10-31-77
5M

FACT SHEET

L-1164

A GUIDE FOR ESTATE PLANNING CONSIDERATIONS

Tom E. Prater
Extension Economist-Management
The Texas A&M University System

Eugene McElyea, L.L.B.
Practicing Attorney-at-Law
Member, State Bar of Texas

This fact sheet considers estate planning and management as it relates to the Texas inheritance tax and estate and gift tax changes of the 1976 Federal Tax Reform Act. Although no change was made in Texas laws, reforms in the 1976 federal laws affect estate management and planning.

Important considerations in developing an estate plan include:

- Inventoring assets and taxable wealth
- Establishing financial security with minimum erosion
- Deciding on alternatives based on the individual and the family's desires and goals
- Establishing plans for property transfer using wills and trusts
- Making plans for sufficient ready cash for payment of taxes, death and administrative cost

Another important step in estate planning is selecting a good executor who can carry out the desired plans of the deceased. (See fact sheet L-1549, *Role of the Executor*.)

In planning an estate, the planner needs to become familiar and understand the following terms which are defined or described later.

- Fair market value
- Current-use value
- No stepped-up basis
- Material participation
- Family member
- Community and separate property

After considering the preceding, contemplate what estate planning should do for a person and a family. Basically it should provide an orderly transfer of property during lifetime and after death, as well as continuity of business management.

This is done considering the planner's desires and also the taxable wealth. The estate is then planned and managed in accordance with these contributions, but should include flexibility for adjustment in family changes or conditions.

Everyone has wealth of some nature in an estate. It may be in the form of personal or real property or some other holding. The amount of tax and the breath and depth of a plan depend on the amount of one's wealth and how one wants to utilize it for himself and his family.

Tax authorities have a definite way of measuring and determining wealth for estate tax purposes. The fair market value approach is used for determining wealth, death taxes and gifting. Fair market value is used to calculate estate taxes of real property, stocks and bonds and other property at death. It is established on values owned at death or, alternatively, on the value of the property 6 months thereafter. Federal regulations define fair market value as the price at which property changes hands in a reasonable time between a willing buyer and a willing seller with neither compelled to buy or sell and both having reasonable knowledge of the facts. Although farmers, ranchers and closely held businesses can use a current-use valuation method, if qualified under the 1976 Tax Reform Act, which is based on a gross rent minus ad valorem taxes divided by Federal Land Bank loan rate interest. This is a 5-year running average.

After developing the inventory and establishing the value of an estate, minus any deductions, determine the amount of the taxable estate both for the Texas Inheritance Program and the federal estate tax.

Texas Agricultural Extension Service • The Texas A&M University System • Daniel C. Pfannstiel, Director • College Station

The Texas Inheritance Program is based on taxation by the amount transferred to individuals and currently utilizes the fair market approach method entirely.

The federal estate tax is based on the total estate value using the fair market value to determine the gross estate. Farmers, ranchers and closely held businesses can use the current-use base for valuing property if it qualifies according to use and heirship.

Who pays the tax, how much and when are foremost questions. The executor is responsible, if directed by will, or the administrator the court appoints with the legal advisor has the responsibility of meeting the legal requirements.

Texas taxes are paid on various class breakdowns. For example, under the present law, Class A is for property that passes to husband and wife or direct lineal heirs with the first $25,000 being exempt, $25,000 to $50,000 at 1 percent, $50,000 to $100,000 at 2 percent, $100,000 to $200,000 at 3 percent, $200,000 to $500,000 at 4 percent, $500,000 to $1 million at 5 percent and more than $1 million at 6 percent.

The Extension publication, L-955, *Texas Inheritance Taxes,* has a complete table giving the breakdown of the classes. For example: an estate with one parent and one child that is valued at $50,000 would pay no tax on the first $25,000, but would pay $250 tax on the next $25,000. Or, a community estate with no separate property (husband and wife accumulated all of the property since marriage) would pay the following tax if all property passes to the wife.

Assets	$300,000
Decedent's interest	150,000
Deductions	11,800
Total inheritance	$138,200

Value	Rate	Tax
$ 25,000	Exempt	-0-
25,000	1%	$ 250
50,000	2%	1,000
38,200	3%	1,146
$138,200		$2,396

This is an example of what must be considered by an individual under the present Texas inheritance tax in planning and managing an estate.

Currently for those estates with deaths in 1977 and hereafter, consider the following points with federal estate tax planning.

- Unified tax tables stating the amount of tentative tax for federal estate death and gift taxes, both at the same level. This is a consideration of all transfers within an estate before and after death.
- Tax credit and equivalent exemption which allows an estate to subtract a tax credit from the tentative tax.
- Valuing all property by fair market value and where qualified as a farm, ranch or closely held business, utilizing the current-use valuation if passing to a qualified member and meeting all guidelines. The value cannot be reduced more than $500,000, however.
- Allowing $250,000 or one-half of the estate or transfer of separate property tax free to the spouse under a marital deduction program. Where this is a community property state, some credit is allowed on the marital deduction of up to $250,000. The above could pass by will.
- In addition, a $100,000 gift can be made to a spouse and passed tax free during lifetime. No deduction is allowed for the next $100,000 with a 50 percent deduction for all subsequent gifts. These all come from separate properties. This means that the next tax upon the death of the remaining spouse is very high.
- The new tax reform act also allows a $250,000 generation-skipping by trust or life estate to a grandchild. The transfer is through the child of the grantor and limited to $250,000 per child, not grandchildren. A family's agreement under a special lien program to materially participate and keep the operation in its present use for 15 years allows recapture of taxes based on the fair market value at death or alternately reporting date 6 months thereafter. If they break this agreement, taxes are recaptured on the whole of fair market value if within 10 years, and partial for the 11th through the 15th year.
- Another good consideration developed for farmers, ranchers and closely held businesses allows 15 years to pay out taxes at 4 percent on the first million dollars of assets and 7 percent of the remaining assets, if 65 percent of assets are attributed to farming, ranching or closely held businesses. The federal government, of course, holds first lien on that property.
- Other considerations within the 1976 Reform Act affect the gifting program. A $3,000 per donee gifting program is still allowed. This is tax free if the income tax has already been paid, if it is used to reduce the estate and if it is given

completely without further management constraints or actions by the donor. Other gifts are measured against the final amount of the gifts and a tax credit at the death of the descendant. If a person gives an amount above the tax credit equivalent exemption, however, he pays a tax on that amount. Any gifts given above the $3,000 amount are automatically considered in the estate if a person dies within 3 years.

The 1976 Tax Reform Act has many other considerations including no stepped up basis using the fair market value for properties when considering the income tax capital gain asset. This has been replaced with a straight-line formula for all property except securities. Although both use December 31, 1976 as a basic date guide, stocks and bonds are based on the fair market value as quoted that date or the original purchase price, whichever is greater.

Farmland and other assets are considered separately. Their appreciation is prorated by a straight-line apportionment method based on the relative amount of time the property was owned before January 1, 1977. The less time this type of asset is owned before this provision takes effect, the greater the percentage of the appreciation that will be taxed. The rule is as follows:

$$\text{Appreciation subject to tax} = \frac{\text{Amount of time asset held after Dec. 31, 1976}}{\text{Total amount of time asset held before sale}} \times \text{Total appreciation}$$

Therefore, no appreciation attributable to an asset before January 1, 1977, is subject to the new carryover basis rules. Executors may elect to exclude up to $10,000 of assets which were household or personal effects of the decedent. In addition, the basis of an estate can be stepped up to $60,000. Thus, the new provision is not intended to apply to beneficiaries of smaller estates.

One advantage which probably will help individuals is the tax credit and equivalent exemption table which follows:

Tax credit		**Equivalent exemption**	
1977	$30,000	1977	$120,667
1978	$34,000	1978	$134,000
1979	$38,000	1979	$147,333
1980	$42,500	1980	$161,563
1981 and after	$47,000	1981	$175,625

An estate of $120,667 passes tax free in 1977 or double this for a community estate with each year stepping up until it reaches $175,025 passing tax free in 1981 or a community estate of double this size.

The tentative tax table is included for use in planning an estate.

If the amount is:	The tentative tax is:
Not over $10,000	18% of such amount
Over $10,000 but not over $20,000	$1,800, plus 20% of the excess of such amount over $10,000
Over $20,000 but not over $40,000	$3,800, plus 22% of the excess of such amount over $20,000
Over $40,000 but not over $60,000	$8,200, plus 24% of the excess of such amount over $40,000
Over $60,000 but not over $80,000	$13,000, plus 26% of the excess of such amount over $60,000
Over $80,000 but not over $100,000	$18,200, plus 28% of the excess of such amount over $80,000
Over $100,000 but not over $150,000	$23,800, plus 30% of the excess of such amount over $100,000
Over $150,000 but not over $250,000	$38,800, plus 32% of the excess of such amount over $150,000
Over $250,000 but not over $500,000	$70,800, plus 34% of the excess of such amount over $250,000
Over $500,000 but not over $750,000	$155,800, plus 37% of the excess of such amount over $500,000
Over $750,000 but not over $1,000,000	$248,300, plus 39% of the excess of such amount over $750,000
Over $1,000,000 but not over $1,250,000	$345,800, plus 41% of the excess of such amount over $1,000,000
Over $1,250,000 but not over $1,500,000	$448,300, plus 43% of the excess of such amount over $1,250,000
Over $1,500,000 but not over $2,000,000	$555,800, plus 45% of the excess of such amount over $1,500,000
Over $2,000,000 but not over $2,500,000	$780,800, plus 49% of the excess of such amount over $2,000,000
Over $2,500,000 but not over $3,000,000	$1,025,000, plus 53% of the excess of such amount over $2,500,000
Over $3,000,000 but not over $3,500,000	$1,290,800, plus 57% of the excess of such amount over $3,000,000
Over $3,500,000 but not over $4,000,000	$1,575,800, plus 61% of the excess of such amount over $3,500,000
Over $4,000,000 but not over $4,500,000	$1,880,800, plus 65% of the excess of such amount over $4,000,000
Over $4,500,000 but not over $5,000,000	$2,205,800, plus 69% of the excess of such amount over $4,500,000
Over $5,000,000	$2,550,800, plus 70% of the excess of such amount over $5,000,000

This affects you personally, so get proper counsel from a trusted attorney. As you inventory, consider personal, real and other assets, as well as personal papers such as deeds, trusts, wills, insurance, etc. Let someone you trust know about these legal instruments. And, re-evaluate your personal plans and goals from time to time. You may want to give it to the church, start transferring some property to your children or keep it all for personal security and let the estate's executor wrestle with paying taxes, if any.

It is your estate so do not overlook the opportunity to plan and manage while you're alive and in good health.

This publication is designed to provide accurate and authoritative educational information regarding the subject matter covered.

It is distributed with the understanding that the publisher is not engaged in rendering legal services. Attorneys should be contacted for legal service.

Educational programs conducted by the Texas Agricultural Extension Service serve people of all ages regardless of socio-economic level, race, color, sex, religion or national origin.

Cooperative Extension Work in Agriculture and Home Economics, The Texas A&M University System and the United States Department of Agriculture cooperating. Distributed in furtherance of the Acts of Congress of May 8, 1914, as amended, and June 30, 1914.

5M—8-77, Revision