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ECONOMICS
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ESTATE PLANNING FOR NORTH CAROLINA FAMILIES

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N. M. GARREN, W. P. PINNA, and R. C. WELLS

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FOREWORD

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

The process of estate planning is a highly specialized area that requires the expertise of a competent attorney. Under no circumstances should the reader consider this publication a substitute for legal assistance. Families are encouraged to study the general principles discusse in this publication in order to become better informed and then to consult their attorney for advice and assistance.

Despite the fact that one of the authors 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.

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ESTATE PLANNING FOR NORTH CAROLINA FAMILIES

N. M. GARREN, W. P. PINNA, and R. C. WELLS

INTRODUCTION

All property owners 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 people, 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 property owners 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 or that individual

who is named executor(rix) about the location of all property, whom to rely upon for advice, and estate settlement procedures.

Everyone has an obligation to himself/herself and to his/her family to acquire some knowledge of estate planning and develop a satisfactory plan. After spending a lifetime in acquiring and developing his/her property, a property owner has the right to decide how it will be distributed after his/her 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 child get started in business, (5) preserving the business 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; and
5. Estate and inheritance, gift and income taxes.

Several hypothetical situations are 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/she is considered to have died intestate. In general, the property owned by an individual who dies intestate is distributed to his spouse and heirs according to the rigid specifications of the North Carolina Intestate Succession Laws. However, the distribution of property, such as insurance contracts with designated beneficiaries and property owned jointly with survivorship rights, is not affected by the statutory 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 intestacy 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.

In North Carolina there is no preference of real property over personal property in the payment of a decedent's debts and expenses of administering his estate. However, the personal representative may not sell real property without first determining that the sale is in the best interests of the estate. The remainder of the estate after payment of debts and administration costs is available for distribution to the heirs. Upon distribution, the property is 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, if the spouse takes the elective life estate, neither the household

furnishings in the dwelling nor the spouse's elective life estate itself is subject to debt (see page 13).

Property or money may be given to an heir by the intestate during his/her 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 advancement 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/she 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/she is entitled to receive an additional amount so that he/she will, in total, receive his/her share. Under the North Carolina Intestate Succession Laws, an heir can renounce his/her share of the estate of an intestate if he/she does so within the time specified by the statute. The reunuciation 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, 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 Successions Laws.

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 estate if neither of the parents of the intestate are alive.

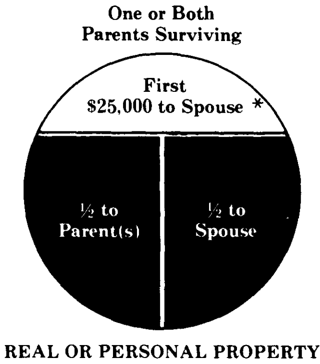
If the intestate is survived by a spouse and by one or more parents, then the first $25,000 in personal property and one-half of the remainder of the net estate passes to the spouse and the other one-half of the

Figure 1

North Carolina Property Distribution If You Do Not Have A Will

Married Person - Spouse Surviving No Children and No Descendants Surviving

One or Both Parents Surviving



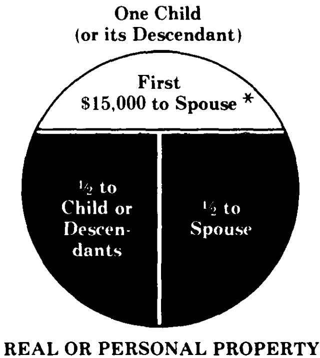
REAL OR PERSONAL PROPERTY

No Parent Surviving

REAL AND PERSONAL PROPERTY

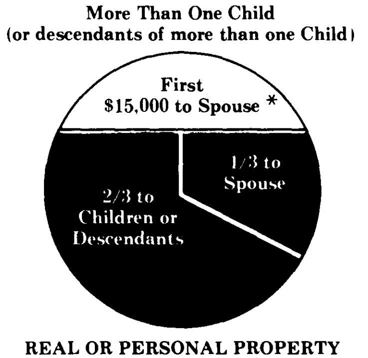
Married Person - Spouse Surviving and Children or Descendants also Surviving

One Child (or its Descendant)



REAL OR PERSONAL PROPERTY

More Than One Child (or descendants of more than one Child)



REAL OR PERSONAL PROPERTY

*in personal property only

Figure 1 (continued)

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

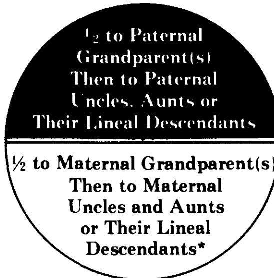
Parent(s) Surviving

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



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 Their Descendants Living

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 State to be used to aid certain students who are residents of North Carolina and enrolled in public institutions of higher education in North Carolina.

*Descendants' Share: See General Statute 29.16 for a complete explanation as to distributive shares.

remainder is distributed equally among the parents or all to the one surviving parent. 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. 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 any real property the deceased owned during the marriage. However, the surviving spouse is entitled to the life estate in the usual dwelling regardless of value as well as outright ownership of the household furnishings.

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 the first $15,000 in personal property plus one-half of the remainder of the net estate and the other one-half of the remainder passes to such child or his/her descendants. When the intestate is survived by two or more children, the spouse takes the first $15,000 in personal property plus one-third of the remainder of the net estate. 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/her parents as if he/she were the natural child of the parents. In case of intestate succession, an illegitimate child is treated as if he/she were the legitimate child of his/her mother. The illegitimate child and his/her descendants are entitled to inherit from the mother. In addition, by statute, the illegitimate child and his/her descendants may inherit from a person who is judicially determined to be the father or who acknowledges himself as the father. 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/her parents, then all of the property goes to the parents in equal shares. If only one parent is living, he/she 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 escheats to the State to be used to aid certain students who are residents of North Carolina and enrolled in public institutions of higher education in North Carolina.

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. Out of the intestate's $90,000 estate, $40,000 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 Successions 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 roughly 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 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/her real and personal property to be distributed at his/her death. A will is revocable during a person's lifetime and doesn't take effect until after his/her death. A will allows a person to decide before his/her death who shall receive his/her 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/her property.

A person who makes a will disposing of his/her property is called a testator. When he/she dies, he/she is said to have died "testate." If a person dies without a will, he/she 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, call "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 probated within six months from the date of making the will unless it has been converted to writing within ten days from the speaking of the will.

Occasionally, married couples prepare written wills which are called mutual wills. Mutual wills are the separate wills of two or more persons in which the provisions made by each testator are substantially the same.

Making a Will

To safeguard against the possibility of an invalid will, it is important to meet with an attorney and have him/her 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 business, should it be kept intact? Who will take it over? What provisions should be made for children who have left the business? What will the spouse's needs be? What provisions should be made for him/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/she will act as the family advisor and manage property during the estate settlement period. The powers given to an executor are important. If he/she can be trusted, he/she should have nearly the same powers to deal with and manage property the testator had while alive. A more thorough discussion of the executor's functions follows on pages 17-20.

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/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/she will have the testator sign the will in the presence of at least two competent witnesses. These persons are witnesses to the fact that the individual signed the papers as his/her will. Each witness will then attest to the individual's signature by signing his/her 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. A beneficiary of a will should never be a witness to the execution thereof. North Carolina's "self-proving will" provision calls for notarization of the testator's signature and witnesses' signatures at the time they sign as witnesses. When the will is later probated, it is not necessary to locate the witnesses to verify their signatures. This provision can save time and money in the estate settlement procedure.

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/her property if

he/she 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 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.

In lieu of an outright intestate share in the decedent's property, the dissenting spouse may elect to take an estate for life in one-third the value of all real estate the decedent owned during the marriage. If the surviving spouse elects to take this life estate, he/she may also elect to take such elective life estate in the customary dwelling of the decedent at the time of the decedent's death. 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. Such shares shall also include complete ownership of the household furnishings located in the dwelling house. 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. Generally, if a spouse dies or fails to exercise his or her right of dissent within six 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/her intestate share, the will isn't entirely upset since the remaining estate is distributed according to the testator's wishes on a pro rata basis.

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

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/she has dissented from the will, shall be entitled to an allowance of $5,000 in value of personal property of the deceased spouse for his/her 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. Where the spouse takes under the will, the allowance is charged against the share. Note, the law also provides a $1,000 allowance for children meeting certain age and/or dependency requirements.

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 known and safe place where it is readily available to the executor and not subject to being lost or destroyed. Executed 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.

SETTLING AN ESTATE

If a person is not familiar with the provisions of his/her spouse's will, it should be examined as soon as possible after his/her 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 surviving spouse's obtaining any funds from the account. If the spouse 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 may offer the will for probate at anytime 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 with the clerk for the probate. The clerk may compel production of the will and the person having custody is responsible for filing the will and can be held in contempt and liable if he/she 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/she has named a person to handle his/her 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 a representative, he or she is called an administrator or administratrix, respectively. Once this person has been appointed he/she 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 is not required to give notice to all interested persons before granting letters. However, persons with an equal or greater right to appointment must be given notice. Interested persons may file objection and thus contest the issuance of letters. Before "letters testamentary" or "administration" can be issued to the personal representative, he/she must take an oath and give bond if required by law. The requirement of a surety bond can be waived by the testator in his/her 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 are 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 personal representative should carefully examine all account books, bank books and recent bank statements, brokers' 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 personal representative's job much easier and less costly.

Once the personal representative has examined the decedent's records, he/she 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/her 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 personal representative needs to check the cash requirements of the estate to pay claims, taxes, legacies, etc. He/she 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/her in the will. He/she 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 for a personal representative with no farming experience to make.

Along with the duty of assembling assets the personal representative 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 file a claim to estate's assets. 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 allowance;
2. Administration costs;
3. Claims which have a specific lien on property;
4. Funeral expenses to the extent of $1,000;
5. Taxes and preferred debts;
6. Judgement liens;
7. Wages due an employee of the decedent; and
8. All other claims.

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, the personal representative may have to sell real and personal property to raise cash. 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 dies. 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 to 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 is deducted from the gross estate value, must be prepared. The North Carolina inheritance tax return is computed and paid nine months after death (Form A-100). The federal estate tax return (Form 706) is due nine months from date of death and is accompanied by an affidavit 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 personal representative 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 Estates 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 personal representative 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 personal representative 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 personal representative may need competent advice in fufilling his/her duties. It will be worthwhile for an individual, while still alive, to assist his/her 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/her executor, his/her 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/her services. This expense is charged as a part of the administration costs of the estate. Generally, the personal representative's allowance is limited to a maximum of 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 personal representative amounted to $15,000 and estate expenditures amounted to $1,500, the personal representative'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 personal representative shall receive the maximum compensation.

In many cases, the personal representative 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.

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/her duties. An executor who is resident of the state is not required to give bond unless the will requires it or unless he/she must sell real property for the payment of debts. All administrators except banks and trust companies must give bond unless all heirs are over 18 years of age and file a written waiver of the bond. 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 $1,000 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. In addition, the bond may be secured by individual sureties, a mortgage, or by a deposit of securities. When the bond is secured with one of these methods, the amount of the bond is equal to twice the value of the decedent's personal property. When a mortgage is used, 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/her 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/her 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 nine 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 payable 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 43 for discussion) if it is to be kept out of his/her estate or convey such incidents prior to three years of his/her death. Alternatively, the insured can irrevocably assign the policy to a trustee for his/her 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.

Frequently, the decedent will have interests in a business that he/she may wish terminated at his/her death. These interests can also provide liquidity for the estate. For example, if the decedent is a partner in a business, he/she 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 family corporation, the following alternatives of providing cash are available:

1. The corporation can buy back some the decedent's stock. The tax consequences depend upon the stock classification and the method of redemption.
2. The stockholders can execute a buy-sell agreement to purchase all or a portion of the decedent's share at his/her death.
3. A buy-sell arrangement can be made with a child in order to insure him/her control of the family corporation and provide cash for the estate to pay its debts.

Another method to ease the liquidity problem is the use of Flower Bonds. Certain series of U.S. Government Treasury Bonds may be purchased at a discount and used in the payment of the Federal Estate Tax at par value. In this manner the estate is provided with a built-in profit. These bonds must meet three requirements:

1. They must be owned by the decedent at death;
2. They must be included in his/her estate; and
3. They must have been issued before March 31, 1971.

Where a closely held business comprises a large part of the gross estate, the Federal Estate Tax may be paid in installments if the personal representative so elects. Such an election may enable the family to avoid selling the business to outsiders. See pages 53-54 for a more detailed discussion of alternative methods of paying the Federal Estate Tax.

In addition to the above provision, the payment of the Federal Estate Tax may be extended upon a showing of reasonable cause. In order to obtain such an extension, the personal representative must prove that a severe cash shortage exists.

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. Parents could transfer real or personal property to children to assist them in getting started in a business. The parents could gradually retire from the business but still provide the children with the benefit of their advice and experience. Whether or not lifetime transfers are possible or acceptable to the property owner depends upon his/her 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 business 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 business 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 child should work for his/her 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. There 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 real 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 child since he/she does not have sufficient cash to make the purchase. An alternative is the use of a down payment, secured by a deed of trust 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 gains over several years. The parties should review the provisions of the Installment Sales Act of 1980 before the contract is finalized (see page 61).

When an installment sale is used, the buyer agrees to make a series of payments. The buyer typically obtains a warranty deed to the property when the final payment of the sales price has been made.

An installment sales 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 of trust on the property until the sales price is paid. The parents have the right of foreclosure as a means of recovering the property in the event of default of the payment.

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

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

4. There is added incentive for the buyer to save money and maintain business productivity.

5. An installment sale of a business may be the only way a young person can get started in an adequate size business.

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

1. In the event of default, the sellers must go through the legal process of foreclosure to recover their property.

2. The buyer's 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 business management.

Installment payment contracts are flexible in nature. After the purchase price is determined, either fixed or variable payments can be used. In the later case, the principal payment could be a percentage of net or gross income. This method provides the buyer with some protection against falling prices or production failure, 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/her 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 equipment and other productive assets, 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. Business property can be sold to the child operating the business with the proceeds to be distributed to the other children under the terms of the will. The will might specify that the business-operating child be given first opportunity to purchase the business from the estate under specified terms. The payments could be made to the estate for the surviving spouse'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 presented 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/she 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 the appreciation value of such property and the value of gift taxes from the donor's taxable estate. Thus, gifts of property which are likely to appreciate greatly in value will especially help reduce donor's taxable estate.

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 of disposition of a bona fide gift.
4. Certain gifts may be subject to estate and inheritance taxes if they are made within three years prior to death (see page 44).

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 property passes to the minor, but until he/she reaches majority age as defined under the laws of North Carolina, the custodian can use the income or sell the securities for the well-being of the minor without a court order and at his/her own discretion (the financing of a college education is an example). When the minor reaches majority age, the custodian must pay over the money or securities to the minor.

The Uniform Gifts 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 reaching majority age, the property goes to the minor's estate. This latter provision may be contrary to the donor's intentions. If the donor serves as custodian and dies prior to the minor reaching majority age, the value of the property, held in this fashion, could be included in the donor's gross estate for death tax purposes because the donor custodian retained control over the property. Therefore, the custodian should be someone other than the donor.

A gift and a sale can sometimes be effectively combined. For example, if a farm worth $40,000 is sold to a child 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/her 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/her life estate, but he/she cannot sell the underlying 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. For example, a farmer could convey by deed the farm real estate to a child 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 child to obtain income for living expenses.

A life estate can be forfeited by the failure of the life 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/her 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 13.

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 must be considered. In certain circumstances they may outweigh the advantages. Some of the disadvantages are:

1. Misunderstandings between the life tenant and reaminderman can occur over property improvements.
2. The value of the property is included in the grantor's estate where the grantor has retained a life estate.
3. The remainder interest in the property upon which the life estate is based cannot be sold by a life tenant for income.

Under prior federal estate and gift tax provisions, a life estate granted to a spouse was not eligible for the marital deduction. The Economic Recovery Tax Act of 1981 now makes it possible for such life interest to qualify for the marital deduction (see page 45).

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 a business during the surviving spouse's lifetime especially where the trustee is a bank specializing in business management services. A steady source of income could thus be reasonably assured to the spouse. Upon his/her death, the property could then pass to the other heirs. If a business was left outright to a spouse, there is often no assurance that he/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. Other variations of a trust include a grandfather trust and a marital deduction trust.

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/herself as trustee for a beneficiary. If a trust is created during the grantor's lifetime, it is called an inter vivos 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. However, the will may provide for the addition of assets to an inter vivos trust after death. This is called a pour over trust.

Care should be used in selecting a trustee. The trustee must invest, manage and protect the property. He/she must exercise good faith in his/her duties and do all he/she 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. The trust is an income tax entity, but 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 of a revocable trust pays taxes on such trust income and can expect the value of the trust property to be placed in his/her gross estate for estate tax purposes if he/she should die.

A generation skipping trust is a trust which has two or more beneficiaries belonging to different generations which are generations younger than that of the grantor. The 1976 Tax Reform Act made changes in the taxation of generation skipping trusts. Under the old law, it was possible to leave the right to income from property to one or more generations without federal estate tax consequences. Thus an individual might have left property at his/her death in trust for his/her child for life, then to the grandchildren for life and then to the great grandchildren outright.

Federal estate tax was imposed at the death of the individuals establishing the arrangement. The property wasn't taxed until the death of the great grandchildren -- assuming they held the property until their deaths. This planning technique permitted families to give intervening generations the principal economic benefit from the property -- the income -- without depletion of the principal by federal estate tax.

The 1976 Tax Reform Act reduces the tax advantage of setting up a generation skipping trust. The purpose of the generation skipping tax is to impose a tax upon a generation skipping transfer substantially equivalent to the tax that would have been imposed if the property had been transferred outright to each successive generation. To achieve this result, the beneficiary whose interest is terminated is treated as the transferor (deemed transferor) of the property. For purposes of the generation skipping tax, a beneficiary is one who possesses an interest or a power, other than the power of an unrelated and unsubordinated trustee, to distribute corpus or income to the descendants of the grantor. The property is then added to his taxable gifts or to his/her estate, as the case may be, so that the tax imposed is at the same marginal rate of tax as an outright transfer. In certain cases the marital deduction may be increased and the deemed transferor's unused unified credit may be available to reduce the tax. However, the tax is paid out of the trust proceeds and not by the deemed transferor or his/her estate. There is a $250,000 exemption for each deemed transferor (generally the child of the grantor who is the parent of a grandchild receiving the transfer) for generation skipping transfers to the grantor's grandchildren. North Carolina also imposes a generation skipping tax on transfers subject to the federal tax.

A trust offers the following advantages:

1. Management of business property for minors or a spouse;
2. Continuation of a business;
3. Income security for beneficiaries;
4. The tax burden may be allocated to more persons, which will 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 estate 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. As a result, the creation of a tenancy by the entirety in North Carolina does not qualify for the North Carolina or federal annual gift tax exclusion, since the wife is not entitled to a present income interest. The husband can 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 the other spouse and himself/herself.

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 child 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 child by will. The child, however, could never be sure that he/she would obtain interest in the farm or that he/she could develop the farm as rapidly as if he/she 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. North Carolina law does not provide for tenancies with right of survivorship, but such tenancies may be created by contract between the parties.

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/her share passes to his/her heirs rather than to the surviving tenants.

Taxation of Co-ownership: In the case of a tenancy in common, each co-tenant owns an undivided proportionate interest in the entire property, but may compel partition. Since this interest is vested, the amount of the interest is included in the co-tenant's estate at death. The property held in joint tenancy by individuals is included in the estate of the first tenant who dies except to the extent the survivor can show he/she contributed to the purchase price. After December 31, 1981, if the joint tenants are a married couple, 50 percent of the value of tenancy by the entirety property or property held as joint tenants with right of survivorship (for example, joint bank accounts) is included in the estate of the first spouse to die under federal estate tax provisions. It makes no difference which spouse provided consideration

for the property. In contrast, North Carolina treats spouses as individuals and includes the value of joint tenancy personal property in the estate of the first spouse to die except to the extent the surviving spouse can show he contributed to the purchase price. A deduction of up to one-half the value of tenancy by the entirety property is allowed regardless of who furnished the purchase price. In North Carolina, the creation of a joint tenancy in personal property is a taxable gift to the extent that a spouse receives an interest greater than his/her contribution. However, the creation of a tenancy by the entirety is not a gift unless so elected.

Advantages of Co-ownership:

1. At the death of one of the tenants, the property passes to the survivor with a minimum of administration expense and time (tenancy by the entirety and joint tenancy with right of survivorship). In North Carolina a co-tenancy is deemed a tenancy in common unless an express right of survivorship is created.
2. Property can be protected from seizure by creditors (tenancy by the entirety).
3. Partial exemption of real property (up to 50 percent) from North Carolina inheritance tax and full exemption from federal estate tax at death of the first tenant (tenancy by the entirety).
4. Tenancies are easy to create.

Disadvantages of Co-ownership:

1. Heirs may be excluded from receiving property (tenancy by the entirety and tenancy with right of survivorship).

   Example: Mr. Smith, whose first wife dies, 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 new 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. Tenancy with right of survivorship property may be fully taxable in the estate of the first tenant to die unless the survivor can prove his/her contributions to the original purchase. See taxation of co-ownership for exceptions regarding married couples (page 32).
3. Tenancy by entirety property may present future income tax problems to the surviving spouse who sells the property.

Example: In 1968 Mr. and Mrs. Brown purchased real property, taking title as tenants by the entirety. Mr. Brown provided $20,000 for the purchase price. At Mr. Brown's death in 1982, the property is valued at $50,000 with Mrs. Brown becoming the sole owner. The basis of the property for federal income tax will be $35,000, not $50,000, the fair market value at death, since only half the property receives a stepped-up basis (one-half of $20,000 + one-half of $50,000). If Mrs. Brown sells the property for $50,000 she may have $15,000 of capital gain income. If Mr. Brown had been the sole owner of the home, Mrs. Brown could have received a stepped-up basis of $50,000.

4. Disruption of business or farming operation is possible if one co-tenant desires to cash in by conveyance or partition (tenancy in common and tenancy with right of survivorship).
5. Costly and lengthy estate settlement (tenancy in common).

In summary, the disadvantages of owning property as joint tenant may outweigh 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 families to get a child started and established in a business, and at the same time, help him/her acquire ownership of real and personal property. A partnership is a joint 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 be shared equally, in proportion to the contributions of land, labor and capital each member makes to the business, or by mutual agreement. Partnership arrangements, however, are not limited to parents and children. Many partnerships involve brothers or unrelated individuals.

As a way of getting the child started on the road to property ownership, the parent can either give or sell the child an interest in the business personal property -- equipment, livestock in the case of a farm, supplies, and bank account. A 50-50 gift or purchase is often used. If a purchase is agreed upon and the child is unable to raise the cash for his/her share, he/she can give his/her parent a secured interest bearing note for the amount he/she is unable to pay. The child can then repay the note out of his/her share of earnings. Purchased equipment

and livestock can be owned jointly or the child can purchase these items himself/herself. Net additions to the business personal property can either be owned on a 50-50 basis or in some other proportion.

Where real estate is involved, the parent, for a time at least, normally owns the real estate. If the child decides to build a home, it should be built on land the child owns. Additional real estate can be purchased by the child as sole owner or jointly by the partners. Title to the real estate can be conveyed to the child by will or the will can give the child the option to buy the real estate 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 business at the father's death has terminated many successful businesses. Other brothers and sisters may want their share of the estate immediately. This can place the business-operating child in the position of seeing the business divided and sold to satisfy other heirs, or else he/she may have to borrow heavily to meet the immediate demands of the other children.

Parent-child 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 child the option to buy his/her parent'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 is a large age difference between a parent and child.

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/her share of the partnership income. Partnership parents who plan to receive Social Security benefits upon reaching age 65-72 (age 70 in 1983) can receive full benefits as long as they earn less than $6,000 in 1982, $6,600 in 1983, $7,320 in 1984, and $8,040 in 1985 from the partnership and from other "earned" income sources. Above $6,000 of total earnings, $1.00 of benefits is lost for each additional $2.00 earned in 1982. For persons under 65 years of age at retirement, the earnings limit is $4,440 in 1982, $4,920 in 1983, $5,400 in 1984, and $5,880 in 1985.

Some advantages of a partnership are that it:

1. Allows the parent to retire gradually from the business.
2. Allows the child to grow into a "going business" without a heavy debt load.
3. Gives the child incentive to remain in the business in expectation that it will be his/hers someday.
4. Permits the transfer of the business intact if a will, buy and sell agreement or other proper arrangement is used.
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 businesses.
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/her investment in the stock of the corporation. The owner will have no personal liability for the debts or obligations of the corporation unless he/she has volunteered liability, such as by co-signing a corporate note. As a practical matter such co-signing is usually required before a lending party will make a loan to a small 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. Shares of stock can be freely given, sold or inherited, and continuity can thus be more easily maintained.
3. Ease of transferring ownership which allows shares to be bought and sold without interfering with the operation

of the business. Whereas it is difficult to periodically give children a little piece of land, it is quite easy to gradually give shares of stock that represent an interest in that land and other corporate property.

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

The corporate structure permits the division of ownership and management of a business among parents and children in varying proportions. Parents can gradually transfer shares of stock (either by sale or gift) to a child(ren) who will relieve the parents of the burden of work and management of the business. 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 are 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 business expenses. The employee does not recognize the income until received and the income of the plan's trust accumulates tax free.

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. Upon liquidation, or redemption of stock, there will be tax consequences.

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

The disadvantages associated with corporate structure include:

1. An additional income tax burden may be incurred if the corporation does not utilize the provisions of law for Subchapter S corporations.
2. There is more formality required in the management of a corporation.
3. A minority stockholder's interest may not be marketable, and the minority stockholder may be unable to change management of the corporation.
4. A minority stockholder does not have an automatic right to dividends. The decision to grant dividends is within the discretion of the board of directors.
5. The initial cost of incorporating may be prohibitive on small businessess. The legal requirements for creating a corporation are quite technical and require strict compliance.

A detailed discussion of incorporating a business is presented in Incorporation of Farm Businesses, EIR-61, Department of Economics at N. C. State University.

Annuities

An annuity is an amount of money payable each year for a specified period. The annuity is one way of transferring a business 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 has 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/her 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/her contribution to the purchase price.

A commonly accepted definition of the term private annuity is a transfer of property to a transferee, who is not in the business of writing commercial annuities, in exchange for the transferee's unsecured promise to make periodic payments of money for a specified period of time for the transfer of the property. An example of the private annuity exists where a parent transfers a business to his/her child in return for the unsecured promise by the child to pay a specified monthly sum to the parent for life. It is through the concept of the private annuity that the parent can lower his/her estate tax liability by getting the business out of his gross estate. In addition, if the present value of the annuity equals the value of the property transferred there is no taxable gift and, therefore, no gift tax. While there are substantial tax advantages from an estate planning standpoint, the party receiving the monthly payments will have income tax consequences on the payments received.

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

1. If the parent dies much earlier than anticipated, the child will receive the business for only a fraction of its value.
2. If the parent lives considerably longer than anticipated, the price for the business may become excessive.
3. If the annual payment is a fixed amount, it becomes payable whether business income is high or low. There is no built-in hedge against inflation, or deflation.
4. If the annual payment is secured only by the promise of the child, the parent 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 is not a gift, it may offer a parent in advanced years and poor health the only feasible approach to reducing his/her death taxes. The child may also be guaranteed title to the business.

A commercial annuity can be purchased from an insurance company to facilitate a business 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 business, or annual installment premiums may be arranged under a deferred anuuity plan.

ROLE OF TAXES IN PLANNING PROPERTY TRANSFERS

Tax considerations play an important part in developing 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/her fair share of taxes, but he/she 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 persons who have small estates feel that tax matters do not concern them. However, the individual with a small estate has greater need for tax advice, since 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) 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

At a property owner's death, the personal representative of his/her estate will be required to list and value all of the property in which the decedent had a fractional or whole interest. This listing is called the gross estate. In general, the property is valued at either fair market value as of the date of death or at the alternative valuation date which is six months after death. However, if certain requirements are met (see discussion, page 50), the personal representative can make a special election to value real property used in farming or other closely held businesses at its "current use" value rather than fair market value. "Current use" valuation can reduce the value of the gross estate by $600,000 in 1981, $700,000 in 1982, and $750,000 in 1983 and later.

Many married couples own property jointly with the right of survivorship such as real estate, bank and checking accounts and securities. The Economic Recovery Tax Act of 1981 replaces the "consideration furnished, fractional shares, and credit for services" rules with a single "50 percent inclusion" rule for the jointly owned property of married couples. Starting in 1982, the estate of the first spouse to die will include one-half of the value of the property owned jointly with survivorship rights regardless of which spouse furnished the consideration for the property.

Life insurance proceeds payable to the estate or payable to others if the decedent retained incidents of ownership are also included in the gross estate. Incidents of ownership include the right to change the beneficiary, cancel the policy or pledge it for a loan. One way of reducing the size of the gross estate is to make a gift to a beneficiary

of the ownership of a life insurance policy on the insured's life. If the gift is a new policy, the gift itself amounts to the premium paid by the insured. If an old policy is transferred to the beneficiary, the value of the gift is roughly equivalent to the cash surrender value of the policy. Later premium payments by the insured would also be gifts.

After 1981, the value of all gifts made within three years of death are generally no longer included in the gross estate. Exceptions to this general rule include the transfer of life insurance policies, retained life interests, revocable gifts and powers of appointment. Where the personal representative wishes to qualify the estate of the decedent for current use valuation, installment payment of taxes and redemption of corporate stock for payment of death taxes and settlement costs, the value of gifts made within three years of death are included in the gross estate for the limited purpose of determining whether eligibility is met.

Annuities payable to the decedent either alone or in conjunction with another person(s) are also included in the gross estate. For example, a man buys an annuity under which payments are to be made to himself and his wife jointly during their joint lives and continued in favor of the survivor during her life. If the wife contributed nothing to the pruchase of the annuity contract, the full value of the annuity at the time of the husband's death is included in the gross estate of the husband.

Property which the decedent transferred to another but reserved the income and/or use thereof during his/her lifetime or reserved the right to designate the person who should possess or use the property is included in the gross estate (retained life estate). For example, assume a widower gives his residence to his child, 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.

Deductions and the Unified Credit

After the gross estate is calculated, deductions are allowed for funeral expenses, enforceable debts, unpaid taxes, the costs of settling the estate, and casualty losses occurring during estate settlement.

The residual is called the adjusted gross estate. One of the most powerful estate planning tools available to married couples is the marital

deduction. It is a deduction from the adjusted gross estate for property passing to the surviving spouse. For deaths occurring in 1982 and after, the marital deduction is unlimited in the amount of property passing to the spouse and qualifying for the marital deduction.

The new unlimited marital deductions may lull many couples into a false sense of security. Some may feel that a simple one-line will leaving all to the surviving spouse will suffice to eliminate federal estate tax liability. However, estate planning with the goal of minimizing taxes should account for the tax liability incurred at the death of each spouse. Starting in 1982 an estate, regardless of size, could pass tax-free to the surviving spouse, but a tax burden will fall on the estate created by the death of the surviving spouse if that estate exceeds $600,000 in value. Therefore, the projected tax liability of both estatesshould be considered in estate planning.

Any property received by the wife through intestate distribution, by will, as insurance proceeds, or by joint tenancy with right of survivorship may qualify for the marital deduction provided it was included in the decedent's estate. Note, however, that a life estate created in a spouse's will for the benefit of the surviving spouse may not qualify for the marital deduction.

Under the new law, transfers of certain terminable interests can qualify for the marital deduction, provided the decedent's executor or, in the case of a gift, the donor, so elects and several other conditions are satisfied. First, the spouse must be entitled to all of the income from the entire interest, or a portion thereof (which is treated as a separate interest), for life that is payable annually or more frequently. As a result, income interests for a term of years, or life estates that terminate on remarriage, or on the occurrence of some other specified event, won't qualify. Second, no one, including the spouse, can have the power to appoint any part of the corpus or property producing the income to anyone other than the spouse during the spouse's life.

Under the new law, property for which an election has been made will be subject to estate or gift tax at the earlier of (a) the date on which the spouse disposes of all or part of it, or (b) upon the spouse's death. If the property subject to the election is not disposed of prior to the death of the spouse, its fair market value will be included in

the spouse's gross estate. The decedent's executor should not elect qualified terminable interest treatment when the estate of the surviving spouse is larger than the decedent's estate, because it will throw more property into the larger estate, in higher tax brackets. The arithmetic must be worked out in each case.

Another deduction which is useful to some persons is the charitable deduction to a qualified charity. The marital and charitable deductions are subtracted from the adjusted gross estate leaving an amount subject to a tentative estate tax. Federal regulations provide a single unified transfer tax for both testamentary (estate) and lifetime (gift) transfers (see page 48). The transfer tax will be both cumulative and progressive in nature. At death, taxable lifetime transfers are added to the taxable estate to determine the "unified transfer tax." The calculated tax is then reduced by any transfer tax imposed on post-1976 gifts and the "unified credit." The amount of the unified credit that can be applied against the tax due depends upon the date of death as follows.

Date of Death	Unified Credit	Equivalent Exemption
1982	$ 62,800	$225,000
1983	79,300	275,000
1984	96,300	325,000
1985	121,800	400,000
1986	155,800	500,000
1987	192,800	600,000

Example

A donor made no gift before 1977. He made the following taxable gifts in excess of the annual exclusion:

Quarter	3rd 1977	4th 1979
Taxable gifts	$37,500	$37,500
Gift tax before credit	7,650	9,250
Unified credit	(7,650)	(9,250)
Gift tax payable	0	0

At his death on August 15, 1982, the donor left a taxable estate of $750,000. His post 1976 taxable gifts were $75,000, the total of 1977

and 1979 gifts excluded from his gross estate. The estate tax payable before other credits was $214,750.

Listed below are the calculations.

Unified Transfer Tax on Estates in 1982

Taxable estate	$750,000
Post 1976 gifts (taxable)	75,000
Total transfers	825,000
Unified transfer tax on total transfer	277,550
Less unified transfer tax on post 1976 gifts	0
Unified transfer tax on estate	277,550
Less unified credit	62,800
Tax due before other credits	214,750

Tax Payments

Federal estate taxes are progressive in nature. That is, the larger the taxable estate, the higher the tax rate. The federal estate tax is normally due within nine months of death and paid unless reasonable cause for a delay can be proven. In such case, the time of payment may be extended for up to ten annual installment payments where there is a finding of reasonable cause. A special installment tax payment provision is available for closely held businesses, which is discussed in a following section (see page 53).

A credit is allowed for federal estate tax paid on property that passed through another estate during the prior ten years. For example, if the present property owner died within two years of the prior decedent who owned the property, the credit is 100 percent but decreases by 20 percent for each two additional years. Beyond ten years, no credit is allowed.

In summary, if an estate amounts to $225,000 or less in 1982, there are no federal estate taxes payable and no federal estate tax return is due. The comparable figure for 1983 is $275,000 or less, $325,000 or less in 1984, $400,000 or less in 1985, $500,000 or less in 1986, and $600,000 or less in 1987.

Tax Rates

Currently the tax rates are graduated from 18 percent for estates of less than $10,000 to 70 percent for taxable estates of $5,000,000. The 1981 Act will reduce the maximum estate and gift tax rate from 70 percent to 50 percent over a four-year period. The tax rates apply to both taxable estate and gifts after all allowable deductions and credits have been taken. When phased in by 1985, the new maximum rate of 50 percent will apply to estates in excess of $2,500,000 (see Table 1). As a practical matter the effective tax rate brackets after 1987 will be 37 percent to 50 percent since estates of value less than $600,000 will pass tax free. These effective rates can be reduced even further when the calculated credit for state death taxes paid is applied to the federal estate tax liability.

Table 1. Federal Estate and Gift Tax Rates

Taxable Amount				
From	To	Tax =	+ Percent	On Excess Over
0	$ 10,000	0	18	$ 0
10,000	20,000	1,800	20	10,000
20,000	40,000	3,800	22	20,000
40,000	60,000	8,200	24	40,000
60,000	80,000	13,000	26	60,000
80,000	100,000	18,200	28	80,000
100,000	150,000	23,800	30	100,000
150,000	250,000	38,800	32	150,000
250,000	500,000	70,800	34	250,000
500,000	750,000	155,800	37	500,000
750,000	1,000,000	248,300	39	750,000
1,000,000	1,250,000	345,800	41	1,000,000
1,250,000	1,500,000	448,300	43	1,250,000
1,500,000	2,000,000	555,800	45	1,500,000
2,000,000	2,500,000	780,800	49	2,000,000
Over 2,500,000		1,025,800	50	2,500,000

Special Provisions and Techniques for Farm Families

For most individuals, the increased unified credit and the unlimited marital deduction will be the major provisions utilized to eliminate federal estate taxes. However, the average North Carolina farm family faces a host of problems resulting primarily from the inflating value of farmland. In the last ten years, inflationary pressures in our economy have pushed farmland values up, thereby creating unexpected estate tax liabilities for remaining family members. In an effort to resolve this problem, estate planners have looked to the following techniques and provisions to lessen the overall estate tax burden.

1. The freezing of asset values.
2. Special use valuation for farms and closely held businesses.
3. Deferral of estate tax payments over a 15 year period.

The Capital or Asset Freeze

The concept of freezing the value of the assets in a person's estate is not a new one. Typically, families have used generation-skipping trusts (see page 31), intra-family installment sales (see page 25), and private annuities (see page 40) as techniques for freezing asset values. One of the advantages to freezing the value of assets in the parents' estate is that it allows for a tax-free transfer of future appreciation in property value to the children.

In recent years, a more sophisticated technique has been developed for the freezing of asset values. This technique can use either the corporation or the partnership as the farm business structure.

With a corporation, two classes of stock, preferred and common, can be created upon initial capitalization or during recapitalization if the corporation currently exists. Although the holder of preferred stock has a preference over common stock in terms of dividends, distributions of assets upon liquidation or other corporate activities, he/she unlike the common stockholder will not share in the future growth of the business. By retaining the preferred stock for themselves and by transferring the common stock to the children either by sale or by gift, the parents would reasonably assure themselves of an income but would have diverted the future growth of the business to the children. The value of the parents' interest in the farm corporation would be frozen for death tax purposes.

In a similar fashion, the frozen interest could be that of a partnership interest. In a partnership capital freeze it is not necessary that a limited partnership be used. The frozen interest, retained by the parents, simply has a priority claim on cash flow and a fixed right on liquidation, while the children would receive a regular partnership interest which would be entitled to residual income and to future appreciation in the partnership assets. Again the value of the business assets is frozen in the parents' estate.

From the parent's viewpoint the frozen partnership or corporate interest seems to be more acceptable as a freezing device than an outright gift or sale, as it allows them to remain involved in the business entity and gives them a degree of security in the form of an income flow.

The Economic Recovery Tax Act of 1981 has had an impact on the establishment of asset freezes. The new gift tax exclusion has made it easier and more advantageous to use the frozen asset technique. The increased exclusion and the increased unified credit will allow a greater transfer to the younger members of the family in the initial establishment of the frozen business interest. The use of the unlimited marital deduction will allow a couple to retain the frozen value for a longer period of time without gift tax exposure. This will allow a longer planning period for the utilization of the gifting program.

Special Use Valuation for Farms and Closely Held Businesses

With the passage of the 1976 Tax Reform Act, the estate tax law included a provision to reduce the estate tax burden on families owning farms and closely held businesses by allowing property to be valued based on a current use value rather than the highest and best use. This relief provision conceptually was very significant in recognizing that the value of land for farming purposes may be substantially less than the value of that same land if it were used for commercial or residential purposes. The 1976 provisions, while theoretically very beneficial, were more illusory than real in terms of applicability and implementation.

The Economic Recovery Tax Act of 1981 readdressed the valuation area. First, the new law recognized that the value of the $500,000 limitation as the maximum discount under special use was seriously eroded from 1976 to 1981 by inflation. As a result, the maximum reduction of the

taxable estate was increased to $600,000 in 1981, $700,000 in 1982, and $750,000 in 1983 and thereafter.

Secondly, the 1981 Act attempted to make available to the surviving spouse the special use valuation discount. Typically, one spouse owns substantially all of the farmland or the closely held assets and if that spouse dies first, the full utilization of the marital deduction would all but eliminate the need for the tax relief of the special use valuation discount. However, if the surviving spouse could also qualify for special use, this would provide the long range planning benefits intended by Congress. Under the new law, it is considerably easier for the surviving spouse to qualify for a special use valuation discount. As a result, it is recommended that sufficient qualifying assets be transferred between spouses so that each spouse will have a sufficient amount of farmland or closely held property to obtain the full benefits of the discount regardless of which spouse dies first.

In 1982 the introduction of the unlimited gift tax marital deduction allows either the husband or the wife to transfer tax free a sufficient amount of property to the other spouse to take advantage of this current use valuation discount. <u>This approach to equalize both estates does require that each spouse meet the material participation test for qualification and utilization of special use valuation</u>. The test requires participation in the production or management of an agricultural commodity. The decedent or a member of the decedent's family must own the property and materially participate in the farm activity for five years out of an eight-year period. A lifetime gift would seem to start a new five-year period. Anyone considering a gift transfer should consider the risk when trying to use special use valuation for both estates.

As an alternative to the equalization of estate by gifting, the transfer between spouses could be delayed until the death of the property owning spouse. Under such circumstances, if the surviving spouse did not participate in the day to day management of the farm so as to be able to meet the "material participation" test, past provisions of the law eliminated the availability of special use for the estate of the second spouse. The attempt to ease the qualifications for special use by the surviving spouse now comes in the form of a less stringent "active management" test. "Active management" means making business decisions

other than those necessary for the day to day operation of the farm. The determination of whether a spouse is involved in "active management" is factual and that requirement can be met even though no self-employment tax is payable by the spouse with respect to income derived from the farm.

In choosing between a lifetime and testamentary transfer of farm property to a spouse, all factors in utilizing special use should be considered. The lifetime gift method is obviously affected by the anticipated life expectancies of each spouse and their participation in farming activities. On the other hand, the testamentary transfer would be influenced by the executor's ability to pick the appropriate assets to transfer to the qualified heirs and the surviving spouse. In either case, the objective should be to maximize the use of the discount available through special use valuation. To the extent you can utilize the $750,000 maximum discount and combine that with the new $600,000 maximum unified tax credit (in 1987), there is $1,350,000 eliminated from a decedent's tax base.

To illustrate the utilization of the new estate tax provisions and the special use provisions, assume that Mr. Green owns a farm that is worth approximately $2,600,000. During his lifetime, he does not wish to transfer any part of the farm to his wife, but wishes to take advantage of the special use value in each of the estates. If Mr. Green dies on January 1, 1987, his estate is taxed as follows:

1.		
	Fair market value of assets January 1, 1987	$ 2,600,000
	Less special use valuation	(750,000)
	Adjusted gross estate	$ 1,850,000
	Less marital deduction	(1,250,000)
	Taxable estate	$ 600,000
	Net estate tax due	-0-

At this point, Mr. Green's executor would distribute to Mrs. Green sufficient farm assets that qualify for the reduced special use valuation to insure that her estate would also qualify for special use. If we assume Mrs. Green lives a few years and her estate appreciates from $1,200,000 to $1,350,000, consider the following:

2.		
	Fair market value of assets January 1, 1990	$ 1,350,000
	Less special use valuation discount	(750,000)
	Marital deduction	-0-
	Taxable estate	$ 600,000
	Net tax due	-0-

As you can readily see, we have taken an estate of $2,600,000 and through the use of the special use discount and the unified credit in 1987, which is equivalent to an exemption of $600,000, we have eliminated all estate taxes.

Summary

The new provisions dealing with special use valuation are much improved over the 1976 version in the following areas:

1. The lesser standard of active management by a surviving spouse is treated as material participation. Active management determination is factual and the requirement can be met even though no self-employment taxes are payable. Active management means the making of business decisions other than the daily operation decisions of a farm or other trade or business. Such activities involve inspecting growing crops, reviewing and approving annual crop plans, making a substantial number of management decisions for the business and operation and approving expenditures for other than normal operating expenses in advance.
2. The definition of family members is expanded to include lineal descendants of the surviving spouse. In the past, this class of individuals was eliminated from the definition of family members.
3. Net share rentals can be used in the valuation method for farm property when no cash rental information is readily available.
4. The election to specially value property can be made on a late estate return provided the return is the first return filed.
5. Standing timber can be specially valued as an interest in the underlying real property.

The above are just a few of the changes that were made in the Economic Recovery Tax Act of 1981 which make special use valuation a reality in today's estate planning for families owning farms or closely held businesses.

Estate Tax Deferral

The 1981 Act made changes to several other provisions that have a significant impact on farms or other closely held businesses. These provisions assist owners of closely held business interests in deferring the payment of estate taxes at a favorable interest cost. In the past, the deferral provisions, like the valuation discount provisions, were limited in their application. The new law makes it much easier to qualify for the tax payment deferral so that is is less likely that estate taxes

and administrative expenses will require the forced sale of a farm or closely held business.

The 1976 Tax Reform Act contained two different sections that permitted deferred payment of estate taxes. One provision allowed for a 10-year deferral while another section allowed a 15-year deferral. Each had its own set of rules and the 15-year deferral was extremely difficult to obtain. The new law merges the two provisions and makes qualifications easier than under the prior sections. After 1981, an estate tax deferral up to 15 years is possible with only interest payable for the first five years if a farm or closely held business interest comprises 35 percent or more of the decedent's adjusted gross estate. The former requirement was 65 percent, which illustrates the significance of the liberalization of this section. In addition, under the prior law, the deferral was terminated if one-third or more of the business interest was sold by the estate. The new law has increased the one-third rule to one-half, which is also a major improvement.

Initially, the provision allowed for the payment of interest only for five years. While the present rate of interest, which is 20 percent, effective February 1, 1982, does not afford an attractive interest cost for the deferred payment of estate taxes, the new law does retain the provision allowing a 4 percent interest rate on the deferred tax attributable to the first $1,000,000 of estate assets that qualify as either a closely held business or farming interest. While the increased unified credit will have the effect of reducing the amount of tax to which the favorable 4 percent rate is applicable, these provisions still represent an important benefit for the smaller estate which has severe liquidity problems. Obviously, the deferred tax attributable to more than $1,000,000 of estate assets will accrue interest at the present 20 percent rate.

The utilization of an asset freeze, the special use valuation discount and the deferred payment of estate taxes are major provisions available to the estate planner to give relief to the farms and closely held businesses so that they can pay their estate taxes without enduring the hardship of financing or the sale of assets.

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-residents' 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 $2,500.
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 three 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.

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.

There are no exemptions for life insurance proceeds, surviving spouses, or children of the decedent. Instead, a credit of $3,150 is allowed. The credit is first applied to the tax liability of the surviving spouse, then to minor and disabled children and then to other children until the credit is used.

Tax Rates

The gross estate less the deductions and exemptions listed above equals the taxable estate. The tax rate to be applied to property transferred 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, nieces and nephews, aunts, and uncles by blood. The highest rate is applied to property passing to all other persons. Table 2 lists the inheritance tax rates on property inherited by lineal descendants.

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

Taxable inheritance (dollars)				Tax rate (percent)
First	10,000			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
Over	1,500,000	to	2,000,000	9
Over	2,000,000	to	2,500,000	10
Over	2,500,000	to	3,000,000	11
Over	3,000,000			12

[a]Rates are higher for nonlineal descendants.

An inheritance tax return (A-100) must be filed and tax paid if due within nine months after the decedent's death unless the gross estate is less than $20,000 and all the beneficiaries are either parents, spouse or 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/she 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, if due, is imposed upon the donor (giver) but if the donor does not pay the tax when due, the donee (recipient) of the gift may be called upon to pay it to the extent of the value of property received by him/her.

The federal gift tax statutes provide several exclusions and a marital deduction which may be used to reduce the value of property subject to the gift tax.

In any calendar year after 1981 the first $10,000 of gifts made to any one beneficiary is excluded in determining the total amount of taxable gifts for the calendar year.

> Example: If a man gave $15,000 to each of three children in a single year, he would get an exclusion of $10,000 per child. His total exclusion would be $30,000 and his taxable gifts would be $15,000.

The 1981 Act provides an unlimited exclusion from gift tax for amounts paid for any individual's medical expenses or tuition provided the donor makes the payment directly to the person or organization providing the medical service or to a qualified educational organization.

Note, if a gift of a future interest in property is made, the $10,000 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 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 $10,000 annual exclusion.

Every person has a unified credit ranging from $62,800 in 1982 to $192,800 for 1987 and years thereafter. The credit is used to offset calculated gift taxes due on gifts which exceed the $10,000 annual exclusion. The credit can be used all in one year or over a period of years.

Example: If a gift of $20,000 is made to a child in 1982, the first $10,000 is applied against the annual exclusion; the other $10,000 would be subject to gift tax of $1,800. The $1,800 gift tax would be offset by a portion of the donor's $62,800 unified credit.

With the consent of the spouse, the donor may "split" the gift with his/her 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 $20,000 of gift made jointly to any one donee is excluded in determining the total amount of taxable gifts for 1982 and years after. The spouses' unified credit for joint gifts could be combined to total $125,600 in 1982 and increased to $385,600 in 1987. Thus, splitting gifts would enable a husband wife to initially give away $450,000 to one donee in 1982 and incur no gift tax.

When a gift is made by one spouse to another, none of the gift is subject to the tax since there is an unlimtied gift tax marital deduction which provides a total tax-free gift. The 1981 Tax Act allows a spouse to create a terminable interest for the other spouse by gift without incurring a gift tax obligation because of the unlimited gift tax marital deduction (see page 45).

For taxable gifts made after 1981, gift tax returns are to be filed and any gift tax paid on an annual basis. In general, the due date for filing the annual gift tax return will be April 15 of the following year. Gifts which qualify for the unlimited marital dedecution do not require the filing of a gift tax return.

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 of present interests 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 $30,000 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 $30,000 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.

Joint Gifts

Husbands and wives may make gifts jointly and claim an annual exclusion of $6,000 and a total lifetime exemption of $60,000. 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 3). Higher tax rates are applied to gifts made to distant relatives and nonrelatives.

Table 3. 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, stock and bonds, livestock held for draft, dairy or breeding purposes, depreciable property used in the business such as machinery, real estate and buildings. Special rules apply to the sale of land and livestock that may require the assistance of tax practitioners knowledgeable in this area. Only 40 percent of the net gain is considered taxable for federal income tax purposes. In contrast, all of the net gain is considered taxable for North Carolina 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 at death, the basis is generally stepped-up to the fair market value of the property as of the date of death or at the alternative valuation date, which is six months after death.

However, if current use valuation is used to reduce the value of the gross estate, then the basis of the affected property is its value determined for purposes of the current use value election rather than its fair market value. Also, the 1981 Tax Act established that the basis of appreciated property acquired by a decedent by gift within one year of death may not be adjusted to fair market value if reacquired by the donor. Because of the step-up in basis for property which is included in a decedent's estate, it was possible for a property owner with appreciated property to transfer the property by gift to a terminally

ill person with the expectation of reacquiring the property at the death of the donee-decedent with a stepped-up basis.

Installment Sales

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--there is 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 regardless of the size of the payments in the year of sale. Property covered includes real property, sales of machinery, livestock, etc., over $800, 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.

Installment sales to a related person may require the assistance of a competent tax practioner. If the related buyer resells the property for a lump-sum, the first seller must report the full gain outstanding in the year of the second sale. If the second sale is made within two years of the first sale, the first seller can avoid the resale rule and immediate recognition of the gain if he can convince IRS that neither deposition was in avoidance of section 453 (c) (7) of the Internal Revenue Code.

Disposition of installment obligations results in immediate recognition of all the postponed gains. A sale, gift or disposition of an installment obligation causes immediate recognition of the postponed gain to the taxpayer. North Carolina's income tax provisions for the treatment of installment sales are similar to the federal provisions.

Sale of a Residence

If you sell a business 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 24 months before or after the sale, you buy <u>and</u> 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 24 months before or after the sale of the old residence and occupy it within two years after the sale. In the event this provision is utilized, the basis of the new home will equal the adjusted sales price of the old home.

> Example: If the allocated value of the residence is $44,000 and the original cost plus all improvements amounted to $26,000, then there would be a taxable gain of $18,000. If another residence is purchased within 24 months for $44,000 or more, the tax on the $18,000 can be postponed. However, if the new residence costs only $34,000, then there would be a tax on $10,000 of the gain and the tax on the other $8,000 would be postponed.

The 1981 Tax Act increases from $100,000 to $125,000 the amount of gain excludable on the sale of a taxpayer's primary residence. A married taxpayer filing separately can now exclude $62,500 of gain, up from $50,000.

This once in a lifetime exclusion is available to taxpayers who are 55 years of age or older. The taxpayer must have lived in the residence for three of the five-year period ending on the date of sale or exchange. The property must be the principal residence of the taxpayer. The higher exclusion applies to residences sold or exchanged after July 20, 1981.

> Example: A married couple, filing a joint return, with both over 55 years of age, sold their primary residence on August 1, 1981 for $175,000. Their basis in the house purchased in 1950 was $25,000. They realized a capital gain of $150,000. Of this gain $125,000 is excludable from taxable income. The remaining $25,000 is taxable as long-term capital gain. North Carolina provides a $100,000 exclusion only.

These examples are not intended to provide "best plans" for the estate situations described but rather to illustrate principles previously presented.

COMPREHENSIVE EXAMPLE I

John Brown is a farmer. He and his wife Mary have three children. On January 1, 1982, Mr. Brown incorporated the farm. The formation of the corporation was pursuant to an estate plan designed to transfer the farm property to the children during the lives of the parents.

Mr. Brown transferred to the corporation farm equipment valued at $125,000 and land and buildings valued at $350,000. The corporation also assumed the farm liabilities of $100,000. Hence, Mr. Brown's stock in the farm corporation is worth $375,000.

Shortly after forming the corporation, Mr. Brown died unexpectedly. The provisions of his will left his entire estate to his wife Mary. The estate consists of:

Stock in farm corporation	$375,000
One-half value of residence	50,000
Other securities	25,000
Cash	20,000
	470,000
Less deductions	23,500
Net estate	$446,500

Since the net estate passes in its entirety to Mrs. Brown, the surviving spouse, the full amount of $446,500 will qualify for the unlimited marital deduction. The estate of Mr. Brown will, therefore, have no federal estate tax liability. The North Carolina inheritance tax liability is $18,590. After the costs of settling the estate and the state inheritance taxes are deducted, the wife receives $427,910 in property which consists of $375,000 worth of stock in the farm corporation, $50,000 represented by one-half the farm residences, and securities or cash in the amount of $2,910.

Mary Brown died in January 1992 after an extended illness which drained her cash reserves. She had retained ownership of the stock in the farm corporation and did not carry out that aspect of the estate plan which called for gifting.

The value of the residence and the farm appreciated over the ten-year period at assumed rate of 10 percent compounded annually. In 1992, the farm equipment on hand is valued at $324,218 and the land and buildings are now worth $907,809 for a total value of $1,232,027. However, since the amount of farm liabilities has also increased to $259,374 (which maintains the 1981 debt/equity ratio), the stock in the farm corporation is worth $972,653 in 1992. The value of the residence has increased from $100,000 to $259,374. Mrs. Brown's estate consists of:

Stock in farm corporation	$ 972,653
Value of residence	259,374
	1,232,027
Less deductions	61,601
Net estate	$1,170,426

The provisions of Mrs. Brown's will leave the estate to the children. The federal estate tax liability on $1,170,426 after all available credits is $179,568. The North Carolina inheritance tax liability on this size estate is $71,634 given all available credits. Therefore the total tax liability due on the estate of Mrs. Brown is $251,202.

Let us assume that Mrs. Brown carried out the gifting of the stock in the farm corporation after her husband's death. Will this reduce the estate and inheritance tax liability incurred on the property passing at her death?

If in 1982 Mrs. Brown elected to gift $10,000 worth of stock to each of the three children at the end of each year over the ten-year period prior to her death in 1992, the value of the stock in the farm corporation included in her estate would be only $494,531 as opposed to $972,653. By using the annual federal gift tax exclusion of $10,000 per recipient, Mrs. Brown has reduced the size of her net estate to $716,210 for federal estate tax purposes.

Stock in farm corporation	$494,531
Value of residence	259,374
	753,905
Less deductions	37,695
Net estate	$716,210

The federal estate tax liability on this amount after all available credits is $24,220. In other words, the federal estate taxes have

been reduced by $155,348. The net estate for North Carolina inheritance tax purposes is $785,720.

Stock in farm corporation	$ 494,531
Value of residence	259,374
Taxable gift made last three years	69,510
	823,415
Less deductions	37,695
Net estate	$785,720

The North Carolina inheritance tax liability is $39,580 after all available credits are used. However, since North Carolina's annual gift tax exclusion is only $3,000 for each recipient, Mrs. Brown during her lifetime will have paid $7,150 in North Carolina gift taxes. Still the total tax liability incurred on the transfer of the property during life or at death is $179,982 less than the taxes which would have been incurred had gifting not taken place. In effect the gifting of the stock markedly reduces the effective annual increase in the value of the stock.

COMPREHENSIVE EXAMPLE II

John and Jane Raynor are both 55 years old, married, and have two children, aged 30 and 27. Both children are married and have established careers of their own. Mr. Raynor dies in 1982. His estate consists of:

One-half value of residence	$ 60,000
Cash	30,000
Securities	60,000
Personal effects	30,000
Life insurance	320,000
	500,000
Less deductions	25,000
Net estate	$475,000

The home is jointly owned and passes to Mrs. Raynor by right of survivorship. The securities and personal effects will pass to her by will. The life insurance owned by Mr. Raynor is payable directly to Mrs. Raynor in a lump sum.

The entire amount of Mr. Raynor's net estate will qualify for the unlimited marital deductions. Hence, no federal estate taxes are due at his death in 1982. However, $21,500 in North Carolina inheritance taxes will be due. When this amount is subtracted from the net estate, the balance of $453,500 is received by Mrs. Raynor.

Mrs. Raynor is successful in managing her wealth. At her death in 1992 her net estate is valued at $1,117,552. Under the provisions of her will the property, both real and personal, passes to the children. The federal estate tax due after all available credits are used is $185,389. The North Carolina inheritance tax due after all available credits are used is $70,554. The total tax liability at the death of Mrs. Raynor is $255,943.

Apparently Mr. and Mrs. Raynor were lulled into a false sense of security by the new unlimited marital deduction. They felt a simple one-line will leaving all to the surviving spouse would suffice to eliminate federal estate tax liability. However, estate planning with the goal of minimizing taxes should account for tax liability incurred at the death of each spouse. Starting in 1982, an estate, regardless of size, could pass free of any federal taxation to the surviving spouse but as seen by the above example a tax burden will fall on the estate,

created by the death of the surviving spouse if that estate exceeds the available property exemption.

The Raynors could have exercised a simple estate planning alternative which would have reduced the amount of taxes due at Mrs. Raynor's death, and yet not increase the amount due at Mr. Raynor's death. Instead of leaving all of his property to his wife at his death, Mr. Raynor could have elected to place part of his estate in trust for his wife during her life with the children named as the remaindermen. The portion of the estate placed in trust would be taxable at Mr. Raynor's death but not at the death of his surviving wife. However, Mr. Raynor's estate would not incur any federal estate tax liability if the amount placed in trust was less than or equal to the equivalent property exemption. This trust is referred to as a "credit shelter" trust.

If the provisions of Mr. Raynor's will had left $250,000 outright to his surviving spouse while placing the remaining $225,000 in trust during her life, the latter amount would have incurred a federal estate tax liability at Mr. Raynor's death of $62,800, but the unified tax credit available in 1982 would have reduced this liability to zero. The amount of North Carolina inheritance tax owed would have been unaffected by these changes. The tax savings occurs at the death of Mrs. Raynor. The amount which was placed in trust passes directly to the children and is not in her estate. The balance of $648,500 (which is $250,000 compounded annually at an assumed rate of 10 percent) is in Mrs. Raynor's estate. When deductions of 5 percent are made, Mrs. Raynor's taxable estate is $616,075. The federal estate tax owed on this size estate after all available credits are used is zero. The North Carolina inheritance tax owed is $31,125. This simple alternative saves the Raynor family $224,818 in estate and inheritance taxes.

GLOSSARY OF TERMS[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).

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

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.

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

Codicil - An addition (or supplement) to a will that explains or changes the provision in the will.

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

Corpus - The principal portion of an estate or trust as contrasted with the income.

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

Decedent - A deceased person, testate or intestate.

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[1]For further explanation of legal terminology, see Black's Law Dictionary, Henry Campbell Black, West Publishing Company, 1968.

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

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

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

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.

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

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.

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/her own affairs (the guardian manages the person, rights and property of the incompetent).

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

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

Inter vivos - 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).

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

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

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

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

Lineal descendant - One who is in the line of descent from the ancestor.

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

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

Majority age - The age at which, by law, a person is entitled to the management of his own affairs. In North Carolina, 18 is considered age of majority.

Mutual will - One in which two or more persons make mutual or reciprocal provisions in favor of each other.

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).

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 between them.

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

Prenuptial - Before marriage.

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

Real property - Land and immovable property upon the land.

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

Spouse - A person's wife or husband.

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.

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

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

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

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

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

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