Estate and Business Planning for Farmers

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ESTATE AND BUSINESS PLANNING
FOR FARMERS*

By NEIL E. HART, **

THE growing body of estate planning literature lists an increasing
number of publications making specific reference to the uniqueness
of the estate planning problem for certain industries or occupational
groups.\(^1\) Although principles of estate planning and applicability of
estate and business planning techniques are generally relevant to
estates and firms in all industries, certain characteristics of an in-
dustry may justify focus on the peculiar problems of that segment of
the economy. Farming has, from time to time, been considered as
such an industry.\(^2\)

Farming is sui generis from two particular standpoints: (1) The
farm firm, traditionally organized as a sole proprietorship, has long
been intimately and inextricably interwoven with the household, and
(2) farm businesses have been for many years and will likely con-
tinue to be buffeted by rapid change as capital needs increase rapidly
on a per farm basis.

General Features of the Estate Planning Problem for Farmers

The Changing Nature of the Farm Business

By current definitions, farms are overwhelmingly “family”\(^3\)
farms.\(^4\) Thus, the estate and business planning problem for farmers
is heavily a family matter at present. However, estate and business
planning must, of necessity, be oriented toward the future needs of
the family and firm as well as the extant situation. Although signifi-

* Journal Paper No. J-5800 of the Iowa Agricultural and Home Eco-
nomics Experiment Station, Ames, Iowa. Project No. 1444.
** Professor, Department of Economics, Iowa State University; member,
Iowa Bar.
\(^1\) E.g., Walsh, *Estate Planning for the Corporate Executive*, 106 TRUSTS
& ESTATES 183 (1967).
\(^2\) E.g., Logan, *Estate Planning: The Special Problems of the Farmer in
Dispositions By Will*, 32 ROCKY MT. L. REV. 329 (1960); O'Byrne, *Devises of
Farm Land*, 49 ILL. B.J. 122 (1960).
\(^3\) E.g., R. Nikolitch, *Our 100,000 Biggest Farms—Their Relative Posi-
tion in American Agriculture* 5 (U.S. Dep't of Agriculture, Economic Re-
search Serv., Agricultural Economic Rep. No. 49, 1964) (farms using less than
1.5 man-years of hired labor are considered to be family farms).
\(^4\) Nationally, the proportion of family farms as defined in note 3 supra
increased from 95.2% of all farms in 1944 to 98% in 1954. R. Nikolitch,
*Family and Larger-Than-Family Farms* 1 (U.S. Dep't of Agriculture, Eco-
cant differences exist among projections, it is generally agreed that in the future farm firms will be fewer in number than the 3.1 million farms enumerated in the 1964 Agriculture Census and larger with much greater amounts of capital managed per farm. The incidence of multimember farm firms will likely increase gradually over time.  

5 See E. Heady & L. Tweeten, Resource Demand and Structure of the Agricultural Industry 481-82 (1963) ("number of farms to produce the 1980 food supply with scale of operations approaching but still short of minimum cost is around [750,000]"); Clawson, Aging Farmers and Agricultural Policy, 45 J. Farm Econ. 13, 26 (1963) (a "high" estimate of 730,000 farms by year 2,000 and a "low" estimate of 418,000); Daly, Agriculture: Projected Demand and Resource Structure, in Iowa State University Center for Agriculture and Economic Development, Rep. No. 29, at 111 (1967) (possibly fewer than a million commercial farms by 1980 if past trends continue); Ruttan, Agricultural Policy in An Affluent Society, 45 J. Farm Econ. 1100, 1113 (1966) ("if production were concentrated entirely on farms such as those with sales of $40,000 or more, the total U.S. farm output could be produced on less than 400,000 farms").

6 Bureau of the Census, Census of Agriculture 1964, United States Summary (Preliminary) 2 (Nov. 1966).

7 Size of farm business is increasing at a relatively rapid rate whether expressed in terms of acres per farm, capital per farm, or output per farm. Butcher & Whittlesey, Trends and Problems in Growth of Firm Size, 48 J. Farm Econ. 1513 (1966). Projections of firm size are related to the cost economies expected for farms of various sizes and with various volumes of production. Available data, while not indicating major economies for very large farms, point toward nearly constant costs over a wide range of farm size. Id. at 1516; E. Hunter & J. Madden, Economics of Size for Specialized Beef Feedlots in Colorado 23 (U.S. Dep't of Agriculture, Economic Research Serv., Agricultural Economic Rep. No. 91, 1966) (very small economies attained beyond 1,500 head).

8 From 1940 to 1966, capital per farm increased nationally at constant dollars from $6,158 to $65,960. During the same period, assets per farm worker increased from $3,326 to $35,958. U.S. Dep't of Agriculture, Economic Research Service, Agriculture Information Bull. No. 314, The Balance Sheet of Agriculture 17 (1966).

Important regional and area differences in size and capitalization of farms are likely to result as firms respond to pressures for change. Types of farming areas may be affected differentially by technological developments. For example, between 1959 and 1964 the number of farms of 500 acres or more increased nationally despite sharp decreases in the total number of farms. Bureau of Census, Census of Agriculture 1964, United States Summary (Preliminary) 2 (Nov. 1966). However, as shown by the following chart, the rate of increase in the North Central states was more than double the national rate.

<table>
<thead>
<tr>
<th>United States</th>
<th>North Central Region</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Chg.</td>
</tr>
<tr>
<td>No. 1964</td>
<td>from 1959</td>
</tr>
<tr>
<td>500-999 acres</td>
<td>210,437</td>
</tr>
<tr>
<td>1,000-1,999 acres</td>
<td>84,996</td>
</tr>
<tr>
<td>2,000 or more acres</td>
<td>60,290</td>
</tr>
</tbody>
</table>

Harl, Organization and Structure of Producer Units of Farm Products, in Iowa State University Center for Agricultural and Economic Development, Rep. No. 29, at 128, 129 n.3 (1967).

9 "Multimember farm firm" means a firm wherein ownership and management are provided by more than one family group.
With a decreasing number of farms expected, and a concomitant increase in average size, it is apparent that many presently existing farm businesses will terminate during the next decade. At the same time, a limited number of presently existing firms will continue as viable economic entities. The estate and business planning process may be significantly different for these two major groupings of firms.

Estate Planning Objectives to be Accomplished

It is axiomatic that estate and business planning should be governed by the objectives articulated by the individuals involved and shaped by the weighting of those objectives after the individuals are advised of the alternatives available. This first step in the estate and business planning process is perhaps the most important phase and the easiest to underemphasize.

Some objectives are almost universal\(^{10}\)—(1) to assure an adequate amount of income and security for the parents for so long as they live, (2) to treat the children equitably (although not necessarily equally) including those associated with the family business,\(^{11}\) and (3) to minimize federal estate and state inheritance taxes and other estate settlement costs.

Each generation must face the choice of whether efforts should be made for the firm to continue as an economic unit beyond the death of the majority or sole owners, or whether it should be assumed that the assets will be recombined with those of other firms at retirement or death. If the decision has been made, at least tentatively, for the family firm to continue into the next generation, additional objectives may be posited: (1) to assure stability of the firm and protection from erosion of firm capital at death; (2) to recognize fairly, accurately and promptly the labor and capital contributions of the various members of the firm; (3) to provide for equitable sharing in firm income; and (4) to select a form of legal organization conducive to firm growth and the maximization of firm income.

Traditionally, farming has been characterized by a "family farm cycle"\(^{12}\) with the farm business paralleling closely the personal life

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\(^{10}\) See O'Byrne, Timmons & Hines, Planning Farm Property Transfers Within Families in Iowa, in IOWA STATE UNIVERSITY BULL. P-125, at 8 (Rev. ed. 1966).

\(^{11}\) This objective includes overcoming the uncertainty faced by heirs employed in the family business as to their ultimate ability to gain a controlling interest in the firm at death of the parents and thus assure its continuation, and as to the recognition of labor, capital, and management contributions to the firm over time.

\(^{12}\) See generally E. Hede, W. Back & G. Peterson, Interdependence Between the Farm Business and the Farm Household with Implications on Economic Efficiency 403, (Iowa State Univ. Agricultural Experiment Station Research Bull. No. 398, 1953).
cycle of the sole proprietor. It has been observed, however, that if firms are "born" and also "die" within or with each generation, inefficiencies occur in the early years and also in the declining years of the firm. This phenomenon is largely due to shortages of management ability and capital in the early years and conservatism in decision making combined with shortages of labor in the declining years of the firm. Planning ownership and management succession to perpetuate the firm with the peak efficiency reached in the midphase of the family farm cycle may result in significant economic benefits to the firm and the family. Perhaps the greatest threat to continuation of the firm is the erosion of equity capital to pay estate settlement costs, taxes, and distributive shares to heirs not associated with the family business.

For a large number of presently existing farm businesses, plans apparently have not been made for continuation of the firm as an economic unit after death of the elder owners. For these families, estate planning may be undertaken in order: (1) to maintain reasonable security of income and capital for retirement, and (2) to assure an equitable disposition of the maximum amount of family wealth among the heirs.

Some farm families, particularly those in the younger age groups, may not have made a decision as to the future of their particular firm. Estate and business planning for this group may, therefore, emphasize flexibility with respect to continuation or noncontinuation of the firm.

The Liquidity Problem in Farm Estates

As an added complication, the liquidity of farm estates poses significant constraints on estate and business planning alternatives. Changing technology and pressures for enlargement of the firm have caused available capital to be channeled into assets used in the business rather than into a form providing readily available liquid capital at death. Moreover, for those operating with limited capital, insurance programs are often modest because the firm has competed successfully for available capital. There have been rapid rises in

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13 Id.
14 See note 8 supra. Moreover, it is likely that the growth of capital per firm will continue to exceed substantially the growth of capital for the agricultural industry because of farm consolidation. Heady & Ball, Economic Growth of the Farm Firm and Projected Changes in Farming, in IOWA STATE UNIVERSITY CENTER FOR AGRICULTURAL AND ECONOMIC DEVELOPMENT, REP. No. 24, at 18 (1965).
15 A study of 527 Kansas farm-operator families in 1955 revealed that farm families with husbands 50 years of age or older who had less than a high school education were the least frequently insured group, and had the smallest average amount of insurance. J. Krebs, Life Insurance Coverage of Kansas Farm-Operator Families, 1955, (unpublished master's thesis at Kansas State University Library, 1961). That group continues to be important, of course, for estate planning purposes. Families with a net worth of more than
land values¹⁶ and increases in amounts of other assets per farm,¹⁷ while death tax exemptions have remained nearly constant and rates have remained constant or increased. Therefore many more farm estates are being subjected to federal estate and state inheritance taxation than formerly.¹⁸

The liquidity problem of farm estates is likely to continue in severity. By 1980, farms are expected to be almost twice their present average size and to involve vastly greater amounts of capital per farm.¹⁹ Estate and business planners are therefore faced with a

$35,000 and a husband age 50 or over had insurance with an average face value of $7,800. For husbands under 50, in the same asset class, the average face amount of insurance coverage was $15,100. Id. at 71. The study found that frequency of insurance coverage was inversely related to the age of husband and, in general, directly related to the education of the husband, family income, net worth, degree of planning, and family size. Id. at 86. Other studies have shown that the percent of husbands insured in rural surveys ranged from 38% of the Oklahoma farm operators to 86% in rural Ohio.


¹⁶ See, e.g., J. ENGLISH, J. BAMBENÉK & P. RAUP, THE MINNESOTA RURAL REAL ESTATE MARKET 1966 at 5 (Dep't of Agricultural Economics, Univ. of Minn. Rep. No. 550, 1967) (farm land values in Minnesota in 1966 increased 7% over 1965 and have risen 18% since 1960); Fardi, Iowa Farm Land Values Rise 13 Percent in 1966, 21 IOWA FARM SCI., no. 8, 1967, at 3 (farm land values up 40% since 1960).

¹⁷ Note 8 supra.

¹⁸ A small measure of relief from illiquidity may be available in paying the federal estate tax. The estate of one whose assets are committed to a closely held business may pay the portion of the federal estate tax attributable to that business in up to 10 annual installments. INT. REV. CODE OF 1954, § 6166(a). To be eligible for deferred payment, the interest in the proprietorship, partnership, or corporation must exceed 35 percent of the value of the gross estate or 50 percent of the taxable estate. Id. The installment payments are subject to an interest rate of 4 percent. INT. REV. CODE OF 1954, §§ 6166 (k) (1), 6601(b).

If the District Director of Internal Revenue finds that payment of any part of the federal estate tax on the due date (15 months after death) would impose undue hardship on the estate, the time of payment may be extended for a period of up to 1 year for each extension or up to 10 years for all extension periods. INT. REV. CODE OF 1954, §§ 6075(a), 6166.

United States treasury bonds of certain issues may be applied in payment of the federal estate tax owed. INT. REV. CODE OF 1954, § 6312. A list of treasury bonds that are acceptable for this purpose may be obtained from the Bureau of the Public Debt, Treasury Department, Washington, D.C. Eligible bonds are redeemable at par which is often considerably higher than the purchase price. This method of funding for payment of federal estate tax may produce a substantial benefit in the form of profit on the bonds. The par value of the bonds, or market value, whichever is higher, plus accrued interest, is includible in the gross estate for federal estate tax purposes. Rev. Rul. 156, 1953-2 CUM. BULL. 253; Bankers Trust Co. v. United States, 284 F.2d 537 (2d Cir. 1960), cert. denied, 366 U.S. 903 (1961).

¹⁹ Gross sales per farm have grown at about 6% per year on the average over the past 25 years. Butcher & Whittlesey, Trends and Problems in Growth of Firm Size, 48 J. FARM ECON. 1513 (1966).
highly dynamic liquidity problem in farm firm planning.

Planning for Continuation of the Firm

If the clear objective is providing for continuation of the farm business beyond the lives of the parents, attention generally shifts to the traditional forms of multimember firm organization—the corporation and partnership. With these forms of organization, individuals and their capital may be moved into and out of the firm in keeping with their personal life cycle without causing cyclic effects on the firm. In addition, the inter vivos trust may merit consideration as an acceptable organizational form.

Corporation

Although the corporation affords a nearly perfect form of organization from an economic standpoint as an allocator of resources and distributor of income,20 and appears to be growing rapidly in popularity as an estate planning device for larger family firms,21 the corporate form does not have a monopoly over estate planning for farmers.22 Certain attributes of the corporation may, however, facilitate intergeneration and intrageneration transfers of property. These attributes include: the opportunity for making gifts or sales of stock with retention of working control over the firm; restricting retransfer of corporate stock by donees and vendees; dividing asset ownership into easily transferred shares of stock, making possible the concept of farm business transfer as opposed to specific asset transfer; and using corporate stock as an income channeling device for minimizing family income tax liability.

Estate Planning Advantages of the Corporation

A major estate planning attribute of the corporation is the ability to transfer the farm business intact from one generation to the next without loss of control by the majority owners after transfer of minority interests. Parents may be reluctant for reasons of personal income security to make inter vivos gifts of specific items of farm property to

20 See Harl, supra note 8, at 140-43.
21 The exact number of farms operated as corporations, partnerships, or trusts is not known since the Census of Agriculture does not presently enumerate farms by method of organization. Data obtained in an unpublished Iowa study indicate that fewer than 1% of the farms in Iowa are operated as corporations but that the number of farm corporations has been increasing since 1958. Unpublished study by Neil E. Harl in the author's files, Iowa State University.
22 For a general discussion of the advantages and disadvantages of farm incorporation, see Harl, Considerations in Incorporating Farm Businesses, 18 U. FLA. L. REV. 221 (1965).
children in order to accomplish objectives of death tax saving or business continuation. Moreover, with perpetual and unqualified restrictions on alienation of real and tangible personal property void under state law, donees or vendees are generally free to retransfer the farm business property. Such a retransfer may be inimical to the objectives of the parents in making the initial transfer.

By virtue of enforceable stock transfer restrictions and shareholder voting requirements, the corporation may offer an attractive estate planning framework. It has generally been said that so long as the parents as majority shareholders retain voting control, they can be assured of continued employment as officers of the corporation and of indirect control over corporate dividend policy, thus easing the income security problem without retaining such control as would result in adverse tax consequences at death. For example, in a corporation with one class of stock and with simple majority rule, it is commonly stated that up to 49 percent of the stock may be given away without loss of corporate control and thereby indirect control over the gift property. Even more could be transferred if part of the stock were nonvoting. However, it is becoming increasingly clear that retention of control over the stock or over the corporation may subject limited stock interests passing inter vivos to the federal estate tax. If the right to receive dividends is withheld, the stock transfer is likely to be treated as a reserved life estate in the donor even though his right to receive the dividends is not expressly specified in the instruments of stock transfer. Although the mere retention of voting rights on transfer of stock may not be a reserved life estate, retention of other powers over the stock in addition to voting rights may be sufficient to subject the transferred stock to the federal estate tax. A recent revenue ruling sketches perhaps the most restrictive

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28 Estate of Foster, 13 B.T.A. 496 (1928).
29 Estate of Holland, 47 B.T.A. 807 (1942), modified, 1 T.C. 564 (1943) (sale of stock for nominal consideration to children with retention of voting rights, permanent option to repurchase, possession of stock as pledgee, and lifetime salary for services of negligible value); see Estate of Gilbert, 14 T.C. 349 (1950) (transfer to spouse with corporation given right to repurchase or pledge stock and with spouse required to will stock to corporation). But see Estate of Hofford, 4 T.C. 790 (1945) (agreement provided for donor to have sole management of corporation at a fixed salary regardless of ability to serve); George C. Doerschuck, 17 B.T.A. 1123 (1929) (donees of stock agreed to raise salary of donor-father to approximately what he received previously in salary and dividends and to employ him for life).
limitations on intrafamily stock transfers. Under the facts of that ruling, a corporation was formed with 10 shares of voting stock and 990 shares of nonvoting common stock. The nonvoting stock was transferred in trust for the benefit of the transferor's children with the trustee required to obtain the permission of the transferor before disposing of the stock. The ruling holds that the transferor retained the power to regulate the income from the transferred property and therefore retained for his life the right to designate who would enjoy the property; thus, the transferor had reserved a life estate. It is not clear from the ruling whether the holding would have been the same had permission of the transferor not been required before the stock could be retransferred. Had the outcome been the same, a threat is posed for family transfer plans wherein stock representing a minority, noncontrolling interest is transferred with a controlling interest retained. But even in the event that permission for retransfer is essential to the holding, family transfer plans may be jeopardized wherein minority interests of stock are transferred subject to a restriction on retransfer.

The transfer of interests in the farm business to minors may be desirable in order to reduce the family income tax burden, decrease death taxes upon death of the parents, and generate interest in affiliation with the firm. The possibilities for gifts of business property interests to minors may be somewhat greater under the corporation than under alternative forms. Corporation stock, unlike interests in real and tangible personal property such as land, machinery and livestock, is eligible for transfer to minors under the Uniform Gifts to Minors Act. This Act provides a convenient, economical, and simple structure which is particularly well-suited for small gifts. In general, property given to minors under the Act is eligible for the annual gift tax exclusion, and the income therefrom is taxed to the donee-minor, and the property is not included in the donor's estate unless the donor also serves as custodian or the property was given in contemplation of death. Although stock in a subchapter S corporation cannot be

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31 INT. REV. CODE OF 1954, § 2036(a).
32 See UNIFORM GIFTS TO MINORS ACT §§ 1(e), (n). The Model Gifts of Securities to Minors Act, originally enacted in 13 states, has been replaced by the Uniform Gifts to Minors Act in all states except Alaska and Georgia. 9B UNIFORM LAWS ANN. 223 (1966).
33 Rev. Rul. 86, 1956-1 CUM. BULL. 449.
34 See Rev. Rul. 484, 1956-2 CUM. BULL. 23-24. Income from custodian-ship property used to discharge the obligation of a person to support the minor is taxed to the obligated person rather than to the minor even though the obligor is neither the donor nor custodian. Id.; cf. Treas. Reg. § 1.662(a)-4 (1956).
35 If the donor is also custodian, the value of the custodial property may be included in the gross estate of the donor-custodian if he dies before the donee attains the age of 21. Rev. Rul. 366, 1957-2 CUM. BULL. 618; see Treas.
owned by a trust; gifts of stock under the Gift Act do not preclude subchapter S election even though the custodian of the gift is not an individual.

The custodianship arrangement under the Gift Act has several inherent disadvantages for holding stock in a farm corporation. Provisions of the statutory arrangement, unlike a trust, cannot be varied to fit individual situations. Under the law of most states, if the minor dies before reaching majority the property would be distributed according to the laws of intestate succession since a minor is generally not permitted to make a valid will. Without a will, the property may pass back to the parents under applicable state law and complicate their estate plans. Also, the gift property and all accumulated income must be distributed when the beneficiary reaches age 21 although at that time he may lack sufficient judgment to use the property wisely. However, if the property received is no more than a minority interest in the family farm business, perhaps neither the rights of the beneficiary nor the responsibilities in management would exceed the individual's capabilities.

Results similar to those of the statutory custodianship can be achieved with an irrevocable inter vivos trust. A short-term reversionary trust may also be used to effect income tax savings.
However, subchapter S election is terminated if corporate stock passes to a trust. 43

At the death of shareholders, the corporate form may simplify the estate settlement process: (1) Only the corporate stock owned by the decedent is subject to probate and not the underlying real and personal property owned by the corporation. The stock must, of course, be valued for federal estate and state inheritance tax purposes; the value for a farm corporation generally is limited to the value of the underlying assets. But the management responsibility for the firm is not necessarily relegated to the estate representative. As an interim holder of stock, the estate representative has a shareholder's rights. (2) Estate settlement should, in most cases, be somewhat less complex than settling the estate of a deceased sole proprietor. Procedures under state law for "short-form" probate 44 or probate avoidance may be an attractive alternative for estate settlement if farm property is owned by a corporation. The procedures for settling the estate of a shareholder should not necessarily affect the title to corporate-owned real or personal property. (3) If real property is owned in two or more states by a corporation, rather than by an individual, ancillary probate proceedings and costs may be avoided since corporate stock generally passes under the law of the state of domicile at death. 45

The corporation may afford substantially greater stability upon death of a majority owner than a partnership, 46 inasmuch as death of a shareholder does not affect the corporate structure. If ownership and management succession have been planned, death should not jeopardize continuation of the family business. Even in the event that minority interests pass to nonfarm heirs, the right of partition and sale is not available to individual shareholders as it is to heirs as coowners of property in joint tenancy or tenancy in common. 47 While this feature of the corporation may enhance stability of the firm and facilitate intergeneration transfers, at the same time it may generate intrafirm disputes by "locked-in" minorities who view stock of a closely held farm corporation as an unattractive investment. Stock in such corporations is often not a high income investment in the short run. Dividends are declared rarely if ever, particularly in a regularly taxed corporation; 48 and earnings are generally allocated

43 See INT. REV. CODE OF 1954, §§ 1371(a) (2), 1372(e) (3).
44 See, e.g., IOWA CODE § 450.22 (1966).
45 See, e.g., A. EHRENZWEIG, CONFLICT OF LAWS §§ 246, 248 (1962); 3 J. BEALE, CONFLICT OF LAWS §§ 477.1, .4 (1935).
46 See notes 76-85 infra and accompanying text.
47 The right of partition dating from the reign of Henry VIII, 31 Hen. 8, c. 1 (1559), is generally available in the United States either by authority of statute or under the general equity power of the court. See 2 AMERICAN LAW OF PROPERTY § 6.21 (A.J. Casner ed. 1952).
48 See Harl, O'Byrne & Timmons, A Closer Look at Iowa Farm Corporations, 15 IOWA FARM SCI., August, 1960, at 13, 15.
Instead either to tax deductible salaries, interest or rent, or to accumu-
lations for expansion. Moreover, stock in small farm corporations
is often unmarketable for reasons other than low shortrun return.
Minority owners generally have few, if any, management rights un-
less special provision is made at the time of incorporation. And re-
strictions are typically placed on transfers of stock which may effec-
tively narrow the market for the stock.49

In order to avoid problems of dissatisfied "locked-in" minorities,
and to assure that the firm will remain closely held, it may be deemed
advisable for heirs associated with the family business gradually to
acquire the stock held by other heirs. This could be done by opera-
tion of a buy-sell or first option agreement upon distribution of stock
from the estate of a decedent providing that the firm (or heirs asso-
ciated with the firm) would purchase or have an option to purchase
stock held by other shareholders. Buy-sell or first option plans may
specify that the purchase price could be paid in cash or, at the option
of the purchaser, be paid over a 5 to 10 year period with interest. An
important component of any first option or buy-sell agreement is the
provision for determining stock value.50

Instead of establishing a procedure for stock purchase at death, it
may be desired to permit stock to pass to heirs not associated with the
firm and for the shareholders to enter an agreement granting minority
shareholders limited management rights, insuring a minimum divi-
dend level, and creating a market for the stock of shareholders desiring
to sell. In this way, corporate stability can be balanced against minor-
ity shareholder rights.

A common problem in unincorporated family farm businesses is
the matter of the son who builds a silo, installs an automatic feeding
system, improves the fertility level of the soil, or makes other im-
provements on his father's farm pursuant to the assurance that "you'll
be well taken care of when we die." Unless the son's contribution
is specifically recognized, the son may pay for the improvements a
second time through purchase of other heir's interests in the firm.
A highly practical economic attribute of the corporation that com-
mends its use in farm estate planning is the fact that the corporation
as a separate and distinct entity both makes investments and reaps
the benefits therefrom. For investments made by the corporation,
the shareholders in turn own a proportionate part of the corporation
including its investments. The uncertainty faced by the individual
making the improvement with respect to ultimately receiving com-

49 Stock transfer restrictions may be motivated by an interest in pre-
cluding transfer of stock to an "outsider" or to an unfriendly heir at death,
or in preventing termination of a subchapter S election by stock transfer to
a nonconsenting shareholder under Int. Rev. Code of 1954, § 1372(e) (1).
plete compensation for the investment before expiration of a lease or
deadth of the parents is somewhat obviated.

Another difficult problem in a family business is the establish-
ment of shares of compensation as between father and sons. If fixed
separately for labor, management, and capital inputs, compensation
amounts are perhaps more likely to be set at equitable levels than if
all inputs of an individual are lumped together into a fractional shar-
ing arrangement. Fractional sharing requires careful calculation and
adjustment at frequent intervals if the compensation arrangement is
to be economically fair to each individual involved. Setting salaries
and bonuses without regard for individual capital contributions fo-
cuses attention more specifically on compensation of individual inputs.

Although the corporation may not affect the liquidity of the
farm business significantly, an additional option may ease the effects
of illiquidity upon death of a shareholder. The liquidity required to
meet estate settlement costs and death taxes in a shareholder's estate
may be met totally or in part by corporate redemption of stock. To
the extent of death taxes and funeral and administration expenses,\textsuperscript{51}
corporate distributions in exchange for stock do not incur the usual
risk\textsuperscript{52} of being treated as a dividend taxable as ordinary income.\textsuperscript{53}
Any gain resulting from the redemption receives capital gains treat-
ment. To be eligible for such privileged redemption, the stock held by
the decedent must be either more than 35 percent of the value of the
gross estate or more than 50 percent of the taxable estate.\textsuperscript{54} The gen-
eration of liquid capital thus becomes a function of the entire farm
business.

Status as a corporate shareholder-employee may facilitate retire-
ment planning as compared to a self-employment relationship. Rather
than endeavoring to meet the "substantial services" test as a self-
employed farmer,\textsuperscript{55} an employee of a farm corporation need be con-
cerned only with compensation received as salary for personal ser-
VICES rendered. After retirement, a corporate employee could receive
a part-time salary of $1,500 per year which is commensurate with
maximum social security benefits.\textsuperscript{56} Additional income could be re-
ceived in the form of dividends which, as investment income and not
income from personal services, do not reduce social security benefits

\textsuperscript{51} There is no requirement that the corporate distribution be needed or
used to pay death taxes and costs of estate administration, however.
\textsuperscript{52} \textsc{Int. Rev. Code of 1954, § 302.}
\textsuperscript{53} \textsc{Int. Rev. Code of 1954, § 303.}
\textsuperscript{54} \textsc{Int. Rev. Code of 1954, § 303(b) (2). The redemption must take place
within 3 years and 90 days after the filing of the federal estate tax return.
\textsc{Int. Rev. Code of 1954, § 303 (b) 1 (A).}
after retirement and before age 72.\textsuperscript{57} Moreover, dividends, as well as undistributed taxable income of a subchapter S corporation, although includible in the shareholder's gross income, are not subject to social security tax and do not produce social security benefits.\textsuperscript{58} In the years prior to retirement, social security benefits may be maximized by setting salaries at an amount equal to or greater than the maximum covered wage for social security purposes.\textsuperscript{59} The fluctuating self-employment income of farmers does not produce maximum social security benefits if earnings fall below the maximum covered amount (currently $6,600 per year) for more years than the permissible 5-year drop out.\textsuperscript{60}

Employee status for owners, which may accompany the corporation, broadens eligibility to participate in employee fringe benefits. Pension, profit sharing, group term life insurance, and health and accident plans may cover shareholder-employees as well as other employees with some restrictions.\textsuperscript{61} The feasibility for some fringe benefits such as group term life insurance may be limited for corporations having only a few employees, however.\textsuperscript{62} Other benefits, such as plans for continuation of wages in the event of illness or injury, and health and accident coverage, may be practical for corporations with few employees.

Employee status also makes owner-employees eligible for tax-free death benefits paid by the corporation. For federal income tax purposes, an amount up to $5,000 paid to the beneficiaries or the estate of an employee may be excluded from the recipients' gross income if paid by or on behalf of the employer by reason of the death of the employee.\textsuperscript{63} This offers an attractive method for providing funds for a widow and children of a deceased employee.

\textit{Estate Planning Disadvantages of the Corporation}

The corporation does, however, pose estate planning problems, some of which may be quite serious in particular situations.

\begin{itemize}
  \item \textsuperscript{57} Social Security Act § 211(a) (3), 42 U.S.C. § 411(a) (2) (1964). \textit{But see} Gant v. Celebrezze, 1 CCH UNEMP. INS. REP. ¶ 12,459.53 (N.D.N.C. Mar. 6, 1964) (dividend income treated as payment for services).
  \item \textsuperscript{58} Rev. Rul. 221, 1959-1 CUM. BULL. 225.
  \item \textsuperscript{59} Compensation must be reasonable under the circumstances and not a sham arrangement to qualify for benefits. \textit{See} Flemming v. Lindgren, 275 F.2d 596 (9th Cir. 1960); Stark v. Flemming, 283 F.2d 410 (9th Cir. 1960).
  \item \textsuperscript{60} \textit{See} Social Security Act § 215(b), 42 U.S.C. § 415(b) (2) (A) (1964).
  \item \textsuperscript{61} \textit{See} Harl, \textit{Selected Aspects of Employee Status in Small Corporations}, 13 KAN. L. REV. 23 (1964).
  \item \textsuperscript{62} Most states have minimum employee requirements for group term life insurance plans. \textit{E.g.}, KAN. GEN. STAT. ANN. § 40-433 (1) (c) (Supp. 1965) (10 employees); NEB. REV. STAT. § 44-1602 (3) (1960) (five employees). For a discussion of "baby group" plans with fewer employees than the statutory minimum, see Harl, \textit{supra} note 61, at 32-33.
  \item \textsuperscript{63} \textit{Int. Rev. Code of 1954}, § 101(b).
\end{itemize}
Subchapter S corporation stock cannot be owned by a testamentary trust for minors or a marital deduction trust for a surviving spouse. The same result obtains for a short-term inter vivos trust even if the grantor is treated as the owner of the trust under the so-called "Clifford" rules. Under the regulations, which have been held invalid by one court, even a voting trust is prohibited from owning stock in a subchapter S corporation. Moreover, if probate proceedings continue long after all administrative activities have been carried out, the estate may be deemed terminated and an ineligible trust created. Apparently, stock held by a life tenant and remainderman would not preclude subchapter S election. Therefore, results similar to a two-trust marital deduction plan may be achieved by leaving one-half of the stock to the surviving spouse outright and the other half to the surviving spouse for life with the remainder to the children.

One of the more serious estate planning shortcomings of the corporation relates to the adjustment of basis of farm property at death of a shareholder. Upon decease of individual owners of property, the income tax basis becomes equal to fair market value as of the date of death or the alternate valuation date thus providing opportunities for increased depreciation deductions and cancellation of unrecognized gain on the property. However, conveyance of property to a corporation precludes adjustment of basis to fair market value for the property on death of a shareholder. At that time, the adjustment of basis is to shares of stock, not individual items of property, and the basis for the underlying property is unaffected by death of its former owner. Therefore, property once fully depreciated by the corporation cannot be placed on the depreciation schedule with a new basis after death of a shareholder.

If a subchapter S corporation is used to accomplish estate planning objectives through stock transfers, additional complicating factors may arise. A change in the interest of a shareholder of a subchapter S corporation, for example by inter vivos gift, may result in a partial or total recapture of investment credit. Recapture may occur if the ownership of stock is brought below two-thirds of the owner-
ship on the date the property (with respect to which the credit was claimed) was acquired by the corporation. Also, subchapter S corporation status may be lost if, through stock transfer, the corporation acquires an ineligible, eleventh, or nonconsenting shareholder. This may be precluded to some extent by placing restrictions on the transferability of stock and by having the wills of shareholders direct their executors to consent to the subchapter S election. Otherwise, in the latter situation, the estate representative may be reluctant to consent to the estate becoming a subchapter S shareholder. The election could increase the estate's taxable income without a guarantee that the corporation will make an actual dividend distribution to pay the added income tax liability.

**Partnership**

The partnership is a highly useful estate planning device for a farm business with multiple owners. It is less costly to organize than a corporation and affords a great amount of flexibility in organization.

The partnership is different from a corporation, even a subchapter S corporation, in many respects. The partnership is also basically different from a landlord-tenant relationship, which is common in farming, although that distinction is drawn less clearly. Perhaps the most striking difference, other than member liability, between a partnership and a corporation is the relatively greater instability of a partnership. Like the sole proprietorship, the partnership is vulnerable to premature liquidation in the absence of prior planning. Nonetheless, the partnership offers opportunities for effective business continuation upon death of a partner because of possibilities for disposition of the decedent's interest to copartners and the presence of potential successor management.

**Partnership Stability**

If the partnership relation is based upon a formal document, the

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73 Forty states have enacted the Uniform Partnership Act, which defines the partnership as "an association of two or more persons to carry on as co-owners a business for profit." Uniform Partnership Act § 6(1).
74 See, e.g., Anderson v. Walker, 255 Iowa 1324, 131 N.W.2d 524 (1964) (livestock share lease held not to be partnership).
75 In a general partnership, partners are jointly and severally liable for torts committed by a partner or by servants or agents. J. CRANE, PARTNER-SHIP § 64, at 338 (2d ed. 1952); Hutchison, Enforceability of Iowa Creditors' Judgments Against Partnership and Partners' Assets, 44 Iowa L. Rev. 643 (1959).
term of existence can be established in that agreement. Typically, partnership agreements provide that the partnership exists at the will of the partners with any partner able to terminate the relationship at any time. Even though a stated term of existence is specified, and dissolution may cause a breach of the partnership agreement, courts will not generally force partnership continuation against the desire of a partner to withdraw.\(^7\) Technically, dissolution of a partnership occurs whenever a partner ceases to be associated with the partnership.\(^7\) This includes withdrawal, retirement, death, insanity, or other legal disability. Dissolution may also occur from expulsion of a partner, fraud, bankruptcy, admission of a new partner,\(^7\) or by mutual agreement.\(^7\) Dissolution need not, however, disturb the firm and precipitate liquidation and winding up of the business. Upon dissolution, the partners may liquidate the partnership, continue the business as a new partnership, or continue the business under a different organizational form.

With the death of the parents constituting a crucial point in the continued life of the family farm business, the instability of the partnership becomes apparent. In the event of death of a partner, the surviving partners are generally under a duty to wind up the business and distribute to the deceased partner's estate its share of the assets absent a contrary provision in the partnership agreement.\(^8\) However, the partnership agreement may contain provisions preventing the termination of a partnership upon death of a partner.\(^8\) The right of partners to bind the survivors to continue the business as a partnership after the death of one is generally recognized.\(^8\) An individual planning to have his successor carry on as a partner should (1) make cer-

\(7\) J. CRANE, supra note 75, at 396; see UNIFORM PARTNERSHIP ACT § 31(2).
\(7\) Under the Uniform Partnership Act, dissolution occurs without violation of the partnership agreement by termination of the definite term, by express will of any partner where no term is specified, by will of all partners either before or after the termination of a specified term, and by expulsion of any partner from the business. In contravention of the partnership agreement, dissolution may occur by the express will of any partner, by any event making it unlawful for the business to be carried on, by death or bankruptcy of a partner or by decree of court. UNIFORM PARTNERSHIP ACT § 31.
\(7\) The Uniform Partnership Act supersedes the general rule that the assignment of a partner's interest dissolves the partnership. UNIFORM PARTNERSHIP ACT § 27(1).
\(7\) See J. CRANE, PARTNERSHIP § 74(c) (2d ed. 1952).
\(8\) E.g., Williams v. Schee, 214 Iowa 1181, 243 N.W. 529 (1932).
tain that the partnership agreement provides for continuation and (2) give his personal representative power to retain the interest and to act as a partner.

For federal income tax purposes, a partnership does not terminate unless it ceases to operate or there is a change of 50 percent or more in partnership capital and profits within a 12-month period. Upon death of a partner, even in a two-man partnership, the partnership is not considered as terminated if the estate or other successor in interest of the deceased partner continues to share in profits or losses of the partnership business. In that situation, the partnership would be terminated when the estate receives its last payment if the surviving partner continues the business.

_Estate Planning with a Partnership_

As with the corporation, partners in a family partnership (particularly partners who are also parents involved in a family business) may wish to make transfers of partnership interests in order to accomplish estate planning objectives. This may involve creation of a partnership with children who do not have property to contribute to the partnership. Although partnership arrangements may be disregarded for income tax purposes unless it can be shown that substantial contributions of capital were made by each partner or that a substantial part of the labor or management is provided by the partner not contributing assets, it is clear that a family partnership may arise by gift to some partners. The partnership is valid if the business is one in which capital is an income-producing factor, the transfer is full and complete and in good faith, and adequate allowance is

83 INT. REV. CODE OF 1954, § 708(b). The death, retirement, or withdrawal of a partner, the sale of his interest, or the addition of a new partner will not result in the closing of the partnership's taxable year. Treas. Reg. § 1.706-1(c)(1) (1956). However, the taxable year of the partnership closes with respect to a partner who sells or exchanges his entire interest in the partnership or whose entire interest, except for that of a deceased partner, is liquidated. Treas. Reg. § 1.706-1(c)(3) (1956). The transfer of a partnership interest by gift does not close the partnership taxable year with respect to the donor but the share of the income up to the date of the gift is taxable to the donor. Treas. Reg. § 1.706-1(c)(5) (1956).

84 Treas. Reg. § 1.708-1(b)(1)(i)(a) (1956); see Estate of Panero, 48 T.C. No. 15 (1967) (partnership continued after death of only general partner). Disposition of the deceased partner's interest can take several different forms including purchase of the interest by the surviving partners or by an outsider, payment for the partner's interest from partnership assets, or satisfaction of the interest by liquidation of the business.

85 The possibility of splitting income by transferring an interest in a personal service partnership to a member of the family is not recognized. See Treas. Reg. § 1.704-1(e)(1)(iii) (1956).
made for the services of the donor in the apportionment of partnership income. To the extent these requirements are not met, income is reallocated by making reasonable allowance for the services of the donor and the donees, and by attributing the balance of the income to the partnership capital of the donor and donees in accordance with their respective interests.

Whether a gift results upon creation of a family partnership depends upon the facts of each case. If the parents provide all or nearly all of the capital, the donee-children are to provide the major part of the labor management, and the income is to be split equally, a gift to the children may not result. On the other hand, the relative capital and labor-management contributions may produce a taxable gift.

Problems similar to those involving a corporation may arise where the majority owners wish to make inter vivos transfers of partnership interests without loss of control and without normal economic consequences of divestment. If a majority partner makes a transfer of part of his interest and retains substantial control over the transferred share with respect to distribution of profits, consent to sale by partners, or general decision making power, it may amount to a reserved life estate. For income tax purposes, the regulations provide some guidance as to what amounts to unacceptable control over the transferred interest: (1) if the donor retains control of the distribution of amounts of income (but some income may be retained in the partnership to meet the reasonable needs of the business); (2) if the donor limits the right of the donee to liquidate or sell his interest in the partnership at his discretion without financial detriment; (3) if the donor retains control of assets essential to the business; or (4) if the donor retains management powers inconsistent with normal relationships among partners. The regulations also specify that substantial participation by the donee in the control and management of the business and actual distribution of a large portion of the donee's distributive share of partnership income are indications

90 William F. Fischer, 8 T.C. 732 (1947).
91 See William H. Gross, 7 T.C. 837 (1946).
92 See notes 26-31 supra and accompanying text.
93 By a parity of reasoning, partnership transfers should be as much subject to the rule subjecting interests (over which the transferor retained control) to death taxes as corporate stock. Cf. note 29 supra and accompanying text. But see Estate of Roddenbery, 8 CCH Tax Ct. Mem. 781 (1949) (no life estate under theory that partnership restrictions applied to the donor would continue after death).
of an independent ownership interest.\textsuperscript{96}

Estate planning for partners in a family partnership occasionally involves transfers of property interests to minors in order to accomplish objectives of income tax minimization,\textsuperscript{96} death tax saving, or involvement of older minors in the firm. While a minor may generally be a partner in a partnership with an adult or competent person, the minor partner can disaffirm\textsuperscript{97} the partnership agreement to the extent that he will not be personally liable to creditors and copartners.\textsuperscript{98} In general, however, a contract made by a partnership with a third person who contracted in good faith cannot be avoided on the ground that one or more of the partners are minors.\textsuperscript{99} If the minor ratifies the partnership agreement after the age of majority, he subjects himself to liabilities of the partnership incurred during his minority while he was a member of the firm.\textsuperscript{100}

The typical legal devices for holding interests of minors may not be available to hold partnership interests. Although there is support for the view that a trustee will be recognized as a partner for income tax purposes,\textsuperscript{101} it has been held that a trust, as distinguished from a trustee, may not be a partner in a partnership, at least for federal income tax purposes.\textsuperscript{102} Moreover, the Uniform Gifts to Minors Act is usable only for gifts of securities or money, not for gifts of partnership interests.\textsuperscript{103} For federal income tax purposes, a minor is not recognized as a member of a partnership unless control of the property is exercised by another person as fiduciary for the benefit of the minor or the minor is shown to be competent to manage his own property and participate in partnership activities.\textsuperscript{104} A minor

\begin{itemize}
  \item \textsuperscript{95} Treas. Reg. §§ 1.704-1(e) (2) (iv), (v) (1956).
  \item \textsuperscript{96} Of course, the income will be taxed to the donor-father rather than to the child if the income is used to provide support which the father is legally obligated to provide. Treas. Reg. § 1.704-1(e) (2) (viii) (1956).
  \item \textsuperscript{97} E.g., \textit{Iowa Code} § 599.2 (1966) (minor not competent to manage property until of age and may disaffirm contracts within a reasonable time after reaching majority).
  \item \textsuperscript{99} E.g., Kuehl v. Means, 206 Iowa 539, 218 N.W. 907 (1928).
  \item \textsuperscript{100} Salinas v. Bennett, 33 S.C. 285, 11 S.E. 968 (1890).
  \item \textsuperscript{101} Treas. Reg. § 1.704-1(e) (2) (vii) (1956); see, e.g., Miller v. Comm'r, 203 F.2d 350 (6th Cir. 1953).
  \item \textsuperscript{103} See \textit{Uniform Gifts to Minors Act} §§ 1(e), 2 (1965).
  \item \textsuperscript{104} Treas. Reg. § 1.704-1(e) (2) (viii) (1956). \textit{But see} \textit{Ballou v. United States}, 370 F.2d 659 (6th Cir. 1966) (no bona fide partnership where trusts established for minor children's interests).
\end{itemize}
may be considered as competent to manage his property for income
tax purposes if he has sufficient maturity and experience to be treated
by disinterested persons as competent to enter business dealings and
otherwise conduct affairs on a basis of equality with adult persons
even though he may be under a legal disability as a minor under state
law.\textsuperscript{105}

**Expected Termination of the Farm Business at
Death of Parents**

If it is not planned for the farm business to continue after death of
the parents, the estate planning problems may be quite different from
those created by an objective of continuity. Emphasis is likely to be
placed on security of income for parents and transmission of a maxi-
mum amount of wealth to heirs at death.

**Adjustments in Property Ownership Between Husband and Wife**

The property ownership pattern, as between husband and wife,
may not be optimal as viewed in conjunction with their stated estate
planning objectives. The form of title passage on acquisition of indi-
vidual items of property may have been consistent with earlier
objectives and earlier law, and appropriate for an earlier size of
estate, but is neither consistent with nor appropriate for their cur-
rent objectives. Once titles are established, individuals exhibit a de-
cided propensity to leave them unchanged even though signals for
change may have flashed quietly as the estate increased in size.

This article focuses primarily upon problems faced in noncom-
munity property states. The additional complications of community
property ownership are beyond the scope of this work.

**Joint Tenancy Between Husband and Wife**

Recent studies in one state, Iowa, reveal an overwhelming popu-
larituy of joint tenancy ownership of real property.\textsuperscript{106} The data
indicate that in 1964, 84 percent of the land titles held in co-ownership
were in joint tenancy; and of all Iowa land transfers that year more
than 51 percent were in joint tenancy.\textsuperscript{107}

Joint tenancy ownership of property may offer important ad-
vantages in some jurisdictions, particularly for estates not subject to

\textsuperscript{105} Id. Compare Olson v. United States, 67-1 U.S. Tax Cas. ¶ 9239 (C.D.
Cal. 1966) (valid partnership found not to exist for income tax purposes with
parents and two minor children as partners), with Arnold v. Green, 186 F.2d
18 (5th Cir. 1951) (partnership found to exist for income tax purposes be-
tween father and two minor daughters).

\textsuperscript{106} See Hines, *Real Property Joint Tenancies: Law, Fact, and Fancy*, 51

\textsuperscript{107} Id. at 607.
federal estate and state inheritance taxation. In many states, when a joint tenant dies, the title obtained by the surviving joint tenant can be perfected by proving nonliability for inheritance, estate, and gift taxes and by showing the death of the deceased joint tenant by affidavit or death certificate. Creditors of the deceased joint tenant cannot reach the joint tenancy property in the hands of the survivor unless the tenancy was severed prior to death. Therefore, settlement of the estate of the first joint tenant to die may be simplified and, in some cases, avoided except for tax obligations. However, even though most of the property of an estate may be in joint tenancy, many decedents have sufficient non-joint-tenancy property to warrant a regular probate proceeding to establish title thereto. A further advantage of joint tenancy is that the survivorship right may prevent division of property interests among the surviving spouse and children under the applicable state law of intestate succession.

Typically, estate planning is not carried out immediately prior to death. Therefore, the estate planner must, in recommending forms of property ownership, deal with the probable size of the estate rather than the size of the estate at the time of planning. Although joint tenancy may be an acceptable choice for individuals with smaller estates, it may not accomplish the client’s objectives as the estate increases in size. Trends in farm land values and amounts of other assets per farm accentuate this predictive problem faced by estate planners.

Joint tenancy property is subjected to federal estate tax, and, in some states, to inheritance tax, except to the extent it can be

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108 E.g., Iowa Code § 450.22 (1966) (“short-form” estate administration as an alternative to regular probate procedure); Iowa State Bar Ass’n, Iowa Title Examination Standards, standard 4.4 (4th ed. 1963); J. Marshall, Iowa Title Opinions and Standards Annotated §§ 3.2(F), 12.1(C) (1963); see Rollison, Co-ownership of Property in Estate Planning, 37 Notre Dame Law. 608, 629 (1962) (decedent’s interest as joint tenant not a probate asset in Indiana); Sheard, Avoiding Probate of Decedents’ Estates, 36 U. Cinn. L. Rev. 70, 82 (1967) (decedent’s interest as joint tenant not a probate asset in Ohio).


110 With written approval of all heirs, United States savings bonds may be redeemed or reissued to specified beneficiaries after death of the sole owner without administration of the estate. 31 C.F.R. § 315.73(b) (1967).


112 See notes 7, 8, 16 supra and accompanying text.


114 E.g., Iowa Code § 450.3(5) (1966). However, in Missouri, for ex-
proven that the survivor contributed to its acquisition. In many cases, it may be difficult to produce sufficient records or other evidence of payments made years earlier based upon the deceased’s income, inheritance, or gift. It should be noted, however, that when a joint tenant dies the death tax burden is generally no greater than if the property had been owned solely by the decedent and left to the survivor by will or intestate succession. But the survivorship right of joint tenancy does preclude use of the life estate-remainder arrangement to reduce the death tax burden on the death of the survivor. Jointly owned property passes to the survivor and may be taxed again in his or her estate.

With each joint tenant usually granted an absolute right to sever the joint tenancy relationship unilaterally, a joint tenant furnishing consideration for acquisition of the property in effect grants to the other tenant a revocable interest that could be portioned and severed at any time. Marital difficulties or other discord between the tenants may lead to division of the jointly owned property without divorce or separation. Each tenant has the power to amend or destroy the other’s estate plan.

For farm property held in joint tenancy, much of which is normally depreciable, the income tax effects following death may be important. Under current law, the surviving joint tenant receives a new income tax basis in the joint tenancy property to the extent that it was included in the estate of the first to die. However, the new basis must be reduced by the amount of depreciation attributable to the survivor prior to death of the decedent. Thus, if a husband provided consideration for property owned in joint tenancy with his wife, on his death the entire value would be subject to death taxes. The wife’s basis for the property would be the fair market value at his death minus the depreciation attributable to the wife (normally one-half of the depreciation previously claimed).

Various problems may arise regarding the biological increase from farm property held in joint tenancy. Thus, if it can be proven that a herd of cows is owned in joint tenancy between husband and wife, the burden of proving the survivor’s contribution is placed on the estate. Treas. Reg. § 20.2040-1(a) (2) (1958). See Int. Rev. Code of 1954, § 2056. 1

115 The burden of proving the survivor's contribution is placed on the estate. In re Gerling, 303 S.W.2d 915 (Mo. 1957).
117 1 A. Casner, Estate Planning 400-01 (3d ed. 1961). It is recognized that tenancies by the entirety, unlike joint tenancies, may not be severed by unilateral action of the parties. 2 American Law of Property § 6.6(b) (A.J. Casner ed. 1952).
118 Int. Rev. Code of 1954, § 1014(b) (9); Rev. Rul. 215, 1956-1 CUM. BULL. 324.
119 Treas. Reg. § 1.1014-6(a) (2) (1957).
120 See Treas. Reg. § 1.1014-6(a) (1957).
are the calves owned in joint tenancy also? A New York court has answered in the affirmative.\textsuperscript{121} The biological increase of domestic animals generally becomes the property of the owner of the dam at the time of birth of the offspring.\textsuperscript{122} Moreover, in an accession such as from pregnancy of animals, the original owner is entitled to possession of the property in its improved state. Since the calves, before birth, were part of jointly owned cows, at birth the calves continued to be jointly owned. Birth, being an act of nature, arguably does not sever the joint tenancy.

Does ownership of land by a husband and wife in joint tenancy subject other property to the survivorship right? For example, is grain stored on such land owned in joint tenancy, tenancy in common, or sole ownership? One commentator emphasizes intent of the parties and opines that "in a husband and wife joint tenancy, the chances are very great that an intent will be found to extend the survivorship right to personal property closely associated with the land."\textsuperscript{123}

Changes to or From Co-ownership as Between Husband and Wife

In order fully and effectively to accomplish the objectives of the farm family, adjustments to co-ownership or away from it may be desirable. Considering the values of farm assets, particularly land, such shifts may involve a taxable gift or at least require that a gift tax return be filed.

With the exceptions noted below, a gratuitous transfer of property by one person to himself and another as joint tenants or tenants in common is considered a gift of half the value for federal gift tax purposes.\textsuperscript{124} Use of the annual exclusion and lifetime exemption may result in no tax being due, but a gift tax return must be filed if the value of the interest transferred exceeds $3,000 (or regardless of value in the case of a gift of a future interest).\textsuperscript{125}

In some cases, transfer of property interests into co-ownership with another may not be treated as a gift at the time of the transfer. For a joint tenancy in real property created between a husband and wife by one of the spouses after December 31, 1954, a taxable gift does not result at the time of the transfer unless the donor elects to treat the transfer as a gift.\textsuperscript{126} The same rule of no taxable gift applies if

\begin{itemize}
\item \textsuperscript{121} In re Ebdon, 198 Misc. 531, 98 N.Y.S.2d 697 (Sur. Ct. 1950); see Comment, 36 Iowa L. Rev. 712 (1951).
\item \textsuperscript{122} \textit{E.g.}, First Nat'l Bank v. Eichmeier, 153 Iowa 154, 133 N.W. 454 (1911).
\item \textsuperscript{123} N. HINES, ESTATE PLANNING IOWA JOINT TENANCIES 9 (Univ. of Iowa Agricultural Law Center, Mono. No. 7, 1965).
\item \textsuperscript{124} See Treas. Reg. § 25.2511-1(h) (5) (1958).
\item \textsuperscript{125} Treas. Reg. § 25.6019-1(a) (1958).
\item \textsuperscript{126} Treas. Reg. § 25.2515-1(b) (1958). To treat the transfer as a gift, a gift tax return must be filed even though it would not otherwise be required. Treas. Reg. § 25.2515-2(a) (1958).
\end{itemize}
the transaction involves an increase in value of property because of improvements or reduction of indebtedness on the property. If the donor does not elect to treat the transfer as a gift, a gift results when the joint tenancy is terminated other than by the death of one of the joint tenants. The termination creates a taxable gift to the extent that the recipients of the property upon termination do not receive the same proportion as their original contribution. Thus, a taxable gift may occur on conversion from joint tenancy to tenancy in common where one spouse provided all of the initial consideration for acquiring the property.

In another exception to the rule of taxable gift on transfer of property into co-ownership, purchase of United States savings bonds registered as payable to the one providing the consideration "or" another does not constitute a taxable gift unless the one not providing consideration redeems the bond during the lifetime of the other without any obligation to account for the proceeds to the other owner. Similarly, transfer of funds into a joint bank account does not produce a taxable gift unless the one not providing the funds withdraws amounts for his own benefit.

Severing Joint Tenancies in Contemplation of Death

In the course of late predeath estate planning, a non-contemplation-of-death severance of joint tenancy property may be desirable to reduce death taxes. Under the predecessor to the present law on transfers in contemplation of death, it was uniformly held that only the decedent's proportionate interest in joint tenancy property would be included in the gross estate in the event that the property was transferred in contemplation of death. This, of course, constituted an opportunity for late predeath estate planning. In 1962, however, the Commissioner withdrew acquiescence to three earlier tax

131 Id.
133 Sullivan's Estate v. Comm'r, 175 F.2d 657 (9th Cir. 1949) (conversion to tenancy in common); Estate of Borner, 25 T.C. 584 (1955) (transfer to trust); Estate of Carnall, 25 T.C. 654 (1955) (property divided between husband and wife as sole owners); Estate of Brockway, 18 T.C. 483 (1952) (joint tenancy property transferred to children).
court cases decided in favor of the taxpayer, and now considers the amount to be included in the gross estate to be the same amount includible had no gift or transfer been made in contemplation of death. In light of this position, and where severance would be advantageous, a question is raised whether the desired result could be obtained if the joint tenant not contemplating death took action to sever the joint tenancy rather than for the severance to be effected by the joint tenant contemplating death.

**Severing Joint Tenancies with Retention of Life Estate**

Another predeath estate planning technique for joint tenants may involve a direct gift of the remainder interest to a donee with a retained joint and survivor life estate. The value of the gift is computed in the usual way by valuing the life estate and subtracting it from fair market value to obtain the value of the remainder interest. However, the $3,000 annual exclusion would not be available because the remainder is a future interest.

Under the provision of the Internal Revenue Code requiring inclusion of property in the gross estate in which the decedent retained a life estate, a question arises whether transfer of a joint tenancy interest with a retained life estate requires inclusion of all, one-half, or none of the value of the property in the decedent's estate. In the situation where the entire value would have been includible had the life estate-remainder transfer not been made, it is arguable that the entire value would be includible after the transfer. However, it has been held that only the portion over which the decedent had control under local law was includible in the estate of the one providing the original consideration (who was also the first to die). The same result has been reached where the wife, as the original noncontributor, died first leaving the husband with a retained life estate in the entire property.

For individuals holding a retained life estate and facing substantial death taxes as a result, a question may be raised whether the death tax result can be avoided by inter vivos transfer of the life

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137 See J. O'BYRNE, W. PHELAN & N. WULF, supra note 72, at § 6D1.4.
138 At least the decedent would not have made a "transfer". INT. REV. CODE OF 1954, § 2035; J. O'BYRNE, W. PHELAN & N. WULF, supra note 72, at § 7F0.11.
141 INT. REV. CODE OF 1954, § 2503(b).
142 INT. REV. CODE OF 1954, § 2036.
143 Glaser v. United States, 306 F.2d 57 (7th Cir. 1962).
144 United States v. Heasty, 370 F.2d 525 (10th Cir. 1966).
estate to another. In one case, involving a life estate under a trust, the corpus of the trust was includible in the gross estate of the life tenant even though the retained life estate was sold (in contemplation of death) for an adequate consideration.\textsuperscript{145} It is not readily apparent how the holder of the life estate could sell his interest for more (i.e. the value of the corpus). Inclusion of the entire value in the gross estate of the life tenant may be inevitable where any transfer would be in contemplation of death.

Transfer of Residence from Husband to Wife

In order to save death taxes, an inter vivos gift of the residence to the wife may appear desirable. For a farmer, transfer of the residence portion of the farm to the wife's name may be undertaken inasmuch as relatively little is sacrificed economically so long as marital relations continue on an amicable plane.

If the transfer is complete, without reservation of legal interest or title and without agreement for continued right of occupancy by the husband, the value of the residence is not includible in the husband's estate under the theory of a retained life estate.\textsuperscript{146} The courts have generally required proof of at least an implied agreement between the husband and wife assuring the husband of continued occupancy before the husband is held to have retained possession or enjoyment so as to require inclusion of the value of the house in his gross estate.

In \textit{Union Planters Nat'l Bank v. United States},\textsuperscript{147} the court held the value of the residence, previously held in tenancy by the entirety and subsequently conveyed to the wife alone, not includible in the husband's estate under the theory of a retained life estate. The concurring opinion in that case states cogently, and perhaps prophetically, that if the Supreme Court holds for the taxpayer on this issue, either Congress will surely act to close what some term a loophole, or taxpayers will rush to put title to their homes in their wives' names.\textsuperscript{148} The Commissioner's acquiescence in \textit{Estate of Gutchess}\textsuperscript{149} indicates, however, that the issue may not be pressed further in the immediate future.

\begin{footnotes}
\item[147] 361 F.2d 662 (6th Cir. 1966).
\item[148] \textit{Id.} at 667.
\item[149] 46 T.C. 554 (1966), \textit{acquiesced in}, 1967 \textit{INT. REV. BULL.} No. 6, at 6.
\end{footnotes}
Sale of Assets at or After Retirement

The individual farmer may wish to sell the farm business (or, more likely, part or all of the property used in the farm business) during life. Although sale of personal property may be desirable to meet social security income requirements or to reduce labor and management inputs by the individual, a strong motivation often exists against sale of assets because of the new basis received for property held at death and included in the estate. With some exceptions, the difference between fair market value and the adjusted basis is subject to income taxation in the event of sale or exchange during life. A legatee or devisee, in contrast, takes as his basis the fair market value of the assets as of the date of death of the decedent from whom the assets were acquired or as of one year after death if the alternate valuation date is elected. Efforts have been made in recent years to provide for taxation of unrecognized gain at death; however, the provision awarding a new basis to property at death remains, and affords benefits to many farmers that may well outweigh the added death taxes which result from retaining ownership of low basis property until death rather than making a gift during life. Particularly in farm estates, the potential gain upon sale or exchange is substantial because of large increases in value of farm land, zero basis for raised livestock by cash basis taxpayers, and use of the so-called fast depreciation methods.

Gain or Loss on Sale of Farm Residence

Just as any other taxpayer is eligible to postpone gain on sale of his principal residence, a farmer can postpone recognition of gain realized from the sale or exchange of his residence to the extent that

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155 See infra note 16 supra.
156 See Int. Rev. Code of 1954, §§ 167(b) (2), (3). Rules for recapture of depreciation, applicable to both personal property and real property since 1962 and 1964, respectively, have reduced the incentive for the use of the accelerated depreciation methods, however. See Int. Rev. Code of 1954, §§ 1245, 1250.
the proceeds are reinvested in another residence.\textsuperscript{158} If the new residence costs as much or more than was received for the old one, none of the gain is recognized. For new residences costing less, the gain is recognized to the extent of the difference between the adjusted basis of the old residence and the cost of the new one.\textsuperscript{159} For a farmer, gain on the residence may be postponed in this fashion whether or not the entire farm is sold. If the residence is sold as a part of the entire farm, a major problem is apportioning the basis between the residence and the remainder of the farm. Either that apportionment may have already been made or it may have been severely restricted by virtue of earlier allocations of basis among depreciable items of property.

The term "residence" is defined broadly by law and provides little guidance as to how much of a farm would be eligible for postponement of gain.\textsuperscript{160} By court decision, a residence of 5 acres has qualified\textsuperscript{161} and a country estate of 65 acres has met the definition.\textsuperscript{162} The residence may not include any part of the premises used for business purposes such as a garage housing a truck used in the farm business.\textsuperscript{163}

For older farmers, sale of the land may permit them to exclude from taxation the gain attributable to the residence portion of the farm.\textsuperscript{164} Once in their lifetime taxpayers\textsuperscript{165} age 65 or over may exclude gain to the extent of the first $20,000 of the adjusted sales price, provided the property was owned and used as the taxpayer's principal residence for at least 5 of the last 8 years prior to sale.\textsuperscript{166} If the adjusted sales price exceeds $20,000, the excluded gain is the same proportion of the total gain as $20,000 bears to the adjusted sales price.\textsuperscript{167} The residence portion of the farm may be carved out for this special income tax treatment. This raises the triple problem of ascertaining

\textsuperscript{158} INT. REV. CODE OF 1954, § 1034. The reinvestment in a new residence must take place within 1 year before or after the sale of the old residence. In the event that the farmer builds a new home, it must be purchased and occupied within 1 year before or 18 months after the sale of the old residence, and construction must have begun before the expiration of 1 year after the date of sale of the old residence. INT. REV. CODE OF 1954, § 1034(c)(5); Treas. Reg. § 1.1034-1(c)(1) (1956).

\textsuperscript{159} Treas. Reg. § 1.1034-1(c)(2) (1956).


\textsuperscript{161} Estate of Campbell, 23 CCH Tax Ct. Mem. 508 (1964).


\textsuperscript{164} INT. REV. CODE OF 1954, § 121.

\textsuperscript{165} The exclusion is available to individuals other than husbands and wives. Rev. Rul. 67-234, 1967 INT. REV. BULL. No. 30, at 5 (unmarried individual holding title in co-ownership with another); Rev. Rul. 67-235, 1967 INT. REV. BULL. No. 30, at 5 (brother and sister).

\textsuperscript{166} INT. REV. CODE OF 1954, § 121(a). For a retiring farmer, this requires that at least the residence portion of the farm must be sold within 3 years after leaving the farm and taking up residence elsewhere.

\textsuperscript{167} INT. REV. CODE OF 1954, § 121(b).
the portion of the farm included in the residence,\textsuperscript{168} determining the amount of the unallocated basis for the farm allocable to the residence, and calculating the portion of the sales price attributable to the residence. Although not conclusive, provisions in the contract of sale may be persuasive evidence as to the extent and value of the residence, particularly if the transaction is between unrelated parties.

Losses on the personal residence are personal losses and therefore are not tax deductible.\textsuperscript{169} If a farm is sold for a single price under circumstances such that a loss may have been sustained on the residence portion, the Internal Revenue Service may require that the transaction be treated as separate sales of the residence and the rest of the farm, with the loss on the residence portion nondeductible.\textsuperscript{170}

\textit{Installment Sale of Farm}

The installment contract has been used increasingly as an instrument to spread the taxable gain from the sale of farm assets, particularly land, over a period of years\textsuperscript{171} and to enable the purchaser, frequently related to the seller,\textsuperscript{172} to acquire the property with a low initial payment.\textsuperscript{173} Installment contracts are additionally beneficial for estate planning use in that periodic payments are available to the vendor for retirement planning, and a security interest may be retained in the property. The installment contract has thus become a relatively popular means for disposing of specific farm business assets.

\textsuperscript{168} The term "residence" has the same meaning as under \textit{Int. Rev. Code} of 1954, § 1034, relating to postponement of gain on reinvestment of the proceeds in a new residence. Treas. Reg. § 1.121-3(a) (1965); see notes 161-62 \textit{supra} and accompanying text.

\textsuperscript{169} Treas. Reg. § 1.165-9(a) (1960). However, if the residence had been rented prior to sale, the loss is deductible. Treas. Reg. § 1.165-9(b)(1) (1960). The basis for property converted from personal to business use is the lesser of the adjusted basis at the time of the conversion or fair market value of the property at the time of the conversion adjusted for depreciation and improvements for the period between conversion and sale. Treas. Reg. § 1.165-9(b) (2) (1960).

\textsuperscript{170} See J. O'BYRNE, \textit{FARM INCOME TAX MANUAL} 160 (3d ed. 1964).

\textsuperscript{171} Gain from the transaction may be spread over the life of the contract if the requirements for installment reporting are met. \textit{Int. Rev. Code} of 1954, § 453. If not, a possibility may exist for deferred-payment reporting. See Treas. Reg. § 1.453-6 (1958).

\textsuperscript{172} In a randomly drawn sample of Iowa installment land contracts recorded between July 1, 1951 and June 30, 1956, it was found that 30% of the farms were bought from relatives. Almost half of the buyers, however, reported that they did not know the sellers before buying the farm. M. HARRIS & N. HINES, \textit{INSTALLMENT LAND CONTRACTS IN IOWA} 13 (Univ. of Iowa Agricultural Law Center Mono. No. 5, 1965).

\textsuperscript{173} The study reported by M. HARRIS & N. HINES, \textit{supra} note 172, at 15, found that the installment land contract was selected in 62 instances out of the 154 because of the buyer's lack of cash for a higher down payment, and in 32 cases because the seller wanted the income tax advantage accompanying installment reporting.
Income tax benefits of installment reporting are available whether the instrument used is a land contract or a deed and mortgage, so long as the basic requirements of installment reporting are met.\textsuperscript{174}

The sale of a farm or small business does not constitute the sale of a single asset.\textsuperscript{176} Separate computations of the gain or loss with respect to each asset sold must be made for the purpose of determining whether profits result in a capital gain or ordinary income; the selling price must be allocated among all assets sold in accordance with their relative values.\textsuperscript{176}

Under installment sales of real property or casual sales of personal property for more than $1,000, the recognition of gain may be postponed until the year payments are actually received if the payments in the year of sale do not exceed 30 percent of the selling price.\textsuperscript{177} Payments in the year of sale include down payments or earnest money paid in a prior year as well as payments in the year that the benefits and burdens of ownership pass from seller to buyer.\textsuperscript{178} This is usually the year of transfer of possession or the year of title passage, whichever occurs first.\textsuperscript{179} Although no cases have been found, it would seem that "payments in the year of sale" would arguably include insurance proceeds paid to the seller.

The amount of the mortgage assumed by the buyer or the amount of the mortgage on property purchased subject to the mortgage is not considered a payment in the year of sale.\textsuperscript{180} Of course, if the buyer pays off the mortgage at the time of sale instead of assuming or taking subject to it, the seller must include the mortgage payment or payments made in the year of sale. If the seller’s mortgage assumed by the buyer is in excess of the adjusted basis for the property, as may be the case where land values have risen drastically since acquisition, the excess of the mortgage over the adjusted basis is considered as payment in the year of sale.\textsuperscript{181} However, in the event that the buyer is not required to take over the mortgage until some future year, the excess of the mortgage over basis is not treated as a payment in the year of sale.\textsuperscript{182} Thus, a thorny problem may be

\begin{thebibliography}{99}
\bibitem{176} See Andrew A. Monaghan, 40 T.C. 680 (1963).
\bibitem{177} \textit{Int. Rev. Code of 1954}, § 453.
\bibitem{180} See Treas. Reg. § 1.453-4(c) (1958).
\end{thebibliography}
avoided with a carefully drafted contract. In general, payments of the seller's liabilities by the buyer such as liens, taxes, and accrued interest are treated as payments received in the year of sale.\textsuperscript{183} Therefore, caution should be exercised in permitting a buyer to pay off obligations of the seller in the year of sale.

A part of each principal payment under an installment sale is treated as interest rather than sales price (and the total sales price is correspondingly reduced) if interest of less than 4 percent per annum is specified.\textsuperscript{184} Thus, unstated or understated interest is to be computed for each contract. However, the unstated or understated interest rules do not apply if all of the payments under the contract will be made within 1 year\textsuperscript{185} or if the sales price is $3,000 or less.\textsuperscript{186} The amount to be reported as unstated or understated interest is computed using a standard or base rate of 5 percent compounded semiannually.\textsuperscript{187}

A sale, gift, or other disposition or satisfaction of an installment obligation results in immediate recognition of the postponed gain to the taxpayer.\textsuperscript{188} However, a transfer of an installment obligation to a revocable inter vivos trust is not a taxable disposition if the grantor is treated as the owner of the trust.\textsuperscript{189} If the grantor is not the owner of the trust, the transfer is a taxable disposition.\textsuperscript{190}

Upon death of an individual owning an installment obligation such as a contract, the installment obligation as an asset of the estate does not receive a new basis as do most other assets.\textsuperscript{191} Payments under the contract that are received after death are treated as income in respect of decedent; and the recipient, whether estate representative, legatee, or other successor, reports the income in the same manner as the decedent would have done if living.\textsuperscript{192} This feature

\textsuperscript{183} Ivan Irwin, Jr., 45 T.C. 544 (1966); Rev. Rul. 52, 1960-1 Cum. Bull. 186; see Riss v. Comm'r, 368 F.2d 965 (10th Cir. 1966) (cancellation of seller's indebtedness equivalent to receipt of payment in year of sale). But see United States v. Marshall, 357 F.2d 294 (9th Cir. 1966) (seller's indebtedness assumed and paid by buyer not to be included in payments in year of sale except to extent assumption of liability exceeds seller's basis).

\textsuperscript{184} Int. Rev. Code of 1954, § 483.

\textsuperscript{185} Int. Rev. Code of 1954, § 483(c)(1).


\textsuperscript{187} Treas. Reg. § 1.483-1(c)(2) (1966). In general, the unstated or understated interest is the excess of the sum of the payments due under the contract over the sum of the present value of such payments (determined by discounting the payment at 5% per annum compounded semiannually) and the present values of any interest payments due under the contract.

\textsuperscript{188} Int. Rev. Code of 1954, § 453(d).


\textsuperscript{192} Treas. Reg. § 1.691(a)-5, T.D. 6808, 1965-1 Cum. Bull. 257; see Trust
of installment obligation taxation constitutes a serious income tax disadvantage for sales of property that has appreciated substantially in value. The disadvantage is particularly acute for older taxpayers who would receive a new income tax basis if the property were held until death.

Sale and Gift Combined

It may be desired for part of the farm property to pass by inter vivos gift to the children in order to accomplish death tax savings and to benefit children while their capital needs are high. Offsetting these advantages of gifts is the fact that gift property retains the donor's basis in the hands of the donee. For purposes of determining gain on sale or exchange of property received by gift, a donee takes the donor's basis increased (but not above fair market value at the time of the gift) by the gift tax paid in respect of the gift. In determining loss, the donee takes as his basis the lower of the donor's basis (adjusted for gift tax paid) or the fair market value at the time of the gift. Therefore, in selecting property for gift making, all else being equal, the property with the highest relative basis should be selected in order to maximize the income tax saving benefit from holding low-basis property until death.

Cancelling Notes or Installment Payments

Installment sales of property to children often combine a sale with a gift transaction. The gift part utilizes the gift tax exclusion and exemption and lowers the purchase price (and the installment payments) making it economically feasible for the purchaser-donee to make payments from income generated by the property. The basis for the gift part carries over from the donor; the purchased part receives a new basis equal to the purchase price. Of course, if a transfer is a good faith, arms-length business transaction, free of any donative intent, the fact of bargain purchase does not create a gift.

Another variation of the sale and gift combination involves use of the installment contract or mortgage with cancellation of part or all of the payments as they become due. Periodic gifts of installment contract or mortgage payments may be used to distribute the


193 INT. REV. CODE OF 1954, § 1015(d).
194 INT. REV. CODE OF 1954, § 1015(a).
195 See, e.g., Geoffrey C. Davies, 40 T.C. 525 (1963).
196 INT. REV. CODE OF 1954, §§ 2512(b), 2503(b), 2521.
estate with part of the payments periodically forgiven or collected and returned to the buyer within the amount of the annual exclusion.\textsuperscript{199} Although existence of a fixed and definite plan for regular forgiveness of payments may result in the value of periodic gifts considered a present gift at the time of the transfer,\textsuperscript{200} the transaction is likely to be treated as a sale if handled in good faith and if it represents a valid business obligation.\textsuperscript{201} If treated as a sale, the buyer's basis in the property is the purchase price, while characterization of the transaction as a gift requires a carryover of the donor's basis.\textsuperscript{202} In the usual situation, it would seem that the new basis established by initial characterization as a sale would not require a reduction of basis as gifts of payments due were subsequently made.\textsuperscript{203}

Private Annuities

Variations of private annuities are occasionally used in farm family estate planning and may involve both a "sale" and "gift" element. With a commercial annuity, typically issued by an insurer for cash, the annuitant parts with consideration paid to the insurance company which promises to make periodic payments for the remainder of the annuitant's life or for the life of the survivor of the annuitant and his spouse. If the right to receive payments terminates upon the death of the annuitant, the annuity interest would not be included in his gross estate for federal estate tax purposes.\textsuperscript{204} However, the value at the decedent's death of payments receivable by a survivor of the decedent would be included in the gross estate to the extent attributable to the decedent's contribution to the purchase price.\textsuperscript{205}

A private annuity differs from a commercial annuity in that ordinarily property other than cash is used to acquire the annuity and the promise to make the annuity payments is made by an individual (often a relative) rather than by an insurance company. Under a private annuity transaction, the amount of each payment is generally fixed in dollar terms but the total amount to be paid may be un-

\textsuperscript{199} See Selsor R. Haygood, 42 T.C. 936 (1964).
\textsuperscript{200} See Int. Rev. Code of 1954, § 2512; Minnie E. Deal, 29 T.C. 730 (1958). (notes executed by daughters to mother in payment for remainder interest to land transferred to trust which were later cancelled held not to reduce amount of gift).
\textsuperscript{201} See Janie Braddock Ogle, 6 P-H B.T.A. Mem. Dec. 384 (1937). Any cancellation or forgiveness of a contract or mortgage payment should be carefully established with evidence in writing to prove such cancellation if death of the seller-donor should occur. See J. O'Byrne, W. Phelan & N. Wulf, supra note 72, at § 6CL2.
\textsuperscript{202} See notes 193-94 supra and accompanying text.
\textsuperscript{203} However, the authority for this statement is sparse. See J. O'Byrne, W. Phelan & N. Wulf, supra note 72, at § 6D6.5.
\textsuperscript{204} Int. Rev. Code of 1954, § 2039(a).
\textsuperscript{205} Int. Rev. Code of 1954, §§ 2039(a), (b).
certain as it is dependent upon the life of the annuitant. If the annuitant desires both to dispose of his property to specific individuals and at the same time to assure a retirement income for the remainder of his life, a private annuity may appear feasible.

A private annuity may have important gift, estate, and income tax consequences. If the present value of the obligation to make the required payments is less than the fair market value of the property at the time of the transfer, the transaction would be deemed a gift to the payor to the extent of the difference. A portion of the payor's basis for the property received is then determined by the annuity obligation and a portion by reference to the basis of the annuitant. As with a commercial annuity, the value of the property transferred in a private annuity transaction is not included in the annuitant's gross estate for federal estate tax purposes if the right to receive payments terminates upon death of the annuitant. However, if the value of the property transferred substantially exceeds the value of the annuity agreement, the transaction may be held to be a transfer of property with a retained life estate. Similarly, if the annuitant retains control over the property during his lifetime, or the payor's use of the property is contingent upon death of the annuitant, the transaction may be treated as a transfer with a retained life estate. In that event, the full value of the property would be included in the annuitant's estate.

With respect to income tax treatment of a private annuity, if the value of the property transferred exceeds its adjusted basis (as it usually does with farm property), the annuitant does not recognize the gain in the year of transfer. The annuitant reports the annuity payments as ordinary income, return of capital, and capital gain as received. The cost of the property is somewhat uncertain to the one promising to pay the annuity; therefore, the basis for the property is likewise uncertain and is subject to adjustment for the total payments made.

206 A private annuity thus differs from a support contract in that payments under the latter are not known with certainty either as to amount or duration, inasmuch as support is generally expressed in terms of a designated standard rather than by a cash amount.
208 See note 204 supra and accompanying text.
210 See Estate of Schwartz, 9 T.C. 229, 238 (1947) (dictum).
213 See Rev. Rul. 119, 1955-1 Cum. Bull. 352. The basis for depreciation is the value of the prospective annuity payments to be made. Excess payments are added to the basis when and if received. After death of the annuitant, subsequent depreciation is computed using the total payments actually
Unless consumed or given away, the amounts received under a private annuity may accumulate to increase the value of the gross estate if the annuitant lives a normal or longer-than-normal life. This may extend the estate planning problem significantly.

Legal Life Estate

An estate plan leaving all of the property (including that of the family farm business) to the wife for life with remainder over to the children continues to be used to a limited extent. If a legal life estate is used, without the aid of a trust, serious administrative problems may arise. Moreover, death taxes may or may not be minimized by use of the life estate.

Because of the relatively short life and depreciable nature of most tangible personal property used in connection with a farm business, it is generally not recommended that a legal life estate be created in such property. As a practical matter, what is a life estate in a sow and pigs? A tractor? A hundred tons of stacked hay? Who provides the cash bonus on a trade of farm machinery? The accounting problems involved with a legal life estate in personalty are likely to be overwhelming. Therefore, an outright gift in fee of the personal property or a transfer of such property to trust may be desirable even if a legal life estate is to be used for the real property.

The use of a legal life estate in real property for the surviving spouse may appear at first glance to be a satisfactory estate plan. A legal life estate qualifies for the marital deduction if a general power of appointment is given the surviving spouse. And it may be felt that the real property could not bear the expense of a trust and at the same time produce a sufficient income to support the surviving spouse. Moreover, it may be believed that the surviving spouse made the basis. In the event of sale of the property before the annuitant's death, the basis for computing gain is the total of payments actually made plus the present value of future payments remaining to be paid based on the annuitant's life expectancy at the date of disposition of the property. For purposes of computing loss on sale of the property before the annuitant's death, the basis is the total of all payments actually made to the date of sale. If the selling price is less than the adjusted basis for purposes of figuring gain and greater than the adjusted basis for loss, neither gain nor loss would be recognized. Death of the annuitant after sale of the property may require adjustment in gain or loss previously reported. If the property is sold after the annuitant's death, the basis for computing gain or loss is the total of all payments actually made. Thus, premature death of the annuitant would leave a low basis for the property involved.

Consumable personal property may generally be ordered sold and the proceeds invested with the income paid to the life tenant or treated as owned in fee by the life tenant. 1 AMERICAN LAW OF PROPERTY § 4.4 (A. J. Casner ed. 1952).

However, a trust need not be a great deal more expensive than a
could satisfactorily manage the property under a rental arrangement or with hired labor. Whether this is true is a question which requires appropriate attention to the possibility that the spouse may lose her competence to manage the property through advancing age or otherwise. Minor remaindermen often create problems because of their incapacity to act, even during the tenure of the life tenant. Generally, either a conservatorship or trust would be needed for sale or mortgage of the remainder interest of a minor.

Various administrative problems may arise in the use of a legal life estate with respect to real property since the law is not always clear on the rights, privileges, and obligations of life tenants and remaindermen. The life tenant, of course, can convey the life interest, can mortgage that interest separately, and can join with the remaindermen in mortgaging or selling the property. But joining the remaindermen may be difficult or expensive to accomplish. Because the life tenant cannot sign a lease that will bind the remainderman’s interest in the event of death of the life beneficiary, tenants may be interested in the property only at reduced rental rates. Who has the power under state law to contest the award in condemnation proceedings? Would the life tenant be subject to a charge of waste if a building were torn down? Does the life tenant have a duty to insure the remainderman’s interest? Who receives the proceeds of insurance in the event of loss? Who bears the cost of improvements? How are the proceeds held and invested if the real property is sold?

A trust with broadly drafted powers answers these questions with relatively more clarity and substantially more flexibility (and certainty) than a legal life estate unless the granting instrument contains a broad charter of powers.

Conclusion

If the objectives of a farm family can be accurately ascertained, the probabilities are quite high that the objectives can be accomplished within the range of estate planning flexibility available. A

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legal life estate if members of the family serve as trustees. Fees of corporate trustees generally vary with size of the estate and income generated.

217 See 1 W. BowE, ESTATE PLANNING AND TAXATION § 3.4 (1957); see Casner, Legal Life Estates and Powers of Appointment Coupled With Life Estates and Trusts, 45 Neb. L. Rev. 342, 346 (1965).


219 Id. at § 2.17(c); see, e.g., Ray v. Young, 160 Iowa 613, 142 N.W. 393 (1913).

220 The life tenant and remainderman each have an insurable interest which can be protected by insurance if desired. In general, no duty is imposed on the life tenant to keep the property insured for the benefit of the remainderman. See 1 AMERICAN LAW OF PROPERTY § 2.23 (A.J. Casner ed. 1952).
major problem, in each case, is the careful derivation and distillation of objectives from the fragmentary articulation by the parties. Improved knowledge of the problem and a more acute awareness of alternatives may help to sharpen and define the objectives. In fact, the educational process and the evaluation of objectives may be an iterative process. The estate planner plays a key role as an educator as well as a legal analyst and draftsman.