm transfer plan. In such an arrangement, the son would pay the cost of the annuity to an insurance company; the company would then make regular payments to the father. The son could raise the money with which to purchase the annuity by mortgaging the farm, or annual installment premiums may be arranged under a deferred annuity plan.

The use of annuities in farm transfer plans may have some disadvantages:

(1) If the father dies much earlier than anticipated, the son will receive the farm for only a fraction of its value.

(2) If the father lives considerably longer than anticipated, the price for the farm may become excessive.

(3) If the annual payment is a fixed amount, it becomes payable whether farm income is high or low. There is no built-in hedge against inflation.

(4) If the annual payment is secured only by the promise of the son, the father has no recourse if payments are not made.

In certain cases, however, the advantages of a family annuity can outweigh all disadvantages. Since a family annuity plan is not a gift, it may offer a parent in advanced years and poor health the only feasible approach to reducing his death taxes. The son may also be guaranteed title to the farm.

ROLE OF TAXES IN PLANNING FARM PROPERTY TRANSFERS

Tax considerations play an important part in developing farm property transfer plans. A plan should be developed that will minimize taxes without destroying or impairing the desired plan of management and disposition of the property. A property owner has the duty to bear his fair share of taxes, but he obviously would not want to pay more than is lawfully necessary.

The taxes to consider in planning property transfers include: federal estate, gift and income taxes and the North Carolina inheritance, gift and income taxes. An estate tax is one which is levied upon the right of transferring property at death; an inheritance tax is a tax levied upon the right of receiving property from the decedent. Both are taxes on the property owned by the decedent at his death. The estate tax is imposed upon the decedent's total taxable estate and the rate is determined by the size of the decedent's estate. The inheritance tax is computed upon the individual share of each beneficiary, and the rate of tax will depend upon the size of the share and the relationship of the beneficiary to the decedent. Although competent tax advice will be necessary in developing a satisfactory plan, each individual should be aware of the general lines of tax planning and tax savings that are available to him. Some farmers who own small farms feel that tax matters do not concern them. However, the small farmer often has greater need for tax advice, as unnecessary taxes may reduce his small estate still further before it is available for distribution.

Federal Estate Tax

The federal estate tax is levied upon all the property the decedent owned, wherever situated. The total value of the property is called the gross estate. The tax is imposed upon the taxable estate (gross estate less allowable deductions and exemptions) of the decedent before the property is distributed. However, in the event the estate doesn't pay the tax when due, the beneficiaries may be called upon to pay the tax. The amount will be limited, however, to the value of the property acquired by each beneficiary.

The Gross Estate

The major items included in the gross estate include:

(1) All property in which the decedent owned a fractional or entire interest.

> Example: real property, machinery and livestock, stocks and bonds, an interest in a business, bank accounts, accounts receivable, etc.

(2) Life insurance proceeds payable to the estate.

(3) Life insurance proceeds payable to beneficiaries if the decedent had any rights of ownership in the policy.

> Example: the right to change the beneficiary, to cancel the policy, or to pledge the policy for a loan, are incidents of ownership.

(4) The full value of property owned jointly with right of survivorship less any portion which originally belonged to the survivor or which the survivor purchased from the decedent or others for an adequate and full consideration in money or money's worth.

Example: Assume a man purchases a farm for $20,000 taking title in his name and his wife's in joint ownership. Suppose he dies first, at which time the value of the farm is $30,000. If he contributed all the money for the property, the entire $30,000 will be included in his gross estate. If, however, the wife had contributed $5,000 to the purchase price of the farm, then upon the husband's death only three-fourths of the value of the property would be included in his estate. His estate would then include $22,500.

(5) Property which the decedent transferred to another but reserved the income and/or use thereof during his lifetime or reserved the right to designate the person who should possess or use the property (retained life estate).

Example: Assume that a farmer gives his farm residence to his son, but reserves the right to occupy the dwelling rent free during his life; this transfer of property will be included and taxed in the father's estate at death.

(6) Gifts made within 3 years prior to the decedent's death if made in contemplation of death.

Example: Some of the facts and circumstances which are considered in determining whether the gift was made in contemplation of death are the donor's age, health, the type of property given, the time span between the gift and the donor's death, the retention of control by the donor, and the execution of a will concurrently with the making of the gift.

(7) Annuities payable to the decedent either alone or in conjunction with another person or persons.

Example: Suppose a man buys an annuity under which payments will be made to himself and his wife jointly during their joint lives and continued in favor of the survivor during his life. This is a joint and survivor annuity. If the husband and wife each contributed $10,000 to the purchase of the annuity contract and the value of survivor's annuity is $18,000 at the husband's death then one-half of the annuity or $9,000 is included in his estate.

Deductions

Deductions from the gross estate are allowed for the following:

(1) Funeral expenses, enforceable debts, unpaid taxes, the costs of administering the estate, and casualty losses occurring during the estate settlement period. The residual is then called the adjusted gross estate.

> Example: If the decedent's gross estate amounted to \$250,000 and the expenses listed above amounted to \$10,000, then the adjusted gross estate is \$240,000.

(2) The marital deduction. If the decedent transfers property to his spouse at death, he is entitled to a deduction from the gross estate. This deduction cannot exceed 50 percent of the adjusted gross estate, even though more than one-half actually goes to the spouse.

> Example: If the adjusted gross estate is \$240,000, then the maximum marital deduction is \$120,000.

(3) Charitable deduction. Money or property transferred to charitable, educational and religious institutions or organizations.

Exemptions

An exemption of \$60,000 is allowed to all estates. Thus, the first \$60,000 after all deductions are subtracted from the gross estate, passes free of estate tax. In our example, the adjusted gross estate of \$240,000 less the sum of maximum allowable marital deduction of \$120,000 and the \$60,000 exemption leaves a taxable estate of \$60,000. If the net estate amounts to less than \$60,000 after all deductions, no tax is due. Also, if the decedent's adjusted gross estate is \$120,000 or less and he leaves at least half of his estate to his wife, no estate tax

would be due. In summary, the gross estate less deductions and the $60,000 exemption equals the taxable estate.

Tax Rates

Tax rates are graduated from 3 percent for estates of less than $5,000 to 77 percent for taxable estates of $10,000,000 or more (Table 1).

Table 1. Federal Estate Tax Rates

Taxable Estate [a] From	To	Tax =	+ Percent	On excess over
$ 0	$ 5,000	$ 0	3	$ 0
5,000	10,000	150	7	5,000
10,000	20,000	500	11	10,000
20,000	30,000	1,600	14	20,000
30,000	40,000	3,000	18	30,000
40,000	50,000	4,800	22	40,000
50,000	60,000	7,000	25	50,000
60,000	100,000	9,500	28	60,000
100,000	250,000	20,700	30	100,000
250,000	500,000	65,700	32	250,000
500,000	750,000	145,700	35	500,000
750,000	1,000,000	233,200	37	750,000
1,000,000	1,250,000	325,000	39	1,000,000

[a] After deducting the $60,000 exemption.

Credits against the computed estate tax are allowed for taxes paid on prior transfers, state inheritance taxes, federal gift taxes and foreign death taxes.

The executor or administrator of the estate must file a preliminary notice (Form 704) if the decedent's gross estate was $60,000 or more. This form is to be filed within two months after the decedent's death or

within two months after the executor's qualification if he qualified within the original two months limit. The federal estate tax return (Form 706) is due fifteen months from the date of the decedent's death. An extension of the date of tax payment may be requested and obtained when the payment places an undue hardship on the estate.

North Carolina Inheritance Tax

The State of North Carolina levies an inheritance tax upon the right to receive property owned by a resident of North Carolina at his death. This is basically the same property included in the gross estate for federal estate taxes. The tax also applies to real and tangible personal property within the state owned by non-residents of North Carolina. Non-resident's intangible personal property over which the state has taxing powers is included for tax purposes.

Deductions

The following deductions are allowed in determining the value of the decedent's net estate which is subject to inheritance tax:

(1) Debts, unpaid taxes and certain assessments.

(2) Reasonable funeral and burial expenses.

(3) Outlays for monuments not to exceed $1,000.

(4) Administration commissions and expenses.

(5) A credit against the computed inheritance tax is allowed for state gift taxes if a gift upon which the tax was paid is included in the gross estate of the decedent or if the property was received, by reason

of death, within 2 years of the death of the current decedent.

Exemptions

After these deductions have been taken, the remainder is the estate that can be passed on to heirs or beneficiaries. Furthermore, exemptions from tax are allowed for the following:

(1) Real property held by husband and wife jointly with survivorship rights but not to exceed one-half of the property's value, regardless of who furnished the purchase price.

(2) Property transferred to non-profit charitable, educational or religious institutions and organizations located in North Carolina and to the State of North Carolina.

(3) $20,000 from total life insurance proceeds if the beneficiary is a wife, parent or child of the decedent. A $2,000 exemption is allowed per beneficiary if the beneficiary is not one of the above relatives of the deceased, but only to the extent that such amount ($2,000) is not allowed as an exemption to the wife or lineal descendants.

(4) $10,000 for a wife and $2,000 for a husband and,

(5) An additional $5,000 for each child under 21. Stepchildren and adopted children fall in this category.

(6) $2,000 for each parent and child over 21. Grandchildren whose grandparent did not share in the estate are allowed a proportionate share of the grandparent's exemption.

Tax Rates

The gross estate less the deductions and exemptions listed above equals the taxable estate. The tax rate to be applied to property trans-

ferred depends upon the relation of the beneficiaries to the decedent. Tax rates are lowest for property passing to a spouse, parents or children (lineal descendants). The rate is higher for property passing to brothers, sisters, aunts, uncles and those persons not related to the decedent by blood. Table 2 lists the inheritance tax rates on property inherited by lineal descendants.

Table 2. North Carolina Inheritance Tax Rates on Property Inherited by Widows, Children, Parents or Grandchildren of the Deceased[a]

Taxable inheritance (dollars)			Tax rate (percent)
First 10,000 above exemption			1
Over 10,000	to	25,000	2
Over 25,000	to	50,000	3
Over 50,000	to	100,000	4
Over 100,000	to	200,000	5
Over 200,000	to	500,000	6
Over 500,000	to	1,000,000	7
Over 1,000,000	to	1,500,000	8

[a]Rates are higher for nonlineal descendants.

An estate tax return (A-100) must be filed and tax paid if due, within 15 months after the decedent's death, if the estate is $2,000 or more and the beneficiaries are lineal descendants. Failure to do so will result in interest charges or a forced sale. Although the inheritance tax is levied on the right of a recipient to receive property, the administrator or executor is required to deduct the tax from the share before delivering it to the heir. If the share subject to tax consists of property rather than money, the heir must pay the amount of tax to the executor before he is entitled to the property.

Federal Gift Tax

Any lifetime transfer of property by one person to another is a gift for gift tax purposes to the extent the giver, or donor, does not receive an equal value in money or other property in return. Taxable gifts are not restricted to the most usual and obvious kinds of property such as gifts of cash, stocks and bonds or real property. Selling property at less than face or market value, foregoing a debt, or permitting another to withdraw funds from a joint bank account deposited by the donor are some examples of other transactions that may be considered gifts. The tax is imposed upon the donor but if the donor does not pay the tax when due, the donee or recipient of the gift may be called upon to pay it to the extent of the value of the property received by him.

The federal gift tax statute provides several exclusions, exemptions and deductions which may be used to reduce the value of property subject to the tax.

Exclusion

In any calendar year, the first $3,000 of gifts made to any one donee is excluded in determining the total amount of taxable gifts for the calendar year.

> Example: If a man gave $5,000 to each of his three sons in a single year, he would get an exclusion of $3,000 per son. His total exclusion would be $9,000 and his taxable gifts would be $6,000, provided he had used up his lifetime exemption.

If a gift of a future interest in property is made, the $3,000 annual exclusion is not available. For gift tax purposes future interests include any interest in property where the possession or enjoyment of the property

is deferred or subject to the will of some person other than the owner.

> Example: A father transfers $20,000 in property in trust to his son. Interest income from the trust property is to accumulate for ten years and then be distributed to the son or the son's estate. This gift is a future interest and would not qualify for the $3,000 annual exclusion.

Specific Exemption

Every person has a lifetime exemption of $30,000. This amount may be given away without a gift tax being levied. This exemption can be used all in one year or over a period of years. In years when individual gifts exceed $3,000, the excess is applied against the $30,000 exemption until it is depleted.

> Example: If a gift of $5,000 is given to a child, the first $3,000 is applied against the annual exclusion; the other $2,000 is applied against the lifetime exemption of $30,000.

Split Gifts

With the consent of the wife (or husband), the donor may "split" the gift with his spouse so that it may be treated as having been given one-half by each. This rule applies even though one spouse is the sole owner of the property. Thus, the first $6,000 of gifts made jointly to any one donee is excluded in determining the total amount of taxable gifts for the year. Similarly the lifetime exemption for joint gifts is increased to $60,000. Thus, splitting gifts enables a husband and wife to initially give away up to $66,000 in one year and incur no gift tax, while taking the $66,000 off the top of any future taxable estate where the tax rate would be higher. Splitting gifts does not allow the spouses to divide their respective lifetime exemptions. For example, if a husband who has used up his lifetime

exemption of $30,000 makes a gift of $18,000 to a daughter, he cannot use his wife's lifetime exemption to avoid gift taxes. If the gift is treated as a split gift, the wife can apply the annual exclusion of $3,000 and $6,000 of her exemption. The husband could apply his annual exclusion of $3,000 and report a taxable gift of $6,000.

Deductions

When a gift is made by one spouse to another, the donor receives the benefit of the gift tax marital deduction which provides that one-half of the gift passes tax free without regard to the $3,000 annual exclusion. Consequently, a donor may give his spouse up to $6,000 each year without incurring a gift tax liability or using any of his $30,000 lifetime exemption. The deduction applies if the recipient of the gift was married to the donor at the time of the gift. The deduction does not apply, however, to a gift in which the recipient's interest is terminated at a certain date or because of certain occurrences. The total amount of gifts made during the calendar year for charitable bequests can be deducted.

Tax Rates

Gift tax rates are exactly three-fourths of the comparable estate tax rates (Table 3).

Table 3. Federal Gift Tax Rates and Computation.

Taxable gifts From	To	Tax =	+ Percent	On excess over
$ 0	$ 5,000	$ 0	2.25	$ 0
5,000	10,000	112	5.25	5,000
10,000	20,000	375	8.25	10,000
20,000	30,000	1,200	10.50	20,000
30,000	40,000	2,250	13.50	30,000
40,000	50,000	3,600	16.50	40,000
50,000	60,000	5,250	18.75	50,000
60,000	100,000	7,125	21.00	60,000
100,000	250,000	15,525	22.50	100,000
250,000	500,000	49,275	24.00	250,000
500,000	750,000	109,275	26.50	500,000
750,000	1,000,000	174,900	27.25	750,000
1,000,000	1,250,000	244,275	29.25	1,000,000

The gift tax computation for each year is based upon all of the accumulated gifts made over a period of years.

Example: If the first year's gifts in excess of exclusions, exemptions and deductions were $5,000, the gift tax for the first year would be $112.50. If the next year's taxable gifts were $10,000, the tax would be $787.50 (tax on $15,000 of gifts) less $112.50 (tax on prior gifts) or $675.00.

No credits are provided for by the federal gift tax statute. A federal gift tax return is required if, during any calendar year, a donor made gifts to any one in excess of $3,000. This return (Form 709) is due not later than the 15th day of April following the close of the calendar year in which the gifts were made.

North Carolina Gift Taxes

The North Carolina gift-tax is similar in certain respects to that of the federal gift-tax law.

Exclusion

In any calendar year, the first $3,000 of gifts made to any one donee is excluded in determining the total amount of taxable gifts for the year.

Exemption

Every person has a lifetime exemption of $25,000 for gifts made to a spouse, children or parents. This exemption can be used entirely in one year or over a period of years. In years when individual gifts exceed $3,000, the excess can be applied against the $25,000 exemption until it is used up. This exemption can be claimed by a donor only if the donee is a direct descendant, ancestor, husband, wife or adopted child of the donor.

Split Gifts

Husbands and wives may make gifts jointly and claim an annual exclusion of $6,000 and a total lifetime exemption of $50,000. Joint gifts of a husband and wife must involve property owned by them as tenants by entirety to qualify for the exemption.

Tax Rates

The North Carolina gift tax rates are the same as those for the North Carolina inheritance tax (Table 4). Higher tax rates are applied to gifts made to distant relatives and nonrelatives.

Table 4. North Carolina Gift Tax Rates on Property Given to Spouse, Children, Parents or Adopted Children

Taxable gifts (dollars)			Tax rate (percent)
First 10,000 above exemption			1
Over 10,000	to	25,000	2
Over 25,000	to	50,000	3
Over 50,000	to	100,000	4
Over 100,000	to	200,000	5
Over 200,000	to	500,000	6
Over 500,000	to	1,000,000	7
Over 1,000,000	to	1,500,000	8

A gift tax report, Form G-600 prepared by the State Department of Revenue, is required for any calendar year in which gifts of over $3,000 are made to an individual donee. This report is to be filed and tax paid if due by April 15 following the calendar year in which the gift was made.

Income Tax

Income tax is of primary interest when property transfer is by sale. If a gain (profit) results from the sale, it will usually be a long term capital gain. Items subject to capital gains treatment include: land, stocks and bonds, livestock held for draft, dairy or breeding purposes, depreciable property used in the business such as farm machinery, real estate and buildings. Livestock must be held for 12 months and other property 6 months or more to qualify for capital gains. Only 50 percent of the net gain is considered taxable for federal income tax purposes. Losses on intra-family sales may not be deductible.

The amount of capital gain or loss from the sale of property is the selling price less the adjusted basis and selling expenses. The adjusted basis is the original cost or other basis, plus the cost of the improvements less depreciation allowed or allowable. If the property was obtained by gift, its basis is the same basis as in the hands of the donor (giver of the gift) plus related gift taxes paid. If the property was received by a transfer made at death, the basis is determined by the fair market value of the property at the decedent's death (or one year later) plus improvements less depreciation.

If property is sold under a contract which postpones all or a part of the payments to a year following the year of the sale, an installment method of reporting the gain may be used under certain conditions. This method treats each payment received as part recovery of cost and part profit -- thus an opportunity for tax savings since all the income is not taxed in one year which would place the taxpayer in a higher tax bracket. The installment method may be used if the payments in the sale year do not exceed 30 percent of the selling price. Property covered includes real property, sales of farm machinery, livestock, etc., over $1,000 and property held primarily for resale such as feeder livestock. Where there is a loss on the sale of property, the installment method cannot be used.

If you sell a farm which includes a residence occupied by you and your family, you must determine the portion of the selling price and the portion of the cost or basis which are allowable to the residence. If there is a gain on the sale of the residence, the tax on the gain may be

postponed if, within one year before or after the sale, you buy and occupy a residence which was equal to or above the adjusted sale price of the old residence. The same rule applies if you start construction of a new residence within one year before or after the sale of the old residence and occupy it within eighteen months after the sale.

> Example: If the allocated value of the residence is $22,000 and the original cost plus all improvements amounted to $13,000, then there would be a taxable gain of $9,000. If another residence is purchased within one year for $22,000 or more, the tax on the $9,000 can be postponed. However, if the new residence costs <u>only</u> $17,000, then there would be a tax on $5,000 of the gain and the tax on the other $4,000 would be postponed.

North Carolina state law has no provision for allowing the deduction of 50 percent of long term capital gains. The installment method of reporting sales of farm property and tax deferrals on the gain realized from selling a residence are similar to the federal tax statutes.

COMPREHENSIVE EXAMPLES

These examples are not intended to provide "best plans" for the estate situations described, but rather to illustrate principles previously presented. Our illustrations are based on the Brown family (hypothetical) consisting of Mr. and Mrs. Brown, two sons, John and Bill, and a daughter, Ann. Mr. Brown's estate consists of:

Cash	$ 15,000
Buildings	35,000
Equipment	125,000
Land	150,000
	$ 325,000
Less Liabilities	- 75,000
Net Estate	$ 250,000

Mrs. Brown has independent assets totaling $50,000. Mr. and Mrs. Brown are 58 years old and in good health. John is 27 years old, married and works as an insurance salesman in Charlotte, N. C. Bill is 20 years old, an agricultural student at N.C.S.U. and quite interested in returning to the farm. Ann is 24 years old and married to a local businessman.

> Example #1: Assume Mrs. Brown dies in an automobile accident without leaving a will. Mrs. Brown's $50,000 estate will be distributed according to the Intestate Succession Act, one-third to Mr. Brown and two-thirds to the children. Since Mrs. Brown's estate was less than $60,000 (the federal estate tax exemption), only a small N. C. inheritance tax will be incurred ($1,500).

If Mr. Brown were to die the next year his taxable estate before the $60,000 exemption would be $267,000 ($250,000 + $17,000 from his wife). Mr. Brown's estate would not have the benefit of any marital deduction since his wife predeceased him. The federal estate tax on the transfer of

his estate would be approximately $51,000 while the N. C. inheritance tax would approach $11,000.

As a result of Mr. Brown's poor planning, (1) federal estate and state inheritance taxes have eliminated over one-fifth of the original estate and (2) the property has passed according to the Intestate Succession Act which leaves Bill (the interested son) with less than one-third of the original farm, hardly enough to support a full size family.

> Example #2: In this case assume Mr. Brown makes out a will leaving one-half of his property to his wife and one-half to his children. At Mr. Brown's death his taxable estate for federal estate tax purposes, after the marital deduction and specific exemption, would be $65,000. As a result the federal estate tax would be $8,400 and the N. C. inheritance tax approximately $10,000. If Mrs. Brown dies 5 years later (without having reduced the estate), her taxable estate after the specific exemption would amount to $115,000. The federal tax would be $25,000 and the N. C. tax would be approximately $4,500. (The life expectancy for a wife is greater than for a husband.)

As a result of a simple will Mr. Brown reduced the total taxes paid by $25,000. However, Bill still received an uneconomic size farm business.

> Example #3: Assume in 1968 Mr. Brown incorporated his farm business. Later Mr. Brown executes a will leaving one-half of his property to his wife (which includes 51 percent of the farm corporation stock), 25 percent of the farm corporation stock to Bill and the remaining stock and other property to John and Ann. At Mr. Brown's death his estate consists of $200,000 worth of his farm corporate stock and $50,000 in miscellaneous assets. His taxable estate after the marital deduction and specific exemption would be $65,000 resulting in a federal estate tax of approximately $8,400 and N. C. inheritance tax of $10,000. The fact that Mrs. Brown has a controlling interest provides her with 51 percent of corporation profit during the rest of her life. As soon as Bill graduates from college, he can plan to buy out his mother's interest at an agreed upon time through a buy-sell agreement.

This estate plan has (1) significantly reduced the tax burden in contrast with our example #1, (2) assured Mrs. Brown a source of income during her life, (3) assured Bill the eventual controlling interest in the farm corporation (with all its assets) in which he is interested, and (4) given consideration to the other two children.

All three example tax computations disregard the payment of ordinary estate settlement costs such as attorney's fees, funeral expenses, medical expenses, etc.

GLOSSARY OF TERMS[1]

1. Administrator (administratrix) - A person who has been granted the authority by the proper court to administer the estate of a deceased (collect assets of estate, pay its debts, and distribute residue to those entitled to it).

2. Advancement - Gifts from a parent to a child (or other prospective heir) as anticipation of the share which the child will inherit from the parents' estate and which is intended to be deducted from that estate.

3. Annuity - A periodic (usually annually) payment of a fixed sum of money for the life of the recipient, or for a fixed number of years.

4. Bond - An instrument which obligates a person, his heirs, executors and administrators to pay a specified sum of money to another person on a specified day.

5. Codicil - An addition (or supplement) to a will which explains or changes the provisions in the will.

6. Corporation - A legal entity that can take, hold and transfer property and carry on business in its own name.

7. Curtesy - The estate to which a husband is lawfully entitled, upon the death of his wife, which she possessed in fee simple.

8. Decedent - A deceased person, testate or intestate.

9. Donee - One to whom a gift or bequest is made. A donor is one who makes a gift or creates a trust.

10. Dower - The life estate which a widow is legally entitled to upon the death of her husband (usually refers to real estate exclusively).

11. Estate - All personal and real property in which a person has a right, title, or interest.

12. Executor (executrix) - A person named by a testator to carry out the provisions in the testator's will, and to dispose of the property according to the will after the testator's death.

13. Fiduciary - A person holding a position of trust which would require the elements of trust and confidence, good faith and candor.

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[1] For further explanation of legal terminology see Black's Law Dictionary, Henry Campbell Black, West Publishing Company, 1951.

14. Grantor - The person who makes a grant. A grantee is one to whom a grant is made. A grant is a transfer of property by deed or writing.

15. Guardian - A person legally empowered and charged with the duty of taking care of another person who because of age, intellect, or health is incapable of managing his own affairs(the guardian manages the person, rights, and property of the incompetent).

16. Holographic will - A will written entirely by the testator with his own hand.

17. Homestead - The house, the adjoining land, and the surrounding buildings where the head of a family dwells.

18. Intervivos - Term used to describe the transfer of property from one living person to another living person (usually does not include gifts made in contemplation of death).

19. Intestate - Used to denote either the failure to make a will, or the person who dies without making a will.

20. Joint will - A will executed by two or more persons designed to dispose of property owned by them in common, or separately, to a third party.

21. Legatee - The beneficiary to whom a legacy is willed (usually includes only personal property).

22. Letters testamentary - The legal instrument of authority given by the court to an executor, enabling him to discharge his duties.

23. Life estate - An estate created by law or by individuals which terminates upon the death of the person holding it, or upon the deaths of one or more other persons.

24. Liquidity - Property or an asset consisting of or readily convertible into cash.

25. Litigation - A court contest for the purpose of enforcing a right.

26. Nuncupative will - An oral will spoken by a testator during his last sickness before a number of witnesses, and afterwards reduced to writing (usually depends only upon verbal testimony of witnesses for proof).

27. Partnership - A voluntary contract between two or more persons to pool some or all of their assets into a business with the agreement that there shall be a proportional sharing of profits and losses between them.

28. Personal property - Any interest a person has in temporary or movable things, as contrasted with real property (land or buildings).

29. Prenuptial - Before marriage.

30. Probate - A court action establishing the validity of a will.

31. Real property - Land and immovable property upon the land.

32. Remainderman - One who is entitled to the remainder of an estate after a particular reserved right or interest has expired.

33. Spouse - A person's wife or husband.

34. Surety - One who is bound to pay money or perform some act in the event that some other certain person who is supposed to do so fails to comply.

35. Testate - An adverb describing the act of leaving a will at death.

36. Tenancy - An interest or right in property (in a restricted sense, tenancy is applied to only real property, usually belonging to another).

37. Testator (Testatrix)- A person who has made a will, or who dies leaving a will

38. Trust - A right in real or personal property held by one party (trustee) for the benefit of another.

39. Will - The legal instrument conveying a person's wishes regarding the disposition of his property after his death.

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