

ESTATE PLANNING PRACTICES OF RURAL RESIDENTS OF VIRGINIA  
AND CASE STUDIES OF ALTERNATIVE ESTATE PLANS UNDER THE  
NEW LAWS RESULTING FROM THE 1976 TAX REFORM ACT,

by

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## CHAPTER I

### INTRODUCTION

Within the last three and a half decades tremendous changes have occurred in the agricultural sector of the United States economy. In 1940 farms were generally small, labor-intensive operations with little capital investment by today's standards. Today farmers have increased the size of their operations many-fold compared to their counterparts of 1940. The present-day farm is a highly mechanized operation requiring large amounts of investment and operating capital. If this trend continues, tomorrow's farms will be even larger, requiring even more capital.

The value of the real estate assets of the farming sector has increased from \$33,636 million in 1941 to \$371,355 million in 1975.<sup>1/</sup> Since there is only 2.5 percent more land used in the farming sector now than in 1940, this reflects a large increase in the value of land and buildings per acre.

In 1940 the average farmer's equity in his farm was \$7,051 whereas in 1975 it was \$155,000.<sup>2/</sup> These numbers may not represent any individual farmer, but they do show a definite trend toward increased value of farm estates. If it is assumed that the average farmer had other assets to cover probate and funeral expenses, the Federal Estate Tax on the average farm estate which passed directly to the next

generation at the death of the owner-operator was negligible in 1940 but was \$19,440 in 1975.

In addition to the capital erosion from taxation of the estate, large amounts of the assets are quite often transferred to the off-farm heirs. The heir or heirs who want to continue operating the farm may have difficulty buying out the off-farm heirs, especially when the off-farm heirs' share is large and payment must be made at once. An imbalance of the factors of production may exist. The new manager is generally less experienced than the old manager. Flexibility of the capital factor is limited as a result of capital erosion during intergeneration transfer. This imbalance of factors of production can lead the farm into a weakened situation so that it is not able to compete effectively with other established farms and to continue efficiently to the production of the nation's food and fiber.

Capital losses during intergeneration transfer are but one segment of the overall problem. Because of these losses, the smooth and continuous operation of the farm business can be jeopardized at the death of an owner-operator. The heir or heirs who wish to continue farming may have problems obtaining sufficient cash and/or credit to purchase the interests of the off-farm heir or heirs and to provide necessary operating capital. The loss of farm capital as a result of Federal Estate and State Inheritance Taxation often compounds this problem. This is especially true for large estates. Partition of the farm among the heirs or sale of portions or all of the farm may be required. This may result in the interruption of maximum or most

efficient production of farm products, causing further erosion of farm capital. This may endanger the optimum utilization of resources in agriculture. The welfare of the farm sector as well as the national economy may suffer.

The estate taxation laws dealing with individual exemptions and rate schedules were not changed from the early 1940's to 1976. According to Woods, if a price deflator is used to adjust for inflation, the \$60,000 personal estate tax exemption authorized in 1942 was worth only \$18,000 in 1975 (in terms of 1942 dollars). To establish the exemption at a level equal in real terms to \$60,000 in 1942 would require that the exemption level be set at approximately \$200,000.<sup>3/</sup>

This problem has received national attention. One hundred eighty-four bills were introduced in the 94th Congress dealing with estate taxation. In the fall of 1976 the Congress passed and the President signed into law the 1976 Tax Reform Act which included major changes in the estate and gift tax laws. Under the new law a progressive unified rate schedule was developed for both estate and gift taxation. The individual gift and estate tax exemptions under the old law were replaced by a unified tax credit of \$30,000 in 1977, increasing to \$47,000 in 1981, which are equivalent to exemptions of \$120,667 and \$175,625, respectively. The unified credit is applicable to lifetime and/or death-time transfers. The new law made several other changes such as increasing the maximum estate tax marital deduction on estates smaller than \$500,000, and allowing certain qualifying estates to receive special valuation based on use value.

## Review of Literature

Over the years a number of studies have been conducted and reports written concerning estate planning problems of farm owner-operators. The tremendous increases in value of farm assets and capital requirements, including the high cost of credit, have cast these problems in a new and more critical context. None of these studies have dealt with this issue in its present context. Furthermore, these problems must now be worked out under a new set of rules as a result of the Tax Reform Act of 1976. If the capital requirement of farm operation continues to increase in the future, as expected, serious social and economic consequences may be generated by a lack of adequate estate planning.

A number of studies concerned with the inheritance of farm assets have been conducted. In 1947 Gibson and Walrath<sup>4/</sup> reported: "Little research in the United States has been directed specifically toward an analysis of land inheritance problems. Most of the investigations in which inheritance has received consideration deal largely with how farmers acquire ownership of farms or with broader phases of the farm tenure process."

A study by Levi and Allwood<sup>5/</sup> reported that "... the magnitude of capital erosion through federal gift and estate taxes was illustrated by Allwood for five estates ranging in value from approximately \$225,000 to \$1,800,000. Assuming a family of five in which the 58-year-old husband and 56-year-old wife lived normal life expectancies, he found differences in transfer costs between optimal planning and

no planning ranging from approximately \$36,000 to nearly \$456,000." These transfer costs were based on the law prior to 1976.

Woods reported in 1973 that "... today the available evidence suggests that estate and inheritance tax may often pose an increasing problem for typical farm estates. While not yet a serious problem for the owners of most types of farms, the rapid increase in farm capital, viewed with the progressive nature and other features of the present Federal Estate Tax (as well as some of the preliminary proposals for its revision), highlight the potential seriousness of the problem."<sup>6/</sup>

In "Case Study Analysis of Arkansas Farm Estates", Graham, Redfern, and Meenen concluded that: "Farm estates are comprised mostly of land, machinery, and other non-liquid assets which can create problems in meeting cash needs for inescapable debts, estate administration and settlement cost, and transfer taxes."<sup>7/</sup>

Neil E. Harl discussed estate planning with respect to the family farm in a series of three articles in News for Farmer Cooperatives in 1972.<sup>8/</sup> He pointed out that the on-farm heir (or heirs) is in a difficult position as a result of the loss of capital at the death of the owner-operator and faces the choice of (1) obtaining a loan, (2) selling off assets, or (3) giving up farming as the entire farm business is sold.

"Large Farm Estate Planning and Probate in Iowa",<sup>9/</sup> a 1974 article, reported that although "there was a potential liquidity problem among the sample of living farmers ..., the findings of the study fail to bear out the existence of the liquidity problem--among the

64 probate estates which were examined." It should be pointed out that the estate tax problems of large farms (by today's and tomorrow's standards) was not investigated, since the appraised gross value of these estates averaged only \$219,000, ranging from \$145,000 to \$623,700.

With the use of a poly-period simulation model that allowed the size of the estate to grow from year to year, Boehlje and Eisgruber developed what they considered an optimal plan. They reported "... if either parent dies before the fourth year (of the planning period), transfer costs are high enough that some productive assets must be liquidated."<sup>10/</sup>

An Alabama study of 10 farm estate cases found that significant savings in death taxes could have been realized by wise use of available estate planning tools, in one case running in excess of \$50,000.<sup>11/</sup>

No final solution of the problem of maintaining optimum farm productivity at the death of the owner-operator is evident from the studies that have been conducted. Contradiction appears to prevail. In light of these inconclusive findings, this study will attempt to shed light on the estate problems of Virginia farm owner-operators.

#### The Problem

The increases in the value of farm assets and the size of farm operations have raised several perplexing questions concerning the ways by which a farmer could most effectively accomplish his estate planning objectives. This is especially true if minimizing capital erosion is one of those objectives.



An understanding of the term "capital erosion" is imperative. Webster defines capital as "accumulated goods devoted to the production of other goods." Erosion, as Webster defines it, is "the process of eating into or away by slow destruction of substance." Capital erosion as used in this study is the process of eating away of accumulated goods devoted to the production of other goods, during intergeneration transfer. Capital erosion is made up of losses from the estate due to probate cost, federal estate tax, state inheritance tax, and payments to off-farm heirs. This may be the result of foregone opportunities to develop an effective estate plan. If proper planning and management are exercised well in advance, capital erosion may be controlled to a significant extent.

Most farm owners are interested in minimizing the capital erosion from the estate at some stage or stages of intergeneration transfer. Generally, if a farmer does not recognize minimizing capital erosion as an objective, other objectives will make it desirable in at least one of the stages of intergeneration transfer.

Typically, when a farmer is faced with an estate planning question, he will specify certain objectives he wishes to achieve. These objectives are generally some combination of the following:

- a. Provide income security and retirement security for self and/or spouse.
- b. Provide security for minor or handicapped children.

- c. Relieve wife of management responsibility.
- d. Maintain the economic viability of the farm unit.
- e. Preserve the estate.
- f. Encourage the children to continue farming.
- g. Indicate to heirs what to expect.
- h. Distribute the property equitably among the heirs.
- i. Minimize losses due to capital erosion.

Factors that affect the development of the estate plan are the marital status of the owner-operator, his perceived ideas of the management ability of his spouse and children and whether any of them want to continue farming, the ages of parents and children, the type of farm, and the size of the estate.

The combination of these objectives and factors presents a perplexing estate planning problem to the farm owner-operator. Quite often these objectives and/or factors result in conflicts which must be resolved before a comprehensive estate plan can be developed.

The major concerns of this study were two-fold. The study was concerned with estimating the degree of estate planning being done by farm and rural residents in Virginia. This provided the basis for the study, indicating the various types of estate plans being used and the frequency of use of various plans. With this basis developed, the study was concerned with analyzing the consequences of alternative estate plans, with primary emphasis on the amount of potential capital erosion under each plan.

## Objectives

This study has the purpose of discovering information which will provide a basis (1) for improved estate planning by Virginia farm owner-operators, and (2) for minimizing the financial problems encountered by the heir or heirs who continue to operate the farm business.

The objectives of this study are:

1. To estimate the degree and kind of estate planning practiced by farm owners and rural residents in Virginia.
2. To estimate the potential capital erosion of the existing estate plans of a selected number of owners of large farms.
3. To estimate the potential capital erosion of selected alternative estate plans.

Hypotheses tested under Objective 1 are:

- 1) Farmers are more likely than non-farmers to have a will.
- 2) Retired persons are more likely than non-retired persons to have a will.
- 3) Farmers are less likely than non-farmers to have formal retirement or pension plans.
- 4) Farmers are less likely than non-farmers to have utilized gifts as a means of transferring property.
- 5) Individuals with larger estates are more likely than individuals with small estates to have a will.

### Procedure

Objective 1 was accomplished by developing a simple questionnaire (see Appendix A) for use with Virginia farmers and rural residents to acquire information regarding the kind and degree of estate planning done by them. This questionnaire was presented to persons who were assembled in group meetings with Extension personnel. Two hundred eighty-five anonymous responses were collected from all parts of the State. No scientific sampling was attempted, but results of the tabulation and analysis of the responses will yield general information presently unknown. Hypotheses were tested, using the Chi-square test for independence. The majority of information from this part of the study is descriptive.

Detailed information on individual estate situations and plans was obtained from three living farm owner-operators in Virginia for use in connection with Objectives 2 and 3. This information was obtained with the use of a survey form developed by G. Wayne Burkhart titled, "Our Estate Inventory". Information gathered is included as family information, special documents, estate planning objectives, personal property, trusts, real estate, personal liabilities, retirement or pension plans, and financial information. These data provided enough information to determine the size of the estate, form of distribution employed, the probable Federal estate and state inheritance tax liabilities, and the probable eventual disposition and use of real property.

The "case study" method was used for analysis of the data obtained. In addition to the existing plan alternative estate planning methods were assumed for each case. A hypothetical date of death of the farm owner-operator was assumed. The amount of estimated estate and inheritance taxes and other inter-generation costs was calculated for each alternative plan and compared with these costs under the existing plan. This provided a basis for comparing the value of estate planning in alternative situations.

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## CHAPTER II

### LAWS, TOOLS, AND TECHNIQUES

The primary purpose of this chapter is to summarize the laws that influence estate planning, and the tools and techniques that can be used.

#### Probate Court

Probate is a court procedure that determines the legal needs of an estate and provides for these needs through court supervision. The probate court determines whether a valid will exists, interprets the construction of the will, and determines who has the right to inherit. In addition, the probate court names the personal representative of the estate. While the court has supervisory authority over the estate, the actual performance of duties is directed by the personal representative of the estate. The duties of this person are as follows:

- (1) To inventory and appraise the estate;
- (2) To pay all debts of the estate;
- (3) To pay estate taxes and see that inheritance taxes are paid; and
- (4) To distribute the property according to the will or the laws of descent and distribution, whichever is applicable.

The probate court will clear title to the property in the estate, so that none of the decedent's creditors may exercise a lien against the property after it passes through probate.

Probate or estate settlement costs usually range from three to six percent of the fair market value of the estate. Typically, the percentage approaches the lower end of the range for large estates. Probate or estate settlement includes the following costs:

- (1) Court costs;
- (2) Personal representative's fee (determined by the court);
- (3) Attorney's fee (subject to the approval of the court); and
- (4) Personal representative's bond cost.

Property passes through probate if the decedent at his death is entitled to dispose of it or, if not disposed of, it would pass to his heirs, personal representative, or next of kin. Property such as that held in co-ownership with rights of survivorship, life estates, life insurance proceeds controlled by the decedent which pass to named beneficiaries other than the estate, or other property rights previously conveyed by contract or like instrument, do not pass through probate. The cost of probate may be lessened by holding property in these ways; however, the loss of flexibility in the conveyance of the estate may result in higher estate taxes.



## Intestate

"Intestacy" occurs when an individual dies without having a valid will. When a person dies intestate, the estate remaining after payment of debts, funeral expenses, taxes, and probate costs is distributed according to the law of descent and distribution. In Virginia the law of descent and distribution<sup>1/</sup> provides that the estate pass to the decedent's children or their descendants subject to the dower or curtesy interest of the surviving spouse. If there is no child or descendant of any child, or surviving spouse, the law specifies how the estate is to be divided.

If an individual dies testate or intestate, his estate is subject to the dower or curtesy rights of the surviving spouse.<sup>2/</sup> Virginia law provides that the surviving spouse has a right to receive one-third of the personal property remaining in the estate after debts, funeral expenses, and probate costs are paid,<sup>3/</sup> and a life estate in one-third of the real estate held in the decedent's name. The real property in an estate (except for the dower or curtesy interest) is subject to payment of any debts of the estate which remain after personal property has been expended for such payments.<sup>4/</sup>

The estate tax consequences of dying intestate can be severe. The law of descent and distribution does not provide for full advantage of the estate tax marital deduction. This is especially true for larger estates in which capital erosion is more of a problem.

### Property Ownership

The form of property ownership greatly affects what property is included in the probate estate and the gross estate; furthermore, it can influence the estate planning options available to the owner.

The forms of property ownership recognized in Virginia are tenancy in severalty, tenancy in common, tenancy in co-parcenary, joint tenancy, tenancy by the entirety, and life estate.

Under tenancy in severalty title is held in one person's name with no other individual having rights in the property. If an individual holds property by tenancy in severalty at death, it is included in the gross estate. Property held in this manner can be transferred by deed, gift, or will, thus enabling the owner to take advantage of the gift tax provisions of the law and/or the estate tax marital deduction.

Tenancy in common differs from tenancy in severalty in that the property is held by two or more persons. Each owner has an undivided interest in the whole property and shares do not have to be equal. The property can be divided voluntarily, partitioned, or sold and the proceeds divided under court order. When a tenant in common dies, only his share of the property passes to his heirs and only this portion of the property is included in his gross estate. This form of ownership has basically the same characteristics for estate planning purposes as tenancy in severalty.

Joint tenancy is distinguished from tenancy in common in two ways: (1) the surviving tenant(s) receives the property upon the

death of one tenant; and (2) each tenant has an identical ownership interest. Upon the death of a joint tenant, the value of the entire property is included in the decedent's gross estate unless the surviving joint tenant or tenants can prove that they contributed materially to the purchase of the property. If the surviving joint tenant can prove a material contribution, a portion of the value of the property is excluded from the estate of the deceased joint tenant. This is often referred to as the "consideration furnished" test.<sup>5/</sup>

Tenancy by the entirety is yet another form of co-ownership which is similar to joint tenancy. Characteristics which distinguish tenancy by the entirety from joint tenancy are:

- (1) It can exist only between husband and wife;
- (2) The creditor of one spouse cannot subject any part of the property to that individual spouse's debt no matter what the relative contribution of the spouses to the purchase of the property; and
- (3) It is not severable without the permission of both husband and wife nor may the property be transferred without the permission of both.

If a property is held in tenancy by the entirety, the value of the entire property is included in the gross estate of the first spouse to die, except to the extent that the surviving spouse can prove "consideration furnished".

The 1976 Tax Reform Act provides another means to exclude one-half of the value of property from the gross estate of the first

spouse to die. This provision, referred to as the "fractional interest rule", applies only to tenancy by the entirety or joint tenancy between husband and wife created after December 31, 1976. Furthermore, the following four requirements must be met before the new rule will apply:<sup>6/</sup>

- (1) The joint tenancy or tenancy by the entirety must have been created by one or both of the spouses;
- (2) In the case of personal property, the creation of the joint interest must have been a completed gift for gift tax purposes;
- (3) In the case of real property, the donor must have elected to treat the creation of the joint ownership as a taxable gift at the time and filed a gift tax return; and
- (4) The decedent and the decedent's spouse are joint tenants.

The life estate is an incomplete form of property ownership which involves three individuals - the grantor, the life tenant, and the remainderman. The grantor is the individual who creates the life estate. The life tenant is the individual who holds a life interest in the property which may be based on his or someone else's life. The remainderman is the individual who receives title to the property at the end of the life estate.

The ownership rights of the life tenant include the right to use and to receive income from the property. The life tenant has the

responsibility to maintain the property as it was when the life estate was created. He may not start any new operation on or with the property, although he may continue existing activities. The life tenant may lease out the property, but the duration of the lease can be no longer than the life estate. The life tenant, acting by himself, cannot transfer title to the property.

A granted life estate is subject to gift tax if it is created during the lifetime of the grantor. If a granted life estate is created by will or the laws of descent and distribution, the property is included in the grantor's gross estate. A granted life estate typically is not included in the gross estate of the life tenant. A retained life estate is included in the gross estate of the life tenant who is also the grantor.<sup>8/</sup> The remainder interest is included in the gross estate of the remainderman should he die before the life tenant no matter whether the life estate is granted or retained; furthermore, the remainderman can transfer his interest in the property subject to the life estate.

#### Gift, Estate, and Inheritance Taxation

Gift, estate, and inheritance taxes have three main purposes in our society: (1) to raise revenue, (2) to redistribute wealth, and (3) to direct the course of society.<sup>9/</sup>

Proponents of these taxes justify their existence because: (1) inheritance or gifts are an indication of ability to pay; (2) inheritance or gifts represent unearned or windfall income to recipients; (3) these taxes serve to equalize opportunity; (4) they are relatively

easy to assess and collect, and can reach incomes and assets which may have avoided taxation previously.<sup>10/</sup>

Opponents of gift, estate and inheritance taxes contend that: (1) these taxes are a frontal attack on the nation's capital base; (2) such taxes diminish and discourage savings; (3) these taxes may distort resource allocation through a forced preference for liquidity; and (4) such taxes interfere with the continuity of closely held business enterprises and may contribute to the breakup of efficient productive units.<sup>10/</sup>

The federal estate tax is a tax to which an individual's estate is subject upon death. The federal gift tax is a tax to which all taxable gifts are subject at the time the gift is made. The Tax Reform Act of 1976 overhauls much of the estate and gift tax legislation. The new provisions in part are being phased in over the next five years. Some provisions became effective January 1, 1977, or earlier.

Under the new law, a single unified rate schedule ranging from 18 to 70 percent applies to all taxable transfers by gift or inheritance. The unified rate schedule is attached as Appendix B.<sup>11/</sup> The individual exemptions for estate and gift taxes were eliminated by the 1976 Tax Reform Act, being replaced with a single individual unified credit applicable to both federal estate and gift taxes. The unified credit became effective January 1, 1977, and will be increased each year for the next five years. The credit and the exemption equivalent are represented in Table 2-1.<sup>12/</sup>

Table 2-1. Unified Credit and Exemption Equivalent for Federal Estate and Gift Tax for Years 1977-1981 and Thereafter

Year	Unified Credit	Exemption Equivalent*
1977	\$30,000	\$120,667
1978	\$34,000	\$134,000
1979	\$38,000	\$147,333
1980	\$42,500	\$161,563
1981	\$47,000	\$175,625

\*Based on lower end of the unified rate schedule.

## Federal Gift Taxation

All gifts except those to qualified non-profit, charitable, or government organizations are subject to taxation. A gift is created when a transfer is made for less than adequate and full consideration in money or money's worth.<sup>13/</sup> The fair market value of a gift is used to determine the amount of tax on the gift. The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of the relevant facts.<sup>14/</sup> An annual exclusion of \$3,000 is allowed the donor for each donee to whom he makes gifts.<sup>15/</sup> A husband and wife can make joint gifts even though only one of them owns the property which makes it possible for them to give a donee as much as \$6,000 tax-free annually. The transfer of property in this manner is referred to as "gift splitting". Each married individual is also allowed a lifetime gift tax marital deduction which applies only to gifts between husband and wife.<sup>16/</sup> Under the new law, in addition to the \$3,000 annual exclusion, the first \$100,000 in gifts from one spouse to the other is tax-free. The next \$100,000 in gifts to the spouse in excess of the available annual exclusion is a fully taxable gift. If cumulative gifts from one spouse to the other are in excess of \$200,000, only one-half of the cumulative gifts in excess of \$200,000 are taxable.<sup>17/</sup> If an individual makes gifts of less than \$200,000 to his spouse, over and above the annual exclusion, the estate tax marital deduction will be reduced.



The federal gift tax is based on the cumulative value of taxable gifts made during the individual's lifetime. Each time a gift tax return is filed, the tax is computed on the total of all taxable gifts made to date. The computed tax is reduced by the unified credit and prior gift taxes paid to arrive at the amount of tax to be remitted with the return.<sup>18/</sup> The 1976 Tax Reform Act outlines special provisions concerning taxable gifts and gift taxes paid prior to 1977.

As examples to illustrate these provisions, assume the following two situations:

Situation #1 -- A husband and wife make gifts to a son as summarized in Table 2-2.

Gift tax consequences for each spouse in 1981:

Previous taxable gifts	\$ 0
Taxable gifts current period	+90,000
Cumulative taxable gifts	<u>\$90,000</u>
Gift tax on cumulative taxable gifts	\$21,000
Unified credit	<u>-47,000</u>
Gift tax after unified credit	\$ 0
Credit for previous gift tax paid	<u>- 0</u>
Gift tax due 1981	\$ 0

Table 2-2. Summary of a Hypothetical Gift Program With the Husband and Wife Making Gifts to a Son

Year	Gifts From Husband and Wife to Son	Gift Attributable To Each Spouse	Annual Exclusion	Taxable Gifts	Cumulative Taxable Gifts
1981	\$186,000	\$ 93,000	\$3,000	\$ 90,000	\$ 90,000
1982	\$196,000	\$ 93,000	\$3,000	\$ 95,000	\$185,000
1983	\$206,000	\$103,000	\$3,000	\$100,000	\$285,000

## Gift tax consequences for each spouse in 1982:

Previous taxable gifts	\$ 90,000
Taxable gifts current period	<u>95,000</u>
Cumulative taxable gifts	\$185,000
Gift tax on cumulative taxable gifts	\$50,000
Unified credit	<u>-47,000</u>
Gift tax after unified credit	\$ 3,000
Credit for previous gift tax paid	<u>- 0</u>
Gift tax due 1982	\$ 3,000

## Gift tax consequences for each spouse in 1983:

Previous taxable gifts	\$185,000
Taxable gifts current period	<u>+100,000</u>
Cumulative taxable gifts	\$285,000
Gift tax on cumulative taxable gifts	\$82,700
Unified credit	<u>-47,000</u>
Gift tax after unified credit	\$35,700
Credit for previous taxes paid	<u>- 3,000</u>
Gift tax due 1983	\$32,700

In situation #1, the husband and wife split the gifts made to the son. Each spouse is responsible for one-half of the value of the gifts in each year and they may take the annual exclusion on these gifts.

Situation #2 -- A husband makes gifts to his wife as summarized in Table 2-3.

No taxable gifts are made by the husband in 1981. The \$103,000 gift uses the first \$100,000 gift tax marital deduction and the remaining \$3,000 is excluded by the annual exclusion. In 1982 the annual exclusion reduces the gift by \$3,000; however, no gift tax marital deduction is available on the remaining \$50,000. Of the \$100,000 in gifts in 1983, \$3,000 is excludable by the annual exclusion. One-half of the cumulative gifts to the spouse in excess of \$200,000 qualifies for the gift tax marital deduction which further reduces the \$100,000 gift by \$28,000. Therefore, the taxable gifts in 1983 are \$69,000 and cumulative taxable gifts are \$119,000.

Gifts can be used to reduce the size of an individual's estate, but caution should be exercised under the new law if reduction of the size of the estate is the objective of the gift program. Any gift, or portion thereof which qualifies for the annual exclusion is a direct reduction of the donor's estate by the amount of the gift which is not taxable and by the appreciation on such amount. Any taxable gift made more than three years prior to donor's death will result in lower estate tax at the donor's death since it reduces the size of the donor's tentative tax base by the amount of appreciation that would have occurred had it remained in the donor's estate. Furthermore, the donor's estate is reduced by the amount of tax, if any, paid on such taxable gifts. Taxable gifts made within three years of death do nothing to reduce the size of the donor's estate since they are added

Table 2-3. Summary of a Hypothetical Gift Program With a Husband Making Gifts to His Wife

Year	Gift From Husband to Wife	Annual Exclusion	Gift Tax Marital Deduction	Cumulative Gifts to Spouse	Taxable Gifts	Cumulative Taxable Gifts
1981	\$103,000	\$3,000	\$100,000	\$103,000	\$ 0	\$ 0
1982	\$ 53,000	\$3,000	\$ 0	\$156,000	\$50,000	\$ 50,000
1983	\$100,000	\$3,000	\$ 28,000	\$256,000	\$69,000	\$119,000

back into his estate at their value at the donor's death, and taxes paid on any such gift are also added back into the donor's estate.

#### Federal Estate Taxation

The unified rate schedule is used to compute the amount of tax on an individual's estate. The size of the estate is based on the fair market value of the property at the individual's death or on an alternate date six months after death. Under a provision of the 1976 Tax Reform Act, the property may receive a special valuation in certain circumstances.

The first step in calculating the estate tax is to determine the property to be included in the gross estate. The following types of property are included in the gross estate:

- (1) Property solely owned by the decedent;
- (2) Property jointly owned by the decedent;
- (3) Revocable gifts made by the decedent;
- (4) Gifts in which the decedent has a retained interest;
- (5) Property over which the decedent had a power of appointment;
- (6) Taxable gifts made within three years of death and any gift tax paid on these gifts; and
- (7) Life insurance policies and certain annuity contracts in which the decedent had incidents of ownership.

Funeral expenses and estate settlement costs are subtracted from the gross estate to arrive at the adjusted gross estate.

The estate tax marital deduction must then be determined. In order for property to qualify for the estate tax marital deduction, it

must pass to the surviving spouse, so that the spouse has the right to receive income from the property and the right to convey title to the property. Property in which the surviving spouse receives a terminable interest, such as a life estate and certain trusts, does not qualify for the marital deduction.<sup>19/</sup> The marital deduction can be as much as \$250,000 or up to one-half of the value of the adjusted gross estate, whichever is greater.<sup>20/</sup> If the surviving spouse received gifts from the deceased spouse during his lifetime, such gifts may affect the amount of marital deduction available to his estate. If the gift tax marital deduction was used by the decedent, the estate tax marital deduction is reduced by the amount by which the gift tax marital deduction claimed exceeds one-half of the value of lifetime gifts, in excess of available annual exclusions, to the surviving spouse.<sup>21/</sup>

After the amount of estate tax marital deduction is determined, it is subtracted from the adjusted gross estate, leaving the taxable estate. To the taxable estate is added the adjusted taxable gifts, which is the sum of all taxable gifts made after December 31, 1976, exclusive of taxable gifts made within three years of death, to arrive at the tentative tax base. The tentative tax is computed from the unified rate schedule. The amount of gift taxes paid in previous periods is subtracted from the tentative tax.<sup>22/</sup> This difference is the amount of estate tax, which is further reduced by the unified credit.<sup>23/</sup> The resulting estate tax due may be reduced even further by other credits such as the credit for state inheritance taxes.<sup>24/</sup>

As an example, assume that in 1981 Mr. Q makes taxable gifts of \$100,000 to his children and gifts to Mrs. Q on which he claims a \$50,000 gift tax marital deduction. In 1984 he makes taxable gifts of \$50,000. Mr. Q dies in 1985, having an estate with a fair market value of \$450,000. He has paid no gift tax since the potential tax did not exceed the \$47,000 unified credit.

At his death Mr. Q had debts of \$50,000, funeral costs were \$5,000, and probate costs were \$15,000. He left Mrs. Q their home and other property valued at \$250,000. The following tabulation illustrates the steps followed in calculating estate tax liability for Mr. Q:

Fair market value of estate	\$450,000
Taxable gifts made within 3 years of death	50,000
Gift taxes paid on gifts made within 3 years of death	0
Gross estate	<u>\$500,000</u>
Funeral expenses	5,000
Probate cost	15,000
Debts	<u>50,000</u>
Adjusted gross estate	\$430,000
Marital deduction	<u>225,000</u>
Taxable estate	\$205,000
Adjusted taxable gifts	<u>100,000</u>
Tentative tax base	\$305,000
Estate tax on tentative tax base	\$ 89,500
Credit for gift taxes paid during life	<u>0</u>



Tax before unified credit	\$ 89,500
Unified credit	47,000
Estate tax due	<u>\$ 42,500</u>

His estate tax marital deduction is \$225,000, which is the value of property he left Mrs. Q minus \$25,000. The \$25,000 decrease in the estate tax marital deduction is the amount by which the gift tax marital deduction claimed exceeds one-half of the value of gifts to Mrs. Q (in excess of annual exclusions).

The new law also provides one other exclusion, referred to as the "orphan's exclusion". It is allowed when an individual dies leaving minor children but with no surviving spouse. Furthermore, the minor children must not have any other living parent. The exclusion is available for any child of the decedent, whether natural or by legal adoption, who has not reached 21 years of age. The maximum deduction cannot exceed the value of property passing from the decedent to the child and included in the gross estate. The property does not qualify for this exclusion if the child receives a terminable interest such as a life estate.<sup>25/</sup>

The new estate tax law allows for special valuation of farms and other closely-held businesses.<sup>26/</sup> This special valuation is based on the value of the farm in its present use and not in its highest and best use. If the special valuation is used, the value of the gross estate cannot be reduced by more than \$500,000. In order for an estate to receive special valuation, it must meet the following qualifications:

- (1) The decedent was a citizen or resident of the United States;
- (2) The real and personal property of the farm or closely-held business is at least 50% of the gross estate, less expenses;
- (3) At least 25% of the adjusted gross estate is farm or closely-held business realty;<sup>27/</sup>
- (4) Real property must pass to a qualified heir such as a spouse, children, and/or close relatives;
- (5) The real property was used in the farm or closely-held business at least 5 of the last 8 years before the decedent's death; and
- (6) The decedent or a member of his family materially participated in the farm or closely-held business operation in 5 of the last 8 years before the decedent's death.

Furthermore, the estate tax benefits from special valuation are recaptured if the heir sells or transfers the property to a non-family member or the property is not used for farming or other closely-held business purposes for 15 years after the decedent's death. There is no recapture if the heir dies without converting the property to an unqualified use. The special valuation benefit is fully recaptured if the property does not stay in a qualified use for the first ten years after the decedent's death. However, the recapture is phased out during the next five years. Several methods of valuing property which qualifies for special valuation are provided in the 1976 Tax Reform Act.

The Tax Reform Act of 1976 changes the way in which carry-over basis is determined for inherited property. The law provides four adjustments which are to be made to the decedent's basis in a property to determine the heirs' basis in the property.<sup>28/</sup> These adjustments are:

- (1) The "fresh start" adjustment;
- (2) The adjustment for federal and state estate taxes paid by the estate;
- (3) The adjustment for the \$60,000 minimum basis; and
- (4) The adjustment for state succession tax paid by the heir.

The personal representative of an estate may petition to have as much as \$10,000 of the household and personal effects of the estate exempt from this carry-over of basis.

The "fresh start" adjustment is applicable if an individual dies after 1976 holding property which he acquired before December 31, 1976. The "fresh start" basis will be the property's fair market value as of December 31, 1976, and will be determined by using a straight-line rate of appreciation. Several steps are involved in determining the carry-over basis in such cases. The first step is to determine the difference between the fair market value of the property at death, or special valuation if this election was taken, and the decedent's adjusted basis in the property. From this difference is subtracted the amount of depreciation taken on the property by the decedent. The resulting amount is the appreciation of the property to the date of death. Next the number of days the decedent held the property before

January 1, 1977, and the number of days the decedent held the property before his death are determined. With these two numbers, a fraction is formed by placing the number of days before January 1, 1977, over the number of days before death. This fraction is multiplied by the amount of appreciation incurred while the decedent held the property. This product is added to the actual amount of depreciation taken on the property by the decedent prior to 1977. The resulting dollar value is the sum of the decedent's appreciation and depreciation on the property prior to January 1, 1977. This sum is added to the adjusted basis the decedent had in the property. This procedure cancels out the depreciation and adds on the appreciation which the decedent incurred on the property prior to January 1, 1977.

As an example, assume that Mr. T purchased a depreciable property 20 years before his death and 15 years before January 1, 1977. He paid \$200,000 for the property, and took a constant amount of depreciation of \$5,000 per year. Calculations would be as follows:

1. Fair market value at date of death	\$400,000
2. Adjusted basis at date of death	100,000
3. Excess of fair market value over adjusted basis	<u>\$300,000</u>
4. Depreciation taken to date of death	<u>100,000</u>
5. Appreciation of property up to date of death	\$200,000
6. Number of days decedent held asset before January 1, 1977	5,475
7. Number of days decedent held asset before date of death	7,300

8.	Fraction composed of line 6 over line 7	$\frac{5,475}{7,300} =$	0.75
9.	Appreciation of the property before January 1, 1977		\$150,000
10.	Depreciation attributable to the holding period before January 1, 1977		<u>75,000</u>
11.	Addition to adjusted basis		\$225,000
12.	Carry-over basis		<u>\$325,000</u>

Any improvement of a substantial nature made to the property by the decedent is treated as separate property in this procedure.

The fair market value of marketable securities and bonds on December 31, 1976, is used as their carry-over basis. These securities and bonds will include those listed with various exchanges on which quotations appear daily, those regularly traded in over-the-counter markets for which published quotations are available, securities locally traded for which quotations can be obtained from reliable brokerage firms, and units in a common trust fund.

If the decedent acquired the property after December 31, 1976, the "fresh start" adjustment is not applicable.

The adjustment for federal and state estate taxes paid by the estate is the portion of the federal and state estate taxes attributable to appreciation of the property after 1976. Property which is exempt from federal estate tax to the extent that it qualifies for the charitable or marital deduction does not receive this adjustment, but property receiving the orphan's exclusion does qualify for this adjustment. If a property is subject to a mortgage or indebtedness, the

fair market or special valuation of the property must be reduced by such lien before computing the adjustment for federal and state estate taxes.

The adjustment for the \$60,000 minimum basis is applicable if the aggregate carry-over basis is less than \$60,000 after the "fresh start" and federal and state estate tax adjustments have been made. This adjustment is made to the carry-over basis for each asset after the preceding two adjustments. This increases the carry-over basis by a proportion of the difference between the aggregate carry-over basis and \$60,000.

The adjustment for state succession taxes is applicable if a person who acquires carry-over basis property from a decedent actually pays estate, inheritance, legacy, or succession taxes on such property for which the estate is not liable. This adjustment increases the carry-over basis of the property by the portion of such tax which is attributable to the net appreciation after adjustments have been made for "fresh start", federal and state estate taxes and the \$60,000 minimum. The same rules apply to this adjustment concerning property which is exempt from taxation and property which is subject to mortgages or indebtedness as those applying to the adjustment for federal and state estate taxes. In addition, if state laws contain provisions exempting certain bequests to orphans from state succession taxes, the carry-over basis of property which qualifies for such exemption does not receive the adjustment for state succession taxes.

### Virginia Gift and Inheritance Taxation

Gifts may be subject to a gift tax imposed by the State of Virginia. The bases for determining the amount of gift tax are the relationship of the donee to the donor and the fair market value of the gift.<sup>29/</sup> The rate schedules used to determine the amount of Virginia gift tax due are included in Appendix B.

The donor is responsible for paying gift taxes; however, the responsibility for paying such taxes may fall on the donee if the donor does not pay the gift tax.<sup>30/</sup> The Virginia gift tax is based on the taxable gifts by the donor to a donee during one calendar year.<sup>31/</sup>

Virginia also has a state inheritance tax. This tax is similar to the Virginia gift tax. The inheritance tax is based on the relationship of the heir to the decedent and the fair market value of the inheritance.<sup>32/</sup> The rate schedules used to determine the amount of inheritance tax due are the same as those used to determine gift tax. The inheritance tax is imposed on the heir receiving the property and not on the estate.<sup>33/</sup> This tax is imposed on any property that the heir receives through inheritance by any of the following means:

- (1) Will;
- (2) Law of descent and distribution;
- (3) Grant or gift made or intended to take effect at the death of the donor;
- (4) Gift made in contemplation of death;
- (5) By a transfer under which the transferrer has retained a life estate in the property; or

- (6) By virtue of the fact that the property was held by the decedent and another party as joint tenants or as tenants by the entirety.

One-half of the value of the residence is excludable from inheritance taxation if the residence was held by the decedent and the surviving spouse as joint tenants or tenants by the entirety.<sup>32/</sup>

### The Will

A will is a legal declaration of the manner in which a person wishes to distribute his estate after death. It takes effect upon the death of the individual making the will. A properly drawn, signed, and witnessed will can be used to achieve many of the objectives which are at the very heart of the estate plan. The following can be accomplished with a will:

- (1) Distribute property;
- (2) Nominate a guardian for minor children;
- (3) Nominate an executor and waive bond requirements; and
- (4) Create and fund trust arrangements.

There must be some redeeming economic or social merit to the disposition of the estate. The testator cannot direct that property be destroyed or wasted. The testator cannot disinherit his spouse since his estate is subject to the dower or curtesy rights of the surviving spouse.



### The Trust

The trust can be a useful arrangement to meet one or more specified objectives of an estate plan. Trusts can have the following uses in estate planning:

- (1) Relieve beneficiaries of management responsibilities of trust property;
- (2) Provide income to the surviving spouse and/or minor children;
- (3) Residual or non-marital deduction trust can keep trust property out of the surviving spouse's estate yet allow the spouse to receive income from it; and
- (4) The marital deduction trust can qualify for the estate tax marital deduction, thus reducing the size of the taxable estate.

The trust is a legal arrangement whereby management, control, and legal title to property are placed in the hands of a trustee for the benefit of specified beneficiaries. The trust instrument specifies the powers of the trustee and the rules for operation of the trust. The applicable state laws and the trust instrument form the basic guidelines for the trust. The trust usually names individuals who are to receive income from the trust property and individuals who are to receive the principal of the trust when it terminates. A high degree of fiduciary duty is placed on the trustee, for which he is entitled to receive compensation. This fiduciary duty limits the trustee's freedom to act on his own judgment in managing the trust and should afford

protection for the beneficiaries. However, the powers of the trustee may be increased within certain limits by the trust instrument.

The inter-vivos or living trust is created during the lifetime of the grantor. If the grantor retains the power to revoke, amend, or modify the trust, or receive income from it, it is a revocable living trust. Since such powers are retained by the grantor, the trust property will be included in his gross estate.<sup>35/</sup> An irrevocable living trust is created if the grantor relinquishes all control or power over the trust. The transfer of property into an irrevocable trust represents a completed gift which is subject to gift taxation.<sup>36/</sup> If the grantor has given up all control over and does not retain the right to income from the trust property, the value of such property is not included in his gross estate; however, if the trust was funded within three years prior to the grantor's death and after 1976, that portion of the trust property representing taxable gifts plus gift taxes paid on it are included in the grantor's gross estate. Furthermore, the taxable gifts created by funding a trust after 1976 and more than three years prior to death are included in the grantor's tentative tax base, but the estate receives a credit for gift taxes paid in previous periods.

The testamentary trust is created by will. The property transferred into a testamentary trust is included in the gross estate of the grantor.

#### The Land Trust

The land trust is a hybrid trust that may be especially valuable in estate planning. The land trust first came into existence in

Illinois. It became legal in Virginia in 1962, and the law was amended in 1975 by adding a paragraph which specifies that the beneficiaries' interest shall be deemed as personal property. A land trust is a device that conveys the title to real estate to a trustee by a deed which provides that the land is held by the trustee under the terms of an identified but unrecorded trust agreement.<sup>37/</sup> The beneficiaries retain the right to exercise normal ownership under the trust agreement. The trustee has the authority to sell, mortgage, or otherwise deal with the title only upon the written direction of the beneficiaries or their representatives. The terms of the trust agreement are not set forth in the deed.

The creation of a land trust requires two basic instruments: (1) the deed conveying the real estate to the trustee, and (2) the trust agreement.

The land trust facilitates the disposition of fractional interest so that the owner may transfer interest in the real estate to his heirs by sale or by gift. The beneficial interest is transferred by the use of a transferable certificate. Since the beneficial interest is personal property, it can be assigned as collateral to secure loans and may be sold or assigned without publicity, documentary stamps, or recording cost. A judgment against a beneficiary is not a lien against the real estate in the trust and is not a cloud on the title. The land trust is not terminated by the death of a beneficiary, nor is the title to trust property affected by such an event.

The individual who creates the land trust normally has the right to revoke it. If some of his interest in the land trust has been transferred to others, all holders of the beneficial interest must consent before the trustee will convey the title. If all beneficiaries of the land trust agree to the revocation or if the trust is revoked under some procedure that has been placed in the trust agreement, the original owner and the new beneficiaries become tenants in common, according to their interests in the land trust.

Unless other provisions have been made, all beneficiaries share in the management of real estate held in a land trust. A management agreement should be used to avoid management problems in situations of multiple beneficiaries. The operation of the property and the performance of such functions as collection of rents, contracting for necessary materials, paying expenses, and performing other ministerial activities could be assigned to a specific party by the terms of the agreement. It could also specify that policy decisions be made by majority rule.

#### Life Insurance

Life insurance can be a means of facilitating fulfillment of certain estate planning objectives. These objectives include the following:

- (1) Provide liquidity in the estate to pay funeral expenses, estate settlement cost, estate taxes, and inheritance taxes;

- (2) Provide security for the surviving spouse and/or minor children; and
- (3) Provide an equitable inheritance for heirs who are not involved in the operation and/or management of the farm or closely-held business.

Life insurance proceeds are included in the decedent's gross estate if he had "incidents of ownership" in the policy, such as the right to borrow against the policy, change the designated beneficiaries, or exercise control over the policy.<sup>38/</sup> Life insurance policies on the decedent's life owned by the spouse, children, or other heirs in which the decedent had no incidents of ownership are not included in his gross estate. An individual may transfer the ownership of a life insurance policy to another but such transfer may be subject to gift taxation based on the cash value of the policy. If an individual dies owning a life insurance policy on another, the cash value of the policy will be included in the decedent's gross estate.

#### Business Organization and Leasing Arrangements

Various forms of business organization and/or leasing arrangements may be useful in estate planning. While the form of business organization or lease arrangement is not necessarily an integral part of the estate plan, it may be a means of facilitating the fulfillment of certain estate planning objectives. Partnership, corporate, or lease arrangements may allow a younger member of the family to gain valuable management and operational experience in the farm or closely

held business. Interest in partnerships can be transferred but there are unique problems concerning the value of such transfers. The corporate arrangement can facilitate this transfer since corporation stock can be conveyed rather easily. Through the use of corporation, partnership, or lease arrangements, retirement income can be provided for the surviving spouse or the parents who do not wish to be actively involved in the management and operation of the family business.

#### The Estate Planning Technique

Estate planning should be approached in a systematic manner to insure that all feasible alternatives have been considered. This results in the best plan for the particular individual's situation under existing laws.

The first step in any planning process is to determine the objectives to be accomplished by the plan. The objectives need to be clearly defined, and ranked in priority order. The objectives should be compared to determine their influence on each other in order of priority. The comparisons will result in one of three possible states: they may complement, conflict, or have no influence on each other.

In order to facilitate the comparison of objectives, the following matrix was developed for use in comparing some of the more common objectives. A list of common objectives precedes the matrix. These are coded alphabetically and correspond to the codes along the margins of the matrix below. Complementary objectives are indicated by a plus, and conflicting objectives are indicated by a minus sign.

If an 0 appears in the comparison block, the objectives have no influence on each other.

Common estate planning objectives:

- A -- Provide maximum security for surviving spouse
- B -- Relieve surviving spouse of management responsibilities
- C -- Minimize estate and inheritance taxes on estate of first deceased spouse
- D -- Minimize estate and inheritance taxes on estates of both spouses
- E -- Make gifts to heirs and others during lifetime
- F -- Take full advantage of the marital deduction

Matrix of Estate Planning Objectives:

Major	Minor					
	A	B	C	D	E	F
A	/	+	+	-	-	+
B	+	/	0	0	0	0
C	+	0	/	-	+	+
D	-	0	-	/	+	+
E	-	0	+	+	/	0
F	+	0	+	+	0	/

The estate should be inventoried to determine the size of the estate, kind of assets which are included, and the forms of ownership. After the inventory has been completed and the estate planning objectives established, alternative estate plans should be developed. One

of the alternative plans considered should be the existing plan. Each of the alternative plans is taylored to meet the needs of the individual involved. This is accomplished with the use of the various estate planning tools. After the alternatives have been developed, the best alternative plan is selected. The primary concern in determining the best plan for the individual is to choose that plan which best meets his objectives. The secondary concern is to select that plan which potentially results in the least capital erosion.

The plan should be put into writing after the best alternative is chosen. It should be reviewed often to make sure that it continues to meet the estate planning objectives of the individual involved. Changes in estate planning objectives, the family situation, laws affecting estate planning and the estate are situations which call for immediate review of the estate plan.



## FOOTNOTES

1. Va. Code § 64.1-1.
2. Va. Code § 64.1-19.
3. Va. Code § 64.1-11.
4. Va. Code § 64.1-181.
5. Int. Rev. Code § 2040(a).
6. Int. Rev. Code § 2040(b).
7. Int. Rev. Code § 2511(a).
8. Int. Rev. Code § 2036(a).
9. Woods, W. Fred, "Death and Taxes Policy Issues Affecting Farm Property Transfers", North Central Regional Extension Publication 40, University of Illinois at Urbana-Champaign, Cooperative Extension Service, September 1975.
10. Woods, W. Fred, "Impact of Estate and Inheritance Taxes on U.S. Farms", Agricultural Finance Review, Vol. 34, July 1973.
11. Int. Rev. Code § 2001(c).
12. Int. Rev. Code § 2010(a) et seq. and 2505(a) et seq.
13. Int. Rev. Code § 2512(b).
14. Int. Rev. Reg. § 20.2031-1(b).
15. Int. Rev. Code § 2503(b).
16. Int. Rev. Code § 2513(a) et seq.
17. Int. Rev. Code § 2523(a).
18. Int. Rev. Code § 2502(a).
19. Int. Rev. Code § 2056(b)(1).
20. Int. Rev. Code § 2056(c)(1)(A).
21. Int. Rev. Code § 2053(c)(1)(B).
22. Int. Rev. Code § 2001(a) et seq.

23. Int. Rev. Code § 2011(a).
24. Int. Rev. Code § 2011(a).
25. Int. Rev. Code § 2057(a) et seq.
26. Int. Rev. Code § 2032(a) et seq.
27. The fair market value is used in the determination of the 25% of the adjusted gross estate and the 50% of the gross estate less expenses.
28. Int. Rev. Code § 1023(a) et seq.
29. Va. Code § 58-219.
30. Va. Code § 58-223 and 58-229.
31. Va. Code § 58-218.
32. Va. Code § 58-153.
33. Va. Code § 58-161.
34. Va. Code § 58-152.
35. Int. Rev. Code § 2038(a) et seq.
36. Int. Rev. Code § 2511(a).
37. Va. Code § 55-17.1.
38. Int. Rev. Code § 2042(1) et seq.

## CHAPTER III

### THE EXISTING SITUATION

The objectives of this chapter are to report and analyze the results of a survey of 285 rural residents in Virginia in early 1976. The survey questionnaire, "What is Your Estate Situation?", was designed to determine the degree and kind of estate planning being done by individuals completing the questionnaire. The survey was administered by Farm Management Extension Agents who distributed the questionnaire to individuals attending meetings on estate planning in various areas of Virginia. The results of the 285 questionnaires returned from the survey are summarized in Table 3-1.

The percentage of retired individuals in this survey is larger than the 23 percent retired persons in the population as reported by the Virginia Department of Taxation.<sup>1/</sup> Because of this, the 84 retired individuals were separated from the entire survey to determine their influence on it. The large proportion of retired individuals in the survey appears to have had some effect on the overall results. A higher percentage of these individuals had made wills, had retirement or pension plans, and had made gifts. This fact is not surprising since these individuals are probably older and have given more thought to estate planning.

Table 3-1. Proportion of Survey Respondents Who Had Taken Specific Actions Indicating Estate Planning Activity, by Sub-Groups, Virginia, 1976

Action Take	Entire Group	Retired Persons	Farmers	Non-Farmers
	Percent Giving "Yes" Response			
Have made will	58	75	57	58
Spouse made will	40	50	38	41
Will made or changed within last five years	28	39	31	26
Have retirement or pension plan	55	73	40	62
Used life estate in estate plan	14	15	11	17
Used trust in estate plan	8	5	6	9
Have made gift or gifts	19	27	15	17
Gifts made in more than one year	11	20	12	11
Have life insurance plans	66	67	59	69
Farm is incorporated	2	--	--	--
Have farm partnership	6	--	--	--
Partners insure each other	4	--	--	--
Already retired	29	100	11	39
Total respondents (number)	285	84	95	190

The average acreage of total land held by, and the average value of the overall estate of, retired individuals is lower than for the entire group (Table 3-2). This also indicates that results of the entire survey may be unduly influenced by retired individuals.

There were 95 farmers and 190 non-farmers surveyed. Each of these occupational groups was studied separately to determine whether the characteristics and factors concerning their estate plans were different (Table 3-1). In general, little difference was noted in the estate plans of farmers and non-farmers. The non-farmers usually had slightly higher percentages who had taken specific steps in planning. However, this may be the result of the higher percentage of retired individuals among the non-farmers. A much larger percentage of the non-farmers than of the farmers had pension or retirement plans. This may also have been the result of a higher percentage of the non-farmers being retired than the farmers. Furthermore, farmers are usually self-employed, and not until recently have self-employed individuals been able to establish retirement plans with equivalent tax benefits. A higher percentage of the non-farmers indicated that they have estate plans involving the use of life estates or trusts. The major difference between farmers and non-farmers was in the average value of the overall estate, primarily due to the larger land holdings and greater value of personal property of the farmers (Table 3-2).

The average number of acres held by farmers was higher than the average number of acres held by the entire group, retired persons, or

Table 3-2. Value of Estate Components Reported by Estate Planning Survey Respondents, by Sub-Groups, Virginia, 1976

Estate Components	Entire Group	Retired Persons	Farmers	Non-Farmers
	Average Value in Dollars			
Land holdings	176,628	94,060	248,548	53,938
Personal property	89,181	78,461	120,850	71,748
Non-farm real estate	64,310	72,464	78,259	61,816
Total estate	212,197	153,301	346,798	118,791
Land value per acre	1,011	-	-	-
Total respondents (number)	285	84	95	190

Note: Average values are for those persons reporting each specific item.

Table 3-3. Acreage Held by Types of Tenure by Estate Planning Survey Respondents, by Sub-Groups, Virginia, 1976

Type of Tenure Under Which Land is Held	Entire Group	Retired Persons	Farmers	Non-Farmers
	(Number of Individual Reporting Type of Tenure in Parentheses)			
Tenancy in severalty	186.7(72)	62.7(24)	315.2(40)	26.1(32)
Spouse holds in severalty	169.1(20)	244.4(5)	246.6(13)	25.0(7)
Tenancy in common	283.9(15)	126.5(2)	422.3(6)	191.6(9)
Joint tenancy or tenancy by the entirety	190.9(120)	73.8(31)	296.9(56)	98.0(64)
Type not known	91.3(16)	14.0(2)	161.5(8)	21.0(8)
Total land holdings	217.4	91.3	298.5	79.8

Note: Average values are for those persons reporting with specific item.

non-farmers (Table 3-3). The most popular form of ownership was tenancy by the entirety or joint tenancy, and the average number of acres held under this form of ownership was second only to tenancy in common. The average number of acres held under tenancy in severalty was lower than the average for tenancy by the entirety or joint tenancy. Tenancy in severalty was the second most popular form of ownership.

There are five general types of estate plans that can result in varying degrees of capital erosion. These plans are as follows: (1) no formal estate plan; (2) will only; (3) will and gifts; (4) will and life estate or trust; or (5) will, gifts, and life estate or trust. It is not known whether the individuals surveyed had set up plans that would take full advantage of various features which lessen capital erosion; however, Table 3-4 indicates the percentages of the entire group, the non-farmers, and the farmers surveyed who had plans with the various features.

#### Testing the Hypotheses

The survey data were also analyzed to determine whether certain attributes of those surveyed were interdependent. The analysis was accomplished by using two-way classification tables, frequently called "contingency tables". The null hypothesis of this statistical method is that the sets of attributes are independent in the sense that the distribution of one set of attributes does not depend on the distribution of the other set of attributes. If one set of attributes



Table 3-4. Proportion of Survey Respondents With Various Estate Plans, by Sub-Groups, Virginia, 1976

Type of Plan	Entire Group	Non-Farmers	Farmers
Percentage With Plan			
No formal plan	37	36	39
Will only	33	31	37
Wills and gifts	9	9	9
Will and life estate or trust	11	12	8
Will, gifts, and life estate or trust	5	7	2
Other	5	5	4

is interdependent with the other set of attributes, the null hypothesis that the two sets of attributes are independent is rejected.

The statistic used to compare the distributions is a chi-square ( $X^2$ ) statistic which is obtained in the following manner. The first step is to prepare a table showing the number of individuals who fall into each category or set of attributes. These are the observed values which should be summed to determine row and column totals in the table. The row and column totals represent the observed number of individuals having a particular attribute. The second step is to determine the expected values for each cell, by multiplying a cell's row total by its column total and dividing this product by the number of individuals in the entire survey. The third step is to calculate the chi-square value of the table, which is the sum of the differences between the observed minus the expected values for each cell squared, divided by the cell's expected value. This computational formula is:

$$X^2 = \sum_{i=1}^c \sum_{j=1}^r \frac{(O_{ij} - E_{ij})^2}{E_{ij}}$$

where

$O_{ij}$  = observed value

$E_{ij}$  = expected value

$c$  = number of different column attributes

$r$  = number of different row attributes.

The computed chi-square is compared with the theoretical chi-square with  $(c-1)(r-1)$  degrees of freedom and a chosen probability level of

95%. If the computed chi-square is larger than the theoretical chi-square, the null hypothesis of independence is rejected at the 5% level of significance.

The first hypothesis tested, using contingency tables and the chi-square statistic, is that farmers were more likely to have a will than were non-farmers. The procedure is illustrated in Table 3-5.

Since the computed chi-square is smaller than the rejection value, the null hypothesis of independence is not rejected at the 5% level of significance. Therefore, according to the survey, farmers were neither more nor less likely than non-farmers to have a will.

The second hypothesis tested is that retired individuals were more likely than non-retired individuals to have a will. The results are shown in Table 3-6. Since the computed chi-square is greater than the theoretical chi-square, the null hypothesis of independence is rejected at the 5% level of significance. The result indicates that retired individuals were more likely than non-retired individuals to have a will.

The third hypothesis tested is that non-farmers were more likely than farmers to have a formal retirement or pension plan (see Table 3-7).

The computed  $X^2$  is 12.49 and the null hypothesis of independence is rejected at the 5% level of significance which indicates that non-farmers were more likely than farmers to have a formal retirement plan or pension plan.

Table 3-5. Number of Farmers Versus Non-Farmers in Survey Who Had Wills, Virginia, 1976

	Farmers	Non-Farmers	Row Totals
Have will:			
Observed	54	110	164
Expected	54.67	109.33	164
Chi-square	0.01	0.004	0.014
No will:			
Observed	41	80	121
Expected	40.33	80.67	121
Chi-square	0.01	0.01	0.02
Column totals:			
Observed	95	190	285
Expected	95	190	285
Chi-square	0.02	0.014	0.034

Degrees of freedom = 1

Table chi-square = 0.03

Theoretical chi-square = 3.82

Table 3-6. Number of Retired Versus Non-Retired Persons in Survey  
Who Had Wills, Virginia, 1976

	Retired	Non-Retired	Row Totals
<b>Have will:</b>			
Observed	63	101	164
Expected	48.34	115.66	164
Chi-square	4.45	1.86	6.31
<b>No will:</b>			
Observed	21	100	121
Expected	35.66	85.34	121
Chi-square	6.03	2.52	8.55
<b>Column totals:</b>			
Observed	84	201	285
Expected	84	201	285
Chi-square	10.48	4.38	14.86

Degrees of freedom = 1

Table chi-square = 14.86

Theoretical chi-square = 3.82

Table 3-7. Number of Farmers Versus Non-Farmers in Survey Who Had Formal Retirement or Pension Plans, Virginia, 1976

	Farmer	Non-Farmers	Row Totals
Have formal retirement or pension plan:			
Observed	38	118	156
Expected	52.00	104.00	156
Chi-square	3.77	1.88	5.65
No formal retirement or pension plan:			
Observed	57	72	129
Expected	43.00	86.00	129
Chi-square	4.56	2.28	6.84
Column totals:			
Observed	95	190	285
Expected	95	190	285
Chi-square	8.33	4.16	12.49

Degrees of freedom = 1

Table chi-square = 12.49

Theoretical chi-square = 3.82

The fourth hypothesis tested is that non-farmers were more likely than farmers to have utilized gifts as a means of transferring property. Based on the test in Table 3-8, the null hypothesis of independence is not rejected at the 5% level of significance. This suggests that farmers were neither more nor less likely than non-farmers to have utilized gifts as a mean of transferring property.

The fifth hypothesis tested is that individuals with larger estates were more likely than individuals with small estates to have a will. The greater magnitude of the computed chi-square results in the rejection of the null hypothesis of independence at the 5% level of significance (Table 3-9). Therefore, the individuals with larger estates were more likely than individuals with small estates to have wills.

Since 76% of the individuals with estates larger than \$125,000 had wills, further investigation of this hypothesis was desirable. Table 3-10 is a contingency table and chi-square test of this hypothesis, which considers only those individuals with estates that are larger than \$125,000. The relationship between the computed chi-square and the theoretical chi-square causes the null hypothesis of independence not to be rejected at the 5% level of significance. This data suggests that when only individuals with estates larger than \$125,000 were considered, the individuals with larger estates were neither more nor less likely than individuals with smaller estates to have a will.

Table 3-8. Number of Farmers Versus Non-Farmers in Survey Who Had Made Gifts, Virginia, 1976

	Farmers	Non-Farmers	Row Totals
Made gifts:			
Observed	16	37	53
Expected	17.67	35.33	53
Chi-square	0.16	0.08	0.24
No gifts:			
Observed	79	153	232
Expected	77.33	154.67	232
Chi-square	0.04	0.02	0.06
Column totals:			
Observed	95	190	285
Expected	95	190	285
Chi-square	0.20	0.10	0.30

Degrees of freedom = 1

Table chi-square = 0.30

Theoretical chi-square = 3.82



Table 3-9. Number of Persons in Survey Who Had Wills, by Size of Estate, Virginia, 1976

Estate Size	Have Will	No Will	Row Totals
\$0-125,000:			
Observed	39	56	95
Expected	55.59	39.41	95
Chi-square	4.95	6.98	11.93
\$125,000-250,000:			
Observed	37	10	47
Expected	27.50	19.50	47
Chi-square	3.28	4.63	7.91
\$250,000-500,000:			
Observed	22	8	30
Expected	17.55	12.45	30
Chi-square	1.13	1.59	2.72
Greater than \$500,000:			
Observed	12	4	16
Expected	9.36	6.64	16
Chi-square	0.74	1.05	1.79
Column totals:			
Observed	110	78	188
Expected	110	78	188
Chi-square	10.10	14.25	24.35

Degrees of freedom = 3

Table chi-square = 24.35

Theoretical chi-square = 7.81

Table 3-10. Number of Persons in Survey With Estates of \$125,000 or More Who Had Wills, by Size of Estate, Virginia, 1976

Estate Size	Have Will	No Will	Row Totals
<b>\$125,000-250,000:</b>			
Observed	37	10	47
Expected	35.88	11.12	47
Chi-square	0.03	0.11	0.14
<b>\$250,000-500,000:</b>			
Observed	22	8	30
Expected	22.90	7.10	30
Chi-square	0.04	0.11	0.15
<b>Greater than \$500,000:</b>			
Observed	12	4	16
Expected	12.22	3.78	16
Chi-square	0.004	0.01	0.14
<b>Column totals:</b>			
Observed	71	22	93
Expected	71	22	93
Chi-square	0.074	0.23	0.30

Degrees of freedom = 2

Table chi-square = 0.30

Theoretical chi-square = 5.99

The sixth hypothesis tested is that farmers were more likely than non-farmers to have a large estate. The result of the test, as shown in Table 3-11, dictates rejection of the null hypothesis of independence at the 5% level of significance, indicating that farmers were more likely than non-farmers to have a large estate.

The seventh hypothesis is that non-farmers with large estates were more likely than farmers with large estates to have a will. The hypothesis was tested as shown in Table 3-12. Results of this test, yielding a larger computed chi-square than theoretical chi-square, leads one to reject the null hypothesis of independence at the 5% level of significance. Therefore, according to the survey, non-farmers with large estates were more likely than farmers with large estates to have a will.

The eighth and last hypothesis tested is that farmers with small estates were less likely than non-farmers with small estates to have a will. Since the table chi-square is smaller than the theoretical chi-square in Table 3-13, the results of the test fail to reject the null hypothesis of independence at the 5% level of significance. This suggests that farmers with small estates were neither more nor less likely than non-farmers with small estates to have a will.

#### Summary

In the 1976 survey it was noted that a significantly higher percentage of the non-farmers than of the farmers had retirement plans.

Table 3-11. Comparison of Number of Farmers and Non-Farmers in Survey, by Size of Estate, Virginia, 1976

Estate Size	Farmers	Non-Farmers	Row Totals
<b>\$0-125,000:</b>			
Observed	21	74	95
Expected	38.91	56.09	95
Chi-square	8.24	5.72	13.96
<b>\$125,000-250,000:</b>			
Observed	21	26	47
Expected	19.25	27.75	47
Chi-square	0.16	0.11	0.27
<b>Greater than \$250,000:</b>			
Observed	35	11	46
Expected	18.84	27.16	46
Chi-square	13.86	9.62	23.48
<b>Column totals:</b>			
Observed	77	111	188
Expected	77	111	188
Chi-square	22.26	15.45	37.71

Degrees of freedom = 2

Table chi-square = 37.71

Theoretical chi-square = 5.99

Table 3-12. Number of Farmers and Non-Farmers in Survey With Larger Estates Who Did and Did Not Have Wills, Virginia, 1976

Farmer or Non-Farmer	Have Will	Do Not Have Will	Row Totals
Farmers with estate greater than \$125,000:			
Observed	39	18	57
Expected	43.52	13.48	57
Chi-square	0.47	1.52	1.99
Non-farmers with estate greater than \$125,000:			
Observed	32	4	36
Expected	27.48	8.52	36
Chi-square	0.74	2.40	3.14
Column totals:			
Observed	71	22	93
Expected	71	22	93
Chi-square	1.21	3.92	5.13

Degree of freedom = 1

Table chi-square = 5.13

Theoretical chi-square = 3.82

Table 3-13. Number of Farmers and Non-Farmers in Survey With Small Estates Who Did and Did Not Have Wills, Virginia, 1976

Farmer or Non-Farmer	Have Will	Do Not Have Will	Row Totals
Farmers with small estate:			
Expected	6	14	20
Observed	8	12	20
Chi-square	0.50	0.33	0.83
Non-farmers with small estates:			
Expected	32	43	75
Observed	30	45	75
Chi-square	0.13	0.09	0.22
Column totals:			
Expected	38	57	95
Observed	38	57	95
Chi-square	0.63	0.42	1.05

Degrees of freedom = 1

Table chi-square = 1.06

Theoretical chi-square = 3.82

This seemed logical since until recently farmers have not had the opportunities to develop retirement plans that other occupational groups have had.

A significantly higher percentage of the retired persons than of the non-retired individuals surveyed had made wills. This seemed reasonable since they were probably older individuals who had given more thought to estate planning. Approximately the same percentage of the farmers surveyed as of the non-farmers had made a will. Therefore, the bare fact that an individual is a farmer or non-farmer does not appear to influence whether or not he has made a will. A significantly larger percentage of the persons with estates greater than \$125,000 had made a will than of those with estates smaller than \$125,000. However, as estate size increased beyond \$250,000, individuals were no more likely to have a will than were individuals with estates of \$125,000 to \$250,000. The farmers surveyed tended to have significantly larger estates than did the non-farmers. These results did not seem to agree with each other, since farmers were no more likely than non-farmers to have made a will, but were more likely than non-farmers to have larger estates, and individuals with estates larger than \$125,000 were more likely than individuals with estates smaller than \$125,000 to have a will. Further investigation indicated that of the individuals with estates smaller than \$125,000, farmers were no more likely than non-farmers to have a will. However, of the individuals with estates larger than \$125,000, farmers were less likely than non-farmers to have a

will. It would seem that farmers with large estates would benefit as much from having a will as would non-farmers with large estates.

The next chapter involves an analysis of alternative estate plans and the resulting capital erosion for large farm estates. That analysis will give some indication of economic benefits farmers with large estates can receive from various estate plans.



FOOTNOTES

1. Telephone interview with the Virginia Department of Taxation, Richmond, Virginia, February 1977.

## CHAPTER IV

### CASE STUDIES OF ALTERNATIVE ESTATE PLANS

The purpose of this chapter is to analyze alternative estate plans for their relative effect upon the amounts of potential capital erosion from the estate. This was accomplished by developing alternative plans for each of three actual estates selected as case studies. The information for the case studies was obtained by conducting in-depth interviews with three Virginia farmers. A survey form, "Our Estate Inventory",<sup>1/</sup> was used to gather and record the information. For each of the case studies, a complete inventory of estate assets and liabilities was obtained. Information was obtained concerning the existing factors which influence the estate and the present estate plan.

Given this information, alternative estate plans were developed and the potential capital erosion was estimated for each case. The alternative plans were as follows:

- (a) The farmer's and his wife's existing estate plan;
- (b) Alternative Estate Plan I:
  - The farmer's estate plan,
    - (1) No will, dies intestate.
  - The wife's estate plan,
    - (1) No will, dies intestate.

(c) Alternative Estate Plan II:

The farmer's estate plan--

A will which leaves all his property to his wife.

The wife's estate plan--

A will which leaves all her property to the children to be divided equally.

(d) Alternative Estate Plan III:

The farmer's estate plan--

- (1) Makes gift to his wife of \$103,000 in 1977 and \$3,000 per year every year thereafter until his death.
- (2) Join with wife in making gifts to each child of \$6,000 per year starting in 1977 and every year thereafter until his death.
- (3) A will which leaves all his property to his wife.

The wife's estate--

- (1) Join with husband in annual gifts to the children during the husband's lifetime.
- (2) Continue annual gifts of \$3,000 to each child after the husband's death.
- (3) A will which leaves all her property to the children to be divided equally.

e. Alternative Estate Plan IV:

The farmer's estate plan--

- (1) A will which divides his estate into two parts, A and B; Part A is left to the wife as tenant in severalty; Part B is left to the children to be divided equally subject to a right of the wife to receive income from this part of his estate for her life.

The wife's estate plan--

- (1) A will which leaves all her property to the children to be divided equally.

(f) Alternative Estate Plan V:

The farmer's estate plan--

- (1) Makes gift to his wife of \$103,000 in 1977 and \$3,000 per year every year thereafter until his death.
- (2) Joint with wife in making gifts to each child of \$6,000 per year starting in 1977 and every year thereafter until his death.
- (3) A will which divides his estate into two parts, A and B; Part A is left to his wife as tenant in severalty; Part B is left to the children to be divided equally subject to a life interest of the wife to receive income from this part.

The wife's estate plan--

- (1) Join with husband in annual gifts to the children during the husband's lifetime.

- (2) Continue annual gifts of \$3,000 to each child after the husband's death.
- (3) A will which leaves all her property to the children to be divided equally.

The two parts of the husband's estate in Alternative Plans IV and V are apportioned based on fair market valuation so that the estimated present value of the marginal tax resulting from increasing or decreasing Part A by one dollar is approximately equal to the estimated present value of marginal tax resulting from increasing or decreasing Part B by one dollar. (For details of solution, see Appendix D.)

Under each of these estate plans the valuation of the property for tax purposes was by both fair market and special valuation. Fair market values were determined with the aid of the local Farm Management Extension Agent and the property owners. The 1976 Tax Reform Act outlines a procedure for determining special valuation of qualified property, as follows:

- (1) Determine for the five most recent calendar years ending before the date of the decedents' death the average annual local cash rent for comparable land used for farming purposes.
- (2) Determine for the same five years the average annual local real estate taxes for comparable land.
- (3) Subtract (2) from (1).

- (4) Determine for the same five years the average annual effective interest rate for all new Federal Land Bank loans.
- (5) Divide (3) by (4).

This formula was used whenever possible in this study. The 1976 Tax Reform Act also specifies several other means of determining special valuation when the preceding method is not applicable. One of these is the use-value assessment for local property taxation. This method was used in this study when the preceding formula was not applicable. Both fair market and special valuation were determined for 1976 and projected to the dates of death. These projections are based on a six percent rate of increase in value per year.

Each plan was developed to estimate the potential capital erosion at each spouse's death, the total potential capital erosion from both estates, and the 1976 present value of the potential capital erosion from both estates, using a discount rate of six percent.

The potential capital erosion was the sum of administrative expenses, estate tax inheritance tax and transfers to off-farm heirs. Each of these elements could vary from one plan to the next. Funeral expenses were not included in the capital erosion since they were small compared to the other elements and were not considered as variable under different plans.

It was assumed that the farmers in the study died in 1985 and their spouses in 1995. This assumption allowed sufficient time for the phase-in of the new laws of the 1976 Tax Reform Act. Furthermore, it allows sufficient time to develop gift programs so that their value

in estate planning could be established. The 10-year spread between the husband's death and the wife's death was assumed, so that no estate tax credit would be allowed the wife's estate for estate taxes paid on the husband's estate. Funeral expenses were estimated to be \$3,000 in 1985 and \$6,000 in 1995. These estimates were based on present day estimates, projected forward at a rate of 6% annually and rounded to the nearest thousand dollars.

It was assumed that the administrative expenses of each estate were four percent of the probate estate. This assumption was made simply to allow a uniform treatment of all the estates. In each case it was assumed that the wife's entire estate passed through probate, which would most likely be the case.

Any gift made to on-farm, or off-farm heirs or to the surviving spouse were appreciated at a rate of six percent per year compounded annually. At the death of each spouse total transfers to the heirs were represented by the appreciated value of gifts to the heirs from the spouse's estate plus the heirs' after tax inheritance from the spouse's estate. This further facilitates uniformity since the value of property the heirs received under each plan was indicated at one point in time.

In cases where the gift program includes transfers of real estate it is necessary to assume that all or part of such real estate would be transferred into a family corporation or land trust. Such arrangements facilitate the transfer of interest in real property.

## Case I

Farmer A has a crop-farming operation in the tidewater section of Virginia. He is 59 years of age and his wife, who has a full-time job off the farm, is 52. They have two children, both girls, who are married with children of their own. The daughters live in nearby states and apparently are not interested in the operation of the farm.

A's farm is 328 acres, of which about 75 acres are open cropland and the remainder is woodland. He produces corn and soybeans on his cropland and on rented land. His farm is basically a one-man operation.

Farmer A's and Mrs. A's estates are summarized in Table 4-1. The land he owns is in several adjoining tracts. Three of the tracts, containing a total of 212 acres, are owned by Farmer and Mrs. A as tenants by the entirety. The remaining 116 acres of land are owned by Farmer A as tenant in severalty.

Farmer A also has some stock which he and Mrs. A own jointly. All bank accounts are in their names jointly. He owns a small life insurance policy on himself which names Mrs. A as beneficiary. A second smaller policy also names Mrs. A as beneficiary; however, it is owned by an organization of which Farmer A is a member.

Farmer A and Mrs. A have no formal estate plan. They do not have wills and have not made any significant lifetime gifts.

The projected value of Farmer A's estate in 1985 is summarized as follows by type of tenure and class of property:



Table 4-1. 1976 Summary of Farmer and Mrs. A's Property

	Value Owned by			Farmer A's Estate	Mrs. A's Estate
	Husband	Wife	Jointly		
	\$	\$	\$	\$	\$
Bank accounts			39,500	39,500	39,500
Stocks			7,370	7,370	7,370
Insurance	6,000	1,000		6,000	1,000
Real estate	74,000		159,000	233,000	159,000
Tangible personal property	26,200			26,200	
Gross estate	106,200	1,000	205,870	312,070	206,870
Liabilities	0	0	0	0	0
Net estate	106,200	1,000	205,870	312,070	206,870

	Tenancy in Severalty	Tenancy by the Entirety	Total
Real estate	\$125,021	\$268,627	\$393,648
Personal property	<u>50,264</u>	<u>79,185</u>	<u>129,449</u>
Gross estate	\$175,284	\$347,812	\$523,097

The real estate is the primary asset and would qualify for special valuation. The 1976 special valuation of the real estate is as follows:

Average local annual rents:

Dwellings @ \$125 per month	\$1,500
75 acres cropland @ \$40 per acre	<u>3,000</u>
Total rent	\$4,500
Less: local property taxes	<u>1,000</u>
Net rent	\$3,500

Five year average annual Federal Land Bank interest rate is 8.4% for 1976.

1976 special valuation of  $(3,500 \div 0.084)$ ;

dwelling and cropland	\$41,666
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1976 assessed use-value of wood-land:

253 acres @ \$195 per acre	<u>49,335</u>
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1976 special valuation of real estate	\$91,001
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1985 projected special valuation of real estate	\$153,744
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1985 projected special valuation of Farmer A's estate	\$283,193
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Table 4-2 is a summary of Farmer A's existing estate plan and the five alternative estate plans. In each plan the estate tax consequences were calculated using both fair market and special valuations.

Tables 4-3 and 4-4 are summaries of Mrs. A's existing estate plan and the five alternative estate plans. In each plan the estate tax consequences were calculated when Farmer A's estate received fair market valuation and Mrs. A's estate received both fair market and special valuations. This is necessary because valuation of the husband's estate affects the amount of estate tax on his estate. This in turn influences the size of the wife's estate. The wife's estate may also receive the two kinds of valuation.

In most of the plans the capital erosion from Mrs. A's estate exceeded the value of Mrs. A's gross estate. This occurred when Mrs. A's estate received special valuation because capital erosion was always reported at fair market valuation. When her estate received fair market valuation, this occurred in the existing plan and in Alternative Plans I, III, IV, and V because the distribution to off-farm heirs and the inheritance tax on property in which Mrs. A had temporary interest was not counted as capital erosion until her death. Furthermore, such property is not included in her estate.

#### Fair Market Versus Special Valuation

Special valuation can be used only if one or more of the heirs or some other member of the family is interested in operating the farm. In this case Farmer A's estate would qualify for special valuation if Mrs. A were to continue operating the farm, but Mrs. A's estate would not qualify for special valuation unless one of the

Table 4-2. Case I, Farmer A's Estate: Its Characteristics and Disposition, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate	523,097	523,097	523,097	214,979	523,097	214,479
2. Expenses, etc.	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>
3. Administrative expenses	6,770 <sup>b</sup>	6,770 <sup>b</sup>	6,770 <sup>b</sup>	8,359 <sup>b</sup>	17,516 <sup>b</sup>	8,359 <sup>b</sup>
4. Marital deduction	256,664	256,664	256,664	153,620	112,444	0
5. Tentative tax base	256,664	256,664	256,664	50,000	390,137	203,620
6. Estate tax	26,066	26,066	26,066	0	71,447	8,958
7. Inheritance tax	11,174	11,174	13,743	4,665	7,799	1,764
8. To off-farm heirs	94,236	94,236	0	118,770 <sup>c</sup>	0	118,770 <sup>c</sup>
9. Total capital erosion at Farmer A's death (3)+(6)+ (7)+(8)=(9)	138,246	138,246	46,579	131,794	96,762	137,851

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>By lifetime gifts compounded @ 6% to date of death.

Table 4-2. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate	283,193	283,193	283,193	162,854	283,193	114,595
2. Expenses, etc.	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>
3. Administrative expenses	6,770 <sup>b</sup>	6,770 <sup>b</sup>	6,770 <sup>b</sup>	8,359 <sup>b</sup>	17,516 <sup>b</sup>	8,359 <sup>b</sup>
4. Marital deduction	200,704	200,704	250,000	101,495	92,175	0
5. Tentative tax base	72,716	72,716	72,716	50,000	170,522	103,236
6. Estate tax	0	0	0	0	0	0
7. Inheritance tax	9,868	9,868	13,743	4,665	7,799	1,764
8. To off-farm heirs	105,036	105,036	0	118,770 <sup>c</sup>	0	118,770 <sup>c</sup>
9. Total capital erosion at Farmer A's death (3)+(6) +(7)+(8)=(9)	122,980	122,980	20,513	131,794	25,315	128,893

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>By lifetime gifts compounded @ 6% to date of death.

Table 4-3. Case I, Mrs. A's Estate: Its Characteristics and Disposition When Farmer A's Estate Received Fair Market Valuation, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation of Mrs. A's Estate

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate:						
2. Real property	481,070	481,070	704,964	413,180	59,562	118,200
3. Personal property	137,507	137,507	144,826	204,918	129,632	140,440
4. Total	618,573	618,573	849,790	618,098	189,194	258,640
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	24,743 <sup>b</sup>	24,743 <sup>b</sup>	27,992 <sup>b</sup>	24,724 <sup>b</sup>	7,568 <sup>b</sup>	10,346 <sup>b</sup>
7. Tentative tax base	587,830	587,830	815,798	587,374	175,626	242,294
8. Estate tax	141,297	141,297	226,961	141,128	0	21,334
9. Inheritance tax	15,180	15,180	21,347	15,094	16,434	12,100
10. To off-farm heirs	498,406	498,406	567,462	510,237 <sup>c</sup>	729,918 <sup>d</sup>	636,555 <sup>c+d</sup>
11. Total capital erosion at Mrs. A's death (6)+(8)+(9)+(10)=(11)	679,625 <sup>d</sup>	679,625 <sup>d</sup>	843,790	691,183 <sup>d</sup>	753,920 <sup>d</sup>	680,335 <sup>d</sup>
12. Total capital erosion, both estates	817,872	817,871	890,369	822,977	850,682	818,186
13. PV of total capital erosion, both estates	306,453	306,453	306,454	306,454	306,454	306,453

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special valuation of property, or a combination.

Table 4-3. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate:						
2. Real property	186,291	186,291	257,332	95,516	23,263	46,164
3. Personal property	137,503	137,503	144,826	204,918	129,632	140,440
4. Total	323,794	323,794	420,158	300,434	152,895	186,604
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	24,743 <sup>b</sup>	24,743 <sup>b</sup>	27,992 <sup>b</sup>	24,724 <sup>b</sup>	7,568 <sup>b</sup>	10,346 <sup>b</sup>
7. Tentative tax base	293,051	293,051	386,166	269,710	139,327	170,258
8. Estate tax	38,437	38,437	70,096	30,501	0	0
9. Inheritance tax	15,180	15,180	21,374	15,094	16,434	12,100
10. To off-farm heirs	601,264 <sup>d</sup>	601,264 <sup>d</sup>	724,328 <sup>d</sup>	620,863 <sup>cd</sup>	729,918 <sup>d</sup>	657,889 <sup>cd</sup>
11. Total capital erosion at Mrs. A's death (6)+(8)+(9)+(10)=(11)	679,625 <sup>d</sup>	679,625 <sup>d</sup>	843,790 <sup>d</sup>	691,184 <sup>d</sup>	753,920 <sup>d</sup>	680,335 <sup>d</sup>
12. Total capital erosion, both estates	817,871	817,871	893,369	822,976	850,682	818,186
13. PV of total capital erosion both estates	306,453	306,453	306,454	306,453	306,454	306,453

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special valuation of property, or a combination.

Table 4-4. Case I, Mrs. A's Estate: Its Characteristics and Disposition When Farmer A's Estate Received Special Valuation, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation of Mrs. A's Estate

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate:						
2. Real property	481,000	481,000	704,964	413,180	59,562	118,200
3. Personal property	157,263	157,263	191,506	204,918	129,632	140,440
4. Total	638,333	638,333	896,470	618,098	189,194	258,640
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	25,533 <sup>b</sup>	25,533 <sup>b</sup>	35,859 <sup>b</sup>	24,724 <sup>b</sup>	7,568 <sup>b</sup>	10,346 <sup>b</sup>
7. Tentative tax base	606,800	606,800	854,611	587,374	175,626	242,294
8. Estate tax	148,316	148,316	242,098	141,128	0	21,334
9. Inheritance tax	15,930	15,930	22,538	15,094	20,272	12,580
10. To off-farm heirs	517,184	517,184	589,976	510,237 <sup>c</sup>	854,030 <sup>d</sup>	652,117 <sup>c,d</sup>
11. Total capital erosion at Mrs. A's death (6)+(8)+(9)+(10)=(11)	706,963 <sup>d</sup>	706,963 <sup>d</sup>	890,470	691,183 <sup>d</sup>	881,870 <sup>d</sup>	696,377 <sup>d</sup>
12. Total capital erosion, both estates	829,943	829,943	918,983	822,977	907,185	825,270
13. PV of total capital erosion both estates	306,453	306,453	306,454	306,454	306,453	306,453

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special valuation of property, or a combination.



Table 4-4. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate:						
2. Real property	186,291	186,291	257,332	95,516	23,263	46,164
3. Personal property	157,263	157,263	191,506	204,918	129,632	140,440
4. Total	343,554	343,554	466,838	300,434	152,895	186,604
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	25,533 <sup>b</sup>	25,533 <sup>b</sup>	35,859 <sup>b</sup>	24,724 <sup>b</sup>	7,568 <sup>b</sup>	10,346 <sup>b</sup>
7. Tentative tax base	312,021	312,021	424,979	269,710	139,327	170,258
8. Estate tax	44,887	44,887	83,293	30,501	0	0
9. Inheritance tax	15,930	15,930	22,538	15,094	20,272	12,580
10. To off-farm heirs	471,352 <sup>d</sup>	471,352 <sup>d</sup>	748,780 <sup>d</sup>	620,863 <sup>cd</sup>	854,030 <sup>d</sup>	673,451 <sup>cd</sup>
11. Total capital erosion at Mrs. A's death (6)+(8)+(9)+(10)=(11)	706,963 <sup>d</sup>	706,963 <sup>d</sup>	890,470 <sup>d</sup>	691,182 <sup>d</sup>	881,870 <sup>d</sup>	696,377 <sup>d</sup>
12. Total capital erosion, both estates	829,943	829,943	910,983	822,976	907,185	825,270
13. PV of total capital erosion both estates	306,453	306,453	306,454	306,453	306,453	306,453

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special valuation of property, or a combination.

daughters were to operate the farm. In this case it was assumed that both daughters would be off-farm heirs so the special valuation option would not be available for Mrs. A's estate. However, the consequences of such a valuation were determined so they could be compared with fair market valuation (Table 4-4).

The present value of the capital erosion did not vary when special valuation was used. This resulted because alternative forms of valuation influence the amount of capital erosion only when an on-farm heir exists. The major differences between fair market valuation and special valuation were in amount of estate tax and the amount of property passing to each heir. When special valuation is used, the estate tax is less than when fair market valuation is used, which causes the net inheritance of the heirs to be larger. When special valuation was used on Farmer A's estate, a larger amount was transferred to Mrs. A, to Mrs. A and the heirs or to Mrs. A and the trust or life estate than when his estate received fair market valuation. This resulted in larger amounts of tax on Mrs. A's estate than would have occurred had Farmer A's estate received fair market valuation. If Mrs. A's estate received special valuation, the amount of estate tax was less and each child's inheritance from the estate was larger than if her estate received fair market valuation. (See Appendix E for details of case studies.)

#### The Alternative Estate Plans

In the first case study the present value of the capital erosion of the alternative plans did not vary from that of the existing plan.

Since no on-farm heir existed after Mrs. A's death, all capital involved in the farm operation was eroded. The differences in capital erosion in the alternative estate plans were the result of variations in the timing and amount of tax and transfers to the off-farm heirs.

The existing plan and Alternative Plan I had the same results as the intestate plan. This plan resulted in the maximum possible estate tax marital deduction on Farmer A's estate since such a large portion of the estate was owned in tenancy by the entirety.

The major difference between the existing estate plan and Alternative Plan II was the amount of property Mrs. A received from Farmer A's estate. In Alternative Plan II all of Farmer A's estate passed to Mrs. A which resulted in Mrs. A's estate being larger than in the existing plan. Inheritance taxes at Farmer A's death, administrative expenses, estate tax, and inheritance tax at Mrs. A's death were larger in Alternative Plan II than under the existing plan.

The major differences between the existing estate plan and Alternative Plan III were in the sizes of Farmer A's and Mrs. A's estates. Farmer A's estate was smaller under Alternative Plan III than under the existing estate plan, which resulted in lower estate tax and inheritance tax on his estate. Administrative expenses were higher in Alternative Plan III than in the existing plan because more was owned by Farmer A as tenant in severalty. This was necessary to facilitate the gift program. The gift program also reduced the size of Mrs. A's estate in Alternative Plan III. However, the size of Mrs. A's estate was approximately equal to that under the existing

plan. There was little difference in estate tax, inheritance tax, and administrative expenses on Mrs. A's estate between Alternative Plan III and the existing plan. Distributions to off-farm heirs from Mrs. A's estate were higher in Alternative III than in the existing plan because these heirs received property through the gift program.

The major difference between Alternative Plan IV and the existing plan was the distribution of Farmer A's estate. Under Alternative Plan IV administrative expenses were higher than in the existing estate plan because it was necessary for Farmer A to hold more property in tenancy in severalty in order to facilitate Plan IV. Mrs. A received less property from Farmer A's estate in Alternative Plan IV than under the existing plan, which resulted in a lower estate tax marital deduction and higher estate tax on Farmer A's estate. Since Mrs. A received less property from Farmer A's estate in Alternative Plan IV than under the existing plan, her estate was smaller, which resulted in lower estate tax and administrative expenses on her estate. Distributions to off-farm heirs at Mrs. A's death were higher in Alternative Plan IV than under the existing plan because the property in which Mrs. A had a lifetime temporary interest was distributed to the off-farm heirs. The distribution of both Mrs. A's estate and the property in which she had a temporary interest, both of which are subject to inheritance tax, resulted in higher inheritance tax at Mrs. A's death in Alternative Plan IV than under the existing estate plan.

The major differences between Alternative Plan V and the existing estate plan were in the sizes of Farmer A's and Mrs. A's estates and the distribution of Farmer A's estate. The gift program in Alternative Plan V reduced the size of both Farmer A's and Mrs. A's estates. For this reason for Farmer A's estate being smaller in Alternative Plan V than in the existing plan, which resulted in lower estate and inheritance taxes in Alternative V. In order to facilitate Plan V, it was necessary for Farmer A to own more property as tenant in severalty in Alternative Plan V than in the existing estate plan, so administrative expenses were higher under Alternative Plan V. Distributions to the off-farm heirs were higher in Alternative Plan V than in the existing plan because they received property through the gift program. Mrs. A received no property from Farmer A's estate under Alternative Plan V. Such a transfer would have increased total tax and administrative expenses on her estate more than they would have been reduced on his estate. Mrs. A's estate was smaller in Alternative Plan V than in the existing plan as a result of the gift program and the distribution of Farmer A's estate under Plan V. Since Mrs. A's estate was smaller in Alternative Plan V, estate tax and administrative expenses were less than in the existing plan. More property was distributed to the off-farm heirs in Alternative Plan V than in the existing plan. This was true in part because the property in which Mrs. A had a temporary interest was not included in her estate. Inheritance tax was also less in Alternative Plan V than in the existing plan; however, there was more property distributed in

Plan V. This result was achieved in Plan V because the marginal inheritance tax rates were equal on distributions from both Mrs. A's estate and the property in which she had temporary interest. This was not the case in the existing plan.

#### Case II

Farmer B has a large crop farm in the tidewater section of Virginia. He is 57 years of age and his wife, who is a full-time homemaker, is 55. They have three daughters and one son. Two of the daughters live in distant states and the other daughter lives in a nearby city in Virginia. None of the daughters are married. The son lives on the farm, has been an active participant in its operation for three years, is married, and has four children.

B's farm is 1,427 acres on which he grows mostly corn, soybeans and small grains. He and his son operate the farm with the assistance of some hired help. At the present Farmer B is handling most of the management of the farm, but his son's responsibilities are increasing each year.

Farmer B's and Mrs. B's estates are summarized in Table 4-5. The farm is in several different tracts of land some of which are adjoining. Farmer B owns 15 tracts of land as tenant in severalty which make up approximately 1,335 acres. A 46-acre tract of land is owned by Farmer and Mrs. B as tenants by the entirety. The remaining three tracts of land, 46 acres also, are owned by Mrs. B as tenant in severalty. Another small tract of land is owned by Farmer B's corporation. Farmer B has one-half interest in nine lots as a tenant in common.

Table 4-5. 1976 Summary of Farmer and Mrs. B's Property

	Value Owned by			Farmer B's Estate	Mrs. B's Estate
	Husband	Wife	Jointly		
	\$	\$	\$	\$	\$
Bank accounts			3,200	3,200	3,200
Bonds	425	100		425	100
Stocks	116,373	22,020	136,259	252,632	158,279
Insurance	5,000	100,000		5,000	100,000
Notes receivable	20,000			20,000	
Real estate	1,229,580	43,737	39,100	1,268,680	82,837
Tangible personal property	20,000		1,500	21,500	1,500
Total gross estate	1,391,378	165,857	180,059	1,571,437	345,916
Personal liabilities	0	0	0	0	0
Net estate	1,391,378	165,857	180,059	1,571,437	345,916

The corporate arrangement of Farmer B's operation is such that the corporation owns all the farm equipment and rents land from Farmer B and/or Mrs. B.

Farmer B and Mrs. B also own one-half interest in a partnership involving a retail store.

Other personal property includes a bank account which Mr. and Mrs. B own as tenants by the entirety. There is also some corporate stock which is owned in part by Farmer and Mrs. B as tenants by the entirety, and in part by Mrs. B as tenant in severalty. The farm corporation owns a small life insurance policy on Farmer B with the corporation as beneficiary. Mrs. B owns a large insurance policy on Farmer B's life in which she is the beneficiary. Farmer B holds two notes receivable. Farmer B and Mrs. B each have a small number of savings bonds. Other personal property includes a sizeable collection of antiques.

Farmer and Mrs. B both have wills which were prepared by a local attorney. Farmer B's will leaves one-half of his estate to Mrs. B as tenant in severalty. The other half is left to Mrs. B in a life estate, with the children named as remaindermen. In both wills an executor has been named, and the requirement for the executor to post bond has been waived.

Other estate planning tools have not been used by Farmer B. Neither he nor Mrs. B has developed a gift program.

The projected value of Farmer B's estate in 1985 is summarized as follows by type of tenure and class of property:



	<u>Tenancy in Severalty</u>	<u>Tenancy in Severalty</u>	<u>Total</u>
Real property	\$2,077,350	\$ 66,059	\$2,143,409
Personal property	269,907	238,147	508,054
Total	<u>\$2,347,257</u>	<u>\$304,206</u>	<u>\$2,651,463</u>

The real estate is the primary asset and would qualify for special valuation. The 1976 special valuation of the real estate would be as follows:

Average annual local rents:

2 dwellings @ \$150 per month	\$ 3,600
1,035 acres cropland @ \$40 per acre	41,400
Total rent	<u>\$45,000</u>
Less: Local property taxes	11,150
Net rent	<u>\$33,850</u>

Five year average annual Federal Land Bank interest rate is 8.4% for 1976.

1976 special valuation of dwelling and cropland; ( $\$33,850 \div 0.084$ )	\$402,976
1976 assessed use-value of woodland; 346 acres @ \$195	67,470
1976 special valuation of real estate	<u>\$470,446</u>

According to 1976 Tax Reform Act special valuation may not reduce the value of the estate by more than \$500,000.

1976 special valuation limit, real estate	\$ 768,680
1985 special valuation limit, real estate	\$1,643,409
1985 Special valuation of Farmer B's estate	\$2,151,463

Table 4-6 is a summary of Farmer B's existing estate plan and the five alternative estate plans. In each plan the estate tax consequences were calculated under both fair market and special valuation.

Table 4-7 is a summary of Mrs. B's existing estate plan and the five alternative estate plans. In each plan the estate tax consequences were calculated when Farmer B's estate received fair market valuation with Mrs. B's estate receiving both fair market and special valuation, and when Farmer B's estate received special valuation with Mrs. B's estate receiving fair market and special valuation. These steps are necessary because valuation of the husband's estate affects the amount of estate tax on his estate. This, in turn, will influence the size of the wife's estate or temporary interest in the property. Mrs. B's estate may also receive both kinds of valuation.

In some of the plans the capital erosion from Mrs. B's estate exceeded the value of Mrs. B's gross estate. This occurred when Mrs. B's estate received special valuation because capital erosion was always reported at fair market value. When her estate received fair market valuation, this occurred in the existing plan and Alternative Plans I, IV, and V because the distribution to off-farm heirs and the inheritance tax on property in which Mrs. B had temporary interest, such as life estates or certain trusts, was not counted as capital erosion until her death; furthermore, such property is not included in her gross estate.

Table 4-6. Case II, Farmer B's Estate: Its Characteristics and Disposition, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate	2,651,463	2,651,463	2,651,463	2,224,576	2,651,463	2,224,576
2. Expenses, etc.	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>
3. Administrative expenses	93,890 <sup>b</sup>	93,890 <sup>b</sup>	93,890 <sup>b</sup>	76,815 <sup>b</sup>	93,890 <sup>b</sup>	76,815 <sup>b</sup>
4. Marital deduction	1,277,287	361,878	1,277,287	1,022,381	554,573	265,393
5. Tentative tax base	1,277,287	2,192,695	1,277,287	1,122,381	2,000,000	1,879,386
6. Estate tax	413,033	828,221	413,033	348,977	733,800	679,074
7. Inheritance tax	81,266	62,346	111,179	90,688	58,009	42,532
8. To off-farm heirs	0	669,276	0	178,154 <sup>c</sup>	0	178,154 <sup>c</sup>
9. To On-Farm heir	0	223,092	0	59,308 <sup>c</sup>	0	59,385 <sup>c</sup>
10. Total capital erosion at Farmer B's death	588,189	1,653,733	618,102	694,634	885,699	976,575

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>By lifetime gifts compounded @ 6% to date of death.

Table 4-6. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate	2,151,463	2,151,463	2,151,463	1,724,576	2,151,463	1,724,567
2. Expenses, etc.	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>
3. Administrative expenses	93,890 <sup>b</sup>	93,890 <sup>b</sup>	93,890 <sup>b</sup>	76,815 <sup>b</sup>	93,890 <sup>b</sup>	76,815 <sup>b</sup>
4. Marital deduction	1,027,287	346,468	1,027,287	772,382	480,759	242,892
5. Tentative tax base	1,027,287	1,708,105	1,027,287	872,382	1,573,814	1,401,869
6. Estate tax	309,988	602,447	309,988	249,029	542,016	466,604
7. Inheritance tax	81,266	62,346	111,179	90,688	58,009	42,532
8. To off-farm heirs	0	785,130	0	178,154 <sup>c</sup>	0	178,154 <sup>c</sup>
9. To on-farm heir	0	261,710	0	59,385 <sup>c</sup>	0	59,385 <sup>c</sup>
10. Total capital erosion at Farmer B's death	485,144	1,543,813	515,057	594,686	693,915	764,105

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>By lifetime gifts compounded @ 6% to date of death.

Table 4-7 . Case II, Mrs. B's Estate: Its Characteristics and Disposition When Farmer B's Estate Received Fair Market Valuation, Under the Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation of Mrs. B's Estate

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate:						
2. Real property	2,110,741	250,633	3,970,850	3,387,283	699,001	451,588
3. Personal property	681,885	851,926	43,559	225,549	568,611	596,328
4. Total	2,792,626	1,102,559	4,014,409	3,612,832	1,267,612	1,047,916
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	117,705 <sup>b</sup>	44,102 <sup>b</sup>	166,576 <sup>b</sup>	144,513 <sup>b</sup>	50,705 <sup>b</sup>	41,917 <sup>b</sup>
7. Tentative tax base	2,674,921	1,052,245	3,847,833	3,462,319	1,210,907	999,999
8. Estate tax	1,071,508	320,307	1,740,978	1,507,322	385,272	298,800
9. Inheritance tax	112,856	42,316	127,713	113,820	94,632	81,148
10. To off-farm heirs	2,074,431	1,095,969	1,484,358	1,449,507 <sup>c</sup>	2,248,932 <sup>d</sup>	2,128,667 <sup>d</sup>
11. To on-farm heirs	691,477	365,323	494,786	449,836	749,644	709,556 <sup>c</sup>
12. Total capital erosion at Mrs. B's death	3,376,500 <sup>d</sup>	1,502,694 <sup>d</sup>	3,565,162	3,265,162	2,779,541 <sup>d</sup>	2,550,532 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-7. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,964,689	3,156,427	4,137,726	3,959,796	3,665,240	3,527,107
14. PV of total capital erosion, both estates	1,464,125	1,475,502	1,529,135	1,490,331	1,442,918	1,421,017

Table 4-7. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate						
2. Real property	1,610,741	Not	3,470,850	2,887,283	259,200	172,781
3. Personal property	681,885	Qualified	156,923	404,540	568,611	596,328
4. Total	2,292,626	for	3,627,773	3,291,823	827,811	769,109
5. Expenses, etc.	6,000 <sup>a</sup>	Special	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	117,705 <sup>b</sup>	Valuation	171,111 <sup>b</sup>	151,676 <sup>b</sup>	50,705 <sup>b</sup>	41,917 <sup>b</sup>
7. Tentative tax base	2,174,921		3,956,662	3,134,150	642,296	721,192
8. Estate tax	819,511		1,504,097	1,320,266	161,450	190,641
9. Inheritance tax	118,392		132,067	120,980	108,368	96,368
10. To off-farm heirs	2,397,678		1,740,374	1,768,673 <sup>c</sup>	2,664,087	2,483,749 <sup>c</sup>
11. To on-farm heirs	799,226		580,125	589,558 <sup>c</sup>	888,029	827,916 <sup>c</sup>
12. Total capital erosion at Mrs. B's death	3,453,286		3,547,649	3,361,595 <sup>d</sup>	2,984,610	2,812,675 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-7. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,928,430	Not	4,062,706	3,956,281	3,678,525	3,576,780
14. PV of total capital erosion, both estates	1,428,512	Qualified for Special Valuation	1,477,406	1,463,045	1,397,180	1,381,898



Table 4-8. Case II, Mrs. B's Estate: Its Characteristics and Disposition When Farmer B's Estate Received Special Valuation, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation of Mrs. B's Estate

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate						
2. Real property	2,110,741	250,633	3,970,850	3,387,283	699,001	451,588
3. Personal property	681,885	851,926	156,923	404,540	568,611	596,328
4. Total	2,792,626	1,102,559	4,127,773	3,791,823	1,267,612	1,047,916
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	117,705 <sup>b</sup>	44,102 <sup>b</sup>	171,111 <sup>b</sup>	151,673 <sup>b</sup>	50,705 <sup>b</sup>	41,917 <sup>b</sup>
7. Tentative tax base	2,674,921	1,052,245	3,956,662	3,634,150	1,210,907	999,999
8. Estate tax	1,071,508	320,307	1,807,364	1,610,632	385,272	298,800
9. Inheritance tax	118,392	46,148	132,067	120,980	108,368	96,368
10. To off-farm heirs	2,074,431	1,095,969	1,484,358	1,499,507	2,248,932 <sup>d</sup>	2,128,667 <sup>d</sup>
11. To on-farm heirs	691,477	365,323	494,786	499,836	749,644	709,556 <sup>c</sup>
12. Total capital erosion at Mrs. B's death	3,376,500 <sup>d</sup>	1,502,694 <sup>d</sup>	3,565,162	3,265,162	2,779,541 <sup>d</sup>	2,550,532 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-8. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,964,689	3,156,427	4,137,726	3,959,796	3,665,240	3,527,107
14. PV of total capital erosion, both estates	1,464,125	1,475,502	1,529,135	1,490,331	1,442,918	1,421,017

Table 4-8. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate						
2. Real property	1,610,741	Not	3,470,850	2,887,283	259,200	172,781
3. Personal property	681,885	Qualified	43,559	225,549	568,611	596,328
4. Total	2,292,626	for	3,514,409	3,112,832	827,811	769,109
5. Expenses, etc.	6,000 <sup>a</sup>	Special	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	117,705 <sup>b</sup>	Valuation	166,576 <sup>b</sup>	144,513 <sup>b</sup>	50,705 <sup>b</sup>	41,917 <sup>b</sup>
7. Tentative tax base	2,174,921		3,347,833	2,962,319	642,296	721,192
8. Estate tax	819,511		1,442,065	1,223,829	161,450	190,641
9. Inheritance tax	112,856		127,713	113,820	94,632	81,148
10. To off-farm heirs	2,263,428		1,708,542	1,712,129	2,416,797 <sup>d</sup>	2,209,787 <sup>cd</sup>
11. To on-farm heirs	754,476		569,514	570,710	805,549	736,596
12. Total capital erosion at Mrs. B's death	3,313,500 <sup>d</sup>		3,444,895 <sup>d</sup>	3,194,291 <sup>d</sup>	2,723,584 <sup>d</sup>	2,523,493 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-8. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,901,689	Not	4,062,997	3,888,925	3,609,283	3,500,068
14. PV of total capital erosion, both estates	1,443,303	Qualified for Special Valuation	1,504,436	1,466,908	1,424,424	1,412,081

### Fair Market Versus Special Valuation

It appeared that the estate could qualify for special valuation at Farmer B's death or at Mrs. B's death since the son is interested in the operation of the farm. The present value of the capital erosion varied widely when special valuation was used as compared to fair market valuation (Table 4-8). When both estates received fair market valuation, the present value of the capital erosion was highest, and when both estates received special valuation, it was lowest. The present value of capital erosion was not consistently higher in any one plan under the combinations of fair market valuation of Farmer B's estate and special valuation of Mrs. B's estate, and special valuation of Farmer B's estate and fair market valuation of Mrs. B's estate. The major difference noted was that when less property was qualified for the estate tax marital deduction than the maximum possible in Farmer B's estate, the use of special valuation of Farmer B's estate and fair market valuation of Mrs. B's results in less capital erosion than when Farmer B's estate received fair market valuation and Mrs. B's estate received special valuation; however, the converse was not always true. In these situations the marginal tax on Farmer and Mrs. B's estates was more closely balanced by special valuation of Farmer B's estate and fair market valuation of Mrs. B's estate than by fair market valuation of Farmer B's estate and special valuation of Mrs. B's estate.

Mrs. B's estate did not qualify for special valuation in Alternative Plan I because the value of real property in her estate was less than 25 percent.

### The Alternative Estate Plans

The present value of the total capital erosion under the existing plan ranged from approximately \$11,100 more to \$6,900 less than under Alternative Plan I. The primary difference between the two plans was the distribution of Farmer B's estate, which caused the capital erosion at Farmer B's death under Alternative Estate Plan I to be higher than under the existing plan. This was the case because less of Farmer B's estate qualified for the marital deduction and because part of his estate was transferred to the off-farm heirs. The capital erosion from Mrs. B's estate was greater under the existing plan than under Alternative Plan I because her estate was larger and because part of the residual trust property was distributed to the off-farm heirs. The difference in capital erosion from Farmer B's estate in favor of the existing estate plan was not counter-balanced by the difference in capital erosion from Mrs. B's estate in favor of Alternative Plan I when both estates received fair market valuation. However, it was counter-balanced when Farmer B's estate received special valuation and Mrs. B's estate received fair market valuation.

The present value of the capital erosion under the existing plan ranged from approximately \$65,000 to \$48,900 less than under Alternative Plan II. The major difference between the two plans was the size of Mrs. B's estate. In Alternative Plan II, Farmer B left his entire estate to Mrs. B which resulted in larger inheritance taxes at both Farmer B's death and Mrs. B's death, and larger

estate taxes and administrative expenses on Mrs. B's estate. So the capital erosion from both Farmer and Mrs. B's estates was larger in Alternative Plan II because that portion of Farmer B's estate which passed to Mrs. B is subject to taxation again in her estate.

The present value of the capital erosion under the existing estate plan ranged from approximately \$23,600 to \$37,700 less than under Alternative Plan III. The major differences between Alternative Plan III and the existing plan were the size of Farmer B's estate and the size of Mrs. B's estate. Farmer B's gross estate was less in Alternative Plan III than in the existing plan as a result of the gift program. Mrs. B's estate was also reduced by the gift program; however, it was larger in Alternative Plan III than in the existing plan because Farmer B left his entire estate to Mrs. B. The capital erosion from Farmer B's estate is larger in Alternative Plan III than in the existing plan, but the capital erosion from Mrs. B's estate is smaller. The lower capital erosion from Mrs. B's estate in Alternative Plan III did not counter-balance the capital erosion from Farmer B's estate. Therefore, the present value of the capital erosion from both estates was more in Alternative Plan III than in the existing plan.

The present value of capital erosion under the existing estate plan ranged from approximately \$18,900 to \$33,700 more than under Alternative Plan IV. The major difference between the two plans is the amount of property left to Mrs. B. She received less than half as much property from Farmer B's estate in Alternative Plan IV as she

did under the existing plan. Since less property passed directly to Mrs. B, the estate tax marital deduction for Farmer B's estate is lower, resulting in higher estate taxes on his estate. Mrs. B's estate was smaller in Alternative Plan IV than under the existing plan because she received less from Farmer B's estate. This resulted in lower administrative expenses, estate taxes, and inheritance taxes on Mrs. B's estate. In Alternative Plan IV the capital erosion from Farmer B's estate exceeded that under the existing plan; however, this saving was counter-balanced by less capital erosion from Mrs. B's estate in Alternative Plan IV.

The present value of the capital erosion under the existing plan ranged from \$31,200 to \$58,500 more than under Alternative Plan V. The major differences between the two plans were the gift program under in Alternative Plan V and the fact that less of Farmer B's estate passed directly to Mrs. B. The gift program reduced the size of Farmer B's estate in Alternative Plan V below that of the existing plan; however, the marital deduction on Farmer A's was much less. Since Farmer B's estate was smaller in Alternative Plan V than in the existing plan was lower administrative expenses and inheritances taxes resulted. However, the smaller amount of property passing from Farmer B's estate to Mrs. B in Plan V resulted in higher estate taxes than in the existing plan. Since Mrs. B received much less property from Farmer B's estate in Alternative Plan V than in the existing plan, her estate was smaller. The capital erosion from Farmer B's estate was larger in Alternative Plan V than in the existing plan, but,



capital erosion from Mrs. B's estate was smaller in Alternative Plan V. In order for Plan V to have had a lower present value of capital erosion than the existing plan, the excess capital erosion from Farmer B's estate in Plan V has been counter-balanced by less capital erosion from Mrs. B's estate. In order for both plans to result in the same present value of capital erosion for each dollar the capital erosion from Farmer B's estate in Alternative Plan V exceeds that of the existing plan there must be approximately \$1.79\* less capital erosion from Mrs B's estate in Alternative Plan V than in the existing plan. In this comparison each dollar of difference in capital erosion from Farmer B's estate in favor of the existing plan was counter-balanced by a difference of \$2.13 less capital erosion from Mrs. B's estate in Alternative Plan V than in the existing plan; therefore, Alternative Plan V had a lower present value of capital erosion than the existing plan.

#### The On-Farm Heir's Equity

At Mrs. B's death the on-farm heir's equity was represented by the 1995 future value of any gift or inheritance he received prior to the death of Mrs. B plus his inheritance from her. The potential equity of the on-farm heir in 1995 was summarized for the existing estate plan and the five alternative plans when the estates received the combinations of fair market and/or special evaluation as shown in Table 4-9. When capital erosion was lowest, the on-farm heir's equity was highest, and vice versa. However, the

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\*The future value of \$1 at 6% 10 years hence.

Table 4-9. Potential Equity of the On-Farm Heir of Case II in 1995 Under the Existing Estate Plan and Five Alternative Estate Plans When the Projected Value of the Real Property was \$3,970,800 in 1995

	<u>Farmer B's Estate</u>		<u>Farmer B's Estate</u>	
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	Fair Market Valuation	Special Valuation	Fair Market Valuation	Special Valuation
	(Dollars)			
Existing Plan	691,477	754,476	736,227	799,226
Alternative I	764,846		864,970	
Alternative II	494,786	569,514	504,308	580,125
Alternative III	606,185	677,059	621,598	695,907
Alternative IV	749,644	805,599	832,074	888,029
Alternative V	815,905	842,945	907,225	934,265

on-farm heir's equity is meaningless unless compared with the amount of capital necessary to continue the farm operation as an efficient productive unit. It was assumed that the 1995 value of real estate (\$3,970,800) was a proxy for the amount of capital necessary to continue operating the farm at Mrs. B's. If the on-farm heir purchased the farm operation at Mrs. B's death by borrowing enough capital to complement his equity in the farm operation, his debt/equity ratios, ranged from a high of 7.03 under Alternative Plan II when both estates received fair market valuation to a low of 3.25 under Alternative Plan V when both estates received special valuation. The on-farm heir's debt/equity ratio was interpreted as the amount of debt he carried for each dollar of equity he had in the farm operation. The consequences of the various distributions of property under the Existing Estate Plan and the Alternative Plans and the election of the combinations of fair market and/or special valuation, resulted in the variations in this ratio. The ratios would have been smaller if there had been fewer heirs. If Farmer B and Mrs. B had transferred more than an equal share of the property to the on-farm heir, his debt/equity ratio would have been smaller. It would appear that such a distribution would improve the chances for continuation of the farm operation as an efficient productive unit under any of the plans. Furthermore, the plan which resulted in the least capital erosion would be complemented by this distribution and provide the best opportunity of any of the alternative plans for continuation of the farm operation as an efficient productive unit.

## Case III

Farmer C operates and owns a purebred beef and crops farm in Tidewater Virginia. Farmer and Mrs. C are both 59 years of age. Mrs. C has a full-time job off the farm. They have two sons and two daughters. The daughters both live in distant states. One of the daughters is married but has no children. The older son, who has a degree in an agricultural science, lives at home and helps manage and operate the farm. The younger son, who is still in college, does not seem to be interested in agriculture.

The farm consists of 930 acres in two adjoining tracts of land. The farming operation consists of a registered beef herd and the production of corn, soybeans, some small grains and meadow. Farmer C's and Mrs. C's estates are summarized in Table 4-10.

Farmer C does have a will which was prepared by an attorney. His will includes the following provisions for distribution of his property: If Farmer C is not survived by his wife or issue, all the property in his estate will be put into a trust, with income going to his father and mother except for \$500 per quarter to his mother-in-law. If he is survived by Mrs. C but not his issue, all the property in his estate will go to Mrs. C. If Farmer C is survived by his spouse and issue, all personal property except that used in the farm business will be left to Mrs. C. The remaining property will be used to establish two trusts. The first trust will name Mrs. C as income beneficiary and she will have power of appointment over the trust. It will contain half of the remaining

Table 4-10. 1976 Summary of Farmer and Mrs. C's Property

	Value Owned by			Farmer B's Estate	Mrs. B's Estate
	Husband	Wife	Jointly		
	\$	\$	\$	\$	\$
Bank accounts			11,000	11,000	11,000
Stocks	7,079			7,079	
Insurance	65,000			65,000	
Real estate	1,318,000			1,318,000	
Tangible personal property	65,100			65,000	
Total gross estate	1,455,179		11,000	1,466,179	11,000
Personal liabilities	0		0	0	0
Net estate	1,455,179		11,000	1,466,179	11,000

property and will qualify for the marital deduction. The second trust names his wife as income beneficiary, and his children are named as corpus beneficiaries at Mrs. C's death.

Mrs. C has a will which leaves all her property to her children, to be divided equally.

The projected value of Farmer C's estate in 1985 is summarized as follows by type of tenure and class of property:

Class	Held by Tenancy in Severalty	Held by Tenancy by The Entirety	Total
Real property	\$2,226,734	\$ 0	\$2,226,734
Personal property	186,945	18,584	205,529
Total	\$2,413,678	\$18,584	\$2,432,263

The real estate is the primary asset which would qualify for special valuation. The 1976 special valuation of the real estate is as follows:

Average annual local rents:

2 dwellings @ \$150 per month	\$ 3,600
372 acres cropland @ \$40 per acre	<u>14,880</u>
Gross rent	\$18,480
Less: local property tax	<u>5,720</u>
Net rent	\$12,760

Five year average annual Federal Land Bank interest rate is 8.4% for 1976.

1976 special valuation of dwellings and cropland: ( $\$12,760 \div 0.084$ )	\$151,905
1976 assessed use-value of woodland, 279 acres @ \$195 per acre	54,405
1976 assessed use-value of pasture land, 279 acres @ \$290 per acre	80,910
	<hr/>
1976 special valuation of all real estate	\$287,220

According to 1976 Tax Reform Act, special valuation may not reduce the value of the estate by more than \$500,000.

1976 special valuation limit, real estate	\$ 818,000
1985 special valuation limit, real estate	\$1,726,733
1985 special valuation of Farmer C's estate	\$1,932,262

Table 4-11 is a summary of Farmer C's existing estate plan and five alternative estate plans. In each plan the estate tax consequences were calculated using both fair market and special valuation.

Table 4-12 and 13 are summaries of Mrs. C's existing estate plan and the alternative estate plans. In each plan the estate tax consequences were calculated when Farmer C's estate received fair market valuation and Mrs. C's estate fair market and special valuation; and when Farmer C's estate received special valuation and Mrs. C's estate fair market and special valuation (Table 4-13). This is necessary because valuation of the husband's estate affects the amount of estate tax on his estate. This, in turn, may influence the size of the wife's estate. The wife's estate may also receive the two kinds of valuation.

Table 4-11. Case III, Farmer C's Estate: Its Characteristics and Disposition, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate	2,432,262	2,432,262	2,432,262	2,002,886	2,432,262	2,002,886
2. Expenses, etc.	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>
3. Administrative expenses	96,547 <sup>b</sup>	96,547 <sup>b</sup>	96,547 <sup>b</sup>	79,472 <sup>b</sup>	96,547 <sup>b</sup>	79,472 <sup>b</sup>
4. Marital deduction	1,166,358	91,050	1,166,358	910,207	631,832	420,414
5. Tentative tax base	1,166,358	2,241,666	1,166,358	1,010,207	1,700,884	1,500,000
6. Estate tax	367,007	852,216	367,007	302,985	599,198	508,800
7. Inheritance tax	63,951	47,151	96,836	79,949	46,681	33,745
8. To off-farm heirs	0	667,950	0	178,154 <sup>c</sup>	0	178,154 <sup>c</sup>
9. To on-farm heirs	0	222,650	0	59,385 <sup>c</sup>	0	59,385 <sup>c</sup>
10. Total capital erosion at Farmer C's death	527,505	1,663,864	560,390	640,560	742,424	800,441

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>By lifetime gifts compounded @ 6% to date of death.



Table 4-11. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate	1,932,262	1,932,262	1,932,262	1,502,886	1,932,262	1,502,886
2. Expenses, etc.	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>	3,000 <sup>a</sup>
3. Administrative expenses	96,547 <sup>b</sup>	96,547 <sup>b</sup>	96,547 <sup>b</sup>	79,472 <sup>b</sup>	96,547 <sup>b</sup>	79,472 <sup>b</sup>
4. Marital deduction	916,358	91,050	916,358	660,207	512,929	371,730
5. Tentative tax base	916,358	1,741,666	916,358	760,207	1,319,787	1,048,684
6. Estate tax	266,180	617,550	266,180	205,281	431,308	318,760
7. Inheritance tax	63,951	47,151	96,836	79,949	46,681	33,745
8. To off-farm heirs	0	785,673	0	178,154 <sup>c</sup>	0	178,154 <sup>c</sup>
9. To on-farm heir	0	261,891	0	59,385 <sup>c</sup>	0	59,385 <sup>c</sup>
10. Total capital erosion at Farmer C's death	426,678	1,546,921	459,563	542,856	574,536	610,401

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>By lifetime gifts compounded @ 6% to date of death.

Table 4-12. Case III, Mrs. C's Estate: Its Characteristics and Disposition When Farmer C's Estate Received Fair Market Valuation, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation of Mrs. C's Estate

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate						
2. Real property	1,993,871	0	3,346,867	2,934,314	948,308	817,092
3. Personal property	71,976	148,073	0	0	99,609	145,838
4. Total	2,065,847	148,073	3,346,867	2,934,314	1,047,917	962,930
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	82,634 <sup>b</sup>	5,923 <sup>b</sup>	133,875 <sup>b</sup>	117,388 <sup>b</sup>	41,917 <sup>b</sup>	38,517 <sup>b</sup>
7. Tentative tax base	1,977,213	136,150	3,206,992	2,811,305	1,000,000	918,413
8. Estate tax	723,546	0	1,361,785	1,143,791	298,800	171,113
9. Inheritance tax	87,112	19,680	102,080	87,780	76,788	64,640
10. To off-farm heirs	1,879,848	705,285	1,307,346	1,303,427	1,948,023 <sup>d</sup>	1,894,781 <sup>cd</sup>
11. To on-farm heirs	626,616	235,095	435,782	434,476	649,341	631,594 <sup>c</sup>
12. Total capital erosion at Mrs. C's death	2,773,140 <sup>d</sup>	730,888 <sup>d</sup>	2,905,086	2,652,386	2,365,528 <sup>d</sup>	2,169,051 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-12. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,300,645	2,394,752	3,465,476	3,292,946	3,107,952	2,969,492
14. PV of total capital erosion, both estates	1,228,788	1,226,407	1,291,863	1,255,795	1,221,277	1,190,679

Table 4-12. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate						
2. Real property	1,493,871	Not Qualified	2,846,867	2,434,314	448,308	317,092
3. Personal property	71,976	for Special	0	0	99,609	145,838
4. Total	1,565,847	Valuation	2,846,867	2,434,314	547,917	462,930
5. Expenses, etc.	6,000 <sup>a</sup>		6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	82,634 <sup>b</sup>		133,875 <sup>b</sup>	117,388 <sup>b</sup>	41,917 <sup>b</sup>	38,517 <sup>b</sup>
7. Tentative tax base	1,477,213		2,706,992	2,311,305	500,000	418,413
8. Estate tax	499,002		1,088,506	886,339	108,800	81,060
9. Inheritance tax	87,112		102,080	87,780	76,788	64,640
10. To off-farm heirs	2,048,256 <sup>d</sup>		1,512,303	1,496,516 <sup>c</sup>	2,090,523 <sup>d</sup>	1,962,320 <sup>cd</sup>
11. To on-farm heirs	682,752		504,101	498,839 <sup>c</sup>	696,841	654,107 <sup>c</sup>
12. Total capital erosion at Mrs. B's death	2,717,004 <sup>d</sup>		2,836,764	2,588,023	2,318,028	2,146,537 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-12. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,244,509	Not	3,397,154	3,228,583	3,060,452	2,946,978
14. PV of total capital erosion, both estates	1,210,235	Qualified for Special Valuation	1,269,281	1,234,522	1,205,578	1,183,238

Table 4-13. Case III, Mrs. C's Estate: Its Characteristics and Disposition When Farmer C's Estate Received Special Valuation, Under His Existing Plan and Five Alternative Plans, With Fair Market Valuation and Special Valuation of Mrs. C's Estate

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
1. Gross estate						
2. Real property	1,993,871	0	3,527,433	3,109,289	948,308	905,024
3. Personal property	71,976	148,073	0	0	99,609	142,894
4. Total	2,065,847	148,073	3,527,433	3,109,289	1,047,917	1,047,918
5. Expenses, etc.	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	82,634 <sup>b</sup>	5,923 <sup>b</sup>	141,097 <sup>b</sup>	124,387 <sup>b</sup>	41,917 <sup>b</sup>	38,517 <sup>b</sup>
7. Tentative tax base	1,977,213	136,150	3,380,336	2,979,289	1,000,000	1,918,413
8. Estate tax	723,546	0	1,460,592	1,232,818	298,800	171,113
9. Inheritance tax	92,532	23,852	109,012	94,499	88,544	76,188
10. To off-farm heirs	2,011,209	806,517	1,358,049	1,357,607	2,164,704 <sup>d</sup>	2,141,372 <sup>cd</sup>
11. To on-farm heirs	607,403	268,839	452,683	452,536 <sup>c</sup>	721,568	731,791 <sup>c</sup>
12. Total capital erosion at Mrs. C's death	2,909,921 <sup>d</sup>	836,292 <sup>d</sup>	3,068,750	2,809,311	2,593,965 <sup>d</sup>	2,427,190 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.

Table 4-13. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Fair Market Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,336,599	2,383,213	3,528,313	3,352,167	3,168,501	3,037,591
14. PV of total capital erosion, both estates	1,214,317	1,192,026	1,286,276	1,249,830	1,197,406	1,163,513

Table 4-13. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
1. Gross estate						
2. Real property	1,493,871	Not	3,027,433	2,609,289	448,308	405,024
3. Personal property	71,976	Qualified	0	0	99,609	142,894
4. Total	1,565,847	for	3,027,433	2,609,289	547,917	547,918
5. Expenses, etc.	6,000 <sup>a</sup>	Special	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>	6,000 <sup>a</sup>
6. Administrative expenses	82,634 <sup>b</sup>	Valuation	141,097 <sup>b</sup>	124,387 <sup>b</sup>	41,917 <sup>b</sup>	38,517 <sup>b</sup>
7. Tentative tax base	1,477,213		2,880,336	2,479,289	500,000	418,413
8. Estate tax	499,002		1,180,378	968,646	108,800	81,060
9. Inheritance tax	92,532		109,012	94,499	88,544	76,188
10. To off-farm heirs	2,179,617		1,568,208	1,555,736 <sup>c</sup>	2,307,204	2,208,911 <sup>cd</sup>
11. To on-farm heirs	726,539		522,736	518,579 <sup>c</sup>	769,068	736,304 <sup>c</sup>
12. Total capital erosion at Mrs. C's death	2,853,785 <sup>d</sup>		2,998,695	2,743,268 <sup>d</sup>	2,546,465 <sup>d</sup>	2,404,676 <sup>d</sup>

<sup>a</sup>Not included in capital erosion.

<sup>b</sup>Based on 4% of probate estate.

<sup>c</sup>Includes lifetime gifts compounded @ 6% to date of death.

<sup>d</sup>Exceeds gross estate due to remainder interest of heirs from Mr. A's estate, gift programs, special programs, special valuation of property, or a combination.



Table 4-13. Continued.

	Existing Plan	Alt. I	Alt. II	Alt. III	Alt. IV	Alt. V
----- Under Special Valuation (Dollars) -----						
13. Total capital erosion, both estates	3,280,463	Not Qualified	3,458,258	3,286,124	3,121,001	3,015,077
14. PV of total capital erosion, both estates	1,195,763	for Special Valuation	1,263,122	1,228,001	1,181,707	1,156,072

In some of the plans the capital erosion from Mrs. C's estate exceeded the value of Mrs. C's gross estate. This occurred when Mrs. C's estate received special valuation because capital erosion was always reported at fair market value. When her estate received fair market valuation, this occurred in the existing plan and Alternative Plans I, II, and IV because the distribution to off-farm heirs and the inheritance tax on property in which Mrs. C had temporary interest, was not counted as capital erosion until her death. Furthermore, it was not included in her gross estate.

#### Fair Market Versus Special Valuation

The present value of capital erosion was highest when both Farmer and Mrs. C's estates received fair market valuation, and it was lowest when both estates received special valuation. The estate plans which use less than the maximum possible marital deduction on Farmer C's estate resulted in a lower present value of capital erosion when Farmer C's estate received special valuation and Mrs. C's estate fair market valuation than when Farmer C's estate received fair market valuation and Mrs. C's estate received special valuation. This difference is attributed to a greater reduction in estate tax when Farmer C's estate received special valuation because his estate was in a higher tax bracket. This resulted in less capital erosion sooner than when Mrs. C's estate received special valuation.

Mrs. C's estate did not qualify for special valuation in Alternative Plan I because no real property was included in her estate.

### The Alternative Estate Plans

The present value of the capital erosion under the existing plan ranges from \$2,400 to \$22,300 more than in Alternative Plan I. The major differences between the two plans were in the amount and kind of property Mrs. C received from Farmer C's estate. The capital erosion from Farmer C's estate under Alternative Plan I exceeded that of the existing plan, and the capital erosion from Mrs. C's estate under the existing plan exceeded that of Alternative Plan I. The greater capital erosion from Farmer C's estate under Alternative Plan I was counter-balanced by much less capital erosion from Mrs. C's estate. Because of the size of Mrs. C's inheritance from Farmer C's estate a lower estate tax resulted on Farmer C's estate and less property passing to the off-farm heirs at Farmer C's death under the existing plan than in Alternative Plan I. There was more capital erosion from Mrs. C's estate under the existing plan because Mrs. C's inheritance from Farmer C's estate was larger than under Alternative Plan I.

The present value of the capital erosion under the existing plan ranged from \$59,000 to \$72,000 less than under Alternative Plan II. The major difference between the two plans was the distribution of Farmer C's estate, which influenced the size of Mrs. C's estate. In the existing plan Mrs. C received approximately half of Farmer C's estate, while in Alternative Plan II she received the entire estate. This resulted in less inheritance tax at Farmer C's death under the existing plan than under Alternative Plan II, and at Mrs. C's death

all factors which make up capital erosion except distributions to off-farm heirs were higher under Alternative Plan II than under the existing plan. So capital erosion from both Farmer and Mrs. C's estate was higher under Alternative Plan II than under the existing plan.

The present value of the capital erosion under the existing plan ranged from \$24,300 to \$35,500 less than under Alternative Plan III. The major differences between the two plans were the size of Farmer C's estate, Mrs. C's inheritance from Farmer C's estate, the size of Mrs. C's estate, and the gift program of Alternative Plan III. Farmer C's estate was smaller in Alternative Plan III than in the existing plan because he had made gifts prior to death which reduced the size of his estate. This resulted in lower estate tax and administrative expenses on Farmer C's estate under Alternative Plan III than under the existing plan. However, inheritance taxes and property passing to off-farm heirs were larger in Alternative Plan III at Farmer C's death. Since Mrs. C received Farmer C's entire estate in Alternative Plan III but only about half his estate in the existing plan, her estate was larger under Alternative Plan III. The gift program reduced the size of Mrs. C's estate in Alternative Plan III. However, it was not enough to result in lower administrative expenses, estate tax and inheritance tax than under existing. Transfers to off-farm heirs were less in Alternative Plan III because there was less property to be transferred. Total capital erosion was less in Alternative Plan III as a result of the lower value of transfers to off-farm heirs.

Alternative Plan III resulted in less capital erosion from Mrs. C's estate but more from Farmer C's estate than under the existing plan, but the lower capital erosion from Mrs. C's estate was not enough to counter-balance the higher capital erosion from Farmer C's estate in Alternative Plan III.

The present value of capital erosion under the existing plan ranged from \$4,700 to \$16,900 more than under Alternative Plan IV. The major difference between the two plans was the amount of property which passes to Mrs. C from Farmer C's estate. Mrs. C received less property from Farmer C's estate in Alternative Plan IV than in the existing plan. This resulted in higher estate tax but lower inheritance tax at Farmer C's death under Alternative Plan IV; furthermore, the net result was more capital erosion from Farmer C's estate under Alternative Plan IV. Mrs. C's estate was smaller in Alternative Plan IV than under the existing plan because she received less property from Farmer C's estate than in the existing plan. This resulted in lower administrative expenses and lower estate and inheritance taxes at Mrs. C's death under Alternative Plan IV than under the existing plan. Alternative Plan IV resulted in more capital erosion from Farmer C's estate and less capital erosion from Mrs. C's estate than under the existing estate plan. The lower capital erosion from Mrs. C's estate counter-balanced the higher capital erosion from Farmer C's estate in Alternative Plan IV. The net result was a lower present value of capital erosion under Alternative Plan IV than under the existing plan.

The present value of the capital erosion under the existing plan ranged from \$50,800 to \$27,000 more than under Alternative Plan V. The major differences between the plans were size of Farmer C's estate, the amount of property Mrs. C received from Farmer C's estate, and the size of Mrs. C's estate. Farmer C's estate was smaller in Alternative Plan V than in the existing plan because the gift program reduced its size. Even though Farmer C's estate was smaller in Alternative Plan V, the resulting estate tax was larger than in the existing plan because less property qualified for the marital deduction in Alternative Plan V. Mrs. C's estate was smaller in Alternative Plan V than in the existing estate plan because she received less property from Farmer C's estate, and the size of her estate was reduced by the gift program. Therefore, administrative expenses and estate and inheritance taxes were lower in Alternative Plan V than in the existing estate plan. The capital erosion from Farmer C's estate was larger under Alternative Plan V than under the existing plan; however, it was counter-balanced by less capital erosion from Mrs. C's estate under Alternative Plan V.

#### The On-Farm Heir's Equity

The on-farm heir's equity in the farm operation was the amount remaining after capital erosion. Table 4-14 summarizes the on-farm heir's equity in Case III for the Existing Estate Plan and the five Alternative Plans when the various combinations of fair market and/or special valuation were used. The continued operation of the farm

Table 4-14. Potential Equity of the On-Farm Heir of Case III in 1995 Under the Existing Estate Plan and Five Alternative Estate Plans When the Projected Value of the Real Property was \$3,987,700 in 1995

	<u>Farmer C's Estate</u> <u>Fair Market Valuation</u>		<u>Farmer C's Estate</u> <u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market</u> <u>Valuation</u>	<u>Special</u> <u>Valuation</u>	<u>Fair Market</u> <u>Valuation</u>	<u>Special</u> <u>Valuation</u>
(Dollars)				
Existing Plan	\$626,616	\$682,752	\$607,403	\$726,539
Alternative I	\$633,827	Not Qualified for Special Valuation	\$737,846	Not Qualified for Special Valuation
Alternative II	\$435,782	\$504,101	\$452,683	\$522,736
Alternative III	\$540,825	\$605,188	\$558,885	\$624,928
Alternative IV	\$649,341	\$696,841	\$721,568	\$769,068
Alternative V	\$631,594	\$760,456	\$838,140	\$842,653

as a single productive unit by the on-farm heir required that he borrow enough capital to purchase the remaining farm assets. It was assumed that the 1995 value of the real estate (3,987,700) was a proxy for the amount of capital necessary to continue operating the farm at Mrs. C's death. If the on-farm heir purchased the farm operation at Mrs. C's death, his debt/equity ratio ranged from a high of 8.15 under Alternative Plan II when both estates received fair market valuation to a low of 3.73 under Alternative Plan V when both estates received special valuation. This ratio was interpreted as the amount of debt the on-farm heir carried for each dollar equity he had in the farm operation. The variation of this ratio was attributable to the consequences of the various distributions of property under the Alternative Plans and existing plan and the election of the combinations of fair market and/or special valuation. These ratios would have been lower if there were fewer heirs. In each of the plans it was assumed that the property would be distributed equally among the children. However, Farmer C and Mrs. C could have reduced the on-farm heir's debt/equity ratio by transferring to him more than an equal share of the property. A distribution such as this would also improve the chances for continuation of the farm operation as an efficient productive unit under any plan. However, the plan which resulted in the least capital erosion appeared to provide the best opportunity of any of the alternative plans to be used in combination with such a distribution.



## Alternative Estate Plans and Capital Erosion

## Alternative Plan I

In this plan both spouses died intestate, so their estate was distributed by the laws of descent and distribution except for property which was owned under joint tenancy or tenancy by the entirety. Intestate distribution did not always allow the most effective use of the marital deduction to reduce estate taxes at the husband's death. This generally resulted in the least capital erosion at the wife's death because she received less property from the husband's estate.

In some cases the wife's estate did not qualify for special valuation under Alternative Plan I because she received little or no real property from the husband's estate. This was dependent upon how much real property was held in tenancy by the entirety and how much real property was held by the wife as tenant in severalty.

## Alternative Plan II

In this plan all of the husband's estate passed to the wife, so the husband's estate received the maximum possible marital deduction. This resulted in the least possible estate tax; however, it resulted in the highest possible inheritance tax since all the property passed directly to the wife. This plan also resulted in the least capital erosion from the husband's estate because no property was transferred to off-farm heirs and the reduction in estate tax far outweighed the higher inheritance tax. This plan resulted in

the most capital erosion from the wife's estate because the wife's estate was largest. Under this plan the husband's entire estate was subject to estate tax twice -- once in his estate and again in the wife's estate. Only the portion of the husband's estate in excess of the marital deduction was taxed in his estate; however, under this plan the husband's entire estate passed to the wife and was subject to tax again in her estate.

#### Alternative Plan III

This plan had three primary characteristics, two of which were the same as in Alternative Plan II. All the husband's estate was transferred to the wife, so the maximum allowable estate tax marital deduction was taken. The husband's entire estate was subject to estate tax again in the wife's estate. The gift program was an additional characteristic of this plan and had a primary purpose, the reduction of the size of the estates. This reduction was two-fold: it resulted in reductions of the actual size of the estate at the time the gift was made, and, in addition, reductions in appreciation of the estate after the gift was made. The reductions in the size of the estate through the gift program resulted in reductions from the top end of the tax bill since both estate and inheritance taxes are progressive taxes.

#### Alternative Plan IV

This plan divided the husband's estate into two parts, one which qualified for the estate tax marital deduction and the other

which did not qualify. This plan allowed only that part of the husband's estate which qualified for the marital deduction to be included in the wife's estate. Furthermore, the amount which was left the wife was so balanced that the marginal tax on the non-marital deduction portion of the husband's estate approximately equaled the marginal tax on the marital deduction portion of the husband's estate. When estimating the marginal tax on the marital deduction portion, it was estimated on the wife's estate when her estate was subject to the tax. Therefore, this plan takes advantages of the estate tax marital deduction on the husband's estate, but only to the extent that it lessens overall capital erosion on the two estates since over-use of the estate tax marital deduction did result in a higher present value of capital erosion.

#### Alternative Plan V

This plan was very similar to Alternative Plan IV except for the use of the gift program. As in Alternative Plan IV, the husband's estate is divided into two parts: a marital deduction and a non-marital deduction part. The estate taxes on the husband's estate were reduced by the use of the marital deduction. Furthermore, the marital deduction portion of the husband's estate was the only part of his estate included in the wife's estate. The gift program of this plan had the same effect as in Alternative Plan III, in that it reduced the size of both the husband's and the wife's estates, which in turn reduced taxes on their estates.

FOOTNOTES

1. Burkhart, G. W., "Our Estate Inventory," Publication 685, Extension Division, Virginia Polytechnic Institute and State University, December, 1975.

## CHAPTER V

### SUMMARY AND CONCLUSIONS

The size and value of farm operations have increased tremendously over the last quarter of a century. This has raised serious questions concerning continuation of commercial farms by the on-farm heir(s) during intergeneration transfer. The heir(s) who wants to continue operating the farm may have difficulty obtaining enough capital to buy out the off-farm heir(s). This problem is oftentimes further compounded by liens against the estate and the heirs' inheritance such as Federal Estate Tax, Virginia Inheritance Tax, and administrative expenses. If the on-farm heir is unable to raise sufficient capital to provide for continued operation of the farm, the assets of the estate will be sold. This may result in interruption of the efficient production of farm products.

Typically, when the farmer is faced with making estate planning decisions, he will specify certain objectives he wishes to accomplish. These objectives must be integrated with factors which influence the development of the estate plan such as the ages of the parents and the children, the type of farm, and the size of the estate. The combination of these factors and objectives may result in conflicts which must be resolved before a comprehensive estate plan can be developed.

The objectives of this study were:

1. To estimate the degree and kind of estate planning practiced by farm owners and rural residents in Virginia.
2. To estimate the potential capital erosion of the existing estate plans of a selected number of owners of large farms.
3. To estimate the potential capital erosion of selected alternative estate plans in cases studied under Objective 2.

A survey was made of rural residents in Virginia attending estate planning meetings in 1976 to estimate the degree and kind of estate planning they were doing and to determine whether any groups among those surveyed were more likely than others to have developed formal estate plans.

Case studies were developed from three actual situations. The purpose of each case study was to estimate the potential capital erosion under each individual's existing estate plan and five alternative estate plans.

#### Summary of the Survey

(1) The survey data came from 285 completed questionnaires. Of those persons responding to the questionnaires, 95 were farmers and 190 were non-farmers; furthermore, of the total number, 84 were already retired. There was a greater proportion of retired individuals in the survey than would have been expected in a random sample of the population.

(2) The majority of the individuals surveyed either had no formal plan or a will only. Slightly more than half of the individuals

surveyed indicated that they had made wills; however, less than one-fourth of the respondents had utilized life estates or trusts in their estate plans. Approximately one-fifth of those surveyed had made gifts.

(3) The retired individuals surveyed were most likely to have made wills. In addition, a much larger percentage of the retired individuals had retirement or pension plans than did the entire group.

(4) The farmers surveyed were, as a group, less likely to have pension or retirement plans than the non-farmers. No large differences were noted between farmers and non-farmers concerning use of other estate planning tools.

(5) As a group, the farmers surveyed had the largest average estates. This was due to the high value of land holdings and personal property of the farmers surveyed.

(6) Joint tenancy or tenancy by the entirety was the most popular form of ownership. Tenancy in severalty was second in popularity to joint tenancy or tenancy by the entirety.

(7) The average number of acres held by farmers was higher than for any other group, and this explains why the value of real estate holdings of farmers was high.

(8) It was noted that individuals with estates larger than \$125,000 were more likely to have made a will than individuals with estates smaller than \$125,000. Further investigation of the individuals with estates larger than \$125,000 did not indicate that individuals were more likely to have a will as estate size increased.

(9) No difference could be detected concerning the likelihood of having a will between farmers with estates less than \$125,000 and non-farmers with estates less than \$125,000; however, farmers with estates larger than \$125,000 were less likely to have wills than were non-farmers with estates larger than \$125,000.

#### Summary of the Case Studies

(1) Fair market valuation of both the husband's and the wife's estates resulted in more capital erosion than the special valuation option or any other combination of options.

(2) Special valuation of both the husband's and the wife's estates resulted in the least capital erosion of any combination of valuation options.

(3) In a situation where no heir was interested in continuing to operate the farm after the deaths of the husband and wife, the amount of capital erosion was not influenced by special valuation versus fair market valuation, or by the various alternative plans.

(4) The wife's estate did not qualify for special valuation when the husband died intestate unless she received enough real estate involved in the farm through tenancy by the entirety and/or she held enough real estate as tenant in severalty so that it composed at least 25% of her adjusted gross estate.

(5) Intestate distribution of the husband's estate resulted in the least property passing to the surviving spouse except when large portions of the estate were held in tenancy by the entirety. Since the surviving spouse received the least property under this plan, less



property qualified for the estate tax marital deduction. This plan resulted in higher estate taxes on the husband's estate than on any of the other plans considered.

(6) When the husband's entire estate passed to the wife, the maximum possible estate tax marital deduction was used which resulted in lower estate taxes on the husband's estate. Since the wife's estate was larger under these plans than under any of the other alternative plans, taxes on her estate were higher.

(7) The use of gift programs, which did not result in taxable gifts, reduced the potential size of both the husband's and wife's tentative base, which, in turn, resulted in lower estate taxes on both estates.

(8) When the husband's estate was divided into two parts, one of which qualified for the estate tax marital deduction and one which did not, total capital erosion was less than the other plans, which provided the wife with income from the husband's entire estate.

(9) When the husband's estate was divided into two parts, the minimum capital erosion resulted when the parts were apportioned so that the present value of the marginal tax on the marital deduction part of his estate was approximately equal to the present value of the marginal tax on the non-marital deduction part.

(10) The estate plans which resulted in less capital erosion resulted in lower debt/equity ratios for the on-farm heir.

### Conclusions

(1) The election of special valuation provided for in the 1976 Tax Reform Act results in less capital erosion than fair market valuation or any combinations of fair market and special valuation.

(2) If the farm owner-operator wishes his wife's estate to qualify for special valuation, his estate plan should provide her with an estate which meets the requirements of special valuation.

(3) Estate plans which minimize capital erosion at the husband's death by using the estate tax marital deduction can result in higher capital erosion at the wife's death.

(4) If a gift program in which no taxable gifts are made is included as a part of the estate plan, the result will be lower capital erosion because the taxable estate is smaller.

(5) The estate plan which minimizes total taxes and administrative expenses on both spouses' estates is that plan which equates the present value of the marginal tax on the two estates.

(6) The increase in value of the estate as a result of appreciation is an important consideration in estate planning.

### Implications

(1) Although the carry-over basis provisions of the 1976 Tax Reform Act may affect the degree of capital erosion from an estate during intergenerational transfer, analysis of the effects of these provisions was beyond the scope of this study. The influence of these provisions should be investigated to determine their possible impact on development of optimum estate plans of land owners.

(2) Although not considered in the study, potential liquidity problems appear to be common in estates involving commercial farms. Further study of this problem would be desirable to determine what adjustments are needed and what opportunities are available to ease these potential liquidity conflicts.

(3) If one of the objectives of society is to maintain an adequate supply of food and fiber which provides for the welfare of the people, the competitive market system should be allowed to operate so as to allow inefficient producers to go out of production and to encourage efficient producers to stay in production. Commercial farm operations are by far the major contributors to the nation's supply of food and fiber. If the owner-operator fails to make adequate plans prior to inter-generation transfer of his farm, the on-farm heir may find it impossible to continue operating the farm. Further study should be given this problem to determine to what extent the flow of products from the farm is impeded, by inadequate forward planning.

(4) An expanded education effort is needed to provide farm owner-operators with an understanding of alternative estate plans, which would aid them in making wise decisions to implement their stated objectives. Individuals who have as an objective the continuation of the farm operation by one or more of the heirs would then have the information available to provide for the fulfillment of this and other objectives.

## APPENDICES

APPENDIX A

QUESTIONNAIRE USED IN THE SURVEY

WHAT IS YOUR ESTATE SITUATION?

What is your occupation? \_\_\_\_\_

Marital status: Single \_\_\_\_\_ Married \_\_\_\_\_ Divorced \_\_\_\_\_

Widowed \_\_\_\_\_

How many children do you have? . . . . . \_\_\_\_\_

Do any of your children want to farm? Yes \_\_\_\_\_ No \_\_\_\_\_

Don't Know \_\_\_\_\_

Do you have an estate plan? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Do you have a will? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Does your spouse have a will? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Was your will drafted or changed in the last 5 years? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Do you have a formal retirement or pension plan other than social security? . . Yes \_\_\_\_\_ No \_\_\_\_\_

Does your estate plan contain provisions for a life estate? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Does your estate plan contain one or more trusts? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Have you made any gifts of land, stocks, bonds, and/or cash? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Have you made gifts in more than one year? . Yes \_\_\_\_\_ No \_\_\_\_\_

Do you have a life insurance plan? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

How many acres do you hold, deeded in your name only? . . . . \_\_\_\_\_

How many acres does your spouse hold deeded in spouse's name only? . . . . . \_\_\_\_\_

How many acres do you hold, deeded jointly with rights of survivorship? . . . . . \_\_\_\_\_

How many acres do you hold, deeded jointly without rights of survivorship? . . . . . \_\_\_\_\_

How many acres do you hold but do not now know how the deed is written? . . . . . \_\_\_\_\_

If you had to sell your farm real estate, what is the lowest price you would take per acre? . . . . . \_\_\_\_\_

What do you estimate the value of your personal property to be? (Cash, stocks, bonds, machinery, livestock, etc.) . . \_\_\_\_\_

What do you estimate the value of your non-farm real estate to be? . . . . . \_\_\_\_\_

Is your farm operation incorporated? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

Do you operate as a farm partnership? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

If so, do you and your partner have insurance on each other? . . . . . Yes \_\_\_\_\_ No \_\_\_\_\_

APPENDIX B

UNIFIED RATE SCHEDULE AND  
VIRGINIA INHERITANCE TAX SCHEDULES



Table B-1. Unified Rate Schedule for Determining Gift and Estate Tax  
(Int. Rev. Code 2001c)

If the amount with respect to which the gift or estate tax to be computed is more than:	but not over:	the gift or estate tax is	of the 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
2,500,000	3,000,000	1,025,800 + 53%	2,500,000
3,000,000	3,500,000	1,290,800 + 57%	3,000,000
3,500,000	4,000,000	1,575,800 + 61%	3,500,000
4,000,000	4,500,000	1,880,800 + 65%	4,000,000
4,500,000	5,000,000	2,205,800 + 69%	4,500,000
5,000,000	--	2,550,800 + 70%	5,000,000

Table B-2. Virginia Inheritance Tax Classes, Rates and Exemptions,  
Code of Va. 58-153 and 58-192

Class A - Father, Mother, Grandfathers, Grandmothers, Husband, Wife,  
Children by Blood or by Legal Adoption, Stepchildren, Grand-  
children, and All Other Lineal Ancestors and Lineal Descend-  
ants of the Decedent.

(Exemption \$5,000 to each beneficiary)

Net Estate		Taxable	Rate Per Cent	Tax for Bracket	Total Tax
Exceeding	Not Exceeding				
\$ 5,000 (Exemption)	\$ 50,000	\$ 45,000	1	\$ 450	\$ 450
50,000	100,000	50,000	2	1,000	1,450
100,000	500,000	400,000	3	12,000	13,450
500,000	1,000,000	500,000	4	20,000	33,450
1,000,000			5		

Class B - Brothers, Sisters, Nephews, Nieces of the Whole or Half  
Blood of the Decedent.

(Exemption \$2,000 to each beneficiary)

Net Estate		Taxable	Rate Per Cent	Tax for Bracket	Total Tax
Exceeding	Not Exceeding				
\$ 2,000 (Exemption)	\$ 25,000	\$ 23,000	2	\$ 460	\$ 460
25,000	50,000	25,000	4	1,000	1,460
50,000	100,000	50,000	6	3,000	4,460
100,000	500,000	400,000	8	32,000	38,460
500,000			10		

Table B-2. Continued.

Class C - Grandnephews and Grandnieces of the Decedent and All Persons Other Than Members of Classes A and B and All Firms, Institutions, Associations and Corporations.

(Exemptions \$1,000 to each beneficiary)

Net Estate		Taxable	Rate Per Cent	Tax for Bracket	Total Tax
Exceeding	Not Exceeding				
\$ 1,000 (Exemption)	\$ 25,000	\$ 24,000	5	\$ 1,200	\$ 1,200
25,000	50,000	25,000	7	1,750	2,950
50,000	100,000	50,000	9	4,500	7,450
100,000	500,000	400,000	12	48,000	55,450
500,000			15		

APPENDIX C

DETAILS FROM THE ESTATE PLANNING SURVEY

Table C-1. Summary of Estate Planning Characteristics of the Entire Survey (285 Individuals)

	(Number of Responses)			
	Yes	No	Do Not Know	No Reply
Children want to farm	49	130	63	43
Had estate plan	60	202	--	23
Had made will	164	119	--	2
Spouse had made will	113	109	--	50
Will drafted or changed in last five years	79	141	--	65
Had retirement or pension plan	156	119	--	10
Utilize life estate in estate plan	41	163	--	81
Utilize trust in estate plan	24	179	--	82
Had made gifts	53	205	--	27
Had made gift in more than one year	31	225	--	29
Had life insurance	188	77	--	20
Farm was incorporated	5	158	--	122
Farm was partnership	18	156	--	111
Partners insured each other	12	118	--	155

Table C-2. Summary of Land Tenure Characteristics of the Entire Survey (285 Individuals)

	(Acres)	
	Average	Range
Land held in tenancy in severalty	186.7	0-1,600
Land held by spouse in tenancy in severalty	169.1	0-1,000
Land held in tenancy by the entirety or joint tenancy	190.9	0-1,570
Land held in tenancy in common	283.9	0-1,200
Land held but do not know form of ownership	91.3	0-500
Land held in all forms of ownership	217.4	0-3,250

Table C-3. Summary of Estate Value of Entire Survey (285 Individuals)

	(Dollars)	
	Average	Range
Price per acre	1,011.3	0-9,000
Value of land holdings	176,628.4	0-3,200,000
Value of personal property	89,181.3	0-1,500,000
Value of non-farm real estate	64,309.8	0-500,000
Value of overall estate	212,197.0	0-4,700,000

Table C-4. Summary of Estate Planning Characteristics of the 84 Retired Individuals Surveyed

	(Number of Responses)			
	Yes	No	Do Not Know	No Reply
Children want to farm	7	48	7	22
Had estate plan	24	49	-	11
Had made will	63	20	-	1
Spouse had made will	42	20	-	20
Will drafted or changed in last five years	33	37	-	14
Had retirement or pension plan	61	20	-	3
Utilize life estate in estate plan	13	42	-	29
Utilize trust in estate plan	4	54	-	26
Had made gifts	23	53	-	8
Had made gift in more than one year	17	58	-	9
Had life insurance	56	23	-	5
Farm was incorporated	0	40	-	44
Farm was partnership	4	38	-	42
Partners insured each other	5	25	-	54



Table C-5. Summary of Land Tenure Characteristics of the 84 Retired Individuals Surveyed

	(Acres)	
	Average	Range
Land held in tenancy in severalty	62.7	0-700
Land held by spouse in tenancy in severalty	244.4	0-900
Land held in tenancy by the entirety or joint tenancy	73.8	0-670
Land held in tenancy in common	126.5	0-218
Land held but do not know form of ownership	14.0	0-27
Land held in all forms of ownership	91.3	0-983

Table C-6. Summary of Estate Values of the 84 Retired Individuals Surveyed

	(Dollars)	
	Average	Range
Price per acre	1,346.7	200-5,000
Value of land holdings	94,059.7	0-670,000
Value of personal property	78,461.0	0-400,000
Value of non-farm real estate	72,464.1	0-300,000
Value of overall estate	153,300.8	0-730,000

Table C-7. Summary of Estate Planning Characteristics of the 95 Farmers Surveyed

	(Number of Responses)			
	Yes	No	Do Not Know	No Reply
Children want to farm	31	24	30	10
Had estate plan	19	71	--	5
Had made will	54	40	--	1
Spouse had made will	36	42	--	8
Will drafted or changed in last five years	29	47	--	19
Had retirement or pension plan	38	51	--	6
Utilize life estate in estate plan	10	61	--	24
Utilize trust in estate plan	6	65	--	24
Had made gifts	16	72	--	7
Had made gift in more than one year	11	77	--	7
Had life insurance	56	34	--	5
Farm was incorporated	4	80	--	11
Farm was partnership	12	74	--	9
Partners insured each other	2	55	--	38

Table C-8. Summary of Land Tenure Characteristics of the 95 Farmers Surveyed

	(Acres)	
	Average	Range
Land held in tenancy in severalty	315.2	0-1,600
Land held by spouse in tenancy in severalty	246.6	0-1,000
Land held in tenancy by the entirety or joint tenancy	296.9	0-1,570
Land held in tenancy in common	422.3	0-1,200
Land held but do not know form of ownership	161.5	0-500
Land held in all forms of ownership	398.5	0-3,250

Table C-9. Summary of the Estate Values of the 95 Farmers Surveyed

	(Dollars)	
	Average	Range
Price per acre	730.9	50-4,000
Value of land holdings	258,548.3	0-3,200,000
Value of personal property	120,850.0	5,000-1,500,000
Value of non-farm real estate	78,258.9	0-500,000
Value of overall estate	346,798.4	0-4,700,000

Table C-10. Summary of the Estate Planning Characteristics of 190 Non-Farmers Surveyed

	(Number of Responses)			
	Yes	No	Do Not Know	No Reply
Children want to farm	18	106	33	33
Had estate plan	41	131	--	18
Had made will	110	79	--	1
Spouse had made will	77	67	--	42
Will drafted or changed in last five years	50	94	--	46
Had retirement or pension plan	118	68	--	4
Utilize life estate in estate plan	33	100	--	57
Utilize trust in estate plan	18	114	--	58
Had made gifts	37	133	--	20
Had made gift in more than one year	20	148	--	22
Had life insurance	132	43	--	15
Farm was incorporated	1	78	--	111
Farm was partnership	6	82	--	102
Partners insured each other	10	63	--	117

Table C-11. Summary of the Land Tenure of the 190 Non-Farmers Surveyed

	(Acres)	
	Average	Range
Land held in tenancy in severalty	26.1	0-370
Land held by spouse in tenancy in severalty	25.0	0-80
Land held in tenancy by the entirety or joint tenancy	98.0	0-670
Land held in tenancy in common	191.6	0-400
Land held but do not know form of ownership	21.0	0-70
Land held in all forms of ownership	79.8	0-670

Table C-12. Summary of the Estate Values of the 190 Non-Farmers Surveyed

	(Dollars)	
	Average	Range
Price per acre	1,498.7	0-9,000
Value of land holdings	53,938.1	0-670,000
Value of personal property	71,747.8	0-400,000
Value of non-farm real estate	61,816.4	0-300,000
Value of overall estate	118,791.2	0-730,000



Table C-13. Summary of the Number of Children of the 285 Individuals Surveyed

	(Number of Children)	
	Average	Range
Entire survey	2.0	0-8
Retired Individuals	1.6	0-5
Farmers	2.3	0-6
Non-Farmers	1.9	0-8

Table C-14. Summary of the Marital Status of the 285 Individuals Surveyed

	(Number of Responses)				
	Single	Married	Divorced	Widowed	No Reply
Entire Survey	16	224	6	39	0
Retired Individuals	4	59	2	19	0
Farmers	6	86	2	1	0
Non-Farmers	10	138	4	38	0

Table C-15. Summary of the Entire Survey Indicating the Number and Percentage of Individuals Having Various Tools in Their Estate Plans

Have Will	Use Life Estate in Estate Plan	Use Trust in Estate Plan	Made Gifts	Frequency	Percent
Yes	Yes	Yes	Yes	3	1.053
Yes	Yes	Yes	No	4	1.404
Yes	Yes	No	Yes	3	1.053
Yes	Yes	No	No	12	4.211
Yes	Yes	No	N/A	1	0.351
Yes	Yes	N/A	Yes	2	0.702
Yes	Yes	N/A	No	4	1.404
Yes	Yes	N/A	N/A	3	1.053
Yes	No	Yes	Yes	5	1.754
Yes	No	Yes	No	4	1.404
Yes	No	No	Yes	17	5.965
Yes	No	No	No	58	20.351
Yes	No	N/A	No	3	1.053
Yes	N/A	Yes	Yes	2	0.702
Yes	N/A	Yes	No	2	0.702
Yes	N/A	No	Yes	2	0.702
Yes	N/A	No	No	6	2.105
Yes	N/A	No	N/A	1	0.351
Yes	N/A	N/A	Yes	6	2.105
Yes	N/A	N/A	No	17	5.965
Yes	N/A	N/A	N/A	9	3.158
No	Yes	Yes	Yes	1	0.351
No	Yes	Yes	No	2	0.702
No	Yes	No	Yes	1	0.351
No	Yes	No	No	4	1.404
No	Yes	N/A	No	1	0.351
No	No	Yes	No	1	0.351
No	No	NO	Yes	2	0.702
No	No	No	No	66	23.158
No	No	No	N/A	1	0.351
No	No	N/A	No	4	1.404
No	No	N/A	N/A	1	0.351
No	N/A	No	No	4	1.404
No	N/A	N/A	Yes	2	0.702
No	N/A	N/A	No	18	6.316
No	N/A	N/A	N/A	11	3.860
N/A	No	No	No	1	0.351
N/A	N/A	N/A	Yes	1	0.351

N/A, no answer.

Table C-16. Summary of the Farmers Surveyed Indicating the Number and Percentage of Individuals Having Various Tools in Their Estate Plans

Have Will	Use Life Estate in Estate Plan	Use Trust in Estate Plan	Made Gifts	Frequency	Percent
Yes	Yes	Yes	Yes	2	2.105
Yes	Yes	Yes	No	1	1.053
Yes	Yes	No	No	1	1.053
Yes	Yes	N/A	No	3	3.158
Yes	Yes	N/A	N/A	2	2.105
Yes	No	No	Yes	8	8.421
Yes	No	No	No	20	21.053
Yes	No	N/A	No	2	2.105
Yes	N/A	Yes	No	1	1.053
Yes	N/A	No	No	3	3.158
Yes	N/A	No	N/A	1	1.053
Yes	N/A	N/A	Yes	1	1.053
Yes	N/A	N/A	No	6	6.316
Yes	N/A	N/A	N/A	3	3.158
No	Yes	Yes	Yes	1	1.053
No	No	Yes	No	1	1.053
No	No	No	Yes	1	1.053
No	No	No	No	24	25.263
No	No	No	N/A	1	1.053
No	No	N/A	No	2	2.105
No	N/A	No	No	2	2.105
No	N/A	N/A	No	5	5.263
No	N/A	N/A	N/A	3	3.158
N/A	N/A	N/A	Yes	1	1.053

N/A, no answer.

Table C-17. Summary of the Non-Farmers Surveyed Indicating the Number and Percentage of Individuals Having Various Tools in Their Estate Plans

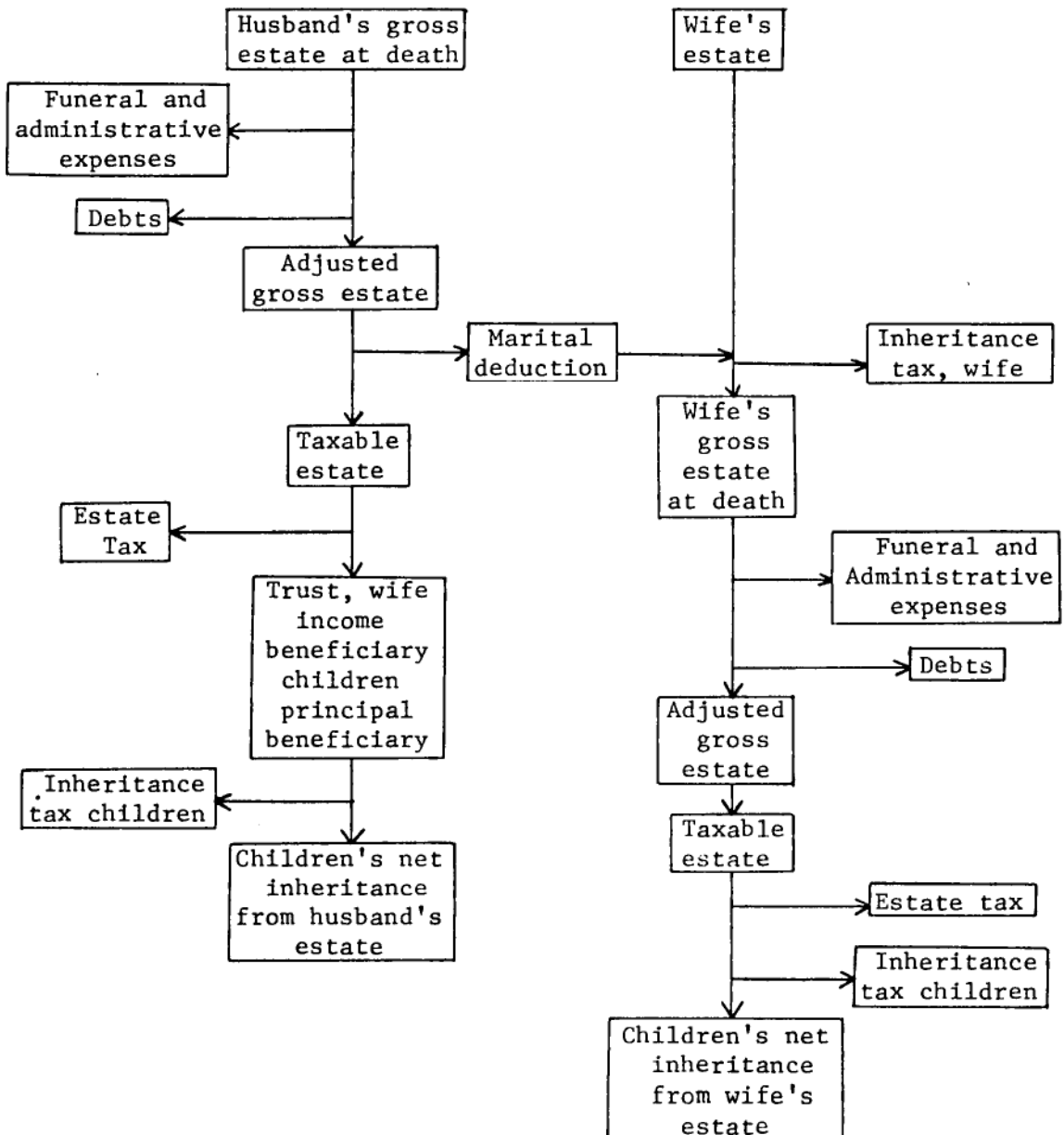
Have Will	Use Life Estate in Estate Plan	Use Trust in Estate Plan	Made Gifts	Frequency	Percent
Yes	Yes	Yes	Yes	1	0.526
Yes	Yes	Yes	No	3	1.579
Yes	Yes	No	Yes	3	1.579
Yes	Yes	No	No	11	5.789
Yes	Yes	No	N/A	1	0.526
Yes	Yes	N/A	Yes	2	1.053
Yes	Yes	N/A	No	1	0.526
Yes	Yes	N/A	N/A	1	0.526
Yes	No	Yes	Yes	5	2.632
Yes	No	Yes	No	4	2.105
Yes	No	No	Yes	9	4.737
Yes	No	No	No	38	20.000
Yes	No	N/A	No	1	0.526
Yes	N/A	Yes	Yes	2	1.053
Yes	N/A	Yes	No	1	0.526
Yes	N/A	No	Yes	2	1.053
Yes	N/A	No	No	3	1.579
Yes	N/A	N/A	Yes	5	2.632
Yes	N/A	N/A	No	11	5.789
Yes	N/A	N/A	N/A	6	3.158
No	Yes	Yes	No	2	1.053
No	Yes	No	Yes	1	0.526
No	Yes	No	No	4	2.105
No	Yes	N/A	No	1	0.526
No	Yes	No	No	1	0.526
No	No	No	Yes	1	0.526
No	No	No	No	41	21.579
No	No	N/A	No	2	1.053
No	No	N/A	N/A	1	0.526
No	N/A	No	No	2	1.053
No	N/A	N/A	Yes	2	1.056
No	N/A	N/A	No	13	6.842
No	N/A	N/A	N/A	8	4.211
N/A	No	No	No	1	0.526

N/A, no answer.

APPENDIX D

MODEL FOR MINIMIZING TAXES AND ADMINISTRATIVE  
EXPENSES FOR ALTERNATIVE PLANS IV AND V

Model for minimizing the capital erosion from both the husband's and the wife's estate when the husband's estate is divided into two parts, the wife receiving one of the parts as tenant in severalty and the other part passes to the children subject to a lifetime interest of the wife.



## Alphabetical Listing of Variables and Constants Used in the Model

- A, rate of administrative expenses
- $B_{CIH}$ , base amount for the tax bracket to which marginal tax rate applies for each child's inheritance from the father's estate
- $B_{CIW}$ , base amount for the tax bracket to which marginal tax rate applies for each child's inheritance from the mother's estate
- $B_H$ , base amount for the tax bracket to which marginal tax rate applies for the husband's tentative tax base
- $B_W$ , base amount for the tax bracket to which the marginal tax rate applies for the wife's tentative tax base
- $B_{WI}$ , base amount for the tax bracket to which the marginal tax rate applies for the wife's inheritance from the husband's estate
- $C_{IH}$ , each child's inheritance from husband's estate
- $C_{IW}$ , each child's inheritance from wife's estate
- $C_T$ , unified credit
- $D_H$ , debts on husband's estate
- $D_W$ , debts on the wife's estate
- $D_{Hi}$ , decreases in the husband's non-probate estate in the  $i^{\text{th}}$  year, due to gifts or transfers to his probate estate, etc.
- $D_{HPi}$ , decreases in the husband's probate estate in the  $i^{\text{th}}$  year, due to gifts, transfers to his non-probate estate, etc.
- $D_{Wi}$ , decreases in the wife's estate in the  $i^{\text{th}}$  year, due to gifts, etc.
- $E_{AFH}$ , administrative expenses and funeral cost at the husband's death
- $E_{AFW}$ , administrative expenses and funeral cost at the wife's death



- $E_{TH}$ , estate tax on the husband's estate  
 $E_{TW}$ , estate tax on the wife's estate  
 $F_H$ , husband's funeral expenses, etc.  
 $F_W$ , wife's funeral expenses, etc.  
 $G_E$ , gifts from husband to wife in excess of the annual exclusion  
 $G_{Hi}$ , gifts from the husband to the wife in the  $i^{\text{th}}$  year  
 $G_{MD}$ , gifts from husband to wife which qualify for the gift tax marital deduction  
 $G_{WCI}$ , gift from the wife's estate to the children in the  $i^{\text{th}}$  year  
 $H$ , husband's gross estate at death  
 $H_A$ , husband's adjusted gross estate  
 $H_{NP}$ , husband's non-probate estate in year Z  
 $H_P$ , husband's probate estate in year Z  
 $H_T$ , husband's tentative tax base  
 $I_{CH}$ , inheritance tax on children's inheritance from the father's estate  
 $I_{CW}$ , inheritance tax on children's inheritance from the wife's estate  
 $I_{Hi}$ , increases in the husband's non-probate estate in the  $i^{\text{th}}$  year, due to gift, inheritance, transfers from the probate estate, etc.  
 $I_{HPi}$ , increases in the husband's probate estate in the  $i^{\text{th}}$  year due to gifts, inheritance, transfers from his non-probate, etc.  
 $I_{Wi}$ , increases in the husband's probate estate in the  $i^{\text{th}}$  year, due to gifts, inheritance, etc.  
 $I_W$ , wife's inheritance from husband's estate for Virginia Inheritance Tax

- J, present value, on the basis of a five percent interest, of an annuity of one dollar, based on the wife's life (Va. Code 55-269.)
- $L_H$ , life insurance owned by husband on his own life payable to the wife
- $L_W$ , life insurance on the husband, owned by the wife
- M, the marital deduction on the husband's estate
- N, number of children
- $P_{CIH}$ , marginal tax rate on each child's inheritance from the husband's estate
- $P_{CIW}$ , marginal tax rate on each child's inheritance from the mother's estate
- $P_H$ , marginal tax rate on the husband's estate
- $P_{IW}$ , marginal tax rate on the wife's inheritance from the husband's estate
- $P_W$ , marginal tax rate on the wife's estate
- $Q_{CIH}$ , base amount of tax for the tax bracket to which the marginal tax applies for each child's inheritance from the father's estate
- $Q_{CIW}$ , base amount of tax for the tax bracket to which the marginal tax applies for each child's inheritance from the mother's estate
- $Q_H$ , base amount of tax for the tax bracket to which the marginal tax applies for the husband's estate
- $Q_W$ , base amount of tax for the tax bracket to which the marginal tax applies for the wife's estate
- $Q_{WI}$ , base amount of tax for the tax bracket to which the marginal tax applies for the husband's estate
- R, rate of increase in value

- T, PV total tax and administrative expenses
- $T_M$ , PV total taxes and administrative expenses on the part of the estate which does not include the marital deduction
- $T_N$ , PV total taxes and administrative expenses on the part of the estate which includes the non-marital deduction
- $T_{WI}$ , inheritance tax paid by the wife on inheritance from husband's estate
- U, one-half the value of the residence if owned in joint tenancy between spouses
- $V_T$ , valuation of wife's interest in trust for Virginia Inheritance Tax
- W, wife's gross estate at her death
- $W_A$ , wife's adjusted gross estate
- $W_E$ , wife's estate in year Z
- $W_I$ , wife's inheritance from the husband's estate
- $W_{IT}$ , wife's taxable inheritance from husband's estate
- $W_T$ , wife's taxable estate
- X, expected year of wife's death (actuarial tables)
- Y, expected year of husband's death (actuarial tables)
- Z, present year

Assume the husband made no taxable gift during his lifetime.

The husband's gross estate at death is defined by

$$(1) \quad H = (1+R)^{Y-Z} H_P + \sum_{i=Z}^Y I_{HPi} (1+R)^{Y-i} - \sum_{i=Z}^Y D_{HPi} (1+R)^{Y-i} \\ + H_{NP} (1+R)^{Y-Z} + L_H + \sum_{i=Z}^Y I_{Hi} (1+R)^{Y-i} - \sum_{i=Z}^Y D_{Hi} (1+R)^{Y-i}$$

Administrative and funeral expenses on the husband's estate are defined by

$$(2) \quad E_{AFH} = A \left\{ (1+R)^{Y-Z} H_P + \sum_{i=Z}^Y I_{HPi} (1+R)^{Y-i} - \sum_{i=Z}^Y D_{HPi} (1+R)^{Y-i} \right\} + F_H$$

The husband's adjusted gross estate is defined by

$$(3) \quad H_A = H - E_{AFH} - D_H$$

The marital deduction for the husband's estate is defined by

$$(4) \quad M = W_I - G_{MD} + 1/2 G_E$$

subject to the greater of

$$M \leq 250,000 - G_{MD} + 1/2 G_E$$

$$M \leq 1/2 H_A - G_{MD} + 1/2 G_E$$

The husband's taxable estate is defined by

$$(5) \quad H_T = H_A - M$$

subject to

$$H_T \geq 0$$

Estate tax on the husband's estate is defined by

$$(6) \quad E_{TH} - P_H (H_T - B_H) + Q_H - C_T$$

subject to  $E_{TH} \geq 0$  where  $P_H$ ,  $B_H$  and  $Q_H = f(H_T)$  such that if

$0 < H_T \leq 10,000$	$B_H = 0$	$Q_H = 0$	$P_H = 0.18$
$10,000 < H_T \leq 20,000$	$B_H = 10,000$	$Q_H = 1,800$	$P_H = 0.20$
$20,000 < H_T \leq 40,000$	$B_H = 20,000$	$Q_H = 3,800$	$P_H = 0.22$
$40,000 < H_T \leq 60,000$	$B_H = 40,000$	$Q_H = 8,200$	$P_H = 0.24$
$60,000 < H_T \leq 80,000$	$B_H = 60,000$	$Q_H = 13,000$	$P_H = 0.26$
$80,000 < H_T \leq 100,000$	$B_H = 80,000$	$Q_H = 18,200$	$P_H = 0.28$
$100,000 < H_T \leq 150,000$	$B_H = 100,000$	$Q_H = 23,800$	$P_H = 0.30$
$150,000 < H_T \leq 250,000$	$B_H = 150,000$	$Q_H = 38,000$	$P_H = 0.32$
$250,000 < H_T \leq 500,000$	$B_H = 250,000$	$Q_H = 70,800$	$P_H = 0.34$
$500,000 < H_T \leq 750,000$	$B_H = 500,000$	$Q_H = 155,800$	$P_H = 0.37$
$750,000 < H_T \leq 1,000,000$	$B_H = 750,000$	$Q_H = 248,300$	$P_H = 0.39$
$1,000,000 < H_T \leq 1,250,000$	$B_H = 1,000,000$	$Q_H = 345,800$	$P_H = 0.41$
$1,250,000 < H_T \leq 1,500,000$	$B_H = 1,250,000$	$Q_H = 448,300$	$P_H = 0.43$
$1,500,000 < H_T \leq 2,000,000$	$B_H = 1,500,000$	$Q_H = 555,800$	$P_H = 0.45$
$2,000,000 < H_T \leq 2,500,000$	$B_H = 2,000,000$	$Q_H = 780,800$	$P_H = 0.49$
$2,500,000 < H_T \leq 3,000,000$	$B_H = 2,500,000$	$Q_H = 1,025,800$	$P_H = 0.53$
$3,000,000 < H_T \leq 3,500,000$	$B_H = 3,000,000$	$Q_H = 1,290,800$	$P_H = 0.57$
$3,500,000 < H_T \leq 4,000,000$	$B_H = 3,500,000$	$Q_H = 1,575,800$	$P_H = 0.61$
$4,000,000 < H_T \leq 4,500,000$	$B_H = 4,000,000$	$Q_H = 1,880,800$	$P_H = 0.65$
$4,500,000 < H_T \leq 5,000,000$	$B_H = 4,500,000$	$Q_H = 2,205,800$	$P_H = 0.69$
$5,000,000 < H_T \leq \infty$	$B_H = 5,000,000$	$Q_H = 2,550,800$	$P_H = 0.70$

Inheritance tax on children's inheritance from trust as principal beneficiaries at wife's death is defined by (assume each receives equal share)

$$(7) \quad I_{CIH} = P_{CIH} \{ (1+R)^{X-Y} (H_A - W_I - E_{TH}) - NB_{CIH} \} + NQ_{CIH}$$

where  $P_{CIH}$ ,  $B_{CIH}$  and  $Q_{CIH} = f[(1+R)^{X-Y} (H_T - E_{TH})]$  such that if

$$0 < (1+R)^{X-Y} (H_T - E_{TH}) \leq 5,000 N, \quad B_{CIH} = 0, \quad Q_{CIH} = 0, \quad P_{CIH} = 0$$

$$5,000 N < (1+R)^{X-Y} (H_T - E_{TH}) \leq 50,000 N, \quad B_{CIH} = 5,000, \quad Q_{CIH} = 0, \quad P_{CIH} = 0.01$$

$$50,000 N < (1+R)^{X-Y} (H_T - E_{TH}) \leq 100,000 N, \quad B_{CIH} = 50,000, \quad Q_{CIH} = 450, \quad P_{CIH} = 0.02$$

$$100,000 N < (1+R)^{X-Y} (H_T - E_{TH}) \leq 500,000 N, \quad B_{CIH} = 100,000, \quad Q_{CIH} = 1,450, \quad P_{CIH} = 0.03$$

$$500,000 N < (1+R)^{X-Y} (H_T - E_{TH}) \leq 1,000,000 N, \quad B_{CIH} = 500,000, \quad Q_{CIH} = 13,450, \quad P_{CIH} = 0.04$$

$$1,000,000 N < (1+R)^{X-Y} (H_T - E_{TH}) \leq \infty, \quad B_{CIH} = 1,000,000, \quad Q_{CIH} = 33,450, \quad P_{CIH} = 0.05$$

Valuation of wife's interest in trust for Virginia Inheritance Tax defined by

$$(8) \quad V_T = 0.05 J (H_A - W_I)$$

Wife's inheritance from husband's estate for Virginia Inheritance Tax defined by

$$(9) \quad I_W = W_I + V_T + \sum_{i=Y-3}^Y G_{Hi} (1+R)^{Y-i} - L_H - U$$

Inheritance tax paid by wife on inheritance from husband's estate

$$(10) \quad T_{WI} = P_{IW} (I_W - B_{WI}) + Q_{WI}$$

where  $P_{IW}$ ,  $B_{WI}$  and  $Q_{WI} = f(I_W)$  such that if

$$\begin{array}{llll} 0 < I_W \leq & 5,000, & B_{WI} = & 0, & Q_{WI} = & 0, & P_{IW} = & 0 \\ 5,000 < I_W \leq & 50,000, & B_{WI} = & 5,000, & Q_{WI} = & 0, & P_{IW} = & 0.01 \\ 50,000 < I_W \leq & 100,000, & B_{WI} = & 50,000, & Q_{WI} = & 450, & P_{IW} = & 0.02 \\ 100,000 < I_W \leq & 500,000, & B_{WI} = & 100,000, & Q_{WI} = & 1,450, & P_{IW} = & 0.03 \\ 500,000 < I_W \leq & 1,000,000, & B_{WI} = & 500,000, & Q_{WI} = & 13,450, & P_{IW} = & 0.04 \\ 1,000,000 < I_W \leq & \infty, & B_{WI} = & 1,000,000, & Q_{WI} = & 33,450, & P_{IW} = & 0.05 \end{array}$$

Wife's gross estate at death is defined by

$$(11) \quad W = (1+R)^{X-Y} (W_I + L_W - T_{WI}) + (1+R)^{X-Z} W_E + \sum_{i=Z}^X I_{Wi} (1+R)^{X-i} - \sum_{i=Z}^X D_{Wi} (1+R)^{X-i}$$

Administrative expenses and funeral cost on wife's estate are defined by (assume wife's entire estate passes through probate)

$$(12) \quad E_{AFW} = AW + F_W$$

Wife's adjusted gross estate is defined by

$$(13) \quad W_A = (1-A) W - F_W - D_W$$

Assume no marital deduction is available for wife's estate so

$$(14) \quad W_A = W_T$$

Estate tax on wife's estate is defined by

$$(15) \quad E_{TW} = P_W (W_A - B_W) + Q_W - C_T$$

where  $P_W$ ,  $B_W$  and  $Q_W = f(W_A)$  such that  $P_W$ ,  $B_W$  and  $Q_W$  have the same functional relationship to  $W_A$  as  $P_H$ ,  $B_H$  and  $Q_H$  have to  $H_T$  in equation (6).

Inheritance tax on the children's inheritance from the wife's estate is defined by (assume each child receives equal share and if gifts are made, each child receives gifts of equal size)

$$(16) \quad I_{CW} = P_{CIW} (W_A + \sum_{i=Y-3}^Y G_{WCi} (1+R)^{Y-i} - N B_{CIW}) + N Q_{CIW}$$

where  $P_{CIW}$ ,  $B_{CIW}$  and  $Q_{CIW} = f(W_A + \sum_{i=Y-3}^Y G_{WCi} (1+R)^{Y-i})$  such that if

$$0 < W_A + \sum_{i=Y-3}^Y G_{WCi} (1+R)^{Y-i} \leq N \times 5,000, \quad B_{CIW} = 0, \quad Q_{CIW} = 0,$$

$$P_{CIW} = 0$$

$$N \times 5,000 < W_A + \sum_{i=Y-3}^Y G_{WCi} (1+R)^{Y-i} \leq N \times 50,000, \quad B_{CIW} = 5,000,$$

$$Q_{CIW} = 0, \quad P_{CIW} = 0.01$$



$$N \times 50,000 < W_A + \sum_{i=Y-3}^Y G_{WCI} (1+R)^{Y-i} \leq 100,000 N, B_{CIW} =$$

$$50,000, Q_{CIW} = 450, P_{CIW} = 0.12$$

$$100,000 N < W_A + \sum_{i=Y-3}^Y G_{WCI} (1+R)^{Y-i} \leq 500,000 N, B_{CIW} =$$

$$100,000, Q_{CIW} = 1,450, P_{CIW} = 0.03$$

$$500,000 N < W_A + \sum_{i=Y-3}^Y G_{WCI} (1+R)^{Y-i} \leq 1,000,000 N, B_{CIW} =$$

$$500,000, Q_{CIW} = 13,450, P_{CIW} = 0.04$$

$$1,000,000 N < W_A + \sum_{i=Y-3}^Y G_{WCI} (1+R)^{Y-i} \leq \infty, B_{CIW} = 1,000,000$$

$$Q_{CIW} = 33,450, P_{CIW} = 0.05$$

The present value at the husband's death of the taxes and administrative expenses, etc., on the part of the estate which does not include the marital deduction is defined by

$$(17) \quad T_N = E_{AFH} + E_{TH} + \frac{I_{CH}}{(1+R)^{X-Y}}$$

The present value at the husband's death of the taxes and administrative expenses, etc., on the part of the estate which includes the marital deduction is defined by

$$(18) \quad T_M = T_{WI} + \frac{E_{AFW}}{(1+R)^{X-Y}} + \frac{E_{TW}}{(1+R)^{X-Y}} + \frac{I_{CW}}{(1+R)^{X-Y}}$$

The present value at the husband's death of the taxes and administrative expenses, etc., on the estates are defined by

$$(19) \quad T = T_N + T_M$$

The objective of the model is to minimize  $T$  by varying  $W_I$ , the amount of the husband's estate left the wife, so from equation (19)

$$(20) \quad \frac{\partial T}{\partial W_I} = \frac{\partial T_N}{\partial W_I} + \frac{\partial T_M}{\partial W_I} = 0$$

$$(21) \quad - \frac{\partial T_N}{\partial W_I} = \frac{\partial T_M}{\partial W_I}$$

from equations (17) and (18)

$$(22) \quad \frac{\partial T_N}{\partial W_I} = \frac{\partial E_{AFH}}{\partial W_I} + \frac{\partial E_{TH}}{\partial W_I} + \frac{\partial I_{CH}/(1+R)^{X-Y}}{\partial W_I}$$

$$(23) \quad \frac{\partial T_M}{\partial W_I} = \frac{\partial I_W}{\partial W_I} \left[ \frac{\partial E_{AFW}/(1+R)^{X-Y}}{\partial W_I} + \frac{\partial E_{TW}/(1+R)^{X-Y}}{\partial W_I} + \frac{\partial I_{CW}/(1+R)^{X-Y}}{\partial W_I} \right]$$

from equation (2)

$$(24) \quad \frac{\partial E_{AFH}}{\partial W_I} = 0$$

substituting equations (4) and (5) into (6)

$$(25) \quad E_{TH} = P_H (H_A - W_I - G_{MD} + 1/2 G_E - B_H) + Q_H - C_T$$

$$(26) \quad \frac{\partial E_{TH}}{\partial W_I} = -P_H$$

Substitute equations (4), (5) and (6) into (7) and divide by  $(1+R)^{X-Y}$ .

$$(27) \quad \frac{I_{CH}}{(1+R)^{X-Y}} = \frac{P_{CIH}}{(1+R)^{X-Y}} \{ (1+R)^{X-Y} [H_A - W_I - P_H (H_A - W_I - G_{MD} + 1/2 G_E - B_H) - Q_H - C_T] - NB_{CIH} \} + \frac{NQ_{CIH}}{(1+R)^{X-Y}}$$

$$(28) \quad \frac{\partial I_{CH} / (1+R)^{X-Y}}{\partial W_I} = -P_{CIH} + P_{CIH} P_H$$

Substitute equations (24), (26) and (28) into (22).

$$(29) \quad \frac{\partial T_N}{\partial W_I} = P_{CIH} P_H - P_{CIH} - P_H$$

Substitute equations (8) and (9) into (10).

$$(30) \quad T_{WI} = P_{IW} [W_I + 0.05 J (H_A - W_I) - L_H + \sum_{i=Y-3}^Y G_{Hi} (1+R)^{Y-i} - B_{WI}] + Q_{WI}$$

$$(31) \quad \frac{\partial T_{WI}}{\partial W_I} = P_{IW} - P_{IW} 0.05 J = P_{IW} (1 - 0.05 J)$$

Substitute equations (30) and (11) into (12) and divide by  $(1+R)^{X-Y}$ .

$$(32) \quad \frac{E_{AFW}}{(1+R)^{X-Y}} = \frac{A}{(1+R)^{X-Y}} \{ (1+R)^{X-Y} [W_I + L_W - P_{IW} (W_I + 0.05 J [H_A - W_I] - L_H + \sum_{i=Y-3}^Y G_{Hi} (1+R)^{Y-i} - B_{WI}) + Q_{WI}] + (1+R)^{X-Z} W_E +$$

$$\sum_{i=Z}^X I_{WI} (1+R)^{X-i} - \sum D_{WI} (1+R)^{X-i} \} + \frac{F_W}{(1+R)^{X-Y}}$$

$$(33) \quad \frac{\partial E_{AFW} / (1+R)^{X-Y}}{\partial W_I} = A - A P_{IW} + A P_{IW} 0.05 J = A [1 - P_{IW} (1 - 0.05 J)]$$

Substitute equations (30), (11) and (13) into (15).

$$(34) \quad \frac{E_{TW}}{(1+R)^{X-Y}} = \frac{P_W}{(1+R)^{X-Y}} \{ ((1-A) [(1+R)^{X-Y} (W_I + L_W - P_{IW} [W_I + 0.05 J (H_A - W_I) - L_H + \sum_{i=Y-3}^Y G_{Hi} (1+R)^{Y-i} - B_{WI}] + Q_{WI}) + (1+R)^{X-2} W_E + \sum_{i=Z}^X I_{WI} (1+R)^{X-i} - \sum_{i=Z}^X D_{WI} (1+R)^{X-i}] - F_W - D_W - B_W \} + \frac{Q_W - C_T}{(1+R)^{X-Y}}$$

$$(35) \quad \frac{\partial E_{TW} / (1+R)^{X-Y}}{\partial W_I} = P_W (1-A) - P_W (1-A) P_{IW} + P_W (1-A) P_{IW} 0.05 J = P_W (1-A) [1 - P_{IW} (1 - 0.05 J)]$$

Substitute equations (30), (11) and (13) into (16) and divide by  $(1+R)^{X-Y}$ .

$$(36) \quad \frac{I_{CW}}{(1+R)^{X-Y}} = \frac{P_{CIW}}{(1+R)^{X-Y}} \{ (1-A) [(1+R)^{X-Y} (W_I + L_W - P_{IW} [W_I + 0.05 J (H_A - W_I) - L_H + \sum_{i=Y-3}^Y G_{Hi} (1+R)^{Y-i} - B_{WI}] + Q_{WI}) + (1+R)^{X-2} W_E + \sum_{i=Z}^X I_{WI} (1+R)^{X-i} - \sum_{i=Z}^X D_{WI} (1+R)^{X-i}] - F_W - D_W - B_W \} + \frac{Q_W - C_T}{(1+R)^{X-Y}}$$

$$W_E (1+R)^{X-Y} + \sum_{i=Z}^X I_{Wi} (1+R)^{X-i} + \sum_{i=Z}^X D_{Wi} (1+R)^{X-i} - F_W - D_W - B_{CIW} + \frac{Q_{CIW} - C_T}{(1+R)^{X-Y}}$$

$$(37) \quad \frac{\partial I_{CW}/(1+R)}{\partial W_I} = P_{CIW} (1-A) - P_{CIW} (1-A) P_{IW} + P_{CIW} (1-A) P_{IW} 0.05 J \\ = P_{CIW} (1-A) [1 - P_{IW} (1 - 0.05 J)]$$

Substitute equations (31), (33), (35) and (37) into (23).

$$(38) \quad \frac{\partial T_M}{\partial W_I} = P_{IW} (1 - 0.05 J) + A [1 - P_{IW} (1 - 0.05 J)] + P_W (1-A) [1 - P_{IW} (1 - 0.05 J)] + P_{CIW} (1-A) [1 - P_{IW} (1 - 0.05 J)] = \\ P_{IW} (1 - 0.05 J) + [A + P_W (1-A) + P_{CIW} (1-A)] [1 - P_{IW} (1 - 0.05 J)]$$

Since the variables which define  $\frac{\partial T_N}{\partial W_I}$  and  $\frac{\partial T_M}{\partial W_I}$  are not continuous, the total taxes and administrative expenses are minimized under this plan when

$$(39) \quad - \frac{\partial T_N}{\partial W_I} \geq \frac{\partial T_M}{\partial W_I} \text{ as } W_I \text{ decreases}$$

and

$$(40) \quad - \frac{\partial T_N}{\partial W_I} \leq \frac{\partial T_M}{\partial W_I} \text{ as } W_I \text{ increases}$$

In most cases it is necessary to assume  $P_{IW}$ ,  $P_{CIW}$  and  $P_{CIH}$  are equal to zero to determine a starting point for  $W_I$  when  $P_{IW}$ ,  $P_{CIW}$  and  $P_{CIH}$  are equal to zero.

$$(41) \quad \frac{\partial T_N}{\partial W_I} = - P_H$$

$$(42) \quad \frac{\partial T_M}{\partial W_I} = P_W$$

when equations (41) and (42) are substituted in equation (21).

$$(43) \quad P_H = P_W$$

which is true when

$$(44) \quad H_T = W_T$$

Substitute equations (4) and (5) and (11), (13) and (14) into (44) and solve  $W_I$ .

$$(45) \quad W_I = \left[ \left( H_A + G_{MD} - 1/2 G_E - [(1+R)^{X-Y} (L_W - T_{WI}) + (1+R)^{X-Z} W_E + \right. \right. \\ \left. \left. \cdot \sum_{i=Z}^X I_{Wi} (1+R)^{X-i} - \sum_{i=Z}^X D_{Wi} (1+R)^{X-i} \right] (1-A) + F_W + D_W \right) \Big] / 1 + \\ (1-A) (1+R)^{X-Y}$$

Equation (45) is a relationship which aids in the solution of  $W_I$  (note  $T_{WI}$  equals zero when  $P_{IW}$  equals zero).

## An Example

## Case Study III, Alternative Plan V

Given:

$$Z = 1976$$

$$Y = 1985$$

$$X = 1995$$

$$R = 0.06$$

$$H_P = 1,390,179$$

$$\sum_{i=3}^Y I_{HPi} (1+R)^{Y-i} = 0$$

$$\sum_{i=3}^Y D_{HPi} (1+R)^{Y-i} = 426,886$$

$$H_{NP} = 11,000$$

$$L_H = 65,000$$

$$\sum_{i=Z}^Y I_{Hi} (1+R)^{Y-i} = 0$$

$$\sum_{i=Z}^Y D_{Hi} (1+R)^{Y-i} = 0$$

$$A = 0.04$$

$$F_H = 3,000$$

$$D_H = 0$$

$$G_{MD} = 100,000$$

$$G_E = 100,000$$

$$C_T = 47,000$$

$$N = 4$$

$$J = 8.205$$

$$\sum_{i=Y-3}^Y G_{Hi} (1+R)^{Y-i} = 9,551$$

$$L_W = 0$$

$$W_E = 0$$

$$\sum_{i=Z}^X I_{Wi} (1+R)^{X-i} = 339,093$$

$$\sum_{i=Z}^X D_{Wi} (1+R)^{X-i} = 158,170$$

$$F_W = 6,000$$

$$D_W = 0$$

$$\sum_{y=Y-3}^Y G_{Wci} (1+R)^{Y-i} = 38,204$$

## Solution

$$H = 2,002,886 \quad E_{AF} = 82,472 \quad H_A = 1,920,414$$

To determine a starting point for  $W_I$ , assume  $P_{WI}$ ,  $P_{CIH}$  and  $P_{CIW}$  are equal to zero. Solve for a starting  $W_I$  using equation (45).

$$(1) \quad W_I = 612,960$$

$$(1) \quad H_T = 1,307,454$$

Based on  $W_I$  and  $H_T$  solve for  $P_W$ ,  $P_H$ ,  $P_{CIH}$ ,  $P_{IW}$  and  $P_{CIW}$ .

$$P_W = 0.41$$

$$P_H = 0.43$$

$$P_{CIH} = 0.03$$

$$P_{IW} = 0.05$$

$$P_{CIW} = 0.03$$

Solve for  $\frac{\partial T_N}{\partial W_I}$  and  $\frac{\partial T_M}{\partial W_I}$  based on P values

$$-\frac{\partial T_N}{\partial W_I} = 0.4461 \text{ as } W_I \text{ increases or decreases}$$

$$\frac{\partial T_M}{\partial W_I} = 0.4763 \text{ as } W_I \text{ increases or decreases}$$

so  $W_I$  must be decreased such that the sum of the increases in  $-\frac{\partial T_N}{\partial W_I}$  and the decreases in  $\frac{\partial T_M}{\partial W_I}$  are approximately equal to 0.0312 if  $W_I$  is



decreased to 470,414,  $H_T$  increased to 1,500,000 and

$$\frac{\partial T_M}{\partial W_I} = 0.4596 \text{ as } W_I \text{ increases or decreases}$$

and

$$- \frac{\partial T_N}{\partial W_I} = 0.4471 \text{ as } W_I \text{ increases}$$

and

$$\frac{\partial T_N}{\partial W_I} = 0.4665 \text{ as } W_I \text{ decreases}$$

So  $T$  is minimized when  $W_I = 470,414$  under Alternative Plan V subject to the given variables.

APPENDIX E

DETAILS OF THE ALTERNATIVE ESTATE PLANS  
FOR THE THREE CASE STUDIES

## Case I, Existing Plan

The distribution of Farmer A's estate in 1985 under his existing plan will be as follows:

Item numbers correspond to Table E-1.

<u>Item #</u>	Under tenancy by the entirety:
1	Real property
2	Personal property
	As beneficiary of life insurance:
3	Personal property
4	Personal property
	Under Mrs. A's dower right:
5	Personal property
6	Real property (life estate)
	To the two daughters to be divided equally:
7	Real property
8	Personal property

Table E-1. Case I, Tentative Distribution of Farmer A's Estate and the Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under the Existing Estate Plan

Distribution	Item Numbers					
	1	2	3	4	5	6
	To Mrs. A					
Law of descent and distribution			X	X		
Tenancy by the entirety	X	X				
Beneficiary of life insurance					X	X
Qualify for the estate tax marital deduction	X	X		X	X	
Subject to Virginia Inheritance Tax, Mrs. A	X	X	X*	X		
Subject to Virginia Inheritance Tax, daughters						
Subject to Federal Estate Tax, Farmer A's estate	X	X	X	X	X	
Subject to Federal Estate Tax, Mrs. A's estate	X	X		X	X	X
1985 fair market valuation	\$268,627	\$79,185	\$41,673	\$11,498	\$6,000	\$1,000
1985 special valuation	\$104,024	\$79,185	\$16,573	\$11,498	\$6,000	\$1,000

\*Valued as life estate.

Table E-1. Continued.

	Item Numbers		Totals	
	7	8	Fair Market	Special
Distribution	To The Daughters			
Law of descent and distribution	X	X		
Tenancy by the entirety				
Beneficiary of life insurance				
Qualify for the estate tax marital deduction			\$365,310	\$200,707
Subject to Virginia Inheritance Tax, Mrs. A			\$380,588	
Subject to Virginia Inheritance Tax, daughters	X	X	\$120,344	
Subject to Federal Estate Tax, Farmer A's estate	X	X	\$513,327	\$273,423
Subject to Federal Estate Tax, Mrs. A's estate				
1985 fair market valuation	\$83,348	\$22,996		
1985 special valuation	\$33,147	\$22,996		

## Case I, Existing Plan

1985 Projected Federal Estate Tax Consequences of  
Farmer A's Existing Estate Plan

	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$523,097	\$283,193
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/> Gross estate	<hr/> \$523,097	<hr/> \$283,193
Less: Administration expenses		
Funeral expenses     \$3,000		
Settlement cost     \$6,770	\$ 9,770	\$ 9,770
<hr/> Adjusted gross estate	<hr/> \$513,327	<hr/> \$273,423
Less: Marital deduction	\$256,663	\$200,707
<hr/> Taxable estate	<hr/> \$256,664	<hr/> \$ 72,716
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/> Tentative tax base	<hr/> \$256,664	<hr/> \$ 72,716
Estate tax on tentative tax base	\$ 73,066	\$ 16,306
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/> Tax before unified credit	<hr/> \$ 73,066	<hr/> \$ 16,306
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/> Estate tax payable	<hr/> \$ 26,066	<hr/> \$ 0

## Case I, Existing Plan

	Fair Market Valuation	Special Valuation
Mrs. A's inheritance		
Real property	\$268,627	\$268,627
Personal property	\$ 97,683	\$ 97,683
Less: Federal Estate Tax	\$ 11,034	\$ 0
Virginia Inheritance Tax	\$ 9,868	\$ 9,868
Net inheritance	\$345,408	\$356,442
Mrs. A's life estate		
Real property	\$ 41,673	\$ 41,673
Less: Federal Estate Tax	\$ 4,232	\$ 0
Net inheritance	\$ 37,441	\$ 41,673
Each daughter's inheritance		
Real property	\$ 41,673	\$ 41,673
Personal property	\$ 11,498	\$ 11,498
Less: Federal Estate Tax	\$ 5,400	\$ 0
Virginia Inheritance Tax	\$ 653	\$ 653
Net inheritance	\$ 47,118	\$ 52,518

## Case I, Existing Plan

Four possible valuations of Mrs. A's estate in 1995 under the existing plan:

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$481,070	\$186,291	\$481,070	\$186,291
Personal property	\$137,503	\$137,503	\$157,263	\$157,263
Total	\$618,573	\$323,794	\$638,333	\$343,554



## Case I, Existing Plan

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan II for Mrs. A's Estate

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$849,790	\$420,158	\$896,470	\$466,838
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$849,790	\$420,158	\$896,470	\$466,838
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 33,992	\$ 33,992	\$ 41,859	\$ 41,859
Adjusted gross estate	\$815,798	\$386,166	\$854,611	\$424,979
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$815,798	\$386,166	\$854,611	\$424,979
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$815,798	\$386,166	\$854,611	\$424,979
Estate tax on tenta- tive tax base	\$273,961	\$117,096	\$289,098	\$130,293
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$273,961	\$117,096	\$289,098	\$130,293
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$226,961	\$ 70,096	\$242,098	\$ 83,293

## Case I, Existing Plan

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each daughter's inheritance from Mrs. A's estate				
Real property	\$240,535	\$240,535	\$240,535	\$240,535
Personal property	\$ 53,380	\$ 53,380	\$ 62,865	\$ 62,865
From life estate				
Real property	\$ 33,526	\$ 33,526	\$ 37,315	\$ 37,315
Less: Federal Estate Tax	\$ 70,648	\$ 19,219	\$ 74,158	\$ 22,444
Virginia Inheritance Tax	\$ 7,590	\$ 7,590	\$ 7,965	\$ 7,965
Net inheritance	\$249,203	\$300,632	\$258,592	\$235,676

## Case I, Alternative Plan II

Under this plan if Farmer A dies in 1985 and Mrs. A in 1995, the distribution of Farmer A's estate will be as follows:

Item numbers correspond to Table E-2.

<u>Item #</u>	Under tenancy by the entirety:
1	Personal property
2	Real property
	Under Mr. A's will:
3	Real property
4	Personal property
	As beneficiary of life insurance:
5	Personal property
6	Personal property

Table E-2. Case I, Tentative Distribution of Farmer A's Estate and the Portion Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan II

Distribution	Item Numbers						Totals	
	1	2	3	4	5	6	Fair Market	Special
	To Mrs. A							
Joint ownership	X	X						
Will			X	X				
Beneficiary life insurance					X	X		
Qualify for marital deduction	X	X	X	X	X		\$513,327	\$273,423
Virginia Inheritance Tax, Mrs. A	X	X	X	X			\$507,327	
Subject to Federal Estate Tax, Farmer A's estate	X	X	X	X	X		\$513,327	\$273,423
Subject to Federal Estate Tax, Mrs. A's estate	X	X	X	X	X			
1985 fair market valuation	\$79,185	\$268,627	\$125,021	\$34,494	\$6,000	\$1,000		
1985 special valuation	\$79,185	\$104,024	\$ 49,720	\$34,494	\$6,000	\$1,000		

## Case I, Plan II

Projected Federal Estate Tax Consequences of  
Plan II for Farmer A's Estate

	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$523,097	\$283,193
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/>		
Gross estate	\$523,097	\$283,193
Less: Administration expenses		
Funeral expenses \$3,000		
Settlement cost <u>\$6,770</u>	\$ 9,770	\$ 9,770
<hr/>		
Adjusted gross estate	\$513,327	\$273,423
Less: Marital deduction	\$256,663	\$250,000
<hr/>		
Taxable estate	\$256,664	\$ 23,423
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/>		
Tentative tax base	\$256,664	\$ 23,423
Estate tax on tentative tax base	\$ 73,066	\$ 4,553
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/>		
Tax before unified credit	\$ 73,066	\$ 4,553
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/>		
Estate tax payable	\$ 26,066	\$ 0

## Case I, Plan II

	Fair Market Valuation	Special Valuation
Mrs. A's inheritance		
Real property	\$393,648	\$393,648
Personal property	120,679	120,679
Less: Federal Estate Tax	26,066	0
Virginia Inheritance Tax	13,743	13,743
Net inheritance	\$474,518	\$500,584

Four possible valuations of Mrs. A's estate in 1995 under the existing plan:

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$704,964	\$275,332	\$704,964	\$275,332
Personal property	144,826	144,826	191,506	191,506
Total	\$849,790	\$420,158	\$896,470	\$466,838

## Case I, Plan II

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan II on Mrs. A's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$849,790	\$420,158	\$896,470	\$466,838
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$849,790	\$420,158	\$896,470	\$466,838
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 33,992	\$ 33,992	\$ 35,859	\$ 35,859
Adjusted gross estate	\$815,798	\$386,166	\$859,611	\$424,979
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$815,798	\$386,166	\$854,611	\$424,974
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$815,798	\$386,166	\$854,611	\$424,979
Estate tax on tenta- tive tax base	\$273,961	\$117,096	\$289,098	\$130,293
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$226,961	\$117,096	\$289,098	\$130,293
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$226,961	\$ 70,096	\$242,098	\$ 83,293

## Case I, Plan II

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
Real property	\$407,899	\$407,899	\$427,306	\$427,306
Personal property	\$ 0	\$ 0	\$ 0	\$ 0
Less: Federal Estate Tax	\$113,482	\$ 35,048	\$121,049	\$ 41,647
Virginia Inheritance Tax	\$ 10,687	\$ 10,687	\$ 11,269	\$ 11,269
Net inheritance	\$283,731	\$362,164	\$294,988	\$374,390



## Case I, Alternative Plan III

Under Alternative Plan III, the distribution of Farmer A's estate in 1985 would be as follows:

Item numbers correspond to Table E-3.

<u>Item #</u>	By gift:
1	Real property
	Under Farmer A's will:
2	Real property
3	Personal property
	As beneficiary of life insurance:
4	Personal property
5	Personal property
	To the two daughters:
6	Real property

Table E-3. Case I, Tentative Distribution of Farmer A's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan III

Distribution	Item Numbers				
	1	2	3	4	5
	To Mrs. A				
By gift	X				
Will		X	X		
As beneficiary of life insurance				X	X
Qualify for estate tax marital deduction		X	X	X	
Virginia Inheritance Tax, Mrs. A	X*	X	X		
Virginia Gift Tax, Farmer A	X				
Subject to Federal Estate Tax, Farmer A's estate		X	X	X	
Subject to Federal Estate Tax, Mrs. A's estate	X	X	X	X	X
Subject to Federal Gift Tax at time of gift	X				
1985 fair market valuation	\$189,348	\$85,530	\$112,090	\$6,000	\$1,000
1985 special valuation	\$ 73,952	\$33,405	\$112,090	\$6,000	\$1,000

\*Gifts within three years of death.

Table E-3. Continued.

	Item Numbers	Totals	
	6	Fair Market	Special
<u>To the Two Daughters</u>			
Distribution			
By gift			
Will			
As beneficiary of			
life insurance			
Qualify for estate			
tax marital			
deduction		\$203,620	\$151,495
Virginia Inheritance			
Tax, Mrs. A		\$207,171	
Virginia Gift Tax,			
Farmer A	X	\$235,000	
Subject ot Federal			
Estate Tax, Farmer			
A's estate		\$203,620	\$151,495
Subject to Federal			
Estate Tax, Mrs.			
A's estate			
Subject to Federal			
Gift Tax at time			
of gift	X		\$235,000
1985 fair market			
valuation	\$118,770		
1985 special			
valuation	\$ 46,387		

## Case I, Plan III

## Gift Program From Farmer A

	<u>1985 Value</u>
To Mrs. A	
1977 - \$103,000	\$164,166
1978-85 - \$3,000/yr.	\$ 25,182

## From Farmer and Mrs. A

To the two daughters	
1977-85 - \$12,000/yr.	\$118,770

## From Mrs. A

To the two daughters - \$6,000/yr.	\$ 79,085
------------------------------------	-----------

## Gift Tax Consequences

1977-1995 Federal Estate Tax	\$ 0
1977 Virginia Inheritance Tax, Farmer A	\$ 1,540
1978-1995 Virginia Inheritance Tax	\$ 0

## Case I, Plan III

1985 Projected Federal Estate Tax Consequences of Alternative  
Plan III for Farmer A's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$214,979	\$162,854
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/>		
Gross estate	\$214,979	\$162,854
Less: Administrative expenses		
Funeral expenses \$3,000		
Settlement cost	\$ 11,359	\$ 11,359
<hr/>		
Adjusted gross estate	\$203,620	\$151,495
Less: Marital deduction	\$153,620	\$101,495
<hr/>		
Taxable estate	\$ 50,000	\$ 50,000
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/>		
Tentative tax base	\$ 50,000	\$ 50,000
Estate tax on tentative tax base	\$ 10,600	\$ 10,600
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/>		
Tax before unified credit	\$ 10,600	\$ 10,600
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/>		
Estate tax payable	\$ 0	\$ 0

## Case I, Plan III

	Fair Market Valuation	Special Valuation
Mrs. A's inheritance		
Real property	\$ 85,530	\$ 85,530
Personal property	119,090	119,090
Less: Federal Estate Tax	0	0
Virginia Inheritance Tax	4,665	4,665
Net inheritance	<u>\$199,955</u>	<u>\$199,955</u>

## Possible Valuation of Mrs. A's Estate in 1995

## Under Alternative Plan III

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$413,180	\$ 95,516	\$413,180	\$ 95,516
Personal property	<u>204,918</u>	<u>204,918</u>	<u>204,918</u>	<u>204,918</u>
Actual estate	\$618,098	\$300,434	\$618,098	\$300,434

## Case I, Plan III

1995 Projected Federal Estate Tax Consequences of  
Alternative Plan III on Mrs. A's Estate

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$618,098	\$300,434	\$618,098	\$300,434
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$618,098	\$300,434	\$618,098	\$300,434
Less: Administrative expenses Funeral ex- penses \$ 6,000 Settlement cost \$13,075	\$ 30,724	\$ 30,724	\$ 30,724	\$ 30,724
Adjusted gross estate	\$587,374	\$269,710	\$587,374	\$269,710
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$587,374	\$269,710	\$587,374	\$269,710
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$587,374	\$269,710	\$587,374	\$269,710
Estate tax on tenta- tive tax base	\$188,128	\$ 77,501	\$188,128	\$ 77,501
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$188,128	\$ 77,501	\$188,128	\$ 77,501
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$141,128	\$ 30,501	\$141,128	\$ 30,501

## Case I, Plan III

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each daughter's inheritance	\$293,687	\$293,687	\$293,687	\$293,687
Less: Federal Estate Tax	70,564	15,251	70,564	15,251
Virginia Inheritance Tax	<u>7,547</u>	<u>7,547</u>	<u>7,547</u>	<u>7,547</u>
Net inheritance	\$215,576	\$270,889	\$215,576	\$270,889



## Case I, Alternative Plan IV

Under Alternative Plan IV, the distribution of Farmer A's estate in 1985 would be as follows:

Item numbers correspond to Table E-4.

<u>Item #</u>	Under tenancy by the entirety:
1	Personal property
	Under Farmer A's will:
2	Real property
	As beneficiary of life insurance:
3	Personal property
	To the trust under Farmer A's will:
4	Real property
5	Personal property
	As beneficiary of life insurance:
6	Personal property

Table E-4. Case I, Tentative Distribution of Farmer A's Estate and Portion Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan IV

	Item Numbers		
	1	2	3
	To Mrs. A		
Distribution			
Joint ownership	X		
Will		X	
As beneficiary of life insurance			X
Qualify for marital deduction	X	X	
Virginia Inheritance Tax, Mrs. A	X	X	
Subject to Federal Estate Tax, Farmer A's estate	X	X	
Subject to Federal Estate Tax, Mrs. A's estate	X	X	X
1985 fair market valuation	\$79,185	\$33,259	\$1,000
1985 special valuation	\$79,185	\$12,990	\$1,000

Table E-4. Continued.

	Item Numbers			Totals	
	4	5	6	Fair Market	Special
	<u>To the Trust</u>				
Distribution					
Joint ownership					
Will	X	X			
As beneficiary of					
life insurance			X		
Qualify for marital					
deduction				\$112,444	\$ 92,175
Virginia Inheritance					
Tax, Mrs. A	X*	X*		\$311,648	
Subject to Federal					
Estate Tax, Farmer					
A's estate	X	X	X	\$502,581	\$262,677
Subject to Federal					
Estate Tax, Mrs.					
A's estate					
1985 fair market					
valuation	\$360,389	\$23,748	\$6,000		
1985 special					
valuation	\$140,754	\$23,748	\$6,000		

## Case I, Plan IV

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan IV for Farmer A's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$523,097	\$283,193
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/> Gross estate	<hr/> \$523,097	<hr/> \$283,193
Less: Administrative expenses		
Funeral expenses \$3,000		
Settlement cost 9,810	\$20,516	\$ 20,516
<hr/> Adjusted gross estate	<hr/> \$502,581	<hr/> \$262,677
Less: Marital deduction	\$112,444	\$ 92,175
<hr/> Taxable estate	<hr/> \$390,137	<hr/> \$170,522
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/> Tentative tax base	<hr/> \$390,137	<hr/> \$170,522
Estate tax on tentative tax base	\$118,447	\$ 45,367
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/> Tax before unified credit	<hr/> \$118,447	<hr/> \$ 45,367
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/> Estate tax payable	<hr/> \$ 71,447	<hr/> \$ 0

## Case I, Plan IV

	Fair Market Valuation	Special Valuation
Mrs. A's inheritance		
Real property	\$ 33,259	\$ 33,259
Personal property	80,185	80,185
Less: Virginia Inheritance Tax	7,799	7,799
Net inheritance	\$105,645	\$105,645
The trust property		
Real property	\$360,389	\$360,389
Personal property	29,748	29,748
Less: Federal Estate Tax	71,447	0
Net property in trust	\$318,690	\$390,137

## Four Valuations of Mrs. A's Estate in 1995

## Under Alternative Plan IV

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$ 59,562	\$ 23,263	\$ 59,562	\$ 23,263
Personal property	129,632	129,632	129,632	129,632
Gross estate	\$189,194	\$152,895	\$189,194	\$152,895

## Case I, Plan IV

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan IV for Mrs. A's Estate

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$1891194	\$152,895	\$189,194	\$152,895
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$189,194	\$152,895	\$189,194	\$152,895
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost \$7,568	\$ 13,568	\$ 13,568	\$ 13,568	\$ 13,568
Adjusted gross estate	\$175,626	\$139,327	\$175,626	\$ 13,327
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$175,626	\$139,327	\$175,626	\$139,327
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$175,626	\$139,327	\$175,626	\$139,327
Estate tax on tenta- tive tax base	\$ 47,000	\$ 35,598	\$ 47,000	\$ 35,598
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 47,000	\$ 35,598	\$ 47,000	\$ 35,598
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 0	\$ 0	\$ 0	\$ 0

## Case I, Plan IV

## Value of Each Daughter's Inheritance

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
From Mrs. A's estate	\$ 87,813	\$ 87,813	\$ 87,813	\$ 87,813
From the trust	\$285,363	\$285,363	\$349,338	\$349,338
Each daughter's Virginia In- heritance Tax	\$ 8,217	\$ 8,217	\$ 10,136	\$ 10,316
Each daughter's portion of Federal Estate Tax	\$ 0	\$ 0	\$ 0	\$ 0
Net inheritance	\$364,959	\$364,959	\$427,015	\$427,015

## Case I, Alternative Plan V

Under Alternative Plan V, the distribution of Farmer A's estate would be as follows:

Item number corresponds to Table E-5.

<u>Item #</u>	To Mrs. A by gift:
1	Personal property
2	Real property
	As beneficiary of life insurance:
3	Personal property
	To the two daughters:
4	Real property
	Under Farmer A's will to the trust:
5	Real property
6	Personal property
	As beneficiary of life insurance:
7	Personal property



Table E-5. Case I, Tentative Distribution of Farmer A's Estate and Portion Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan V

	Item Numbers		
	1	2	3
	To Mrs. A		
Distribution			
By gift	X	X	
Under will			
As beneficiary of life insurance			X
Qualify for estate tax marital deduction			
Virginia Inheritance Tax, Mrs. A		X**	
Subject to Federal Estate Tax, Farmer A's estate			
Subject to Federal Estate Tax, Mrs. A's estate	X	X	X
Subject to Federal Gift Tax	X	X	
1985 fair market valuation	\$79,185	\$110,163	\$1,000
1985 special valuation	\$79,185	\$ 43,026	\$1,000

\*\*Gift within three years of death.

Table E-5. Continued.

	Item Numbers
	4
<u>To the Two Daughters</u>	
Distribution	
By gift	X
Under will	
As beneficiary of	
life insurance	
Qualify for estate	
tax marital	
deduction	
Virginia Inheritance	
Tax, Mrs. A	
Subject to Federal	
Estate Tax, Farmer	
A's estate	
Subject to Federal	
Estate Tax, Mrs.	
A's estate	
Subject to Federal	
Gift Tax	X
1985 fair market	
valuation	\$118,770
1985 special	
valuation	\$ 46,387

Table E-5. 'Continued.

	Item Numbers			Totals	
	5	6	7	Fair Market	Special
	<u>To the Trust</u>				
Distribution					
By gift					
Under will	X	X			
As beneficiary of					
life insurance			X		
Qualify for estate					
tax marital					
deduction				0	0
Virginia Inheritance					
Tax, Mrs. A	X*	X*		\$110,456	
Subject to Federal					
Estate Tax, Farmer					
A's estate	X	X	X	\$203,620	\$103,236
Subject to Federal					
Estate Tax, Mrs.					
A's estate					
Subject to Federal					
Gift Tax				\$235,000	
1985 fair market					
valuation	\$164,715	\$32,905	\$6,000		
1985 special					
valuation	\$ 64,331	\$32,905	\$6,000		

## Case I, Plan V

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan V for Farmer A's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$214,979	\$114,595
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/>		
Gross estate	\$214,979	\$114,595
Less: Administrative expenses		
Funeral expenses \$3,000		
Settlement cost	\$ 11,359	\$ 11,359
<hr/>		
Adjusted gross estate	\$203,620	\$103,236
Less: Marital deduction	\$ 0	\$ 0
<hr/>		
Taxable estate	\$203,620	\$103,236
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/>		
Tentative tax base	\$203,620	\$103,236
Estate tax on tentative tax base	\$ 55,958	\$ 24,771
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/>		
Tax before unified credit	\$ 55,958	\$ 24,771
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/>		
Estate tax payable	\$ 8,958	\$ 0

## Case I, Plan V

## Value of Property in the Trust

	Fair Market Valuation	Special Valuation
Real property	\$164,715	\$164,715
Personal property	\$ 38,905	\$ 38,905
Less: Federal Estate Tax	\$ 8,958	\$ 0
Net trust property	\$194,662	\$203,620

## Value of Mrs. A's Inheritance for Virginia Inheritance Tax

	\$110,456
Virginia Inheritance Tax	\$ 1,764

## Four Possible Valuations in 1995 of Mrs. A's Estate Under

## Alternative Plan V

## Farmer A's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$118,200	\$ 46,164	\$118,200	\$ 46,164
Personal property	\$140,440	\$140,440	\$140,440	\$140,440
Actual estate	\$258,640	\$186,604	\$258,640	\$186,604

## Case I, Plan V

## Gift program

	<u>1985 Value</u>	<u>1995 Value</u>
From Farmer A to Mrs. A		
\$103,000 in 1977	\$164,166	\$293,997
\$3,000/yr. 1978-1985	\$ 25,182	\$ 45,096
From Farmer and Mrs. A to the two daughters		
\$12,000/yr. 1977-1985	\$118,770	\$212,698
From Mrs. A to the two daughters		
\$6,000/yr. 1986-1995		\$ 79,085
Gift tax consequences		
1977-1995 Federal Gift Tax	\$ 0	
1977 Va. Gift Tax Farmer A	\$1,540	
1978-1995 Va. Gift Tax	\$ 0	

Effect of Gift Tax Marital Deduction on  
Estate Tax Marital Deduction

Gift tax marital deduction claimed	\$100,000
1/2 of gifts to Mrs. A in excess of annual exclusion	50,000
Estate tax marital deduction reduced by	<u>\$ 50,000</u>

## Case I, Plan V

1995 Projected Federal Estate Tax Consequences of  
Alternative Plan V for Mrs. A's Estate

	Farmer A's Estate			
	Fair Market Valuation		Special Valuation	
	Mrs. A's Estate		Mrs. A's Estate	
	Fair Market Valuation	Special Valuation	Fair Market Valuation	Special Valuation
Actual estate	\$258,640	\$186,604	\$258,640	\$186,604
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$258,640	\$186,604	\$258,640	\$186,604
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 16,346	\$ 16,346	\$ 16,346	\$ 16,346
Adjusted gross estate	\$242,294	\$170,258	\$242,294	\$170,258
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$242,294	\$170,258	\$242,294	\$170,258
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$242,294	\$170,258	\$242,294	\$170,258
Estate tax on tenta- tive tax base	\$ 68,334	\$ 45,283	\$ 68,334	\$ 45,283
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 68,334	\$ 45,283	\$ 68,334	\$ 45,283
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 21,334	\$ 0	\$ 21,334	\$ 0

## Case I, Plan V

## Each Daughter's Inheritance

	Farmer A's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. A's Estate		Mrs. A's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
From Mrs. A's Estate	\$121,147	\$121,147	\$121,147	\$121,147
From the trust	\$174,305	\$174,305	\$182,326	\$182,326
Less: Federal Estate Tax	\$ 10,667	\$ 0	\$ 10,667	\$ 0
Virginia Inheritance Tax	\$ 6,050	\$ 6,050	\$ 6,290	\$ 6,290
Net inheritance	\$278,735	\$289,402	\$286,516	\$297,183



## Case II, Existing Plan

Farmer B's existing plan

The distribution of Farmer B's estate would be as follows:

Item numbers correspond to Table E-6.

<u>Item #</u>	Under tenancy by the entirety:
1	Real property
2	Personal property
	Under Farmer A's will:
3	Real estate tenancy in severalty
4	Personal property (tenancy in severalty)
5	Real estate (life estate)
6	Personal (life estate)
	Beneficiary of life insurance
7	Policy owned by Mrs. B

Table E-6. Case II, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under the Existing Plan

	Item Numbers				
	1	2	3	4	5
	To Mrs. B				
Distribution					
Tenancy by the entirety	X	X			
Will			X	X	X
As beneficiary of life insurance					
Qualify for estate tax marital deduction	X	X	X	X	
Virginia Inheritance Tax, Mrs. B	X	X	X	X	X*
Subject to Federal Estate Tax, Farmer B's estate	X	X	X	X	X
Subject to Federal Estate Tax, Mrs. B's estate	X	X	X	X	
1985 fair market valuation	\$66,059	\$238,147	\$1,038,675	\$86,509	\$1,038,675
1985 special valuation	\$50,649	\$238,147	\$ 796,380	\$86,509	\$ 796,380

\*Value based on life estate.

Table E-6. Continued.

	Item Numbers		Totals	
	6	7	Fair Market	Special
	<u>To Mrs. B</u>			
Distribution				
Tenancy by the entirety				
Will	X			
As beneficiary of life insurance		X		
Qualify for estate tax marital deduction			\$1,429,390	\$1,171,685
Virginia Inheritance Tax, Mrs. B	X*		\$1,956,314	
Subject to Federal Estate Tax, Farmer B's estate	X		\$2,554,573	\$2,054,573
Subject to Federal Estate Tax, Mrs. B's estate		X		
1985 fair market valuation	\$86,509	\$100,000		
1985 special valuation	\$86,509	\$100,000		

## Case II, Existing Plan

## 1985 Projected Federal Estate Tax Consequences of

## Farmer A's Existing Estate Plan

	Fair Market Valuation	Special Valuation
Actual estate	\$2,651,463	\$2,151,463
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
Gross estate	\$2,651,463	\$2,151,463
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$94,030	\$ 96,890	\$ 96,890
Adjusted gross estate	\$2,554,573	\$2,054,573
Less: Marital deduction	\$1,277,287	\$1,027,287
Taxable estate	\$1,277,287	\$1,027,287
Plus: Adjusted taxable gifts	\$ 0	\$ 0
Tentative tax base	\$1,277,287	\$1,027,287
Estate tax on tentative tax base	\$ 460,033	\$ 356,988
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
Tax before unified credit	\$ 460,033	
Less: Unified credit	\$ 47,000	\$ 47,000
Estate tax payable	\$ 413,033	\$ 309,988

## Case II, Existing Plan

	Fair Market Valuation	Special Valuation
Mrs. B's inheritance		
Real property	\$1,104,734	\$1,104,734
Personal property	\$ 424,656	\$ 424,656
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 81,266	\$ 81,266
Mrs. B's net inheritance		
Real property	\$1,104,734	\$1,104,734
Personal property	\$ 343,390	\$ 343,390
Mrs. B's life estate		
Real property	\$1,038,675	\$1,038,675
Personal property	\$ 86,509	\$ 86,509
Less: Federal Estate Tax	\$ 413,033	\$ 309,988
Mrs. B's net life estate		
Real property	\$ 712,151	\$ 815,196

## Case II, Existing Plan

Four Possible Valuations of Mrs. B's Estate Under  
the Existing Plan in 1995

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$2,110,741	\$1,610,741	\$2,110,741	\$1,610,741
Personal property	<u>\$ 681,885</u>	<u>\$ 681,885</u>	<u>\$ 681,885</u>	<u>\$ 681,885</u>
Actual estate	\$2,792,626	\$2,292,626	\$2,792,626	\$2,292,626

## Case II, Existing Plan

1995 Projected Federal Estate Tax Consequences of  
The Existing Plan for Mrs. B's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$2,792,626	\$2,292,626	\$2,792,626	\$2,292,626
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$2,792,626	\$2,292,626	\$2,792,626	\$2,292,626
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 117,705	\$ 117,705	\$ 117,705	\$ 117,705
Adjusted gross estate	\$2,674,921	\$2,174,921	\$2,674,921	\$2,174,921
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$2,674,921	\$2,174,921	\$2,674,921	\$2,174,921
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$2,674,921	\$2,174,921	\$2,674,921	\$2,174,921
Estate tax on tenta- tive tax base	\$1,118,508	\$ 866,511	\$1,118,508	\$ 866,511
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$1,118,508	\$ 866,511	\$1,118,508	\$ 866,511
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$1,071,508	\$ 819,511	\$1,071,508	\$ 819,511

## Case II, Existing Plan

## Each Child's Inheritance

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
From Mrs. B's estate	\$668,730	\$668,730	\$668,730	\$668,730
From the life estate	\$318,838	\$318,838	\$364,972	\$364,972
Less: Federal Estate Tax	\$267,877	\$204,378	\$267,877	\$204,878
Virginia Inheritance Tax	<u>\$ 28,214</u>	<u>\$ 28,214</u>	<u>\$ 29,598</u>	<u>\$ 29,598</u>
Net inheritance	\$691,477	\$754,476	\$736,227	\$799,226



## Case II, Alternative Plan I

Under Alternative Plan I, the distribution of Farmer B's estate will be as follows:

Item numbers correspond to Table E-7.

Item # Under tenancy by the entirety:

1 Real property

2 Personal property

Under the dower rights:

3 Real property (life estate)

4 Personal property

As beneficiary of life insurance:

5 Personal property

To the children under the laws of descent and distribution:

6 Real property

7 Personal property

Table E-7: Case II, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan I

Distribution	Item Numbers				
	1	2	3	4	5
	To Mrs. B				
Tenancy by the entirety	X	X			
Dower rights			X	X	
Laws of descent and distribution					
As beneficiary of life insurance					X
Qualify for marital deduction	X	X		X	
Virginia Inheritance Tax, Mrs. B	X	X	X*	X	
Virginia Inheritance Tax, the children					
Subject to Federal Estate Tax, Farmer B's estate	X	X	X	X	
Subject to Federal Estate Tax, Mrs. B's estate	X	X		X	X
1985 fair market valuation	\$66,059	\$238,147	\$692,450	\$57,672	\$100,000
1985 special valuation	\$50,649	\$238,147	\$530,920	\$57,672	\$100,000

\*Valued as life estate.

Table E-7. Continued.

	Item Numbers		Totals	
	6	7	Fair Market	Special
	<u>To the Children</u>			
Distribution				
Tenancy by the entirety				
Dower rights				
Laws of descent and distribution	X	X		
As beneficiary of life insurance				
Qualify for marital deduction			\$ 361,878	\$ 346,468
Virginia Inheritance Tax, Mrs. B			\$ 752,211	
Virginia Inheritance Tax, the children	X	X	\$1,500,245	
Subject to Federal Estate Tax, Farmer B's estate	X	X	\$2,554,573	\$2,054,573
Subject to Federal Estate Tax, Mrs. B's estate				
1985 fair market valuation	\$1,384,900	\$115,345		
1985 special valuation	\$1,061,840	\$115,345		

## Case II, Plan I

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan I for Farmer B's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,651,463	\$2,151,463
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
Gross estate	\$2,651,463	\$2,151,463
Less: Administrative expenses Funeral expenses \$3,000 Settlement cost	\$ 96,890	\$ 96,890
Adjusted gross estate	\$2,554,573	\$2,054,573
Less: Marital deduction	\$ 361,878	\$ 346,468
Taxable estate	\$2,192,695	\$1,708,105
Plus: Adjusted taxable gifts	\$ 0	\$ 0
Tentative tax base	\$2,192,695	\$1,708,105
Estate tax on tentative tax base	\$ 875,221	\$ 649,447
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
Tax before unified credit	\$ 875,221	\$ 649,447
Less: Unified credit	\$ 47,000	\$ 47,000
Estate tax payable	\$ 828,221	\$ 602,447

## Case II, Plan I

	Fair Market Valuation	Special Valuation
Mrs. B's inheritance		
Real property	\$ 66,059	\$ 66,059
Personal property	461,878	461,878
Less: Federal Estate Tax	0	0
Virginia Inheritance Tax	23,538	23,538
Net Inheritance	<u>\$504,399</u>	<u>\$504,399</u>
Mrs. B's life estate		
Real property	\$692,450	\$692,450
Less: Federal Estate Tax	261,551	190,252
Net life estate	<u>\$430,899</u>	<u>\$502,198</u>
Each child's inheritance		
Real property	\$346,225	\$346,225
Personal property	28,836	28,836
Less: Federal Estate Tax	141,667	103,049
Virginia Inheritance Tax	9,702	9,702
Net inheritance	<u>\$223,092</u>	<u>\$261,710</u>

## Case II, Plan I

Four possible valuations of Mrs. B's estate in 1995 under Alternative Plan I:

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$ 250,633	Not Qualified	\$ 250,633	Not Qualified
Personal property	\$ 851,926	for Special	\$ 851,926	for Special
Actual estate	\$1,102,559	Valuation	\$1,102,559	Valuation

## Case II, Plan I

1995 Projected Federal Estate Tax Consequences of  
Alternative Plan I for Mrs. B's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$1,102,559	Not	\$1,102,559	Not
Taxable gifts within 3 years of death and gift tax paid		Qualified for Special Valuation		Qualified for Special Valuation
Gross estate	\$1,102,559		\$1,102,559	
Less: Administrative expenses Funeral ex- penses \$ 6,000 Settlement cost \$44,102	\$ 50,102		\$ 50,102	
Adjusted gross estate	\$1,052,245		\$1,052,245	
Less: Marital deduction	\$ 0		\$ 0	
Taxable estate	\$1,052,245		\$1,052,245	
Plus: Adjusted tax- able gifts	\$ 0		\$ 0	
Tentative tax base	\$1,052,245		\$1,052,245	
Estate tax on tenta- tive tax base	\$ 367,307		\$ 367,307	
Less: Credit for gift taxes paid during life	\$ 0		\$ 0	
Tax before unified credit	\$ 367,307		\$ 367,307	
Less: Unified credit	\$ 47,000		\$ 47,000	
Estate tax payable	\$ 320,307		\$ 320,307	

## Case II, Plan I

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. B's estate	\$263,061	Not	\$263,061	Not
From the life estate	\$192,919	Qualified	\$224,840	Qualified
Less: Federal Estate Tax	\$ 80,077	for	\$ 80,077	for
		Special		Special
		Valuation		Valuation
Virginia Inheritance Tax	\$ 10,579		\$ 11,537	
Net inheritance	\$365,323		\$396,287	



## Case II, Alternative Plan II

Under Alternative Plan II, the distribution of Farmer B's estate in 1985 would be as follows:

Item numbers correspond to Table E-8.

Item # Under tenancy by the entirety:

- 1 Real property
- 2 Personal property

Under Farmer B's will:

- 3 Real property
- 4 Personal property

As beneficiary of life insurance:

- 5 Personal property

Table E-8. Case II, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan II

	Item Numbers					Totals	
	1	2	3	4	5	Fair Market	Special
	To Mrs. B						
Distribution							
Tenancy by the entirety	X	X					
Farmer B's will			X	X			
As beneficiary of life insurance					X		
Qualify for the estate tax marital deduction	X	X	X	X		\$2,554,573	\$2,054,573
Virginia Inheritance Tax, Mrs. B	X	X	X	X		\$2,554,573	
Subject to Federal Estate Tax, Farmer B's estate	X	X	X	X		\$2,554,573	\$2,054,573
Subject to Federal Estate Tax, Mrs. B's estate	X	X	X	X			
1985 fair market valuation	\$66,059	\$238,147	\$2,077,350	\$173,017	\$100,000		
1985 special valuation	\$50,649	\$238,147	\$1,592,760	\$173,017	\$100,000		

## Case II, Plan II

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan II for Farmer B's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,651,463	\$2,151,463
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/>		
Gross estate	\$2,651,463	\$2,151,463
Less: Administrative expenses		
Funeral expenses     \$ 3,000		
Settlement cost     \$93,890	\$ 96,890	\$ 96,890
<hr/>		
Adjusted gross estate	\$2,554,573	\$2,054,573
Less: Marital deduction	\$1,277,287	\$1,027,287
<hr/>		
Taxable estate	\$1,277,287	\$1,027,287
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/>		
Tentative tax base	\$1,277,287	\$1,027,287
Estate tax on tentative tax base	\$ 460,033	\$ 356,988
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/>		
Tax before unified credit	\$ 460,033	\$ 356,988
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/>		
Estate tax payable	\$ 413,033	\$ 309,988

## Case II, Plan II

	Fair Market Valuation	Special Valuation
Mrs. B's inheritance		
Real property	\$2,143,409	\$2,143,409
Personal property	511,164	511,164
Less: Federal Estate Tax	413,033	309,988
Virginia Inheritance Tax	<u>111,179</u>	<u>111,179</u>
Net inheritance		
Real property	\$2,143,409	\$2,143,409
Personal property	-13,048	89,997

## Farmer B's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Mrs. B's estate				
Real property	\$3,970,850	\$3,470,850	\$3,970,850	\$3,470,850
Personal property	<u>\$ 43,559</u>	<u>\$ 43,559</u>	<u>\$ 156,923</u>	<u>\$ 156,923</u>
Actual estate	\$4,014,409	\$3,514,409	\$4,127,773	\$3,627,773

## Case II, Plan II

1995 Projected Federal Estate Tax Consequences of  
Alternative Plan II for Mrs. B's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$4,014,409	\$3,514,409	\$4,127,773	\$3,627,773
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$4,014,409	\$3,514,409	\$4,127,773	\$3,627,773
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 166,576	\$ 166,576	\$ 171,111	\$ 171,111
Adjusted gross estate	\$3,847,833	\$3,347,833	\$3,956,662	\$3,456,662
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$3,847,833	\$3,347,833	\$3,956,662	\$3,456,662
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$3,847,833	\$3,347,833	\$3,956,662	\$3,456,662
Estate tax on tenta- tive tax base	\$1,787,978	\$1,489,065	\$1,854,364	\$1,551,097
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$1,787,978	\$1,489,065	\$1,854,364	\$1,551,097
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$1,740,978	\$1,442,065	\$1,807,364	\$1,504,097

## Case II, Plan II

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
Real property	\$961,958	\$960,958	\$989,166	\$989,166
Personal property	\$ 0	\$ 0	\$ 0	\$ 0
Less: Federal Estate Tax	\$435,245	\$360,516	\$451,841	\$376,024
Virginia Inheritance Tax	<u>\$ 31,928</u>	<u>\$ 31,928</u>	<u>\$ 33,017</u>	<u>\$ 33,017</u>
Net inheritance	\$494,786	\$569,514	\$504,308	\$580,125

## Case II, Alternative Plan III

Under Alternative Plan III, the distribution of Farmer B's estate in 1985 would be as follows:

Item numbers correspond to Table E-9.

<u>Item #</u>	By gift:
1	Real property
	Under tenancy by the entirety:
2	Real property
3	Personal property
	Under Farmer B's will:
4	Real property
5	Personal property
	As beneficiary of life insurance:
6	Personal property
	To the children by gift:
7	Real property

Table E-9. Case II, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan III

	Item Numbers					
	1	2	3	4	5	6
	To Mrs. B					
Distribution						
By gift	X					
Under tenancy by the entirety		X	X			
Under Farmer B's will				X	X	
As beneficiary of life insurance						X
Qualify for the marital deduction		X	X	X	X	
Subject to Federal Gift Tax	X					
Subject to Virginia Gift Tax	X					
Virginia Inheritance Tax, Mrs. B	X*	X	X	X	X	
Subject to Federal Estate Tax, Farmer B's estate		X	X	X	X	
Subject to Federal Estate Tax, Mrs. B's estate	X	X	X	X	X	X
1985 fair market valuation	\$189,348	\$66,059	\$238,147	\$1,650,463	\$190,092	\$100,000
1985 special valuation		\$46,817	\$238,147	\$1,169,705	\$190,092	\$100,000

\*Gifts within three years of death.



Table E-9. Continued.

	Item Numbers	Totals	
	7	Fair Market	Special
<u>To The Children</u>			
Distribution			
By gift	X		
Under tenancy by the entirety Under Farmer B's will As beneficiary of life insurance			
Qualify for the marital deduction		\$2,144,761	\$2,144,761
Subject to Federal Gift Tax	X	\$ 316,000	
Subject to Virginia Gift Tax	X	\$ 316,000	
Virginia Inheritance Tax, Mrs. B		\$2,154,312	
Subject to Federal Estate Tax, Farmer B's estate		\$2,144,761	\$1,644,761
Subject to Federal Estate Tax, Mrs. B's estate			
1985 fair market valuation	\$237,539		
1985 special valuation			

## Case II, Plan III

## Gift program

	<u>1985 Value</u>	<u>1995 Value</u>
From Farmer B to Mrs. B		
1977 - \$103,000	\$164,166	\$293,997
1978-1985 - \$3,000/yr.	\$ 25,182	\$ 45,096
From Farmer and Mrs. B to the children		
1977-1985 - \$24,000/yr.	\$237,539	\$425,397
From Mrs. B to the children		
1977-1985 - \$1,200/yr.		\$158,170

## Case II, Plan III

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan III for Farmer B's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,224,576	\$1,724,576
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/> Gross estate	<hr/> \$2,224,576	<hr/> \$1,724,576
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$13,075	\$ 79,815	\$ 79,815
<hr/> Adjusted gross estate	<hr/> \$2,144,761	<hr/> \$1,644,671
Less: Marital deduction	\$1,022,382	\$ 772,382
<hr/> Taxable estate	<hr/> \$1,122,382	<hr/> \$ 872,382
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/> Tentative tax base	<hr/> \$1,122,382	<hr/> \$ 872,382
Estate tax on tentative tax base	\$ 395,977	\$ 296,029
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/> Tax before unified credit	<hr/> \$ 395,977	<hr/> \$ 296,029
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/> Estate tax payable	<hr/> \$ 348,977	<hr/> \$ 249,029

## Case II, Plan III

	Fair Market Valuation	Special Valuation
Mrs. B's inheritance		
Real property	\$1,716,522	\$1,716,522
Personal property	\$ 528,239	\$ 528,239
Less: Federal Estate Tax	\$ 348,977	\$ 249,029
Virginia Inheritance Tax	\$ 90,688	\$ 90,688
Net inheritance		
Real property	\$1,716,522	\$1,716,522
Personal property	\$ 88,574	\$ 188,522

## Farmer B's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$3,387,283	\$2,887,283	\$3,387,283	\$2,887,283
Personal property	\$ 225,549	\$ 225,549	\$ 404,540	\$ 404,540
Actual estate	\$3,612,832	\$3,112,832	\$3,791,823	\$3,291,823

## Case II, Plan III

1995 Projected Federal Estate Tax Consequences of  
Alternative Plan III for Mrs. B's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$3,612,832	\$3,112,832	\$3,791,823	\$3,291,823
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$3,612,832	\$3,112,832	\$3,791,823	\$3,291,823
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 150,513	\$ 150,513	\$ 157,673	\$ 157,673
Adjusted gross estate	\$3,462,319	\$2,962,319	\$3,634,150	\$3,134,150
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$3,462,319	\$2,962,319	\$3,634,150	\$3,134,150
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$3,462,319	\$2,962,319	\$3,634,150	\$3,134,150
Estate tax on tenta- tive tax base	\$1,554,322	\$1,270,829	\$1,657,632	\$1,367,266
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$1,554,322	\$1,270,829	\$1,657,632	\$1,367,266
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$1,507,322	\$1,223,829	\$1,610,632	\$1,320,266

## Case II, Plan III

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
Real property	\$846,820	\$846,820	\$846,820	\$846,820
Personal property	\$ 18,759	\$ 18,759	\$ 63,507	\$ 63,507
Less: Federal Estate Tax	\$376,831	\$305,957	\$402,658	\$330,067
Virginia Inheritance Tax	\$ 28,455	\$ 28,455	\$ 30,245	\$ 20,245
Net inheritance	\$460,294	\$531,167	\$477,424	\$550,015

## Case II, Alternative Plan IV

Under Alternative Plan IV, the distribution of Farmer B's estate in 1985 would be as follows:

Item numbers correspond to Table E-10.

<u>Item #</u>	Under tenancy by the entirety:
1	Real property
2	Personal property
	Under Farmer B's will:
3	Real property
	As beneficiary of life insurance:
4	Personal property
	To the trust under Farmer B's estate:
5	Real property
6	Personal property

Table E-10. Case II, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan IV

	Item Numbers			
	1	2	3	4
	To Mrs. B			
Distribution				
Under tenancy by the entirety	X	X		
Under Farmer B's will			X	
As beneficiary of life insurance				X
Qualify for estate tax marital deduction	X	X	X	
Virginia Inheritance Tax, Mrs. B	X	X	X	
Subject to Federal Estate Tax, Farmer B's estate	X	X	X	
Subject to Federal Estate Tax, Mrs. B's estate	X	X	X	
1985 fair market valuation	\$66,059	\$238,147	\$250,367	\$100,000
1985 special valuation	\$50,649	\$238,147	\$191,963	\$100,000



Table E-10. Continued.

	Item Numbers		Totals	
	5	6	Fair Market	Special
	<u>To the Trust</u>			
Distribution				
Under tenancy by the entirety Under Farmer B's will	X	X		
As beneficiary of life insurance				
Qualify for estate tax marital deduction			\$ 554,573	\$ 480,759
Virginia Inheritance Tax, Mrs. B	X*	X*	\$1,503,593	
Subject to Federal Estate Tax, Farmer B's estate	X	X	\$2,554,573	\$2,054,573
Subject to Federal Estate Tax, Mrs. B's estate				
1985 fair market valuation	\$1,826,983	\$173,017		
1985 special valuation	\$1,451,446	\$173,017		

## Case II, Plan IV

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan IV for Farmer B's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,651,463	\$2,151,463
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/> Gross estate	<hr/> \$2,651,463	<hr/> \$2,151,463
Less: Administrative expenses		
Funeral expenses \$3,000		
Settlement cost	\$ 96,890	\$ 96,890
<hr/> Adjusted gross estate	<hr/> \$2,554,573	<hr/> \$2,054,573
Less: Marital deduction	\$ 554,573	\$ 480,759
<hr/> Taxable estate	<hr/> \$2,000,000	<hr/> \$1,573,814
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/> Tentative tax base	<hr/> \$2,000,000	<hr/> \$1,573,814
Estate tax on tentative tax base	\$ 780,800	\$ 589,016
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/> Tax before unified credit	<hr/> \$ 780,800	<hr/> \$ 589,016
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/> Estate tax payable	<hr/> \$ 733,800	<hr/> \$ 542,016

## Case II, Plan IV

	Fair Market Valuation	Special Valuation
<b>Mrs. B's inheritance</b>		
Real property	\$ 316,426	\$ 316,426
Personal property	\$ 338,147	\$ 338,147
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 58,009	\$ 58,009
	<hr/>	<hr/>
<b>Net inheritance</b>		
Real property	\$ 316,426	\$ 316,426
Personal property	\$ 280,138	\$ 280,138
<b>To the trust</b>		
Real property	\$1,826,983	\$1,826,983
Personal property	\$ 173,017	\$ 173,017
Less: Federal Estate Tax	\$ 733,800	\$ 542,016
	<hr/>	<hr/>
<b>Net trust property</b>		
Real property	\$1,266,200	\$1,457,984

## Case II, Plan IV

Four possible valuations of Mrs. B's estate in 1995 under Alternative Plan IV would be as follows:

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$ 699,001	\$259,200	\$ 699,001	\$259,200
Personal property	\$ 568,611	\$568,611	\$ 568,611	\$568,611
Actual estate	\$1,267,612	\$827,811	\$1,267,612	\$827,811

## Case II, Plan IV

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan IV for Mrs. B's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$1,267,612	\$827,811	\$1,267,612	\$827,811
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$1,267,612	\$827,811	\$1,267,612	\$827,811
Less: Administrative expenses				
Funeral ex- penses \$6,000				
Settlement cost \$50,705	\$ 56,705	\$ 56,705	\$ 56,705	\$ 56,705
Adjusted gross estate	\$1,210,907	\$642,296	\$1,210,907	\$642,296
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$1,210,907	\$642,296	\$1,210,907	\$642,296
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$1,210,907	\$642,296	\$1,210,907	\$642,296
Estate tax on tenta- tive tax base	\$ 432,272	\$208,450	\$ 432,272	\$208,450
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 432,272	\$208,450	\$ 432,272	\$208,450
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 385,272	\$161,450	\$ 385,272	\$161,450

## Case II, Plan IV

## Farmer B's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. B's estate	\$302,727	\$302,727	\$302,727	\$302,727
From the trust	\$566,893	\$566,893	\$652,757	\$652,757
Less: Federal Estate Tax	\$ 96,318	\$ 40,363	\$ 96,318	\$ 40,363
Virginia Inheritance Tax	\$ 31,189	\$ 31,189	\$ 27,092	\$ 27,092
Net inheritance	\$749,644	\$805,599	\$832,074	\$888,029

## Case II, Alternative Plan V

Under Alternative Plan V, the distribution of Farmer B's estate in 1985 would be as follows:

Item numbers correspond to Table E-11.

<u>Item #</u>	To Mrs. B by gift:
1	Real property
	Under tenancy by the entirety:
2	Real property
3	Personal property
	Under Farmer B's will:
4	Real property
	As beneficiary of life insurance:
5	Personal property
	To the trust under Farmer B's will:
6	Real property
7	Personal property
	To the children by gift:
8	Real property

Table E-11. Case II, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan V

Distribution	Item Numbers				
	1	2	3	4	5
	To Mrs. B				
By gift	X				
Under tenancy by the entirety		X	X		
Under Farmer B's will				X	
As beneficiary of life insurance					X
Subject to Virginia Inheritance Tax	X*	X	X	X	
Subject to Federal Gift Tax	X				
Subject to Federal Estate Tax, Farmer B's estate		X	X	X	
Subject to Federal Estate Tax, Mrs. B's estate	X	X	X	X	X
Qualify for estate tax marital deduction		X	X	X	
1985 fair market valuation	\$189,348	\$66,059	\$238,147	\$11,187	\$100,000
1985 special valuation		\$46,817	\$238,147	\$ 7,928	\$100,000

\*Gift within three years of death.



Table E-11. Continued.

	Item Numbers	
	6	7
	<u>To the Trust</u>	
Distribution		
By gift		
Under tenancy by the entirety		
Under Farmer B's will	X	X
As beneficiary of life insurance		
Subject to Virginia Inheritance Tax	X**	X**
Subject to Federal Gift Tax		
Subject to Federal Estate Tax, Farmer B's estate	X	X
Subject to Federal Estate Tax, Mrs. B's estate		
Qualify for estate tax marital deduction		
1985 fair market valuation	\$1,639,276	\$1,161,777
1985 special valuation	\$ 190,092	\$ 190,092

\*\*Valued as life estate.

Table E-11. Continued.

	Item Numbers	Totals	
	8	Fair Market	Special
<u>To the Children</u>			
Distribution			
By gift	X		
Under tenancy by the entirety			
Under Farmer B's will			
As beneficiary of life insurance			
Subject to Virginia Inheritance Tax		\$1,181,637	
Subject to Federal Gift Tax	X		
Subject to Federal Estate Tax, Farmer B's estate		\$2,144,761	\$315,393
Subject to Federal Estate Tax, Mrs. B's estate			
Qualify for estate tax marital deduction		\$1,644,761	\$292,892
1985 fair market valuation	\$237,539		
1985 special valuation			

## Case II, Plan V

## Gift program

	<u>1985 Value</u>	<u>1995 Value</u>
From Farmer B to Mrs. B		
1977 - \$103,000	\$164,166	\$293,997
1978-1985 - \$\$3,000/yr.	\$ 25,182	\$ 45,096
From Farmer and Mrs. B to the children		
1977-1985 - \$24,000/yr.	\$237,539	\$425,397
From Mrs. B to the children		
1985-1995 - \$12,000/yr.		\$158,170

## Case II, Plan V

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan V for Farmer B's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,224,576	\$1,724,576
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
Gross estate	\$2,224,576	\$1,724,576
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$13,075	\$ 79,815	\$ 79,815
Adjusted gross estate	\$2,144,761	\$1,644,761
Less: Marital deduction	\$ 265,393	\$ 242,892
Taxable estate	\$1,879,386	\$1,401,869
Plus: Adjusted taxable gifts	\$ 0	\$ 0
Tentative tax base	\$1,879,386	\$1,401,869
Estate tax on tentative tax base	\$ 726,074	\$ 513,604
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
Tax before unified credit	\$ 726,074	\$ 513,604
Less: Unified credit	\$ 47,000	\$ 47,000
Estate tax payable	\$ 679,074	\$ 466,604

## Case II, Plan V

	Fair Market Valuation	Special Valuation
Mrs. B's inheritance		
Real property	\$ 77,246	\$ 77,246
Personal property	\$ 338,147	\$ 338,147
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 42,532	\$ 42,532
Net inheritance		
Real property	\$ 77,246	\$ 77,246
Personal property	\$ 295,615	\$ 295,615
The trust property		
Real property	\$1,639,276	\$1,639,276
Personal property	\$ 190,092	\$ 190,092
Less: Federal Estate Tax	\$ 679,074	\$ 466,604
Net trust property		
Real property	\$1,150,294	\$1,362,764

## Case II, Plan V

Four possible valuations of Mrs. B's estate in 1995 under Alternative Plan V:

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$ 451,588	\$172,781	\$ 451,588	\$172,781
Personal property	\$ 596,328	\$596,328	\$ 596,328	\$596,328
Actual estate	\$1,047,916	\$769,109	\$1,047,916	\$769,109

## Case II, Plan V

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan V for Mrs. B's Estate

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$1,047,916	\$769,109	\$1,047,916	\$769,109
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$1,047,916	\$769,109	\$1,047,916	\$769,109
Less: Administrative expenses Funeral ex- penses \$ 3,000 Settlement cost \$13,075	\$ 47,917	\$ 47,917	\$ 47,917	\$ 47,917
Adjusted gross estate	\$ 999,999	\$721,192	\$ 999,999	\$721,192
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$ 999,999	\$721,192	\$ 999,999	\$721,192
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$ 999,999	\$721,192	\$ 999,999	\$721,192
Estate tax on tenta- tive tax base	\$ 345,800	\$237,641	\$ 345,800	\$237,641
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 345,800	\$237,641	\$ 345,800	\$237,641
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 298,800	\$190,641	\$ 298,800	\$190,641

## Case II, Plan V

	Farmer B's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. B's Estate		Mrs. B's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. B's estate	\$250,000	\$250,000	\$250,000	\$250,000
From the trust	\$515,000	\$515,000	\$610,126	\$610,126
Less: Federal Estate Tax	\$ 74,700	\$ 47,660	\$ 74,700	\$ 47,660
Virginia Inheritance Tax	<u>\$ 20,287</u>	<u>\$ 20,287</u>	<u>\$ 24,092</u>	<u>\$ 24,092</u>
Net inheritance	\$670,013	\$697,053	\$761,334	\$788,374



## Case III, Existing Plan

The distribution of Farmer C's estate under his existing plan would be as follows:

Item numbers correspond to Table E-12.

<u>Item #</u>	To Mrs. C under tenancy by the entirety:
1	Personal property
	Under Farmer C's will:
2	Personal property
	As beneficiary of life insurance:
3	Personal property
	To the marital deduction trust:
4	Real property
5	Personal property
	To the residual trust:
6	Real property
7	Personal property

Table E-12. Case III, Tentative Distribution of Farmer B's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under the Existing Plan

	Item Numbers		
	1	2	3
	To Mrs. C		
Distribution			
Under tenancy by the entirety	X		
Under Farmer C's will		X	
As beneficiary of life insurance			X
Qualify for estate tax marital deduction	X	X	X
Virginia Inheritance Tax, Mrs. C	X	X	
Subject to Federal Estate Tax, Farmer C's estate	X	X	X
Subject to Federal Estate Tax, Mrs. C's estate	X	X	X
1985 fair market valuation	\$18,584	\$18,718	\$65,000
1985 special valuation	\$18,584	\$18,718	\$65,000

Table E-12. Continued.

	Item Numbers	
	4	5
<u>To the Marital Deduction Trust</u>		
Distribution		
Under tenancy by the entirety Under Farmer C's will	X	X
As beneficiary of life insurance Qualify for estate tax marital deduction	X	X
Virginia Inheritance Tax, Mrs. C	X	X
Subject to Federal Estate Tax, Farmer C's estate	X	X
Subject to Federal Estate Tax, Mrs. C's estate	X	X
1985 fair market valuation	\$1,113,367	\$1,840
1985 special valuation	\$ 863,367	\$1,840

Table E-12. Continued.

	Item Numbers		Totals	
	6	7	Fair Market	Special
	<u>To the Residual Trust</u>			
Distribution				
Under tenancy by the entirety Under Farmer C's will	X	X		
As beneficiary of life insurance				
Qualify for estate tax marital deduction			\$1,217,509	\$ 967,509
Virginia Inheritance Tax, Mrs. C	X*	X*	\$1,610,023	
Subject to Federal Estate Tax, Farmer C's estate	X	X	\$2,332,716	\$1,832,716
Subject to Federal Estate Tax, Mrs. C's estate				
1985 fair market valuation	\$1,113,367	\$1,840		
1985 special valuation	\$ 863,367	\$1,840		

\*Valued as life estate.

## Case III, Existing Plan

1985 Projected Federal Estate Tax Consequences of  
Farmer C's Existing Estate Plan

	Fair Market Valuation	Special Valuation
Actual estate	\$2,432,262	\$1,932,262
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/> Gross estate	<hr/> \$2,432,262	<hr/> \$1,932,262
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$96,547	\$ 99,547	\$ 99,547
<hr/> Adjusted gross estate	<hr/> \$2,332,715	<hr/> \$1,832,716
Less: Marital deduction	\$1,166,358	\$ 916,358
<hr/> Taxable estate	<hr/> \$1,166,358	<hr/> \$ 916,358
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/> Tentative tax base	<hr/> \$1,166,358	<hr/> \$ 916,358
Estate tax on tentative tax base	\$ 414,007	\$ 313,180
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/> Tax before unified credit	<hr/> \$ 414,007	<hr/> \$ 313,180
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/> Estate tax payable	<hr/> \$ 367,007	<hr/> \$ 266,180

## Case III, Existing Plan

	Fair Market Valuation	Special Valuation
Mrs. C's inheritance		
Real property	\$1,113,367	\$1,113,367
Personal property	\$ 104,142	\$ 104,142
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 63,951	\$ 63,951
Net inheritance		
Real property	\$1,113,367	\$1,113,367
Personal property	\$ 40,191	\$ 40,191
Residual trust property		
Real property	\$1,113,367	\$1,113,367
Personal property	\$ 1,840	\$ 1,840
Less: Federal Estate Tax	\$ 367,007	\$ 266,180
Net residual trust property		
Real property	\$ 748,200	\$ 849,027

## Case III, Existing Plan

Four possible valuations for Mrs. C's estate in 1995 under the Existing Plan are as follows:

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$1,993,871	\$1,493,871	\$1,993,871	\$1,493,871
Personal property	\$ 71,976	\$ 71,976	\$ 66,156	\$ 66,156
Actual estate	\$2,065,847	\$1,565,847	\$2,065,847	\$1,565,847

## Case III, Existing Plan

## 1995 Projected Federal Estate Tax Consequences of

## Mrs. C's Existing Estate Plan

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$2,065,847	\$1,565,847	\$2,065,847	\$1,565,847
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$2,065,847	\$1,565,847	\$2,065,847	\$1,565,847
Less: Administrative expenses Funeral ex- penses \$ 6,000 Settlement cost \$82,401	\$ 88,634	\$ 88,634	\$ 88,634	\$ 88,634
Adjusted gross estate	\$1,977,213	\$1,477,213	\$1,977,213	\$1,477,213
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$1,977,213	\$1,477,213	\$1,977,213	\$1,477,213
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$1,977,213	\$1,477,213	\$1,977,213	\$1,477,213
Estate tax on tenta- tive tax base	\$ 770,546	\$ 546,002	\$ 770,546	\$ 546,002
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 770,546	\$ 546,002	\$ 770,546	\$ 546,002
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 723,546	\$ 499,002	\$ 723,546	\$ 499,002



Case III, Existing Plan  
Each Child's Inheritance

## Farmer C's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
From Mrs. C's estate	\$494,303	\$494,303	\$494,303	\$494,303
From the residual trust	\$334,978	\$334,978	\$380,120	\$380,120
Less: Federal Estate Tax	\$180,887	\$124,751	\$180,887	\$124,751
Virginia In- heritance Tax	<u>\$ 21,778</u>	<u>\$ 21,778</u>	<u>\$ 23,133</u>	<u>\$ 23,133</u>
Net inheritance	\$626,616	\$682,752	\$670,403	\$726,539

## Case III, Alternative Plan I

Under Alternative Plan I, the distribution of Farmer C's estate in 1985 would be as follows:

Item numbers correspond to Table E-13.

<u>Item #</u>	To Mrs. C's under tenancy by the entirety:
1	Personal property
	As beneficiary of life insurance:
2	Personal property
	Under Mrs. C's dower right:
3	Real estate (life estate)
4	Personal property
	To the children under the laws of descent and distribution:
5	Real property
6	Personal property

Table E-13. Case III, Tentative Distribution of Farmer C's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan I

	Item Numbers			
	1	2	3	4
	To Mrs. C			
Distribution				
Under tenancy by the entirety	X			
As beneficiary of life insurance		X		
Under Mrs. C's dower right			X	X
Under the laws of descent and distribution				
Qualify for the estate tax marital deduction	X	X		X
Virginia Inheritance Tax, Mrs. C	X		X*	X
Virginia Inheritance Tax, the children				
Subject to Federal Estate Tax, Farmer C's estate	X	X	X	X
Subject to Federal Estate Tax, Mrs. C's estate	X	X		X
1985 fair market valuation	\$18,584	\$65,000	\$742,245	\$7,466
1985 special valuation	\$18,584	\$65,000	\$575,578	\$7,466

\*Valued as life estate.

Table E-13. Continued.

	Item Numbers		Totals	
	5	6	Fair Market	Special
	<u>To the Children</u>			
Distribution				
Under tenancy by the entirety				
As beneficiary of life insurance				
Under Mrs. C's dower right				
Under the laws of descent and distribution	X	X		
Qualify for the estate tax marital deduction			\$ 91,050	\$ 91,050
Virginia Inheritance Tax, Mrs. C			\$ 330,556	
Virginia Inheritance Tax, the children	X	X	\$1,499,421	
Subject to Federal Estate Tax, Farmer C's estate	X	X	\$2,332,716	\$1,832,716
Subject to Federal Estate Tax, Mrs. C's estate				
1985 fair market valuation	\$1,484,489	\$14,932		
1985 special valuation	\$1,151,156	\$14,932		

## Case III, Plan I

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan I for Farmer C's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,432,626	\$1,932,626
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/>		
Gross estate	\$2,432,626	\$1,932,626
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$96,547	\$ 99,547	\$ 99,547
<hr/>		
Adjusted gross estate	\$2,332,716	\$1,832,716
Less: Marital deduction	\$ 91,050	\$ 91,050
<hr/>		
Taxable estate	\$2,241,666	\$1,741,666
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/>		
Tentative tax base	\$2,241,666	\$1,741,666
Estate tax on tentative tax base	\$ 899,216	\$ 664,550
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/>		
Tax before unified credit	\$ 899,216	\$ 664,550
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/>		
Estate tax payable	\$ 852,216	\$ 617,550

## Case III, Plan I

	Fair Market Valuation	Special Valuation
Mrs. C's inheritance		
Personal property	\$ 91,050	\$ 91,050
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 8,367	\$ 8,367
Net inheritance	\$ 82,683	\$ 82,683
Life estate property		
Real estate	\$742,245	\$742,245
Less: Federal Estate Tax	\$282,180	\$204,479
Net life estate	\$460,065	\$537,766
Each child's inheritance		
Real property	\$371,122	\$371,122
Personal property	\$ 3,733	\$ 3,733
Less: Federal Estate Tax	\$142,509	\$103,268
Virginia Inheritance Tax	\$ 9,696	\$ 9,696
Net inheritance	\$222,650	\$261,891

## Case III, Plan I

Four possible valuations of Mrs. C's estate in 1995 under Alternative Plan I are as follows:

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Personal property	\$148,073	Not	\$148,073	Not
Actual estate	\$148,073	Qualified	\$148,073	Qualified
		for		for
		Special		Special
		Valuation		Valuation

## Case III, Plan I

## Farmer C's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market</u> <u>Valuation</u>	<u>Special</u> <u>Valuation</u>	<u>Fair Market</u> <u>Valuation</u>	<u>Special</u> <u>Valuation</u>
Each child's inheritance				
From Mrs. C's estate	\$ 34,038	Not Qualified	\$ 34,038	Not Qualified
From the life estate	\$205,977	for Special Valuation	\$240,764	for Special Valuation
Less: Federal Estate Tax	\$ 0		\$ 0	
Virginia Inheritance Tax	\$ 4,920		\$ 5,963	
Net inheritance	\$235,095		\$268,839	



## Case III, Alternative Plan II

The distribution of Farmer C's estate in 1985 will be as follows under Alternative Plan II:

Item numbers correspond to Table E-14.

Item # To Mrs. C under tenancy by the entirety:

1 Personal property

Under Farmer C's will:

2 Real property

3 Personal property

As beneficiary of life insurance:

4 Personal property

Table E-14. Case III, Tentative Distribution of Farmer C's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan II

	Item Numbers				Totals	
	1	2	3	4	Fair Market	Special
Distribution						
Under tenancy by the entirety Under Farmer C's will	X					
As beneficiary of life insurance		X	X			
Qualify for estate tax marital deduction				X		
Virginia Inheritance Tax, Mrs. C	X	X	X	X	\$2,332,716	\$1,832,716
Subject to Federal Estate Tax, Farmer C's estate	X	X	X	X	\$2,267,716	
Subject to Federal Estate Tax, Farmer C's estate	X	X	X	X	\$2,332,716	\$1,832,716
1985 fair market valuation	\$18,584	\$2,226,734	\$22,398	\$65,000		
1985 special valuation	\$18,584	\$1,726,734	\$22,398	\$65,000		

## Case III, Plan II

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan II for Farmer C's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,432,262	\$1,932,262
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
<hr/>		
Gross estate	\$2,432,262	\$1,932,262
Less: Administrative expenses		
Funeral expenses     \$ 3,000		
Settlement cost     \$96,547	\$ 99,547	\$ 99,547
<hr/>		
Adjusted gross estate	\$2,332,716	\$1,832,716
Less: Marital deduction	\$1,166,358	\$ 916,358
<hr/>		
Taxable estate	\$1,166,358	\$ 916,358
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/>		
Tentative tax base	\$1,166,358	\$ 916,358
Estate tax on tentative tax base	\$ 414,007	\$ 313,180
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/>		
Tax before unified credit	\$ 414,007	\$ 313,180
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/>		
Estate tax payable	\$ 367,007	\$ 266,180

## Case III, Plan II

	Fair Market Valuation	Special Valuation
Mrs. C's inheritance		
Real property	\$2,226,734	\$2,226,734
Personal property	\$ 105,982	\$ 105,982
Less: Federal Estate Tax	\$ 367,007	\$ 266,180
Virginia Inheritance Tax	\$ 96,836	\$ 96,836
Net inheritance	\$1,868,873	\$1,969,700

Four possible valuations of Mrs. C's estate in 1995 under Alternative Plan II:

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$3,346,867	\$2,846,867	\$3,527,433	\$3,027,433
Actual estate	\$3,346,867	\$2,846,867	\$3,527,433	\$3,027,433

## Case III, Plan I

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan I for Mrs. C's Estate

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$148,073	\$148,073	\$148,073	\$148,073
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$148,073	\$148,073	\$148,073	\$148,073
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 11,923	\$ 11,923	\$ 11,923	\$ 11,923
Adjusted gross estate	\$136,150	\$136,150	\$136,150	\$136,150
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$136,150	\$136,150	\$136,150	\$136,150
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$136,150	\$136,150	\$136,150	\$136,150
Estate tax on tenta- tive tax base	\$ 34,645	\$ 34,645	\$ 34,645	\$ 34,645
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 34,645	\$ 34,645	\$ 34,645	\$ 34,645
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 0	\$ 0	\$ 0	\$ 0

## Case III, Plan II

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan II for Mrs. C's Estate

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$3,346,867	\$2,846,867	\$3,527,433	\$3,027,433
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$3,346,867	\$2,846,867	\$3,527,433	\$3,037,433
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 139,875	\$ 139,875	\$ 147,097	\$ 147,097
Adjusted gross estate	\$3,206,992	\$2,706,992	\$3,380,336	\$2,880,336
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$3,206,992	\$2,706,992	\$3,380,336	\$2,880,336
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$3,206,992	\$2,706,992	\$3,380,336	\$2,880,336
Estate tax on tenta- tive tax base	\$1,408,785	\$1,135,506	\$1,507,592	\$1,227,378
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$1,408,785	\$1,135,506	\$1,507,592	\$1,227,378
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$1,361,785	\$1,088,506	\$1,460,592	\$1,180,378

## Case III, Plan II

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. C's estate	\$801,748	\$801,748	\$845,084	\$845,084
Less: Federal Estate Tax	\$340,446	\$272,127	\$365,148	\$295,095
Virginia Inheritance Tax	<u>\$ 25,520</u>	<u>\$ 25,520</u>	<u>\$ 27,253</u>	<u>\$ 27,253</u>
Net inheritance	\$435,782	\$504,101	\$452,683	\$522,736

## Case III, Alternative Plan III

The distribution of Farmer C's estate in 1985 under Alternative Plan III would be as follows:

Item numbers correspond to Table E-15.

<u>Item #</u>	To Mrs. C by gift:
1	Real property
	Under tenancy by the entirety:
2	Personal property
	Under Farmer C's will:
3	Real property
4	Personal property
	As beneficiary of life insurance:
5	Personal property
	To the children by gift:
6	Real property



Table E-15. Case III, Tentative Distribution of Farmer C's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan III

	Item Numbers				
	1	2	3	4	5
	To Mrs. C				
Distribution					
By gift	X				
Under tenancy by the entirety Under Farmer C's will		X			
As beneficiary of life insurance			X	X	
Qualify for estate tax marital deduction					X
Virginia Gift Tax	X	X	X	X	X
Virginia Inheritance Tax, Mrs. C	X*	X	X	X	
Subject to Federal Gift Tax	X				
Subject to Federal Estate Tax, Farmer C's estate		X	X	X	X
Subject to Federal Estate Tax, Mrs. C's estate	X	X	X	X	X
1985 fair market valuation	\$189,347	\$16,129	\$1,799,848	\$39,437	\$65,000
1985 special valuation		\$16,129	\$1,299,848	\$39,437	\$65,000

\*Gift within three years of death.

Table E-15. Continued.

	Item Numbers		Totals	
	6	Fair Market	Special	
<u>To the Children</u>				
Distribution				
By gift	X			
Under tenancy by the entirety				
Under Farmer C's will				
As beneficiary of life insurance				
Qualify for estate tax marital deduction		\$1,905,081	\$1,405,081	
Virginia Gift Tax	X	\$ 316,000		
Virginia Inheritance Tax, Mrs. C		\$1,864,965		
Subject to Federal Gift Tax	X	\$ 316,000		
Subject to Federal Estate Tax, Farmer C's estate		\$1,920,414	\$1,420,414	
Subject to Federal Estate Tax, Mrs. C's estate				
1985 fair market valuation		\$237,539		
1985 special valuation				

## Case III, Plan III

1995 Projected Federal Estate Tax Consequences of  
Alternative Plan III for Mrs. C's Estate

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$2,934,314	\$2,439,314	\$3,109,289	\$2,509,289
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$2,934,314	\$2,434,314	\$3,109,289	\$2,609,289
Less: Administrative expenses Funeral ex- penses \$6,000 Settlement cost	\$ 123,388	\$ 123,388	\$ 130,387	\$ 130,387
Adjusted gross estate	\$2,811,305	\$2,311,305	\$2,979,289	\$2,479,289
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$2,811,305	\$2,311,305	\$2,979,289	\$2,479,289
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$2,811,305	\$2,311,305	\$2,979,289	\$2,479,289
Estate tax on tenta- tive tax base	\$1,190,791	\$ 933,339	\$1,279,818	\$1,015,646
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$1,190,791	\$ 933,839	\$1,279,818	\$1,015,646
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$1,143,791	\$ 886,339	\$1,232,818	\$ 968,646

## Case III, Plan III

Gift program	<u>1985 Value</u>	<u>1995 Value</u>
From Farmer C to Mrs. C		
1977 - \$103,000	\$164,166	\$293,997
1978-1985 - \$3,000/yr.	\$ 25,181	\$ 45,096
From Farmer and Mrs. C to the children		
1977-1985 - \$24,000/yr.	\$237,539	\$425,397
From Mrs. C to the children		
1986-1995 - \$12,000/yr.		\$158,170

## Case III, Plan III

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan III for Farmer C's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,002,886	\$1,502,886
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
Gross estate	\$2,002,886	\$1,502,886
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$13,075	\$ 82,472	\$ 82,472
Adjusted gross estate	\$1,920,414	\$1,420,414
Less: Marital deduction	\$ 910,207	\$ 660,207
Taxable estate	\$1,010,207	\$ 760,207
Plus: Adjusted taxable gifts	\$ 0	\$ 0
Tentative tax base	\$1,010,207	\$ 760,207
Estate tax on tentative tax base	\$ 349,985	\$ 252,281
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
Tax before unified credit	\$ 349,985	\$ 252,281
Less: Unified credit	\$ 47,000	\$ 47,000
Estate tax payable	\$ 302,985	\$ 205,281

## Case III, Plan III

	Fair Market Valuation	Special Valuation
Mrs. C's inheritance		
Real property	\$1,799,848	\$1,799,848
Personal property	\$ 120,566	\$ 120,566
Less: Federal Estate Tax	\$ 302,985	\$ 205,281
Virginia Inheritance Tax	\$ 79,949	\$ 79,949
Net inheritance		
Real property	\$1,537,480	\$1,635,184
Personal property	\$ 0	\$ 0

Four possible valuations of Mrs. C's estate in 1995 under Alternative Plan III:

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$2,934,314	\$2,434,314	\$3,109,289	\$2,609,289
Actual estate	\$2,934,314	\$2,434,314	\$3,109,289	\$2,609,289

## Case III, Plan III

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. C's estate	\$702,826	\$702,826	\$744,822	\$744,822
Less: Federal Estate Tax	\$285,948	\$221,585	\$308,205	\$242,162
Virginia Inheritance Tax	\$ 21,945	\$ 21,945	\$ 23,624	\$ 23,624
Net inheritance	\$394,843	\$459,206	\$412,993	\$479,036

## Case III, Alternative Plan IV

The distribution of Farmer C's estate in 1985 under Alternative Plan IV would be as follows:

Item numbers correspond to Table E-16.

<u>Item #</u>	To Mrs. C under tenancy by the entirety:
1	Personal property
	Under Farmer C's will:
2	Personal property
3	Real property
	As beneficiary of life insurance:
4	Personal property
	To the trust:
5	Personal property
6	Real property



Table E-16. Case III, Tentative Distribution of Farmer C's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan IV

	Item Numbers			
	1	2	3	4
	To Mrs. C			
Distribution				
Under tenancy by the entirety Under Farmer C's will	X			
As beneficiary of life insurance		X	X	
Qualify for Federal Estate Tax marital deduction	X	X	X	X
Virginia Inheritance Tax, Mrs. C	X	X	X	
Subject to Federal Estate Tax, Farmer C's estate	X	X	X	X
Subject to Federal Estate Tax, Mrs. C's estate	X	X	X	X
1985 fair market valuation	\$18,584	\$18,718	\$529,530	\$65,000
1985 special valuation	\$18,584	\$18,718	\$410,627	\$65,000

Table E-16. Continued.

	Item Numbers		Totals	
	5	6	Fair Market	Special
	<u>To the Trust</u>			
Distribution				
Under tenancy by the entirety Under Farmer C's will	X	X		
As beneficiary of life insurance Qualify for Federal Estate Tax marital deduction			\$ 631,832	\$ 512,929
Virginia Inheritance Tax, Mrs. C	X*	X*	\$1,264,620	
Subject to Federal Estate Tax, Farmer C's estate	X	X	\$2,332,716	\$1,832,716
Subject to Federal Estate Tax, Mrs. C's estate				
1985 fair market valuation	\$1,697,204	\$3,680		
1985 special valuation	\$1,316,107	\$3,680		

\*Valued as life estate.

## Case III, Plan IV

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan IV for Farmer C's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,432,262	\$1,932,262
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0
Gross estate	\$2,432,262	\$1,932,262
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$13,075	\$ 99,547	\$ 99,547
Adjusted gross estate	\$2,332,716	\$1,832,716
Less: Marital deduction	\$ 631,832	\$ 512,929
Taxable estate	\$1,700,884	\$1,319,787
Plus: Adjusted taxable gifts	\$ 0	\$ 0
Tentative tax base	\$1,700,884	\$1,319,787
Estate tax on tentative tax base	\$ 646,198	\$ 478,308
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
Tax before unified credit	\$ 646,198	\$ 478,308
Less: Unified credit	\$ 47,000	\$ 47,000
Estate tax payable	\$ 599,198	\$ 431,308

## Case III, Plan IV

	Fair Market Valuation	Special Valuation
Mrs. C's inheritance		
Real property	\$ 529,530	\$ 529,530
Personal property	\$ 102,302	\$ 102,302
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 46,681	\$ 46,681
	<hr/>	<hr/>
Net inheritance		
Real property	\$ 529,530	\$ 529,530
Personal property	\$ 55,621	\$ 55,621
The trust property		
Real property	\$1,697,204	\$1,697,204
Personal property	\$ 3,680	\$ 3,680
Less: Federal Estate Tax	\$ 599,198	\$ 431,308
	<hr/>	<hr/>
Net trust property		
Real property	\$1,101,686	\$1,269,576

## Case III, Plan IV

Four possible valuations of Mrs. C's estate in 1995 under Alternative Plan IV are as follows:

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$ 948,308	\$448,308	\$ 948,308	\$448,308
Personal property	\$ 99,609	\$ 99,609	\$ 99,609	\$ 99,609
Actual estate	\$1,047,917	\$547,917	\$1,047,917	\$547,917

## Case III, Plan IV

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan IV for Mrs. C's Estate

## Farmer C's Estate

	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$1,047,917	\$547,917	\$1,047,917	\$547,917
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$1,047,917	\$547,917	\$1,047,917	\$547,917
Less: Administrative expenses Funeral ex- penses \$ 6,000 Settlement cost \$41,917	\$ 47,917	\$ 47,917	\$ 47,917	\$ 47,917
Adjusted gross estate	\$1,000,000	\$500,000	\$1,000,000	\$500,000
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$1,000,000	\$500,000	\$1,000,000	\$500,000
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$1,000,000	\$500,000	\$1,000,000	\$500,000
Estate tax on tenta- tive tax base	\$ 345,800	\$155,800	\$ 345,800	\$155,800
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$ 345,800	\$155,800	\$ 345,800	\$155,800
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$ 298,800	\$108,800	\$ 298,800	\$108,800

## Case III, Plan IV

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. C's estate	\$250,000	\$250,000	\$250,000	\$250,000
From the trust	\$493,238	\$493,238	\$568,404	\$568,404
Less: Federal Estate Tax	\$ 74,700	\$ 27,200	\$ 74,700	\$ 27,200
Virginia Inheritance Tax	\$ 19,197	\$ 19,197	\$ 22,136	\$ 22,136
Net inheritance	\$649,341	\$696,841	\$721,568	\$769,068

## Case III, Alternative Plan V

The distribution of Farmer C's estate in 1985 under Alternative Plan IV would be as follows:

Item numbers correspond to Table E-17.

<u>Item #</u>	To Mr. C by gift:
1	Real property
	Under tenancy by the entirety:
2	Personal property
	Under Farmer C's will:
3	Personal property
4	Real property
	As beneficiary of life insurance:
5	Personal property
	To the trust under Farmer C's will:
6	Real property
7	Personal property
	To the children by gift:
8	Real property



Table E-17. Case III, Tentative Distribution of Farmer C's Estate and Portions Subject to Taxation After Administrative and Funeral Expenses are Deducted Under Alternative Plan V

	Item Numbers				
	1	2	3	4	5
	To Mrs. C				
Distribution					
By gift	X				
Under tenancy					
by the entirety		X			
Under Farmer C's					
will			X	X	
As beneficiary of					
life insurance					X
Virginia Gift Tax	X				
Virginia Inheritance					
Tax, Mrs. C	X*	X	X	X	
Subject to Federal					
Gift Tax	X				
Subject to Federal					
Estate Tax, Farmer					
C's estate		X	X	X	X
Subject to Federal					
Estate Tax, Mrs.					
C's estate	X	X	X	X	X
Qualify for estate					
tax marital					
deduction		X	X	X	X
1985 fair market					
valuation	\$189,347	\$16,129	\$34,051	\$355,234	\$65,000
1985 special					
valuation		\$16,129	\$34,051	\$256,550	\$65,000

\*Gift within three years of death.

Table E-17. Continued.

	Item Numbers	
	6	7
	<u>To the Trust</u>	
Distribution		
By gift		
Under tenancy by the entirety		
Under Farmer C's will	X	X
As beneficiary of life insurance		
Virginia Gift Tax		
Virginia Inheritance Tax, Mrs. C	X**	X**
Subject to Federal Gift Tax		
Subject to Federal Estate Tax, Farmer C's estate	X	X
Subject to Federal Estate Tax, Mrs. C's estate		
Qualify for estate tax marital deduction		
1985 fair market valuation	\$1,444,614	\$5,386
1985 special valuation	\$1,043,298	\$5,386

\*\*Valued as life estate.

Table E-17. Continued.

	Item Numbers	Totals	
	8	Fair Market	Special
<u>To the Children</u>			
Distribution			
By gift	X		
Under tenancy by the entirety			
Under Farmer C's will			
As beneficiary of life insurance			
Virginia Gift Tax	X	\$ 316,000	
Virginia Inheritance Tax, Mrs. C		\$1,009,828	
Subject to Federal Gift Tax	X	\$ 316,000	
Subject to Federal Estate Tax, Farmer C's estate		\$1,920,414	\$1,420,414
Subject to Federal Estate Tax, Mrs. C's estate			
Qualify for estate tax marital deduction		\$ 479,414	\$ 371,730
1985 fair market valuation	\$237,539		
1985 special valuation			

## Case III, Plan V

Gift program	<u>1985 Value</u>	<u>1995 Value</u>
From Farmer C to Mrs. C		
1977 - \$103,000	\$164,166	\$293,997
1978-1985 - \$3,000/yr.	\$ 25,181	\$ 45,096
From Farmer and Mrs. C to the children		
1977-1985 - \$24,000/yr.	\$237,539	\$425,397
From Mrs. C to the children		
1985-1995 - \$12,000/yr.		\$158,170

## Case III, Plan V

1985 Projected Federal Estate Tax Consequences of  
Alternative Plan V for Farmer C's Estate

	Fair Market Valuation	Special Valuation
Actual estate	\$2,002,886	\$1,502,886
Taxable gifts within 3 years of death and tax paid	\$ 0	\$ 0
<hr/> Gross estate	<hr/> \$2,002,886	<hr/> \$1,502,886
Less: Administrative expenses		
Funeral expenses \$ 3,000		
Settlement cost \$13,075	\$ 82,472	\$ 82,472
<hr/> Adjusted gross estate	<hr/> \$1,920,414	<hr/> \$1,420,414
Less: Marital deduction	\$ 420,414	\$ 371,730
<hr/> Taxable estate	<hr/> \$1,500,000	<hr/> \$1,048,684
Plus: Adjusted taxable gifts	\$ 0	\$ 0
<hr/> Tentative tax base	<hr/> \$1,500,000	<hr/> \$1,048,684
Estate tax on tentative tax base	\$ 555,800	\$ 365,760
Less: Credit for gift taxes paid during life	\$ 0	\$ 0
<hr/> Tax before unified credit	<hr/> \$ 555,800	<hr/> \$ 365,760
Less: Unified credit	\$ 47,000	\$ 47,000
<hr/> Estate tax payable	<hr/> \$ 508,800	<hr/> \$ 318,760

## Case III, Plan V

	Fair Market Valuation	Special Valuation
<b>Mrs. C's inheritance</b>		
Real property	\$ 355,234	\$ 355,234
Personal property	\$ 115,180	\$ 115,180
Less: Federal Estate Tax	\$ 0	\$ 0
Virginia Inheritance Tax	\$ 33,745	\$ 33,745
	<hr/>	<hr/>
<b>Net inheritance</b>		
Real property	\$ 355,234	\$ 355,234
Personal property	\$ 81,435	\$ 81,435
<b>The trust property</b>		
Real property	\$1,444,614	\$1,444,614
Personal property	\$ 5,386	\$ 5,386
Less: Federal Estate Tax	\$ 508,800	\$ 318,760
	<hr/>	<hr/>
<b>Net trust property</b>	\$ 941,200	\$1,131,240

## Case III, Plan V

Four possible valuations for Mrs. C's estate in 1995 under Alternative Plan V would be as follows:

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Real property	\$817,092	\$317,092	\$817,092	\$317,092
Personal property	<u>\$145,838</u>	<u>\$145,838</u>	<u>\$145,838</u>	<u>\$145,838</u>
Actual estate	\$962,930	\$462,930	\$962,930	\$962,930

## Case III, Plan V

## 1995 Projected Federal Estate Tax Consequences of

## Alternative Plan V for Mrs. C's Estate

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Actual estate	\$962,930	\$462,930	\$962,930	\$462,930
Taxable gifts within 3 years of death and gift tax paid	\$ 0	\$ 0	\$ 0	\$ 0
Gross estate	\$962,930	\$462,930	\$962,930	\$462,930
Less: Administrative expenses Funeral ex- penses \$ 6,000 Settlement cost	\$ 44,517	\$ 44,517	\$ 44,517	\$ 44,517
Adjusted gross estate	\$918,413	\$418,413	\$918,413	\$418,413
Less: Marital deduction	\$ 0	\$ 0	\$ 0	\$ 0
Taxable estate	\$918,413	\$418,413	\$918,413	\$418,413
Plus: Adjusted tax- able gifts	\$ 0	\$ 0	\$ 0	\$ 0
Tentative tax base	\$918,413	\$418,413	\$918,413	\$418,413
Estate tax on tenta- tive tax base	\$218,113	\$128,060	\$218,113	\$128,060
Less: Credit for gift taxes paid during life	\$ 0	\$ 0	\$ 0	\$ 0
Tax before unified credit	\$218,113	\$128,060	\$218,113	\$128,060
Less: Unified credit	\$ 47,000	\$ 47,000	\$ 47,000	\$ 47,000
Estate tax payable	\$171,113	\$ 81,060	\$171,113	\$ 81,060



## Case III, Plan V

	Farmer C's Estate			
	<u>Fair Market Valuation</u>		<u>Special Valuation</u>	
	Mrs. C's Estate		Mrs. C's Estate	
	<u>Fair Market Valuation</u>	<u>Special Valuation</u>	<u>Fair Market Valuation</u>	<u>Special Valuation</u>
Each child's inheritance				
From Mrs. C's estate	\$229,603	\$229,603	\$229,603	\$229,603
From the trust	\$421,386	\$421,386	\$506,470	\$506,470
Less: Federal Estate Tax	\$ 42,778	\$ 20,265	\$ 42,778	\$ 20,265
Virginia Inheritance Tax	\$ 16,160	\$ 16,160	\$ 19,047	\$ 19,047
Net inheritance	\$592,051	\$614,564	\$674,248	\$696,761

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ESTATE PLANNING PRACTICES OF RURAL RESIDENTS OF VIRGINIA AND  
CASE STUDIES OF ALTERNATIVE ESTATE PLANS UNDER THE  
NEW LAW RESULTING FROM THE 1976 TAX REFORM ACT

by

E. M. Jones, Jr.

(ABSTRACT)

Within the last two-and-a-half decades tremendous increases have occurred in the value and size of farm operations and in the amount of capital required. These increases and enactment of the 1976 Tax Reform Act have cast the estate planning problems of farmers in a new and more critical context. The farm owner-operator has certain objectives which he wishes to accomplish through estate planning, constrained by certain factors which influence his situation.

The uninterrupted operation of the farm may be jeopardized during intergeneration transfer. If an heir wishes to continue operating the farm, he must raise enough capital to complement his equity in the farm so that he may purchase the assets of the farm. This problem is further compounded by administrative expenses, estate taxes and inheritance taxes.

A survey was made of rural residents in Virginia in 1976 who attended estate planning meetings. The majority of the individuals surveyed had either no formal estate plan or a will only. Less than

one-fourth had used life estates or trusts in their estate plans, and approximately only one-fifth had made gifts.

According to a case study analysis of alternative estate plans based upon three actual cases, estate plans which utilize a will only resulted in the highest capital erosion from the estate of the alternatives considered. Estate plans which utilize a will, gifts, and trusts or life estates resulted in the least capital erosion. The plan which equates the present value of the marginal tax on the husband's and the wife's estates resulted in the minimum taxes and administrative expenses.

The major implication drawn from the study is that an expanded educational effort is needed to provide farmers with an understanding of alternative estate plans which would aid them in making decisions concerning their own estate plans.