Family Planning of Titles and Taxes: the Transfer of Farm Property

G. P. KRAUSZ and A. R. ALLEN
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Planning with the family pays dividends in many ways, including earlier retirement.
Some successful farmers could have retired five years earlier and still have left a greater net amount to their families if they had spent just a few hours planning their estates.

How about you? Do you know your net worth? Have you any idea of the amount of the probable inheritance taxes on your estate? Do you have a will? Does your spouse? Are your wills up to date? Who will continue to farm your farm? How do you plan to keep the farm intact as a unit? Do you understand the consequences of holding property in joint tenancy? Have you planned your titles and taxes?

The purpose of this circular is to show why farmers should plan their estates, to suggest some of the considerations in planning estates, and to explain methods generally used. It is not intended as a substitute for legal advice. It is designed to provide farmers with information on alternative courses of action and to encourage them to make adequate plans with the help and advice of their attorney.

PERIODS TO PLAN FOR

A sound estate plan should take into consideration three different periods of time. The first is your own lifetime. Your primary purpose during this period should be to provide for satisfactory income and security for yourself and family. The key to achieving this object is an efficient farm operation, but a wise estate plan can be a great help.

The plan should focus on managing income taxes, achieving a sound retirement program, making legal arrangements for eventual farm transfer, and reducing death taxes. It may also be fashioned to give one or more of the children the start of an ownership interest in the farm. A judicious plan should assure you an adequate and steady retirement income and maintain the value of the farm. Your heirs should know about the plan so that they can make their own plans accordingly.
The second period of time that you should plan for is the one immediately following your death. This period is critical because of financial demands on the estate, including costs of last illness, funeral expense, claims of creditors, estate administration costs, and state and federal taxes. Most farm estates are likely to consist of land and equipment and very little cash or property easily converted into cash. Yet taxes and estate expenses must be paid within a short time after death. When there is no estate plan, a forced sale of part of the farm’s assets may be necessary, and forced sales often do not bring proceeds equal to the actual value of the property sold. This loss of some of the farm assets will be reflected in less income for your family and often a lesser value of the remainder of the farm. In larger estates, the impact of death taxes will be severe, and unless some plan for paying them has been worked out, may cripple the operation of the farm.

The last period you should consider is the extensive period of family adjustment after your death. For this period, you are most concerned with adequate security and income for your widow and an equitable distribution of property among your children. If one child carries on the farm business, your plan should be designed to allow
him to do so with a minimum of financial hardship but without injustice to your other children.

Before learning about various legal devices that you can use to achieve your objectives in planning, you will have to have some understanding of taxes and inheritance laws that apply to your estate.

**GIFT, ESTATE, AND INHERITANCE TAXES**

Would you like to have your family lose 5-, 10-, 15-, 20,000 tax-free dollars? It can if you fail to do some estate planning. Taxes are an important factor in determining how much of your property your family will eventually receive.

For example, take Farmer Bill Weeks who held his farm in joint tenancy with his wife. He knew that the farm would pass directly to her at his death by this arrangement and felt that this was the best way to give her the most income and security. But he forgot about taxes. If his farm is worth $150,000, federal and state taxes will be about $2,500 at his death. When his wife dies some years later (assuming she makes no change in the estate), the federal tax alone will amount to $17,500. With two children, the combined federal and state tax bite on the father's and mother's estates will be about $22,000.

This could have been avoided. As little as ten hours' attention can mean the difference between large savings and heavy loss. For
example, through a different title and transfer arrangement, the Widow Weeks could have had full income, and the children could have owned the farm at her death at a tax saving of more than $17,000.

You should keep two things in mind in tax planning. First, reducing taxes is only one object in planning and should not be given such over-riding importance as to impair other planning goals. A successful estate plan will arrange property to secure such tax savings as are consistent with other goals. Second, it is entirely proper to do all possible within the framework of tax laws to reduce taxes. Only tax evasion is punished, not tax avoidance. A few timely legal moves can often result in tax savings of thousands of dollars.

What taxes do you need to consider? Besides income tax, there are three other taxes you should consider when you plan your estate — the federal gift tax, federal estate tax, and the Illinois inheritance tax. Illinois does not impose a gift tax.

**Federal gift tax**

This tax applies to lifetime transfers of either real estate or personal property. You can make tax-free yearly gifts of up to $3,000 each to as many people as you wish for as long as you live. Such gifts are called your annual exclusion. To qualify as tax-free, however, these gifts must be complete; that is, you cannot retain any interest or control of them. In addition, you can make gifts totaling $30,000 over your lifetime free of tax. This is your lifetime exemption. To the extent any gift you make is over your $3,000 annual exclusion, it is counted against the $30,000 exemption. For instance, if you sell your son a farm for less than its market value, the difference between the price he pays and the market value is a gift. If the difference is more than your annual exclusion for the year and your $30,000 lifetime exemption, it will be subject to tax.

The gift tax is cumulative — that is, taxable gifts in previous years are counted when figuring rates applying to gifts for the current year. You and your wife may elect to have gifts made by one of you to a third person taxed as if each made one-half the gifts. This tax benefit doubles the amount of property a married person can give tax-free to someone. In effect, the $30,000 lifetime exemption becomes $60,000 and the $3,000 annual exclusion becomes $6,000 even though one spouse may not own any property to give.
Here are a few rules in effect on gifts.

1. The value of the gift is its fair market value at the time of the gift.

2. Gifts from one spouse to the other are subject to tax on only half the value because of a marital deduction.

3. Gifts must be complete with no income or possession retained.

4. Gifts to certain charitable, educational, civic, and religious organizations are not taxed.

5. The person making the gift pays the tax. A return must be filed and the tax paid before April 15 of the year following the year in which the gift was made.

Here is the gift tax schedule.

<table>
<thead>
<tr>
<th>Net gifts after exemptions and exclusions</th>
<th>Tax</th>
<th>Rate on next block, percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 ..................................</td>
<td>...</td>
<td>2.25</td>
</tr>
<tr>
<td>$5,000 ................................</td>
<td>$112.50</td>
<td>5.25</td>
</tr>
<tr>
<td>$10,000 ................................</td>
<td>$375.00</td>
<td>8.25</td>
</tr>
<tr>
<td>$20,000 ................................</td>
<td>$1,200.00</td>
<td>10.50</td>
</tr>
<tr>
<td>$30,000 ................................</td>
<td>$2,250.00</td>
<td>13.50</td>
</tr>
<tr>
<td>$40,000 ................................</td>
<td>$3,600.00</td>
<td>16.50</td>
</tr>
<tr>
<td>$50,000 ................................</td>
<td>$5,250.00</td>
<td>18.75</td>
</tr>
<tr>
<td>$60,000 ................................</td>
<td>$7,125.00</td>
<td>21.00</td>
</tr>
<tr>
<td>$100,000 ................................</td>
<td>$15,525.00</td>
<td>22.50</td>
</tr>
<tr>
<td>$200,000 ................................</td>
<td>$38,025.00</td>
<td>22.50</td>
</tr>
</tbody>
</table>

Rates increase to a maximum of 57.75 percent.
Federal estate and Illinois inheritance taxes

These taxes apply to transfers at death. Both taxes apply, at graduated rates, to the fair market value of the property. The chart below compares the property subject to each tax.

**Federal estate tax**

- All real and personal property to the extent of decedent's interest
- The value of the dower interest of the surviving spouse
- Gifts\(^1\) in contemplation of death; presumed to be such if made within three years of death\(^2\)
- Gifts during lifetime in which decedent retained a life estate or some control or interest until death\(^3\)
- Full value of joint property purchased by decedent reduced by that part purchased by surviving joint tenant or tenants; where joint property was acquired by gift, devise, bequest, or inheritance, only decedent's fractional share is taxed
- Property over which the decedent at death possessed the power to transfer to himself, his estate, or his creditors, even though he may not have had complete title to such property
- Life insurance proceeds if: (1) payable to the estate; or (2) if deceased retained any interest in the policy\(^4\)

**Illinois inheritance tax**

- Same, but different rules apply to property of nonresidents
- Same
- Same, except that presumption extends only to those gifts made within two years of death\(^2\)
- Value of decedent's fractional share of property held in joint tenancy, determined by dividing value of entire property by the number of joint tenants
- Property received from any person through the exercise of a power of appointment of any nature
- Life insurance proceeds only when payable to the estate, not when paid to a named beneficiary

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\(^1\) "Gifts" include the value of transferred property in excess of consideration received in money or money's worth. This is to reach those transfers where a nominal price is received to disguise a gift.

\(^2\) This presumption may be overcome by sufficient evidence, such as where it is shown that gifts were made in accordance with a long standing policy of making gifts at regular intervals, made to avoid high income tax brackets, and to make children independent, or made to start a child in business.

\(^3\) This is a brief general statement of rules that are complex. A common example of such a taxable transfer is one in which the deceased retained at death the power to amend, alter, or revoke a trust arrangement created during life.

\(^4\) Examples of such an interest are the power to change beneficiaries, to surrender or cancel the policy, to assign, or pledge, or borrow on the policy, etc.

**Deductions**

Both Illinois and the federal government allow deductions. Among those allowable are: (1) costs of last illness and burial; (2) costs of estate administration; (3) outstanding debts of the
Your surviving spouse can inherit one-half of your estate tax-free.

deceased; (4) amounts of gifts to certain institutions or charities; and (5) the amount of certain taxes owed.

A marital deduction is allowed by federal estate tax law. It applies only to property left to a spouse, and includes only title interests in which the spouse is given a right to transfer to others. Fee simple estates qualify but a simple life estate does not.

Up to one-half of the adjusted gross estate can pass tax-free to the surviving spouse, but the marital deduction cannot exceed the actual value of the qualified property received. The adjusted gross estate is the amount remaining after ordinary deductions have been subtracted from the total value of the estate. This deduction is important in estate planning since reducing the value of the estate by half often eliminates the federal tax.

Exemptions

After allowances for deductions, both the Illinois and federal laws exempt portions of the remaining amount from the tax. The federal exemption is a flat $60,000 of the entire estate. It does not depend on degree of relationship. If an estate is valued at $120,000 and $60,000 is given to the spouse to take advantage of the marital deduction, the remaining $60,000 is covered by the exemption and no tax is due the federal government.

Under Illinois law, exemptions depend on the degree of relationship in which the person receiving the property stands to the deceased; the closer the relationship, the higher the exemption. The spouse, children, grandchildren, parents, and grandparents are each allowed an exemption of $20,000.

Rates

Both Illinois and federal taxes have a progressive rate structure, the rate increasing with the size of the estate.
Following are rates and taxes under federal and Illinois law. The rates are set up in blocks ($5,000, $10,000, etc.) and apply to any part of the block. For example, the federal tax rate on the first $5,000 above $60,000 is 3 percent. If the value of an estate is $64,000, the tax is $120 ($4,000 \times 3 \text{ percent}). The rate on amounts between $65,000 and $70,000 is 7 percent and the rate on amounts between $70,000 and $80,000 is 11 percent. If the value of an estate is $73,000, the tax is $830 ($5,000 \times 3 \text{ percent} = $150; $5,000 \times 7 \text{ percent} = $350; $3,000 \times 11 \text{ percent} = $330; $150 + $350 + $330 = $830).

### Federal Estate Tax

<table>
<thead>
<tr>
<th>Taxable estate</th>
<th>Tax</th>
<th>Rate on next block, percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>$60,000</td>
<td>none</td>
<td>3</td>
</tr>
<tr>
<td>$65,000</td>
<td>$150</td>
<td>7</td>
</tr>
<tr>
<td>$70,000</td>
<td>$500</td>
<td>11</td>
</tr>
<tr>
<td>$80,000</td>
<td>$1,600</td>
<td>14</td>
</tr>
<tr>
<td>$90,000</td>
<td>$3,000</td>
<td>18</td>
</tr>
<tr>
<td>$100,000</td>
<td>$4,800</td>
<td>21.2</td>
</tr>
<tr>
<td>$110,000</td>
<td>$6,920</td>
<td>24.2</td>
</tr>
<tr>
<td>$120,000</td>
<td>$9,340</td>
<td>27.2</td>
</tr>
<tr>
<td>$150,000</td>
<td>$17,500</td>
<td>26.4</td>
</tr>
<tr>
<td>$160,000</td>
<td>$20,140</td>
<td>28.4</td>
</tr>
<tr>
<td>$200,000</td>
<td>$31,500</td>
<td>27.6</td>
</tr>
<tr>
<td>$300,000</td>
<td>$59,100</td>
<td>26.8</td>
</tr>
<tr>
<td>$310,000</td>
<td>$61,780</td>
<td>28.8</td>
</tr>
<tr>
<td>$500,000</td>
<td>$116,500</td>
<td>28.0</td>
</tr>
</tbody>
</table>

Rates increase to a maximum of 62 percent.

### Illinois Inheritance Tax

Under Illinois law, the rate at which an inheritance is taxed depends on the relationship of the beneficiary to the decedent, the rate becoming higher as the relationship becomes more distant. The rate also becomes higher as the size of the inheritance increases. Beneficiaries are divided into four classes: (1) mother, father, husband, wife, children, and descendants; (2) brothers and sisters; (3) aunts, uncles, nieces, and nephews; and (4) all other persons.

**Mother, father, husband, wife, and children, or descendants.** Each is allowed an exemption of $20,000. Thus each in this group may inherit $20,000 without tax. In the sample estates shown below, the tax to beneficiaries in this group would be:
Brothers and sisters. Each is allowed a $10,000 exemption. The rate on any amount over $10,000 is the same as the rate a mother, father, husband, wife, or children pay. But a brother or sister would pay a proportionately larger amount of tax, because of the $10,000 difference in the exemption.

Aunts, uncles, nieces, and nephews. Each is allowed an exemption of only $500. They must pay a tax on any amount over $500. The tax rate is also higher. In the sample estates shown below, the tax to beneficiaries in this group would be:

<table>
<thead>
<tr>
<th>Amount above the $500 exemption</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$10,000</td>
<td>$600</td>
</tr>
<tr>
<td>$20,000</td>
<td>$1,200</td>
</tr>
<tr>
<td>$50,000</td>
<td>$3,600</td>
</tr>
<tr>
<td>$70,000</td>
<td>$5,200</td>
</tr>
</tbody>
</table>

The rate starts at 6 percent and goes to 16 percent.

All other persons. Each is allowed an exemption of only $100. In the sample estates shown below, the tax to beneficiaries in this group would be:

<table>
<thead>
<tr>
<th>Amount above the $100 exemption</th>
<th>Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>$500</td>
<td>$50</td>
</tr>
<tr>
<td>$10,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>$20,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>$50,000</td>
<td>$5,600</td>
</tr>
<tr>
<td>$70,000</td>
<td>$8,800</td>
</tr>
</tbody>
</table>

The rate starts at 10 percent and goes to 30 percent.

Comment on market value

The law requires an appraisal of the property at market value at the time a gift is made or at death. Tax officials use market value as a basis in their audits, and only reasonable variations for differences in judgment are allowed. The range of judgment is not very great, probably not more than 10 percent in most cases. Keep this in mind when you inventory your estate.
INHERITANCE LAWS

Transfer by inheritance laws

Property not held in joint tenancy and not disposed of by will is distributed according to inheritance laws. These laws set forth the way in which the legislature believes the average person would want to have his property distributed. In any given individual's estate, the statute is arbitrary and inflexible in its operation.

Distribution of Property Without a Will in Illinois

(All distributions are subject to the election of dower)

<table>
<thead>
<tr>
<th>Survivors</th>
<th>Real estate and personal property (fractions of real estate taken apply to each parcel)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spouse and children</td>
<td>one-third to spouse; two-thirds to children</td>
</tr>
<tr>
<td>Spouse but no children</td>
<td>all to spouse</td>
</tr>
<tr>
<td>No spouse but children</td>
<td>all to children</td>
</tr>
<tr>
<td>No spouse or children, but a parent, brother or sister, or children of a brother or sister</td>
<td>all to parent, brother, or sister (when only one parent survives, that parent is entitled to a double share of each parcel of real estate)</td>
</tr>
</tbody>
</table>

If no spouse, child, parent, brother, sister, or child of a brother or sister survives, one-half the estate passes to the nearest survivor on the side of the maternal grandparents, and one-half to the nearest survivor on the side of the paternal grandparents. If no surviving relative can be located, real property passes to the county where it is located, and personal property passes to the county in which the deceased lived.

Dower

Rather than accept the share of property allowed by the inheritance laws (or by a will), a surviving spouse, either husband or wife, may elect to take a dower interest in any parcel of real estate owned by the deceased during marriage. Dower entitles the spouse to a one-third interest in such property for life, free from claims of creditors of the estate.

Dower applies only to real estate. It does not deprive a spouse of absolute ownership of the personal property that the inheritance laws allow.

Electing to take dower may be advantageous in protecting the spouse from the claims of creditors. It may also reduce probate and tax costs on the spouse's death, since the dower interest is extin-
guished and the property passes directly to those entitled to it without further administration.

Dower, however, may also have some serious disadvantages. It frequently makes the entire parcel of real estate that is subject to the dower interest unmarketable during the surviving spouse's lifetime. The income from such an interest is often inadequate as a means of support for a spouse who is without other sources of income. Finally, and what is generally more important in fairly large estates, the portion of property subject to the dower interest, when elected, does not qualify for the marital deduction of the federal estate tax.

Illinois inheritance laws also give a surviving spouse the right to renounce a testator's will and entitles him or her to the following outright share of the testator's estate after payment of all claims.

1. If the testator leaves children or descendants, one-third of the personal estate and one-third of each parcel of real estate.

2. If the testator leaves no descendant, one-half of the personal property and one-half of each parcel of real estate.

Because any estate plan can be upset by a spouse's renunciation of the will, it is obvious that the husband and wife should do their planning together. If they both understand the reasons for the planned distribution and transfer, an over-all estate loss occasioned by a spouse's renunciation of a will is less likely.

Comment on inheritance laws

A farmer's basic objectives are seldom achieved when his property is distributed by inheritance laws. Here are some of the possible undesirable consequences of such distribution:

1. The farm does not pass as a going concern because real estate and personal property are separated, and liquid assets necessary to meet taxes and administration expenses are not provided for.

2. An equitable distribution is not achieved. The widow's share may not be sufficient to support her. One child may have remained on the farm and helped to make it prosperous; another may have infirmities and be unable to provide for himself; others may be well off in nonfarm occupations. Yet all children take the same share.

3. Sons may leave the farm because of the delay in acquiring ownership and because of the distribution by law, which does not consider contribution to the farm.
4. Heirs may not agree on over-all management, and the result may be division of the farm into fractions.

5. Estate taxes are often higher than they need be because the maximum marital deduction is not used.

**PLANNING AND ACTION**

Once you decide on the goals you want to accomplish through estate planning and have some understanding of gift and inheritance taxes, your next step is to select the methods you can use to attain your goals. You will usually do this with the help and advice of an attorney. A number of legal arrangements are possible to you, each with advantages and disadvantages. Using a single one will seldom suit all your needs. You can most often attain the greatest advantage by using a combination of measures.

**A will is essential**

A will is the foundation document in your estate plan. If you have relied heavily on lifetime transfers, you can use your will to distribute your remaining property, and thus round out your plan. If you have chosen to retain your property until your death, your will controls the entire distribution of it, except that which is held in joint tenancy.

With a will, you may:

1. Provide for family members according to their needs.
Your will is the basis of your plan.

2. Make a truly equitable plan for property distribution.
3. Transfer your farm intact as a going concern including livestock, equipment, and machinery.
4. Make maximum use of tax-saving devices, such as the marital deduction, life estates, and trusts.
5. Designate who shall be guardian of minor children.
6. Designate a responsible executor to manage and distribute the estate and provide that he serve without bond.

Formalities of wills. Any person of sound mind and at least 18 years old may make a will. A will must be in writing and signed by the maker (or by some other person in his presence and at his direction if he is unable to sign). It must also be signed by two credible witnesses. Such witnesses must be mentally competent and have no financial interest in the transaction. A spouse should not be a witness.

Selecting an executor. Important qualities you should consider when you select an executor are: financial and farm managerial experience; financial responsibility; impartiality; and availability and permanence.

It is fairly common to find widows, relatives, and friends engaged in farming selected as executors. The advantage of selecting such
persons is that they will generally be familiar with the extent of your property and of your family’s needs. Also, an executor’s fee is not taken in most cases. In view of the qualities required of an executor, however, it may sometimes be wiser to choose a corporate executor for the task. Many banks and trust companies in farming communities provide such services.

The advantages of a corporate executor are that:

1. A corporate executor is experienced in handling estates and is familiar with the financial and business considerations involved.

2. A corporate executor insures continuity of representation. In the course of prolonged administration, an individual executor may die or become otherwise unavailable and thereby cause added delay in distribution.

3. A corporate executor is in a better position to supply impartiality and be less influenced by family disputes that may arise than is an individual executor.

If you require someone with a more intimate knowledge of family affairs, but also want the advantages of a corporate executor, you can appoint co-executors.

**Amendment and revocation.** You can alter or revoke your will at any time. This is important, since you can make changes in your estate plan to correspond to changes in your circumstances.

You can amend a will by a codicil, which is an addition at the end of a will. The codicil must be also signed and witnessed. When you find extensive change necessary, it is often best to revoke or destroy your old will entirely and draft a new one. Marriage generally revokes a will, and makes a new one necessary.

**Joint and mutual wills.** A joint will is one made by two or more persons, disposing of the property of each. A joint will must meet the same formalities required of ordinary wills. Mutual wills are separate wills which are reciprocal in their provisions. Joint and mutual wills are most often made by husband and wife. They are useful in some cases to coordinate an entire family estate plan and to provide for unexpected events such as simultaneous death. However, the survivor may be bound for life by the terms of a joint or mutual will, which may in time have tragic consequences. It is often better to use individual wills. Joint wills are complex documents that should be used only on advice and assistance of an attorney.
In your will, the gift of a farm includes only the land and improvements unless you state that the property necessary to operate the farm is to go with it.

**Bequests and devises in wills.** Personal property includes cash, bank accounts, stocks, bonds, farm equipment, grain, livestock, and so on. Gifts of personal property by will are called bequests. When gifts are of real estate, they are called devises. When a farm estate is involved, transfers can create special problems, because a farm operation is more than merely buildings and land. It is a going business and usually should be transferred as such.

Legally a gift by will of "my farm" or "my farmland" transfers only real estate and buildings. It does not include equipment, machinery, livestock, grain, business accounts or debts, and encumbrances on the farm. You must make separate reference to these items if they are to pass with the real property. You should also include the insurance on these items. Otherwise, the property may pass to one person, and if the item is destroyed, the insurance may go to another person.

You must decide whether the person or persons who are to receive the farm should receive business accounts and should assume business debts and encumbrances. If you do not make such a provision, all accounts owed to you will be collected by your executor and used to pay expenses and debts during administration of your estate. Any remaining balance will be distributed to the persons designated to take what remains of the estate after your specific gifts are made. Without a specific provision, your business debts and sometimes encumbrances on your farmland may not have to be assumed by the person to whom you leave the farm. They may have to be paid by your executor out of personal assets. This could decrease the inheritance of your other beneficiaries since gifts of personal property will be liquidated before real property is touched. Therefore, if you are going to pass the farm on as a going business,
it is best to have the new owner assume both your business assets and liabilities by providing this in your will.

One more problem should be mentioned. If you sell or give away property during your life which is included in your will, the intended beneficiary in your will will receive neither an interest in the land nor the purchase price. Likewise, if, for example, you acquire acreage adjoining your farm after your will is drawn, the acreage you acquired usually will not pass as part of your farm but will be distributed among those who are to take the balance of the estate after specific gifts are satisfied. In order to safeguard your estate plan, you should periodically review and revise your will.

**When to use joint tenancy**

Joint tenancy is a form of co-ownership of property, both real and personal, and has advantages in smaller estates. The distinguishing characteristic of joint tenancy is the *right of survivorship*. On the death of one joint tenant, full ownership of the property vests immediately in the other. It does not pass as part of the deceased’s estate. This avoids probate and administration, thereby reducing cost and delay.

You gain little tax advantage by using joint tenancy. If you have a large estate (over $100,000), double death taxes may apply before your children receive your property. Unless some of the purchase price was paid by a surviving owner, the federal estate tax falls upon the entire value of the property. The Illinois inheritance tax falls only on the deceased owner’s share, generally one-half where the property is held by husband and wife.
Where farm property is involved, joint tenancy may carry with it other disadvantages. At your death, the burden of farm management is immediately thrust on your wife. Also, if she should already be in a high income bracket, the additional income-producing property increases her income tax liability. Still another possible disadvantage is that all or most of the property may come from one side of the family and end up in the other. If there are no children, this is a particularly important point to consider.

Thus, although the use of joint tenancy is a simple method by which property may be transferred at death, in larger estates it is often more desirable to hold property in another way: (1) full ownership to remain in the husband; or (2) tenancy in common; or (3) each spouse to hold part of the land or part of the land and part of the personal property separately. As a general rule, taxes are less when the assets of husband and wife are about equal and each transfers at least part of the estate to descendants subject to a life interest in the surviving spouse.

If too much of your property is held in joint tenancy with your wife, dividing the title into separate holdings or converting to a tenancy in common in some of the property can often eliminate most of the estate tax. For example, Mr. and Mrs. A own all their property in joint tenancy. All of the property was purchased with funds earned by Mr. A. and is valued at $150,000. If Mr. A dies, his estate will receive the maximum marital deduction, and the federal estate tax will be only $1,050, but Mrs. A will end up with all $150,000 worth of property, and the federal tax on her estate will be over $17,000, assuming she does not give away or use up some of the property before she dies.

If the title were changed so that each owned $75,000 worth of property, they could provide in their wills for a life interest to each other with remainders to their children. The result would be an estate tax on each estate of only $1,050. These changes may involve the gift tax, and it would be wise to consult an attorney about the consequences before making any transfers.

When you establish a joint tenancy in personal property (bank account, safety deposit box, savings and loan account, etc.), make certain that the signature card is signed by all joint tenants and that it contains language to the effect that it is a joint tenancy and not a tenancy in common. A recent Illinois Supreme Court decision has
tightened the rules on creating joint tenancy in personal property and the law must be carefully followed.

**What about tenancy in common?**

Tenancy in common is different from joint tenancy in two ways:

1. There is no right of survivorship. Each co-tenant has a right to transfer his undivided interest by selling it, by giving it away, or by transferring it to persons of his choice at his death. If not disposed of by will at death, the interest goes to the heirs according to inheritance laws.

2. Inheritance laws create a tenancy in common (not a joint tenancy) when there is more than one heir. For example, a father dies without a will leaving a mother and two children. A farm in father's name would go to them as tenants in common, each receiving a one-third undivided interest.

The tax importance of holding property as tenants in common is that the federal estate tax applies only to the fractional interest that a person holds at his death. With joint tenancy, the presumption is that the entire property is taxable to the deceased tenant. Therefore, tenancy in common often offers tax advantages over joint tenancy.

There are some difficulties, however, with tenancy in common. All co-tenants have equal rights to manage the property and this can lead to family discord, particularly where there are more than two co-tenants. Tenancy in common generally creates a greater need for husband and wife to have wills so as to assure the income to the other from the entire property, with only remainder interests to the children. For example, if farmer and wife own a farm as tenants in common, each can make a will leaving the half each owns to the other for life and then to the children. This plan avoids the estate tax on one-half of the farm if the farmer should die first, and when the wife dies, only the half that she owns would be taxable since her one-half life interest is not subject to death taxes.

Tenancy in common has a place in many estate plans, but it is primarily useful for tax savings in the estates of parents, particularly as a substitute for joint tenancy.

**Pros and cons of life estates**

A life estate is usually created to make sure that one individual has adequate support for his lifetime, while at the same time making
A life estate or a life interest trust sometimes provides very great tax savings.

HUSBAND’S ESTATE

\[ \frac{1}{2} \text{ to Wife} \]
\[ \text{Full Title} \]
\[ \frac{1}{2} \text{ to Wife} \]
\[ \text{Life Estate} \]
\[ \text{to Children...} \]
\[ \text{Tax Applies} \]
\[ \text{to Children...} \]
\[ \text{Tax Free} \]

certain that at the death of the life tenant full ownership of the property will go to other designated persons. For example, a farmer may provide in his will that his farm should pass to his son subject to a life estate in the farmer’s wife. The wife is called the life tenant and the son the remainderman.

The rights of a life tenant in the property resemble the rights of an absolute owner. The life tenant (subject to certain restrictions) can use the property as he wishes as long as he does not commit willful destruction or waste. He is entitled to all rents and profits.

When a widow is a life tenant, an arrangement is often made with a son to farm the property under a lease. The son, usually a remainderman or one of the remaindermen, will pay rent to the mother for her life and upon her death will succeed to full or part ownership.

Tax advantages are generally possible in using a life estate (or a life interest trust). The portion given for life is not taxed when the life tenant dies. For example, a farmer with a $200,000 estate could leave half to his wife outright for the marital deduction and leave a life estate to his wife in the other half with the remainder to his children. At the wife’s death, only the $100,000 left to her outright would be taxed. If the entire $200,000 were left to her outright, all would be taxed in her estate. A tax saving of about $25,000 would result from using the life estate (or trust).

Another advantage lies in reduced probate costs upon the life tenant’s estate. Life interests dissolve at death, and property subject to them passes directly to remaindermen rather than through administration.

Farmers with small estates usually favor use of life estates when they feel that farm income would not be sufficient to meet the expenses
of a trust and still adequately provide support for the widow. By a carefully drafted will, the rights and duties of the life tenant and remaindermen should be stated. In this way, normal restrictions upon the life tenant’s use of the property can be reduced and the relationship with the remaindermen made more satisfactory. The problem of providing responsible management and operation of the farm still remains, however, and should be carefully considered.

There are several drawbacks to the use of life estates:

1. Unless someone, usually a member of the family, is available to lease the farm, the burden of management is thrust on the widow. If she lacks business capabilities, conflict with remaindermen may arise.

2. Little or no tax savings result to the estate of the deceased owner. The whole property is subject to the estate tax, and the marital deduction does not apply to ordinary life estates. The Illinois inheritance tax applies to both life estates and remainders, apportioning the amount of the tax depending on the age of the life tenant.

3. There are restrictions on the life tenant’s use of the property:
   a. He must keep the property in a reasonable condition of repair, although he cannot be compelled to engage in sound farming practices or to keep the premises insured.
   b. He cannot cut more timber than is necessary to clear the land or to use for fuel, fences, or repairs.
   c. He cannot lease or develop mineral deposits found on the premises, but he is entitled to proceeds from such leases if they were outstanding when he received the property.
   d. He can make no agreement concerning the use of the property for any period beyond his lifetime unless approved by the remaindermen.

A life estate with a power of appointment modifies the ordinary life estate-remainder plan. A power of appointment allows the life tenant to name (appoint) a person to receive the property after the life tenancy. Powers of appointment given to life tenants provide both flexibility and opportunity for tax savings. From a tax standpoint, leaving a life estate with a power of appointment to a wife (or to a husband) allows the marital deduction to be used. In such case, the power of appointment must allow an appointment of property to any one, including the life tenant.
When you use powers of appointment, it is important to set up an alternative plan of distribution in case the person who is given the power fails to exercise it. Otherwise, the property subject to the power may be distributed under the inheritance laws.

**Use of farm trusts**

The trust, because it is flexible and provides the family with security, is a practical tool for some estates. It has the advantages of deeds in escrow¹ and life estates without their disadvantages. Keep in mind that complete gifts in trust during life are treated the same as outright gifts to a person or persons, and estate and inheritance taxes would not generally apply.

**The nature of trusts.** A lifetime trust is created by executing an instrument called a deed of trust. By this instrument, the owner transfers property to a custodian, called the trustee. The trustee manages or invests the property to provide income for persons named in the instrument as beneficiaries.

A person establishing a trust may name himself trustee or he may choose another, often a corporation, for this purpose. He may choose to act as co-trustee with other persons. He may also reserve to himself such powers as, for example, the power to alter or amend the trust provisions, to change the trustee or beneficiaries, to invade the assets of the trust, or to cancel the trust altogether. He may name himself as beneficiary, alone or with others, so long as he is not both trustee and sole beneficiary. Such reservations often nullify intended tax savings, and it is extremely important that reserved powers be carefully drafted.

A trust written into a will differs from the lifetime trust only in that it does not begin to operate until death, and, of course, the owner cannot serve as trustee. A farmer who wishes to fully control all his property until his death and to protect his heirs thereafter without the disadvantages of life estates should consider using a trust created by will.

**Advantages of trusts.** Trusts provide a high degree of safety. The trustee is held by law to observe strict standards of conduct in dealing with trust property in order that beneficiaries will be fully protected. Unless the trust instrument provides otherwise, he will not be allowed

¹ For discussion, see page 28.
A farm trust has many advantages — among them safety and security.

to engage in speculative investments and must use conservative management procedure in dealing with the farm business. He cannot in any way use the property for his own benefit or contrary to the interests of the beneficiaries. He cannot mingle the trust property or income with his own. In case of mismanagement or breach of any obligation, the trustee will be liable for the loss and may be removed by a court.

The lifetime trust has other substantial advantages:

1. It may be put in operation before death so that experimentation and changes may be made.

2. Management through a trust can reduce operating and investment burdens and provide steady income during retirement.

3. Trustees may be given the power to invade principal to meet the cost of illness attendant with age.

4. The trust can assure efficient management of property for a wife or heirs having little management ability or who are not interested in farming.

5. In the event of sudden death, the trust will be able to provide minors with income until they are ready to take over management.

6. The lifetime trust passes outside probate, reducing administration costs and attorney’s fees.

7. Upon death, there is the assurance that the farm will continue to operate as a single unit under unified management.

8. Management conflicts and the possibility of suits for partition by quarreling heirs are eliminated.
9. Gifts can be made to children with good management assured until the children are mature.

10. Through the use of an irrevocable trust, substantial income tax and estate tax savings may be effected.

A trust effective at death also has advantages:

1. It can provide sound management where a wife or child has little interest in farming or in financial investments.
2. It avoids possible conflicts between life tenant and remaindermen.
3. It avoids the possibility of partition by heirs so that tracts will be kept intact as economical farm units.
4. It avoids probate proceedings upon the deaths of intermediate beneficiaries.
5. It provides a way in which all types of property, including machinery and equipment, may be dealt with by the manager without restriction.
6. It provides tax saving possibilities. Most tax advantages of the testamentary trust will occur in future estates, those of the beneficiaries. Marital deduction trusts, however, can achieve tax savings in the original estate.
7. It is flexible. The maker may place all kinds of restrictions upon the trust, and he may also give the trustee broad powers to deal with problems that are unforeseen at the time of the maker's death.

The role of gifts

In addition to expressing love and affection, gifts during life can serve other purposes:

1. They give children training in the management and conservation of property and may aid them to obtain an education.
2. The gift of an interest in the farm encourages a son to remain on and improve the farm and thereby lessens the father's management burden as he grows less active with age.
3. They reduce the size of the estate that must pass through court administration, thereby cutting probate costs as well as estate and inheritance taxes.
4. Through gifts of income-producing property, income can be shifted from one family member to another in a lower bracket
A gift will be subject to estate and inheritance taxes if you retain any control over it.

to accomplish income tax savings. Where trusts are used, further income tax savings can be accomplished.

A gift program must be planned carefully in view of retirement security and tax risks. A gift is inflexible and cannot be altered or revoked unless such powers have been reserved. If they are not reserved, principal and income are given up forever, thereby reducing future security. If power of control is retained when the gift is made, or if a life estate is reserved by the giver, the gift will be subject to estate and inheritance taxes.

Another tax risk is the presumption that gifts made within three years of death (two years under Illinois inheritance tax law) were made in contemplation of death and therefore subject to the federal estate tax. This presumption may be overcome where there is evidence sufficient to show that gifts were made as part of a long-standing policy of making gifts at regular intervals or were made to start a child in business, but as a donor ages, the chances of making a successful argument diminish and the whole gift may be subject to estate and inheritance taxes.

Due to exclusions and exemptions allowed by the gift tax law, however, a program of gifts over a period of years can transfer a sizeable amount of property without any gift tax applying. And even though a gift tax may be incurred, it will usually be less than the estate and inheritance taxes on the same property if it passed
through the estate of the donor. This is because the gift tax rates start at the bottom of the scale, while the property that is given away is removed from the top estate tax bracket. Any gift tax that is payable is also removed from the taxable estate of the donor, whereas funds in the estate used to pay the estate tax must be included in computing the estate tax.

The choice of gifts is important for income tax purposes. Generally speaking, property with a high cost basis should be given. For example, a 40-acre tract that cost $350 an acre and is now worth $400 an acre should be given in preference to a tract purchased for $100 and now worth $400 an acre. The reason is that the tax basis (cost plus improvements less depreciation taken) carries over to the receiver of the gift. If the basis is low, depreciation deductions will be small, and if the property is later sold, the income tax will be high because of high capital gains.

Leaving low basis property in the farmer’s estate has the advantage of creating a new higher tax basis at his death. The fair market value at that time becomes the new basis, and a subsequent sale by the heirs incurs little or no income tax.

**Gifts to minors.** The recent “Uniform Gifts to Minors Act” in Illinois allows securities, money, insurance policies, and annuity contracts to be given to a minor and held for his benefit by a custodian. The custodian, who has broad powers to deal with the property for the child’s benefit, may be a member of the family or the donor himself.
Tax officials have ruled that such transfers are completed gifts and qualify for the gift tax exemptions. If the income from these gifts, however, is used to satisfy the legal support obligation of a parent, the income is taxable to the parent even if some one else makes the gift. For example, suppose a grandparent makes a gift of bonds with direction that the custodian should use the income to support the child. Under the law, the parent has an obligation to furnish the child’s support; therefore, tax authorities have held that income from the grandparent’s gift is income taxable to the parent.

**Gifts with some rights retained.** Farmers occasionally use one of two devices to retain possession and control of property during their lifetimes. *Neither provides tax advantages and in general are not recommended in estate planning.* In special circumstances, however, they may be useful.

*The deed in escrow.* The owner of property executes a deed giving it to a third party with instructions to have it recorded and given to the beneficiary at his (the owner’s) death. In this way the owner retains his property during life and may also keep secret the intended transfer. At his death, the property passes without probate.

This device involves inherent dangers. A deed, to be valid, must be delivered. To have a valid delivery *in escrow,* the donor or grantor must surrender all opportunity to retrieve the deed. If dissatisfied heirs can prove that the donor did not completely surrender the power to get the deed back during his lifetime, the deed fails and the property passes by the law of descent. Whether or not they succeed, litigation is expensive.

*Deeds with retained life estates.* This arrangement is similar to the deed in escrow. By deeding a farm to an heir and reserving a life estate for himself and his wife, probate at death can be avoided and the heir may be willing to remain and improve the farm. Parents will often then lease their interests to the heir for retirement income.

Where these deed transactions have been secretive, litigation again may follow. Control problems also arise. When this step is taken, the power to alter the arrangement is generally lost. So, too, is the power to borrow on the property in time of emergency. Unless the income or rent from the farm is sufficient or the parent has other sources of income, the security benefit of such a transaction is doubtful. Life tenants are responsible for maintaining the property and are prohibited from
making substantial alterations or allowing damages that lessen property value. These burdens, unless limited in the deed, may fall upon the parent as tenant for life.

Sales to family members

Installment land contracts. The usual transaction involves a sale of farmland from parents to a son or to a daughter and son-in-law for a definite price payable in installments for a definite number of years. Legal title remains in the parents as security until the final installment is paid, or until a mortgage is used as security. The interest rate is generally set at or near the going market rate. It may, however, be any rate agreed to, even zero.

The installment land contract is a useful estate planning device for a number of reasons. A son remaining on the farm is anxious to acquire farm ownership but does not expect ownership in the form of a gift. Through a family installment sale, he is set up in a going business with incentive to increase his own and the farm’s well being. This transaction is often the best arrangement for parents. It relieves them of the burden of management and provides for steady income during retirement. At death of the parents the farm is still intact, and the remainder of the purchase price may be distributed to achieve equitable treatment for all children.

The installment sale should also be considered from a tax stand-
Sale to a family member at a fair market price eliminates gift tax questions and establishes a value for death taxes. Proceeds from the contract not expended or given away by the parents, are taxed at death as part of the estate.

There may be income tax advantages. The parents are taxed upon payments received only to the extent that they represent capital gain. If the son’s payment in the first year of the sale is less than 30 percent of the sale price, the capital gain may be prorated over the future installment period.

In some cases, there may be difficulties with using an installment sale. Unlike disposition by will or revocable trust, this transfer is final. Family disputes may arise. A party may die before the contract is completed. The son may default on his payments. These problems can be minimized by setting out the complete agreement in writing so that both parents and son are certain of their rights and obligations.

Size of payments must be considered in view of the farm’s income producing capacity. The son will have to make his payments from income after repairs, maintenance, and taxes. Long-range, low installments may be the answer for the son, yet may fail to provide sufficiently for the parents during their lives.

Some tax risk is present. Retention of too much security or control by the parents may lead to classification of the transfer as one to take effect after death and therefore subject to the estate tax.

**Family annuity agreements.** This transaction involves conveyance of the farm to one or more children in exchange for the promise to pay fixed amounts periodically to the parents for the remainder of their lives. Aside from its tax aspects, the annuity has much in common with the installment sale. It offers a son, for example, an opportunity to own the home farm while at the same time providing the parents with retirement security. One disadvantage is that annuity payments, which are based upon the parents’ life expectancy, will almost always be greater than would installment payments, creating a heavy burden upon the son who must meet them from after-tax income.

From a tax standpoint, the annuity is treated differently from an installment sale. Estate and inheritance taxes generally do not apply when an annuitant dies. With joint annuities, however, if the father predeceases the mother, the annuity, based upon her life expectancy
Family annuity agreements offer parents security during retirement, but may put a heavy burden on children if payments are high.

at the time of his death, may be subject to the estate tax. For income tax purposes, a part of each annuity payment is subject to tax. The remainder is excluded as a return of capital. Calculations are based on the value of the property and the life expectancy of the person or persons getting the annuity. The gift tax may apply if the fair market value of the property transferred is greater than the present value of the annuity.

Tax problems may also arise for the son or other family member who buys the property through an annuity agreement. The income tax basis for determining gain or loss and depreciation is the value of the annuity at the time of the transaction. If the parents should die before the amount paid equals the previously estimated value of the annuity, the income tax basis must be reduced to the amount of payments made. If the parents live beyond life expectancy and annuity payments exceed the estimated value, the basis is increased to the total amount paid. If the property is sold by the son before the parents' death, there will be an additional gain (or loss) that has to be taken into account by the son on his income tax return.
Use of partnerships and corporations

In recent years, many farmers have recognized the usefulness of the partnership and corporate form in operation of the farm business. Voices have been raised against the trend, the argument being that it heralds an end to the "family farm." The truth is often quite to the contrary. These business forms are simply legal devices for arranging family ownership and management. Like other tools used in estate planning, these are attended by certain advantages and disadvantages. When used properly and in the right circumstances, these arrangements can be an important factor in holding the family together in farming and increasing their financial well-being.

Partnerships. Family partnerships offer enough flexibility to achieve lifetime income and retirement advantages for the farmer and to assure a smooth transition and equitable distribution to the next generation.

The opportunity to acquire an ownership interest in the farm is usually attractive to the children. A son who might otherwise feel that he is "getting nowhere" and thus seek a different vocation will be encouraged to remain on the farm and to work to make it prosper.

The family partnership has income tax advantages. It is not taxed as a business. Partners each report their share of profits on individual returns. Since children will generally be in lower income tax brackets, sharing profits with them as partners will reduce the tax on the whole
of farm income. Children may be treated as partners so long as they have an ownership share of the business by a contribution to capital or labor and so long as they participate to some degree in management.

Under Illinois law a partnership must be liquidated on the death of a partner unless some provision is made to the contrary. An orderly transition and business continuity can be achieved through a well-drafted partnership agreement.

The agreement may provide for periodic gifts of an interest in the farm. This will result in lower estate taxes. An installment purchase plan is often incorporated in the partnership agreement or exists in a separate agreement. This has all the advantages of an installment sale. The father receives greater income with a lesser tax burden as he grows less able to take part in the labor of farming. The son acquires more ownership as he grows better able to handle tasks of management. A sound retirement plan and a continually prosperous farm are the objectives. At the father’s death, further installments may be used to support the mother and to equalize the shares of other children.

The disadvantages of partnerships are:

1. Unlimited liability of each partner for partnership debts and obligations.
2. Loss of some control by the parents.
3. Opportunity for conflict over the rights and obligations of each partner in labor and management of the farm.

**Family corporations.** Farm corporations can attain many of the advantages of a partnership while avoiding some of its disadvantages. A corporation differs from a partnership in that it is considered a separate business entity, apart and distinct from its owners. Owners conduct and control the business through the shares of stock they hold. They are liable for business debts and obligations only to the extent of the value of their shares. Management obligations as well as rights of the shareholders are controlled by its articles of incorporation and by laws, together roughly equivalent to the partnership agreement. Since the corporation is regarded as a separate entity, a transfer of an ownership interest by sale or gift of stock or by distribution upon the death of a stockholder does not terminate the business.
Like the partnership, the corporation provides an excellent means by which ownership of the farm may be shared with and transferred to children:

1. Gradual sale of stock allows parents to develop an adequate retirement plan while a son or son-in-law is encouraged to build and improve the farm.

2. Upon the death of the parents, the farm continues to function as a going concern.

3. Shares may also be the subject of gifts to provide equality of treatment among children. Children can shuffle their shares, depending upon their financial abilities and interest in farming, and thus plan their futures in relation to the family farm before the parents' deaths.

4. Transfers of stock by gift will reduce the size of the estate subject to estate and inheritance taxes.

Prior to 1958, the corporate income tax was a serious obstacle to farm incorporation in some cases, since a tax was levied first upon the corporate profits, then upon dividends of the owner-shareholders. There was, in effect, double taxation of corporate farm income. In that year, Subchapter S was added to the income tax laws to provide for tax treatment of corporations substantially identical to that of partnerships so long as stock ownership is closely held. Like the partnership, the corporate device enables the farmer to
spread business earnings among children in low tax brackets in the form of salaries and dividends, thus reducing taxation on the whole of farming earnings.

Added advantages may be secured through various forms of corporate fringe benefits. These include insurance payments by the corporation for employees (officers and employees), medical and hospital plans paid by the corporation, pension and profit sharing plans, and others related to the income tax. Payments by the corporation are generally a business expense, fully deductible on the income tax return. Unlike the sole owner or partner, a stockholder may be treated as an employee of the corporation and eligible for these benefits.

Disadvantages of incorporation include:
1. Initial cost of incorporating — may be $500 to $1,000 for all fees, taxes, and professional help.
2. Capital stock tax on intangibles if incorporated in Illinois. Some farm corporations have incorporated in other states to avoid this tax.
3. Formality of organization and operation.
4. Restricted market for shares.
5. Annual tax payable to the state for the privilege of operating as a corporation — 50 cents per $1,000 of stated capital and paid-in surplus.

**How life insurance can be used**

People usually think of life insurance first as a family protection plan and secondly perhaps as a retirement program. As protection, insurance provides cash during the critical period following death. With much of farm property tied up in fixed capital assets, the immediate need for cash can mean heavy financial loss to the estate as a result of forced sale. Insurance payable to the estate is available almost immediately to meet the costs of interim management, mortgage payments, last illness, burial, and probate. Insurance can also be used to provide the funds needed to buy out the partnership interest of a deceased partner.

Insurance payable to the estate, however, may increase inheritance taxes. Under the Illinois inheritance tax law, proceeds of life insurance
Proceeds of life insurance are subject to estate and inheritance taxes if paid to the estate, but not if a person is beneficiary and if the deceased did not own the policy.

are taxed if paid to the estate. If a person is named as beneficiary, the Illinois tax does not apply.

To escape the federal estate tax, the above requirement must be met, and further, the deceased must not have any incidents of ownership in the policy at his death. Some one else (usually a member of the family) must own the policy. This means, for example, that the insured can not retain the power to borrow on the policy or to change the beneficiary.

Aside from family protection, there are other good uses for life insurance. If the parents intend to pass the farm business to a son, they may want to give life insurance proceeds to other children to achieve equality of treatment. An idea that is becoming more popular is to set up a life insurance trust during one's lifetime. At death, the insurance is paid to a trustee, which might be the family bank. The trust agreement directs the use of the money—education for the children, illness of spouse or children, or monthly income for the spouse, for example. Under certain conditions, the funds in an insurance trust are not subject to inheritance taxes.

Keep in mind that before lifetime transfers of insurance are made
Family Planning of Titles and Taxes

Careful consideration must be given to the need for cash during estate administration. Tax savings through gifts look attractive, but the advantage to beneficiaries may be lost if an executor or administrator is forced to sell farmland and equipment at a sacrifice to meet needed cash requirements.

How much life insurance? Every family's situation is different and an insurance program should be tailored to fit. The Life Insurance Guide (page 38) is a listing of some of the more important insurance objectives. The guide will help you check your own needs and make decisions relating to the kind and amount of life insurance you should carry. You are the only one who can decide how much life insurance you should buy. The answer depends on your objective—interpreted in terms of your age and money available. The decision will depend also on the number of children, the standard of living, retirement plans, other sources of income, size of the estate, and death tax needs.

Self-employed retirement plan

A new law passed in 1963 permits self-employed individuals, including partners, to set up a retirement plan with current tax deductions for contributions to the plan. Also, no fund will be taxed until it is distributed or made available to the self-employed person or his beneficiary. Presumably he will be in a lower income tax bracket and will have more exemptions and credits when he receives retirement benefits than when he earned the income placed in the retirement fund.

Plans that qualify for the special tax treatment include: (1) a retirement trust fund with a bank as trustee; (2) a custodial account in a bank which is invested in redeemable stock of a regulated investment company or invested in life insurance policies; (3) life insurance contracts (endowment or annuity) payable no earlier than age 59½; and (4) a special series of U. S. government bonds.

A self-employed person, including a partner with more than a 10 percent interest in capital or profits of the partnership, may contribute up to the lesser of $2,500 or 10 percent of earned income during the taxable year to a qualified retirement plan. If both capital and services materially contribute to income, then no more than 30 percent of such income, but not less than $2,500, is considered to be earned; but if net profits are $2,500 or less, the whole amount of such profits
# A Life Insurance Guide for Farmers

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<td>Reducing term</td>
<td>Reducing term</td>
<td>Reducing term or ordinary life</td>
<td>Amount of mortgage</td>
<td></td>
</tr>
<tr>
<td>Education of children</td>
<td>Limited pay, or endowment, or family income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Retirement income (to supplement other income such as social security)</td>
<td>Any policy that builds a cash value, or a combination life and annuity policy</td>
<td>Any policy that builds a cash value, or a combination life and annuity policy</td>
<td>Any policy that builds a cash value, or a combination life and annuity policy</td>
<td>Enough to bring total income to at least $400 a month (based on 1962 price levels)</td>
<td></td>
</tr>
<tr>
<td>Investment</td>
<td>Limited pay or endowment</td>
<td>Limited pay or endowment</td>
<td>Limited pay or endowment</td>
<td>Personal decision</td>
<td></td>
</tr>
<tr>
<td>Cash for estate administration and expenses</td>
<td>Ordinary life</td>
<td>Ordinary life</td>
<td>Ordinary life</td>
<td>4 to 5 percent of value of estate plus amount for death taxes</td>
<td></td>
</tr>
<tr>
<td>Estate builder for surviving family</td>
<td>Ordinary life or term</td>
<td>Ordinary life or limited pay (premiums paid for a period such as 20 years)</td>
<td>Ordinary life or limited pay</td>
<td>2 to 5 times annual income — depends on family needs</td>
<td></td>
</tr>
<tr>
<td>Estate planning (for example, to equalize gifts to children)</td>
<td>Ordinary life or limited pay</td>
<td>Ordinary life or limited pay</td>
<td></td>
<td>Coordinate insurance with estate plan</td>
<td></td>
</tr>
</tbody>
</table>
may be considered earned income. Farmers are considered to be engaged in activities in which both capital and services are material income-producing factors.

Half of the amount contributed to the plan is deductible on the income tax return up to a maximum of $1,250. Any amounts paid for employees are entirely deductible.

Illustration 1. Farmer A has a net profit from farming for the year of $12,000. Only 30 percent or $3,600 can be considered as “earned” income. He may contribute 10 percent of his earnings or $360 to a retirement plan and may deduct $180 on his tax return.

Illustration 2. Farmer B has an annual net profit of $6,000. Thirty percent of $6,000 is only $1,800, so if he wants to, he may consider his “earned” income to be $2,500, and be allowed to contribute 10 percent of that amount or $250 to his retirement plan and may deduct $125 on his return.

A self-employed person who wants to set up a retirement plan must also cover all full-time employees with three or more years' service. Employees working less than five months a year or not over 20 hours a week may be excluded.

Benefit payments under retirement plans qualified under this law may not begin before age 59½ unless the individual becomes disabled or dies. Any use of the fund or its earnings before that time results in tax penalties. There are also penalties for making excessive contributions to the plan.

The tax benefits to farmers are less than to professional people because of the 30 percent rule used for determining earned income and because the funds earmarked for retirement are lost for other purposes. Where employees must be included, the extra expense may actually exceed the benefits derived.

Farmers nearing retirement age will not gain significant tax benefits from a qualified retirement plan. Any tax saving possibilities, however, are worth investigating, and the tax advantages increase with the number of self-employed years remaining. Before you decide to embark on a retirement program, weigh the tax advantages against the loss of use of the retirement funds for business purposes.
Estate Administration

Why does an estate need to be administered in court?

Three groups or parties may have interests in the property of a deceased person.

1. Federal and state governments are interested in collecting any taxes that may be owing.
2. Creditors are entitled to collect any just debts owed by the deceased.
3. Heirs have a right to the share of the property left them by will or due them under inheritance law.

Society as a whole benefits from the existence of a forum where all the conflicting claims of these three groups can be finally resolved in an equitable manner.

Without court administration, there is no official record of whether the deceased had a valid will, who the heirs are, or the property interest of each heir. Title to real estate is clouded without this official record, and buyers will not buy until title is cleared.

If death taxes are not computed and paid, they become a lien on the property and accumulate interest. Creditors may assert claims against the estate or the heirs.

Without court supervision and approval of the distribution of a decedent’s assets, no one could be sure that the will is valid or that it has been legally carried out, and objections may arise at a later time.

Who represents the estate?

If a will is used, an executor is usually named in the will. If one dies without a will or fails to name an executor, an administrator is appointed by the court. In such cases, preference is given by law first to the spouse and then to children, grandchildren, and other relatives in order of kinship. If a person is entitled to serve as administrator and would rather not, he may nominate another person to serve in his place.

The executor is obligated to carry out the instructions in the will, collect all assets, negotiate and pay claims against the estate, exercise care in protecting assets during administration, file tax returns, and finally distribute the assets.
The length of time for administration is usually from one to two years. During this period, the executor or administrator will have to make business and financial decisions concerning the estate property. For example, he may have to decide what property must be sold and how the proceeds should be spent or invested. He will, of course, have the advice of an attorney, and he may deal with business counselors. Yet the executor or administrator is charged with final responsibility. He is held to a standard of conduct similar to that of a trustee. If he should be negligent or use bad judgment, he will be held financially responsible for the loss.

The steps in settlement of an estate in court

The legal steps necessary in the settlement of an estate are not substantially different whether intestacy or a will is involved. In nearly all cases, except for very small estates, administration will require that the following measures be taken by the executor.

1. As soon after death as possible, permission must be obtained to open safe deposit boxes; the will, if any, is procured and filed with the court.
2. Letters testamentary or letters of administration (in cases of intestacy) are granted by the court, opening the process of
administration and giving the executor or administrator authority to act.

3. Heirship is proven; where there is a will, its validity is proven.

4. All assets are collected and an inventory and independent appraisal are made and filed.

5. Steps are taken to collect all debts owed to the deceased.

6. Unless other arrangements have been made, unincorporated businesses in which the deceased had an interest must be liquidated.

7. Publication for claims against the estate must be made; doubtful claims must be contested and valid debts of the deceased paid.

8. Where necessary, a sale of assets must be made to raise cash for debts and expenses.

9. Estate and inheritance tax returns must be prepared and filed and the taxes paid. The Illinois tax is paid within 18 months of death and federal tax within 15 months of death. Under certain circumstances, the federal tax can be paid over a 10-year period, with interest.

10. Yearly income tax returns for the estate must be prepared and the tax paid.

11. An accounting of estate income and expenditures must be made semi-annually and must be submitted to the court for approval.

12. The estate is distributed according to the requirements of the will or of the inheritance laws.

13. A final accounting is then submitted to the court for approval.

These steps require a knowledge of many laws and therefore an attorney is an essential part of the probate procedure and estate settlement.
**TWO EXAMPLES OF ESTATE PLANS**

**Example 1: Estate of $114,000 Plus Life Insurance**

The family consists of a father, mother, two sons, and a daughter. The father is 50 years old, the mother, 48, the older son, 26, the daughter, 22, and the younger son, 18. The younger son is interested in farming.

The estate consists of the following:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>A 200-acre farm bought in 1940 for $200 an acre. It is held in joint tenancy. The wife contributed no money.</td>
<td>$80,000</td>
</tr>
<tr>
<td>Equipment and machinery.</td>
<td>$15,000</td>
</tr>
<tr>
<td>Average grain inventory.</td>
<td>$5,000</td>
</tr>
<tr>
<td>Bank account held in joint tenancy. Average amount.</td>
<td>$3,000</td>
</tr>
<tr>
<td>Livestock.</td>
<td>$5,000</td>
</tr>
<tr>
<td>U. S. bonds in husband’s name.</td>
<td>$6,000</td>
</tr>
<tr>
<td>Life insurance on the father with the mother as beneficiary</td>
<td>$10,000</td>
</tr>
<tr>
<td>Life insurance on the mother with the father as beneficiary</td>
<td>$3,000</td>
</tr>
<tr>
<td>Total assets (exclusive of insurance on the mother)</td>
<td>$124,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Debts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Mortgage on the farm.</td>
<td>$9,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$1,000</td>
</tr>
<tr>
<td>Total debts</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Future liabilities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Estate costs at the death of the husband (exclusive of taxes)</td>
<td>$4,000</td>
</tr>
<tr>
<td>Estate costs at death of wife (assuming she survives the husband)</td>
<td>$4,500</td>
</tr>
<tr>
<td>Total future liabilities</td>
<td>$8,500</td>
</tr>
</tbody>
</table>

Based on the above assets, this is the father’s taxable estate.

<table>
<thead>
<tr>
<th>Taxable estate</th>
<th>Federal</th>
<th>Illinois</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm</td>
<td>$71,000</td>
<td>$35,500</td>
</tr>
<tr>
<td>($80,000 less $9,000 mortgage)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment and machinery.</td>
<td>$15,000</td>
<td>$15,000</td>
</tr>
<tr>
<td>Grain.</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Livestock.</td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>Bank account.</td>
<td>$3,000</td>
<td>$1,500</td>
</tr>
<tr>
<td>Bonds.</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>Insurance.</td>
<td>$10,000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$115,000</td>
<td>$68,000</td>
</tr>
<tr>
<td>Less accounts payable.</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Adjusted gross estate.</td>
<td>$114,000</td>
<td>$67,000</td>
</tr>
<tr>
<td>Less estate costs.</td>
<td>$4,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>Net taxable estate.</td>
<td>$110,000</td>
<td>$63,000</td>
</tr>
</tbody>
</table>

What would happen to this estate if the family had no estate plan and the father died without a will?

First, the mother would take all the property that was held in joint tenancy. This would be the farm and bank account. She would also
take the $10,000 life insurance. The remaining property after payment of accounts, taxes, and expenses would pass by the law of descent. This means that in this estate the mother would take one-third of all the personal property and the children would take two-thirds. This two-thirds would be divided evenly three ways. The personal property includes: equipment and machinery, grain, livestock, and bonds.

Second, no federal tax would be owed. A wife can inherit as much as half the adjusted gross estate without tax, and the estate is allowed in addition a $60,000 tax exemption. These provisions eliminate the federal tax in this estate. Illinois allows each of these heirs a $20,000 tax exemption. This Illinois exemption eliminates the Illinois tax on each child's share, but the mother would owe the state $513.34.

What are the taxes at the mother's death?

If the mother does not remarry and survives her husband by 10 years and if the size of the estate does not change, what will the estate taxes be? This is her taxable estate.

<table>
<thead>
<tr>
<th></th>
<th>Federal</th>
<th>Illinois</th>
</tr>
</thead>
<tbody>
<tr>
<td>Farm</td>
<td>$71,000</td>
<td>$71,000</td>
</tr>
<tr>
<td>Personal property</td>
<td>$11,154</td>
<td>$11,154</td>
</tr>
<tr>
<td>Cash from husband's insurance</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>$3,000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$95,154</td>
<td>$92,154</td>
</tr>
<tr>
<td>Less accounts payable</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Adjusted gross estate</td>
<td>$94,154</td>
<td>$91,154</td>
</tr>
<tr>
<td>Less estate costs</td>
<td>$4,500</td>
<td>$4,500</td>
</tr>
<tr>
<td>Net taxable estate</td>
<td>$89,654</td>
<td>$86,654</td>
</tr>
</tbody>
</table>

The federal tax would be $2,951.56. The Illinois tax would be $474.06 ($158.02 per child).

How can this estate be planned to minimize taxes, and to provide ample family security and an equitable inheritance for the heirs?

Here is one possible plan. It consists of three necessary steps. A fourth step is optional, but worth considering.

Step 1. Change the title of the farm from joint tenancy to tenancy in common. This puts $40,000 (half the value of the farm) in the husband's name and $40,000 in the wife's. The transfer of title eliminates the federal estate tax because each can inherit from the other half the adjusted gross estate and because each has a marital deduction of $60,000.

Step 2. If the son remains interested in farming, give him some special incentives that will gradually lead to a partnership with his father and possibly enable him to rent additional land. After a few years, sell up to half the machinery, equipment, and livestock to him on an installment basis. Put such a father-son agreement in writing.

Each parent to leave a half interest in the farm to the other for life and the remainder to the children undivided. Each thus creates a life estate for the other. Each to include a clause allowing the son (if he remains on the farm) to purchase the farm at its appraised value on an installment basis, the installments to run for not more than 10 years.

The father to leave the remainder of his equipment, machinery, and livestock to the son who is on the farm. Equalize this bequest with gifts to the daughter and older son from term insurance paid directly to them or to the estate as beneficiary. (If the father’s estate grows, he can later make such gifts from his personal estate; by taking advantage of the gift tax laws, he can thus effect further tax savings.)

The father to leave the U. S. bonds to the mother. Either the bonds or grain inventory will be largely consumed by estate costs and accounts payable.

Step 4 (optional.) The father to carry reducing term or ordinary life insurance policy to cover the mortgage. This step, however, is not essential. The surviving parent can continue to make the mortgage payments.

How much in taxes will such a plan save?

Such a plan as this will eliminate all the federal tax ($2,951.56). It will also reduce the Illinois tax to about $400, depending on the mother’s age at the time of the father’s death. A total tax saving of over $3,500 should be enough to lead most families to make their estate plans and to carry out whatever steps are necessary to put them in action.

Example 2: Estate of $232,000 Plus Life Insurance

The family consists of a father, mother, two daughters, and a son who is physically handicapped. The father is 58 years old, the mother, 54, the older daughter, 34, the younger daughter, 29, and the son, 25.

The estate consists of the following:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>A 280-acre home farm inherited by the father in 1946 and valued at that time at $250 an acre. It is held in his name</td>
<td>$140,000</td>
</tr>
<tr>
<td>80 acres, two miles from the home farm, bought in 1954 for $400 an acre. It is held in joint tenancy</td>
<td>$36,000</td>
</tr>
<tr>
<td>40 acres, three miles from the home farm, inherited by the mother in 1950, and valued at that time at $350 an acre</td>
<td>$18,000</td>
</tr>
<tr>
<td>Equipment and machinery</td>
<td>$24,000</td>
</tr>
<tr>
<td>Bank account held in joint tenancy. Average amount</td>
<td>$4,000</td>
</tr>
<tr>
<td>U. S. bonds held in father’s name payable on death to the mother</td>
<td>$4,000</td>
</tr>
<tr>
<td>Common stocks held in father’s name</td>
<td>$6,000</td>
</tr>
<tr>
<td>Life insurance on the father with the mother as beneficiary</td>
<td>$20,000</td>
</tr>
<tr>
<td>Life insurance on the father with the son as beneficiary</td>
<td>$5,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>$257,000</strong></td>
</tr>
</tbody>
</table>
Debts

Mortgage on 80 acres ...................................................... $10,000
Accounts payable .......................................................... $1,000

Future liabilities

Estate costs at death of father (exclusive of taxes) ................... $8,000
Estate costs at death of mother (exclusive of taxes and assuming she survives her husband) ........................................... $10,000
Total estate costs .................................................................. $18,000

If the father has a will in which he leaves everything to his wife, what would be the federal and state inheritance taxes at his death? The following is his estate as used for tax computations.

<table>
<thead>
<tr>
<th>Taxable estate</th>
<th>Federal</th>
<th>Illinois</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home farm</td>
<td>$140,000</td>
<td>$140,000</td>
</tr>
<tr>
<td>80 acres</td>
<td>$26,000</td>
<td>$13,000</td>
</tr>
<tr>
<td>(40 acres less $10,000 mortgage)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Equipment and machinery</td>
<td>$24,000</td>
<td>$24,000</td>
</tr>
<tr>
<td>Bank account</td>
<td>$4,000</td>
<td>$2,000</td>
</tr>
<tr>
<td>Stocks</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>Bonds</td>
<td>$4,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>Insurance</td>
<td>$25,000</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>$229,000</td>
<td>$189,000</td>
</tr>
<tr>
<td>Less accounts payable</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Balance</td>
<td>$228,000</td>
<td>$188,000</td>
</tr>
<tr>
<td>Less estate costs</td>
<td>$8,000</td>
<td>$8,000</td>
</tr>
<tr>
<td>Adjusted gross estate</td>
<td>$220,000</td>
<td>$180,000</td>
</tr>
</tbody>
</table>

The federal estate tax is $6,920. The Illinois inheritance tax is $5,184.80.

If the mother survives her husband by 10 years, if the estate remains at the same value as when left to her, and if she leaves no will, what will be the taxes on her estate? This is her taxable estate.

<table>
<thead>
<tr>
<th>Taxable estate</th>
<th>Federal</th>
<th>Illinois</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home farm</td>
<td>$140,000</td>
<td>$140,000</td>
</tr>
<tr>
<td>80 acres</td>
<td>$26,000</td>
<td>$26,000</td>
</tr>
<tr>
<td>40 acres</td>
<td>$18,000</td>
<td>$18,000</td>
</tr>
<tr>
<td>Equipment and machinery</td>
<td>$24,000</td>
<td>$24,000</td>
</tr>
<tr>
<td>Bank account</td>
<td>$3,895</td>
<td>$3,895</td>
</tr>
<tr>
<td>Stocks</td>
<td>$6,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>Bond proceeds</td>
<td>$4,000</td>
<td>$4,000</td>
</tr>
<tr>
<td>Total</td>
<td>$221,895</td>
<td>$221,895</td>
</tr>
<tr>
<td>Less accounts payable</td>
<td>$1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Balance</td>
<td>$220,895</td>
<td>$220,895</td>
</tr>
<tr>
<td>Less estate costs</td>
<td>$10,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Adjusted gross estate</td>
<td>$210,895</td>
<td>$210,895</td>
</tr>
</tbody>
</table>

The federal estate tax is $34,507. The Illinois inheritance tax is $2,327.76.
The federal and Illinois taxes on this estate total $36,834.76. On both estates, they total: federal tax, $41,427; Illinois tax, $7,512.56; all estate taxes on both estates, $48,939.56.

How can this estate be planned to minimize taxes, to provide ample security for the family, and to provide an equitable inheritance for the heirs?

Here is one possible plan. It consists of two steps.

Step 1. Reduce the estate by making lifetime gifts. The father owns the stocks and insurance policies. The mother and father own the 80-acre farm jointly. Distribute these properties as gifts in this way:

- Give part or all the stocks to the daughters; the father could wait two or three years to do this.
- Assign the $5,000 life insurance policy to the son.
- Assign the $20,000 life insurance policy to the mother.
- Transfer the 80-acre farm with the mortgage to the son or place it in trust for his benefit.

Step 2. Make wills. The father’s will to do the following things:

- Give a half interest in the home farm and all the personal property to his wife outright and give the other half interest in the farm to her for life with the remainder to the children. (Or as an alternate plan, establish a trust to which the home farm and equipment and machinery would pass and to which his wife would be given a life interest with the remainder to the children. In this plan, give the wife a general power of appointment over half the property to qualify for the marital deduction. Give remainder of his estate to his wife outright, but most of the personal property would be needed to pay estate expenses.)

- Give remainder of his estate to his wife outright, but most of the personal property would be needed to pay estate expenses.

The mother’s will to do the following things:

- Give only a life interest in the land to the father. Give the insurance policy to the children. After the father’s death, provide for adjustments in the children’s inheritance so as to treat them as fairly as possible, taking into account prior gifts and special needs and circumstances of the son. Consider making gifts during her lifetime to reduce the estate further.

How much in taxes would such a plan save? If the father dies before the mother, the total savings on the two estates would be $35,674.

The father’s estate would be reduced by $57,000 for the federal estate tax. This would reduce the federal estate tax on his estate by $5,110. It would be reduced $19,000, plus $30,000 because of additional exemptions created by the life estate and remainders in the home farm, for the
Illinois inheritance tax. This would mean a saving of $1,741 on the Illinois inheritance tax. The total tax saving on his estate would be $6,851.

The mother’s estate would be reduced by $100,000 for both the federal estate tax and the Illinois inheritance tax. This would save $27,370 in federal estate tax and $1,453 in Illinois inheritance tax, or a total saving in her estate of $28,823.

Just a little time spent in planning and executing the plan will result in savings equal to many years of farming profits. Keep this in mind, however. Every estate presents different problems and has a different solution. Get professional help in planning and drafting the legal documents necessary to carry out the plan.

Readers desiring additional information on estate planning may obtain single copies of the following publications from their county farm adviser or by writing the Information Office, College of Agriculture, Urbana:

Inheritance and Gift Taxes on Illinois Farm Property. Circular 728.
Partnerships in the Farm Business. Circular 786.
Corporations in the Farm Business. Circular 797.
Insurance for Farmers. Circular 832.
Farm Property and Trusts. Circular 842.
Family Estate Record (for making inventory of assets).