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An Agricultural Law Research Article

Estate Planning for Agricultural Interests

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ESTATE PLANNING FOR AGRICULTURAL INTERESTS

FREDRIC H. WRIGHT*

Introduction

WHEREAS, Senate Bill No. 9 is the result of an interim study of the Oklahoma State Legislative Council; and

WHEREAS, it is the considered judgment of the Oklahoma State Senate that the widespread use of rural Oklahoma lands by publicly held corporations is not in the best interest of this state; and

WHEREAS, § 1 of Senate Bill No. 9 sets forth guidelines under which family farms can receive certain corporate benefits afforded other types of business.

NOW, THEREFORE, BE IT RESOLVED BY THE OKLAHOMA STATE SENATE OF THE FIRST SESSION OF THE THIRTY-THIRD LEGISLATURE:

THAT the legislative intent in connection with Senate Bill No. 9 was to afford family corporate farming.

BE IT FURTHER RESOLVED that in order to resolve all doubts the Senate again expresses its intent that said Bill be interpreted as a family corporate farming measure with prohibition against certain types of corporations which might, absent this Act, engage in farming or ranching.[1]

Carrying this facade to its customary extreme, section 1 of Senate Bill No. 9 provides: "It is hereby declared to be the public policy of this state and shall be the prohibition of this Act that, notwithstanding the

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[1] Enrolled Senate Resolution No. 67, adopted by the Senate the 11th day of June, 1971.

provisions of Section 1.9, Title 18 of the Oklahoma Statutes, no foreign corporation, and no domestic corporation except as provided herein, shall be formed or licensed under the Oklahoma Business Corporation Act *for the purpose of engaging in farming or ranching* or for the purpose of owning or leasing any interest in land to be used in the business of farming or ranching. A domestic corporation may, however, be formed under the Oklahoma Business Corporation Act to engage in such activity if the following requirements are met by that domestic corporation: . . . ." (Emphasis supplied).[2] The deep and grave concern of the Oklahoma Legislature reflected both in Senate Resolution No. 67 and in Senate Bill No. 9 to protect the Oklahoma agricultural community from absorption by financial conglomerates is indeed meritorious but perhaps somewhat blind to the economic realities attending preservation of the agricultural community and expanding farming units in Oklahoma. A fortiori, the legislature may have actually defeated its own purpose by closing the door to investment capital that might very well save the family farm, rather than absorb it.

Or, is the legislature merely telling Oklahoma agronomists that if expanded aggregated capital is to be employed in farming or ranching operations, it will have to be accomplished by a less convenient business vehicle such as a limited partnership or business trust rather than a corporation?

The point may actually be that the real threat to economic preservation of the agricultural community in Oklahoma has been overlooked and the solution to the real problem again delegated to the citizenry.

If we are to find a solution to the agricultural problem of such grave concern to the legislature, we should first review some of the basic facts. The agricultural community in Oklahoma is still, by and large, a "first-generation" community, owned, operated, managed, administered, and financed by the first owner of the agricultural unit. We are just now proceeding into the second generation which will bear the financial brunt of high probate costs, high estate taxes, high interest rates, and high costs of machinery and equipment, with only one question to be answered—how?

The answer to this question may never come to many, may come too late to others, but may yet be available to most. If there is a satisfactory answer, it will be found through the affirmative efforts of the individual and the ingenuity of his attorney and other financial and business advisors.

The principal purpose of this article is to pinpoint the real problem,

[2] Enrolled Senate Bill No. 9, passed by the House of Representatives on June 7, 1971, passed by the Senate on June 11, 1971, approved by the Governor of the state of Oklahoma on June 24, 1971, and received by the Secretary of State on June 24, 1971.

examine typical planning errors that have been made, suggest curative procedures for these errors, and recommend remedial techniques for the future.

Financial Aspects of Agricultural Interests

If the realities of the problems are to be squarely faced, a general premise to the financial aspects of agricultural interests must be established. The following materials are illustrative only, but they are extremely realistic in the community where compiled.[3]

Land Values. Much of the agricultural land in Oklahoma was acquired by the first generation owner at a cost of as little as $50 an acre, considerably more at a cost of approximately $100 an acre, and very little at a cost of more than $175 an acre. The average cost basis of the first generation agricultural unit in Oklahoma is approximately $125 an acre or approximately $20,000 per quarter section.

On the other hand, unrealized appreciation in good Oklahoma farmland is staggering! For example, a quarter section of land having a 20-acre peanut allotment has sold at a price in excess of $125,000, a completely unimproved quarter of land has sold at a price of approximately $90,000, and rarely will any good farmland sell at less than $375 per acre or $60,000 per quarter.

How can agricultural land sell at these prices? This is the unknown factor. To illustrate, let us look at the quarter section with the 20-acre peanut allotment and assume that the selling price was exactly $125,000, $50,000 being paid by the buyer at the time of acquisition and $75,000 financed at 8% for a period of twenty-five years. Amortizing debt service will run $6,563 annually for the entire twenty-five-year period. If we assume that the average annual net profit on 20 acres of peanuts will be $275 per acre and that the buyer can realize a 4% net return on the fair market value of the remaining land, he will realize $2,218 net cash flow (before taxes) annually. At the time debt service has been completely retired the buyer will have an asset in which he has invested $125,000 and will have realized net cash flow of $55,450 or a total of $180,450. On the other hand, if the $50,000 equity cash had been invested at 6% interest for the same twenty-five-year period, the accumulated fund (before income taxes) would aggregate $214,600 or $34,150 more!

The net result is that the farmer has spent twenty-five years of labor

[3] The author sincerely appreciates and acknowledges consultation afforded by Mr. William D. Epperly and Mr. Fred Stange, Oklahoma farmers for more than fifty years; and Mr. Henry E. Entz, an Oklahoma farmer for more than forty-five years and custom combiner for more than fifteen years.

and risk, for less money than could have been realized by doing nothing—a real deterrent to incentive.

To further illustrate, consider the $90,000 quarter with no peanut allotment. If our agricultural investor can pay cash for this quarter section and realize a 4% net return on his investment, he can "get his money back" ($90,000) in twenty-five years. Comparatively, the same $90,000 invested at 6% for a twenty-five-year period would aggregate $386,280 or 429.2% more money. It should also be quite apparent that the net return on agricultural land investments will not pay the interest to finance the acquisition, much less the principal.

The net result is that agricultural dollars are going to be forced out of the agricultural community and into investment savings unless existing land owners take a much more realistic look at the real value of land as distinguished from what "a willing buyer will pay." This will be particularly true of the second generation which simply does not have the incentive of the original land owners.

An even more serious long-range problem in the agricultural community is the effect of high priced land transactions on estate values for estate tax purposes. To illustrate, let us assume that the buyer of the $90,000 quarter section owns the three adjoining quarters which are identical farmland and in which he has a cost basis of $175 per acre or $84,000. By his own acquisition he has pegged an estate tax value of $270,000 on this additional land—unrealized appreciation of $186,000!

Similarly, the probate value of all four quarters is now pegged at $360,000 to serve as a basis of nearly $10,000 in probate expenses.

Farm Machinery and Equipment. Compounding the land cost/yield problem confronting the Oklahoma farmer is the fantastic investment required in farm machinery and equipment. It is virtually impossible for even the most successful farmers of large agricultural units to acquire a substantial amount of new equipment at any one time. For example, a self-propelled combine will cost $15,000; a good tractor, $10,000; a bailer, $3,500; a swather, $2,500; a plow, $1,500; a disk, $900; a planter, $2,500; a pick-up truck, $3,000; a 2½ ton truck, $4,000 plus; tillage machinery, $2,000; fencing (four-strand barbed wire), approximately $3 per rod, including labor; and hand tools, $1,000.

In short, it takes $45,000-$50,000 to "get started" and a good "home mechanic" to keep going.

It will take approximately $6,000 a year to finance these acquisitions at 8% over a ten-year period which means that a 4% net profit on $150,000 of land will break even with equipment costs.

Cattle Raising. If the Oklahoma farmer is to make economic ends meet, he is invariably forced to expand into other areas such as raising a few head of cattle, but it cannot be done on his good crop land. Why not? Let us consider 100 head of calves held for a year and run on 200 acres of crop land. The calves themselves will each cost at least $100, feed will cost $80, and veterinary bills, hauling expenses and miscellaneous will amount to another $10. This is $190 per head which let us assume are sold at an average weight of 700 pounds to a feeder at 34 cents a pound. This gives the owner a gross profit of $48 per head. However, he has lost one year's crop on 200 acres of crop land which, if valued at $75,000 and a 4% net return is projected, aggregates a loss of $3,750 from crops. This means that the net profit on the cattle is $10.50 a head or $1,050 for the year. However, we also have to look at the investment in the cattle which started at $10,000 and ultimately grew to $19,000 over the course of the year. The same money invested at 6% during the course of the year would give approximately the same net profit but without risk.

If instead of running the cattle on 200 acres of crop land, wheat pasture had been rented at $1.25 per 100 pounds per month, the overall profit margin would most assuredly increase, but not appreciably.

When risk is taken into consideration, the cattle business is only profitable when it can be conducted in quantity.

Summary. Farming an agricultural unit in Oklahoma is a financially marginal business at best. Consideration has not been given to such disasters as the 1971 wheat crop failure or cattle losses due to winter blizzards. Even if everything goes exactly right, there is still no financial recoupment from the unanticipated indirect loss which may be caused by probate expenses, estate taxes, and similar expenses.

The Cost and Tax Impact on the Agricultural Estate

The agricultural estate from acquisition of the initial asset, during accumulation and at the time of disposition is not unlike estates involving other assets and business interests in that it is entirely dynamic, fluctuating with economic trend and changes in family status. As might be expected, no two estates are identical (though some are similar); consequently, no fixed planning pattern can be established. Nonetheless, properly applied, certain general techniques can give substantial relief in virtually any situation.

If there is a typical agricultural estate, assume it to be this: Farmer Brown is married and has four adult children, two sons and two daughters, all of whom are married. He acquired good crop land as follows: in 1915, [illegible] acres at a cost of $4,000; in 1920, 80 acres at a cost of $6,000; in 1945, 160 acres at a cost of $28,000; in 1960, 160 acres at a cost of $40,000; and in 1970, 160 acres at a cost of $75,000. All land is held in Farmer Brown's sole name, is comparable, and is held free and clear except the 1970 acquisition which is subject to a mortgage of $50,000.

In addition, Farmer Brown and his wife own other assets all of which are in Farmer Brown's name except those indicated as being in the name of Farmer and Mrs. Brown as joint tenants with right of survivorship:

Checking account	$5,000	(JTRS)
Certificate of deposit	8,000	(JTRS)
Residence and miscellaneous	12,000	(JTRS)
Equipment, machinery, etc.	30,000	
Cattle	20,000	
Co-op stock	5,000	
Total	$80,000	

In the event Farmer Brown predeceases Mrs. Brown, the fair market value of his estate for federal estate tax purposes will be $330,000 and for probate purposes—$305,000. Notably, Farmer Brown has virtually "pegged" the fair market value of the land acquired from 1915 through 1960 by his 1970 acquisition and the entire value of the assets, less mortgage indebtedness, is includable in his gross estate for estate tax purposes. Of course, the joint tenancy property ($25,000) vests in Mrs. Brown by operation of law in the event of Farmer Brown's death and therefore is excludable from estate administration.

Farmer Brown's present estate planning goals are quite simple: (i) to insure the subsistance of himself and Mrs. Brown as long as both are living, (ii) to insure the subsistence of Mrs. Brown should he predecease her, (iii) to pass any remaining estate to his four children, in equal shares.

It is reasonable to assume that with proper land, crop and cattle management the estate will produce income before taxes but after debt service of approximately $12,000.

Assume Farmer Brown dies on November 1, 1971, all other things remain constant, and Mrs. Brown dies exactly ten years later. How much of Farmer Brown's estate will actually be preserved for and reach his four children?

First let us assume that Farmer and Mrs. Brown each die intestate. In this event, the joint tenancy property will vest in Mrs. Brown at Farmer Brown's death and she will receive one-third of his probate estate in accordance with the statutes of descent and distribution of the state of Oklahoma.[4] Federal and Oklahoma estate taxes with regard to Farmer

[4] 84 OKLA. STAT. § 213 (1961).

Brown's estate will be approximately $49,000 and probate expenses, $7,625, or total costs of $56,625.[5]

Then, at the time of Mrs. Brown's presumed subsequent death, federal and Oklahoma estate taxes with respect to her estate will be approximately $9,850 and probate expenses, $2,700 or a total cost of $12,550, making the aggregate cost to pass the estate to the four children approximately $69,175.

If, in the alternative, Farmer Brown has a will bequeathing and devising his entire estate to Mrs. Brown and she in turn has a will bequeathing and devising the entire estate to the children in equal shares, the federal and Oklahoma estate taxes with respect to Farmer Brown's estate will be reduced by approximately $11,500; however, federal and Oklahoma estate taxes with respect to Mrs. Brown's subsequent estate will be increased approximately $58,900! In other words, it costs Farmer and Mrs. Brown's children $47,400 in increased taxes for Farmer Brown to have a will!

Let us assume another alternative. Farmer Brown bequeaths and devises one-half of the estate to Mrs. Brown and the residue to the children in equal shares. Mrs. Brown then bequeaths and devises her entire estate to the children in equal shares. In this event, federal and Oklahoma estate taxes with respect to Farmer Brown's estate will be approximately $37,900, probate expenses, $7,625 or a total of $45,525. With respect to Mrs. Brown's subsequent estate, federal and Oklahoma estate taxes will be approximately $23,750, probate expenses, $3,850 or a total of $27,600. Aggregate probate and tax costs to pass the estate to the four children amount to $73,125 under these circumstances. Again, the children would be better off if Farmer and Mrs. Brown had no wills at all—or would they?

Just as a matter of curiosity, suppose that Farmer Brown's will bequeathed and devised his entire estate to Mrs. Brown for life, remainder to the children in equal shares. In this event, the total probate and estate tax costs to the estate in reaching the children will aggregate approximately $84.600 at the time of Farmer Brown's death and approximately $1,000 additional to clear up the joint tenancy property that would descend from Mrs. Brown—a total of $85,600.

In any of these events, the aggregate cost of passing the estate from the parents to the children is staggering, but the greater problem yet is finding a source of funds to pay those costs and finding it simultaneously with the required payment due dates. One way to find the necessary cash might be to sell one or more quarter sections of the land, but who is going to buy it? Those persons in the community who have the financial capacity

[5] Probate expenses, primarily consisting of attorney's fees, are projected to be 2½% of the probate estate. It is assumed that no executor or administrator expense will be incurred.

to purchase the land are confronted with exactly the same problems, and the ability of the land to pay for itself has already been demonstrated to be marginal.

If a buyer for the land cannot be found, perhaps the local banker will come to the family's rescue and loan the required liquidity to the estate on the security of the land. However, even though we have a good sound farming operation, the principal farm operator has died, and unless the two sons are local residents and able to continue to farm the property, Mrs. Brown will be confronted with a sharecrop arrangement hoping to receive 40% of crop sales plus some cattle money. Under these circumstances the farm simply will not produce sufficient monies to support Mrs. Brown and retire the indebtedness.

The Oklahoma farmer's quandary is indeed real and immediate and must be solved on an extended basis if "family farms" are to survive in Oklahoma. The only possible solution must and does lie in a continuing program of sound family estate planning.

Interim Self-Help

The Oklahoma farmer is not altogether oblivious to his financial plight and as a result frequently undertakes to develop his own estate plan on the basis of advice from his local banker, bookkeeper, tax return preparer, life insurance agent, and other members of the farm community who may have already experienced the "sting of doing nothing." This program of "interim self-help" is generally ill-advised and more often than not compounds, rather than relieves, the problem.

Creation of Joint Tenancy. Title to great portions of the agricultural community is held in the names of husband and wife as "joint tenants with right of survivorship." It is the exception, rather than the rule, that the wife has in fact contributed individual capital to the acquisition; hence the source of joint tenancy property is usually attributable to the continued earning capacity and capability of the husband.

Just what motivates the creation of the joint tenancy is a matter of speculation; however, more often than not it is a security requirement imposed by the lender of funds for acquisition of the property or an alternative to probate selected by the property owner on the advice of someone as poorly informed as he. While holding title in the names of husband and wife as joint tenants with the right of survivorship will in fact eliminate the probate or intestate administration of that property in the estate of the first decedent, a proceeding for judicial determination of death is still required pursuant to the provisions of Section 911 of Title 58 of the Oklahoma Statutes, and it invariably "guarantees" probate or intestate administration in the estate of the survivor. This "guaranty" is nevertheless one of the more nominal problems arising by creation of the joint tenancy.

Most assuredly there is no federal estate tax relief afforded by creation of the joint tenancy, but rather, holding title in this manner invariably assures that the property will be included in the gross estate of husband and wife, successively, or in the estate of the husband without the benefit of the marital deduction.[6]

The value of the gross estate includes the value of all property to the extent of the interest therein held as joint tenants by the decedent and any other person, or as tenants by the entirety by the decedent and spouse.[7] However, that part of joint tenancy property *as may be shown* to have originally belonged to a person other than the decedent and never to have been received or acquired from the decedent for less than an adequate and full consideration in money or money's worth may be excluded from the gross estate of the decedent for purposes of determining federal estate taxes.[8] Thus, in any case in which title to property is held in the joint names of husband and wife (or the decedent and any other person) it is includable in the gross estate subject only to the right of the survivor to show either (i) the extent of the interest of the decedent is less than the entire value of the property; or (ii) the surviving joint tenant furnished some portion of the consideration for the acquisition of the property which was not received or acquired from the decedent.

Consider the problem that arises in the typical agricultural estate in which husband farms the land, wife rears the children and runs the household, all property is held by husband and wife as joint tenants with right of survivorship, and wife dies first. In accordance with the provisions of the statutory scheme of federal estate taxation, the wife's gross estate includes the total value of the joint tenancy property subject to *proof* by the husband that he in fact furnished all of the consideration for the acquisition. Invariably that proof can be made, but not without contest and more than minimum expense. Also, should the proof fail, the estate tax cost can be substantially increased to no useful end.

On the other hand, if husband predeceases the wife, the property is includable in the husband's estate by reason of section 2040 of the Internal Revenue Code of 1954 and again includable in the gross estate of the wife as the surviving sole owner pursuant to other provisions of the Internal Revenue Code.[9]

6 INT. REV. CODE OF 1954, § 2056. All references to Internal Revenue Code of 1954 refer to sections as amended to date.

7 *Id.* § 2040.

8 *Id.*

9 *Id.* §§ 2031, 2033.

Fortunately, the creation of a joint tenancy in real property by husband and wife does not, ipso facto, give rise to a taxable event for federal gift tax purposes.[10] A gift does not arise for federal gift tax purposes unless the proportion of the consideration furnished by each spouse is unequal and the party furnishing the greater consideration elects to have the creation of the joint tenancy treated as a transfer constituting a gift.[11]

It is, and would be, unique that the husband and wife creating a joint tenancy in real property would elect to treat the transaction as a gift and taxable event for federal gift tax purposes; however, if such an election is made,[12] there is no apparent estate tax relief even though the transferee acquires a present, vested interest in the property. This is because the interest of the donee-spouse has been acquired from the other for less than an adequate and full consideration in money or money's worth[13] and the property is still includable in the gross estate of the first joint tenant to die.

The net result of the election to treat the creation of a joint tenancy in real property by husband and wife as a transfer for gift tax purposes may very well be the incurrence of an immediate tax, inclusion of the value of the property in the gross estate of each husband and wife, and ultimate probate or intestate administration of the property in the estate of the last decedent.

It should be noted that there is a different result if title to real property held by husband and wife as joint tenants with right of survivorship has been acquired by gift, bequest, devise or inheritance from a third party. In this event the gross estate of a deceased joint tenant includes one-half of the value of the property, or where so acquired by the decedent and another person as joint tenants and their interests are not otherwise specified or fixed by law, the value of the property included in the decedent's gross estate is a fractional part thereof determined by dividing the total value of the property by the number of joint tenants.[14]

There is an even more innocuous federal estate tax result in those instances in which husband and wife acquire real property as joint tenants or tenants by the entirety,[15] treat the creation of the joint tenancy as a

[10] *Id.* § 2515(a).

[11] *Id.*

[12] *Id.* § 2515(c).

[13] *Id.* § 2040.

[14] *Id.*

[15] A common misconception exists, primarily among attorneys, that the distinction between a joint tenancy with right of survivorship and a tenancy by the entireties is that the former exists between persons other than husband and wife and the latter exists only between husband and wife. Each tenancy has the characteristic of "survivorship" and is therefore subject to the provisions of Int. Rev. Code of 1954, § 2040, and it is true, tenancies by the entirety under Oklahoma law may exist only between husband and wife. However, the real

transfer, and pay the cost of acquisition in installments over an extended period of time. Here the noncontributing spouse's interest is "vested" *ab initio* not only as to an interest in the property itself, but also as to the income provided therefrom. If income produced by the property, one-half of which is presumably vested in the noncontributing spouse, is utilized to provide the source from which deferred acquisition cost is met, it is arguable that such spouse is making a continuing contribution to the acquisition of the property and creation of the tenancy. It is equally arguable, however, that the income right of the transferee spouse is acquired from the other without full consideration in money or money's worth, and therefore the general rule of section 2040 is nonetheless applicable.

Clearly, if the initial acquisition and creation of the joint tenancy in real property between husband and wife is not treated as a transfer for purposes of Internal Revenue Code section 2515, the entire value of the property (under the facts in question) is includable in the estate of the husband.

Conversely, if a joint tenancy with right of survivorship is created between husband and wife in personalty, an immediate transfer subject to federal gift taxes arises at the time of creation of the tenancy except in two specific instances: (i) the creation of a joint bank account,[16] and (ii) the acquisition of certain United States savings bonds.[17] Subject only to these two exceptions, the creation of a joint tenancy between the contributor and any other person similarly gives rise to an immediate gift.

The immediate reaction of most persons caught in the joint tenancy estate-gift tax trap is to terminate the tenancy by either a new deed to themselves as tenants in common or reconveyance to the spouse furnishing the entire consideration. Neither of these procedures affords a proper solution to the problem. For example, suppose that in 1945 husband and wife took title to Blackacre as joint tenants with right of survivorship and did not elect to treat the creation of the joint tenancy as a gift. Then, in 1971 the joint tenancy is converted to tenancy in common. The termination

distinction under the Oklahoma law is that a joint tenancy with right of survivorship, even between husband and wife, affords an alienable estate to the extent of the interest of either while tenancy by the entirety requires the joinder of both co-tenants to alienate any interest in the property. For purposes of Internal Revenue Code § 2515 an estate by the entirety in real property is essentially a joint tenancy between husband and wife with the right of survivorship. *See* INT. REV. CODE OF 1954, § 2515(d) and Treas. Reg. § 25.2515-1(a) (1958). Also, the term "tenancy by the entirety" includes a joint tenancy between husband and wife in real property with right of survivorship, or a tenancy which accords to the spouse rights equivalent thereto regardless of the term by which such a tenancy is described in local property law. Treas. Reg. § 25.2515-1(a) (1958).

16 Treas. Reg. § 25.2511-1(h)(4) (1958).

17 Rev. Rul. 68-269, 1968-1 CUM. BULL. 339.

of the joint tenancy other than by reason of death of a spouse is deemed a gift to the extent that the proportion of the total consideration furnished by each spouse multiplied by the proceeds of the termination exceeds the value of the proceeds of termination received by such spouse.[18] In short, since the wife furnished none of the consideration for the property, at the time it is converted to tenancy in common a transfer measured by one-half of the fair market value of the property is deemed to have been made by the husband to the wife and the same is subject to federal gift taxes.

If, on the other hand, title to the property is revested in the sole name of the husband, there is no federal gift tax incident either at the time of creating or terminating the joint tenancy.

The result for Oklahoma gift tax purposes is not so clear. First, the Oklahoma law provides that Oklahoma gift taxes shall apply "to the value of any property purchased by an individual with his own funds where title to such property is taken in the name of such individual and another as joint tenants with right of survivorship, but which rights may be defeated by either party severing his interest."[19] Taken literally, the creation of a joint tenancy with right of survivorship between husband and wife will give rise to a taxable gift, since either party may sever his interest. However, creation of a tenancy by the entirety will not give rise to a taxable gift since neither party may sever his or her interest without the joinder of the other.

Though the law is quite clear in this regard, the position of the Oklahoma Tax Commission is less than conforming. It is the opinion of the Oklahoma Tax Commission that the federal estate tax law is applicable in Oklahoma and no gift arises on the creation of joint tenancies between husband and wife unless the contributor elects to treat the transfer as a gift. It is the further position of the Oklahoma Tax Commission that the value of the gift is such as may be elected, for example, 50% of the value of the property, 20%, 10%, or 80%. There is one additional proviso to the position of the Oklahoma Tax Commission—the taxpayer must be consistent between Oklahoma and federal tax treatment of the transfer.[20]

For Oklahoma estate tax purposes the value of the gross estate includes:

> the value of any interest of the decedent in any property owned by the decedent and any other person as joint tenants, or tenants by the entirety,

[18] INT. REV. CODE OF 1954, § 2515(b).

[19] 68 OKLA. STAT. § 901(e) (Supp. 1970).

[20] If consistency is required, it appears that the position of the Oklahoma Tax Commission in allowing the taxpayer to elect the "quantum" of the transfer is less than meaningful.

> *including* funds or securities deposited with any person, corporation, bank or trust company, or held in any safety deposit box kept by the beneficiary or joint survivor, except such part of the property or deposit as may be shown to have originally belonged to such other person and never to have been acquired by the latter from the decedent for less than an adequate and full consideration in money or money's worth. A surviving spouse or other person claiming to own an interest with the decedent in any property, *real or personal,* included in the taxable estate of the decedent must support his claim by adequate proof, showing the value of the claimant's interest contributed in money or money's worth from separate funds or properties.[21]

Some relief is afforded by further provision that a sworn affidavit setting forth the facts supporting such claim shall be considered prima facie evidence of adequate proof.

The extent to which an Oklahoma taxpayer may rely on the nonstatutory position of the Oklahoma Tax Commission appears to be a matter of political hope at which the attorney must "cringe" from year to year. Since there is no provision for this position in the Oklahoma Statute,[22] a "change in policy" could be more than inexpensive to the taxpayer. For example, if the federal law is followed and joint tenancy property reconveyed to the contributing spouse, there is no federal gift tax result either at the time of creation or termination of the tenancy. However, if the Oklahoma law is followed in accordance with the statutory provision, there is a gift by the contributing spouse to the noncontributor at the time the joint tenancy is created and an additional gift by the noncontributing spouse to the contributor at the time the property is revested in the sole name of the contributor. On the other hand, if title to the joint tenancy property is severed by converting the joint tenancy to a tenancy in common, the Oklahoma taxpayer is confronted with determining whether the initial transfer constituted a gift based on fair market value of the property at that time, or whether termination of the joint tenancy gives rise to the taxable gift based on fair market value of the property at the date of termination.

The position of the Oklahoma Tax Commission notwithstanding, it would appear that an Oklahoma taxpayer has the right to rely on the statutory provision in any event. This becomes significant in those instances in which the property subject to substantial debt service is acquired by husband and wife and title taken in their joint names as joint tenants with right of survivorship. Probably, if the gift arises at the time of acquisition, no taxable gift will be incurred since annual transfers will be well within

[21] 68 OKLA. STAT. § 807(A)(4) (Supp. 1970).

[22] *Id.* § 901(e).

the $3,000 gift tax exemption.[23] *However, if the gift arises on termination* of the tenancy, a substantial transfer may be found with resulting gift tax liability.

Due to the interplay between the federal estate and gift tax laws, the Oklahoma estate and gift tax laws, and because of the uncertainty of planning by reason of the position of the Oklahoma Tax Commission with regard to joint tenancies, utilization of joint tenancy with right of survivorship or tenancy by the entirety as a means of holding title to real property constituting a principal asset of the agricultural estate in Oklahoma accomplishes very little, if anything of a constructive nature, and may very well bring to the estate the economic disaster so desperately sought to be avoided.

"*Deeding*." Without concern for the legal and tax effects of his transactions, the Oklahoma farmer frequently "deeds" his real properties to members of his family to insure that particular parcels ultimately vest in particular persons or to eliminate the necessity of a will or probate administration. This practice of "deeding," as it is commonly termed in the agricultural community, may very well result in complicated tax problems as well as confusion to record title, intestacy as to part of the property, vesting of undivided rather than divided interests, and general frustration of the overall objectives sought to be accomplished.

Even though title to agricultural realty may be in the joint names of husband and wife as either joint tenants with right of survivorship or tenants by the entirety, the husband usually considers the property his, to the exclusion of any interest in the wife other than a right to receive it in the event of his death. While this may be the case for federal and Oklahoma estate and gift tax purposes, it invariably is not the case for purposes of Oklahoma property law. As a consequence, the deed of the husband to other members of the family may, in the case of joint tenancy with the wife, convey only an undivided one-half interest while in the case of tenancy by the entirety, convey no interest whatsoever by reason of the wife's failure to join in the transfer.

To illustrate, assume that each of four quarters of Oklahoma farmland is held in the names of husband and wife as joint tenants with right of survivorship and husband deeds one quarter to Child *A*, one quarter to Child *B*, one quarter to Child *C*, and one quarter to Child *D*, his intention being to vest divided interests in the agricultural unit in his four children. The legal effect of these conveyances is to vest, immediately, an undivided one-half interest in a particular tract in each child and destroy the right of survivorship in the wife who becomes a tenant in common with each

[23] *Id.* § 905; INT. REV. CODE OF 1954, § 2503(b), relating to gifts of present interests.

the four children. Also, unless the wife follows suit by either an inter vivos conveyance or appropriate testamentary act, her continuing interest in the properties will pass to the children in undivided interests through the intestate administration of her estate. If the children are sufficiently compatible, they may then, by family property settlement agreement, divide their respective interests in accordance with husband's original intentions.

In the alternative, had title of husband and wife been held as tenants by the entirety, the husband's deed would be a nullity for want of the wife's joinder. In this case, it is quite probable that the entire interest in the property will pass to the children by descent and distribution from the wife. Assuming that husband and wife realize that title to property held in their joint names must be conveyed by their joint act, it is rare indeed that they actually intend to irrevocably divest themselves of any interest in the property. Under these circumstances it is not uncommon for husband and wife to join in the deed (or husband to execute a deed to property standing in his sole name and wife execute a deed to property standing in her sole name) and "hold it in the dresser drawer" or family safety deposit box, for future delivery to the children at the appropriate moment.

It is axiomatic that, to be effective as a conveyance of real property, delivery of the deed is essential; otherwise, the deed is a nullity (not just voidable).[24] Under the circumstances above, has there been such a delivery as to render the deed an effective conveyance? Probably not, particularly if husband or wife continues to exercise dominion and control over the property and the deed is not filed of record until after the death of the grantor. Again, the net result is potential intestacy as to the property sought to be conveyed. If constructive delivery of the deed can be found under these circumstances, the transfer will give rise to a gift and potential gift taxes.

Complicating the scheme of the conveyance is the right to receive income after the transfer and proper reporting of the same for income tax purposes. In those cases in which an effective conveyance is made, the grantor frequently continues to receive the income for life and to report the same for income tax purposes. Here, there is a deficiency in the income tax reporting of the grantee, and over an extended period of time, claims for refund to the grantor may become barred by applicable statutes of limitation.

Little relief to the nullity of an undelivered deed may be found in the distinction between a deed and a will. The principal distinction is that a deed conveys a present interest, takes effect upon delivery, and is irre-

[24] Brown v. Peck, 335 P.2d 907 (Okla. 1959).

vocable after delivery while a will is an instrument granting property to become effective and absolute at the maker's death.[25] If the purported deed is a nullity, inter vivos, will it suffice as a will or testamentary transfer? In most instances the answer is clearly "no" since requirements for testamentary execution are invariably omitted.[26]

If property is to be transferred inter vivos, it is mandatory that the grantor be fully informed as to the status of the title to the property which is to be conveyed, the method by which the conveyance must be effected, the income, estate and gift tax ramifications of the conveyance, the absolute necessity of delivery, and the great desirability of recordation.

Similarly, the estate owner must be informed that the "dresser drawer deed" is an absolute nullity, a fruitless act, and prompting of litigation not only with taxing authorities but also among members of the family designated as grantees.

Inter Vivos Transfers With Retained Life Estate or Income Interests. Another common misconception in the agricultural community is that property may be transferred inter vivos subject to a continuing economic interest in the grantor and yet removed from the grantor's taxable estate for federal and Oklahoma estate tax purposes. It is not uncommon to find situations in which the owner of the agricultural unit will "deed" all or a substantial portion of his real property to various members of his family retaining a life estate in himself or a life estate in himself and his spouse.

The only benefit derived from this type of transaction, assuming a valid deed and delivery, is the avoidance of probate or intestate administration of the property in the grantor's estate and the estate of the grantor's spouse.

The Internal Revenue Code clearly provides that, "the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has

[25] Nobell v. Beaver, 133 Okla. 247, 271 P. 420 (1928). *See also* White v. Wester, 170 Okla. 250, 39 P.2d 22 (1935); Herren v. Herren, 152 Okla. 281, 4 P.2d 92 (1931); Wright v. Jordan, 161 Okla. 192, 17 P.2d 408 (1933); and Blackwell v. Lee, 160 Okla. 73, 15 P.2d 574 (1932).

[26] Requirements for testamentary execution under the Oklahoma Statutes are as follows: every will, other than a nuncupative will, must be in writing; it must be subscribed at the end by the testator himself, or some person, in his presence and by his direction; the subscription must be made in the presence of the attesting witnesses, or must be acknowledged by the testator to them to have been made by him or by his authority; the testator must, at the time of subscribing the will or acknowledging the same, declare the instrument to be his will; and two witnesses must sign at the end of the will and at the testator's request and in his presence. 84 OKLA. STAT. § 55 (1961).

retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death (1) the possession or enjoyment of, or right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."[27] And, an interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, either express or implied, that an interest would be retained by the grantor or that the interest or right to use, possess, or receive the income from the property, would later be conferred.[28]

Consequently, if property is "deeded" to the children and a life estate expressly reserved in the deed, the property is still includable in the estate of the grantor. Even if the life estate is not expressly reserved in the deed, if it is "understood" between the grantor and grantee, the property is still includable in the grantor's gross estate for federal estate tax purposes. The same rule exists in Oklahoma.[29]

Not only is such a conveyance an ineffective tool for reduction of potential federal and Oklahoma estate taxes, but also there is an immediate transfer for gift tax purposes. The substance of a transfer with retained life estate is to vest the remainder interest in the grantee, or better described, to vest the fee in the grantee subject to the intervening life estate. In other words, the full fair market value of the property, less the value of the retained life estate, has been transferred to and vested in another person. If the gift is made in property, both the Oklahoma Statutes[30] and the Internal Revenue Code[31] provide that the fair cash market value thereof at the date of the gift is considered the amount of the gift. This fair cash market value is reduced by the retained interest which is not conveyed but which is subject to special valuation.[32]

For example, assume that Farmer Brown is sixty-five years of age and makes a transfer of Blackacre having a fair market value of $100,000 to his son, retaining a life estate in the property. The value of the retained life estate is 33.42% of the fair market value of Blackacre and the value of the "remainder interest" is 66.58% of the value of Blackacre.[33] The result is that Farmer Brown has made a taxable gift of $66,580 and the full fair market value of Blackacre is still includable in the estate of

27 INT. REV. CODE OF 1954, § 2036(a).

28 Treas. Reg. § 20.2036-1(a) (1960).

29 68 OKLA. STAT. § 807(A)(2) (Supp. 1970).

30 *Id.* § 904(a).

31 INT. REV. CODE OF 1954, § 2512(a).

32 *See* Treas. Reg. § 25.2512-5(c) (1958).

33 *Id.* § 25.2512-5(f) Table I (1958).

Farmer Brown by reason of the provisions of section 2036 of the Internal Revenue Code of 1954.

To confuse and further compound the potential problems, assume that husband acquired Blackacre in his sole name, later converted title to the joint names of himself and his spouse as joint tenants with right of survivorship without electing to treat any portion of the transfer as a gift, and he and his spouse jointly convey Blackacre when it has a fair market value of $100,000 to the wife (age 65) for life, and the remainder to their children in equal shares. Under these circumstances it appears that the intention of husband and wife is to remove the property from the taxable estate of the husband, remove the property from probate or intestate administration expense in both estates, to indirectly retain the economic benefits of the property, and to insure that it passes to their children in all events. But, what are the tax ramifications of the transaction?

As to the husband, it appears to be clear that he has made a gift of the entire fair market value of Blackacre, since title to the property was held by him and his wife as joint tenants with right of survivorship, no election was ever made pursuant to Internal Revenue Code section 2515(c), and upon termination of the joint tenancy he received no interest in the propery.[34]

As to the wife's interest in the property, the situation is not so simple. Even though the taxable gift from husband to wife has been deferred pursuant to the provisions of section 2515 of the Internal Revenue Code, at the time the joint tenancy was created the wife acquired a vested one-half interest in the property. At the time of the joint deed by husband and wife to the wife for life, and the remainder to the children, there was a definite alteration in the wife's vested interest—an irrevocable transfer of a remainder interest. Therefore, it is probable that by reason of the joint deed of husband and wife, the wife has made a gift of 66.58% of an undivided one-half interest in the property or $33,290. The result is that husband has made a $100,000 gift of Blackacre for federal gift tax purposes and the wife has made a $33,290 gift of Blackacre for federal gift tax purposes.

In addition, since an undivided one-half interest in Blackacre was in fact vested in the wife at the time of the conveyance of the remainder interest to the children, the wife has made a transfer with a retained life estate as to that one-half interest with the result that one-half of the fair market value of Blackacre will be includable in her estate pursuant to the provisions of section 2036 of the Internal Revenue Code.

This latter example seems to carry the multiple problems of joint tenancy, "deeding," and transfers with retained life estates to a ridiculous

[34] INT. REV. CODE OF 1954, § 2515(b).

extreme; nonetheless, the potential is quite real and the economic result potentially alarming.

Problems and Concepts of Remedial Planning

Because of the marginal economic success of agricultural operations in Oklahoma, acquisition of larger agricultural units will continue to be a primary goal of the family farming operation. As larger agricultural units are developed, the problems of funding probate and administration costs, federal and Oklahoma estate taxes, acquisition debt service, and preserving the agricultural estate will expand. With expansion of the problems, potential loss of the entire family agricultural unit is not only more possible, but it also borders on becoming probable. Nothing could be more in order than an objective review of the specific problems, other than failure of the agricultural unit to provide a yield sufficient to meet family needs, and the concepts of remedial planning to avoid these problems.

Probate and Estate Administration Expenses. At the time of a person's death the decedent's property passes to a successor in interest in one, or a combination of four methods: (1) by estate administration in the event of intestacy; (2) by probate administration in the event of testacy; (3) by operation of law, such as the vesting of interest in a surviving joint tenant; and (4) by contract, such as the payment of life insurance proceeds to the designated beneficiary or the vesting of interest in a secondary beneficiary pursuant to the terms of an existing trust.

In the first two of these instances the estate must bear an expense for estate administration or probate, while in the latter two no such expense arises other than a very nominal cost relating to judicial determination of death in the event of joint tenancy property. The basic costs of administration of the estate in the event of intestacy or probate of a will in the event of testacy, such as court costs, filing fees and required bonds, though not insignificant, are minimal in comparison with fees awarded to executors and the attorney for the executor. Fees for each will normally run a minimum of 2½% of the total fair market value of the estate subject to administration or probate, and in the event "extraordinary services" are afforded by either, additional fees may be awarded.

To illustrate the immediate financial impact on the estate, if the estate subject to administration or probate is $300,000 and both executor's and attorney's fees are paid,[35] the cost will normally be a minimum of $15,000, and it could be as much as twice that amount. A $15,000 cost is generally

[35] Frequently a member of the family will serve as administrator or executor of the estate and either waive the right to receive compensation for services rendered in that capacity or receive the same as an increased distribution.

the equivalent of fifteen months' net earnings of the estate, which will be lost to the beneficiaries.

Payment of this expense is a luxury that not even the most liquid of agricultural estates can afford and a totally unnecessary waste of financial resources that may be much more beneficially applied within the family.

Remedial planning to substantially decrease or completely eliminate administration or probate expenses simply entails passing the entire estate either by operation of law or pursuant to contract. The problems of passing the estate by operation of law, for example, through the creation of successive joint tenancies, have heretofore been discussed, and the simplicity of passing property by contract, such as through an inter vivos (lifetime) trust will be discussed hereinafter.

Federal and Oklahoma Estate Tax Costs. So long as individuals continue to own interests in property in excess of allowable estate tax exemptions, estate taxes will continue to be a principal financial problem, and the larger the estate, the larger the problem. However, the principal aspects of the estate tax problem do not lie in the quantum of the estate itself but in the lack of planning to eliminate unnecessary estate taxation.

For example, if the estate owner has a will bequeathing and devising everything to his or her spouse and the spouse has a will bequeathing and devising everything to the children, for Oklahoma estate tax purposes the entire estate (subject to nominal exemptions) will be subject to estate taxation in each estate before it reaches the children. For federal estate tax purposes, it will be taxed one-half (approximately) in the estate of the first decedent and in full in the estate of the survivor.[36]

If, by comparison, one-half of the estate is provided to the surviving spouse on terms and provisions qualifying for the federal estate tax marital deduction and the remainder as a life estate, a substantial tax saving is afforded.

In some instances there is a reluctancy on the part of the estate owner to divide the estate available to the surviving spouse. This is a normal reaction since husband and wife normally feel that the survivor of them should own the entire estate, and then if there is any remaining estate upon the death of the survivor, that remainder may benefit the children. However, reluctance to divide the estate is more academic than real when we categorically examine the economic benefit of property. Property is meaningful to its owner only in terms of use, income production, and avail-

[36] *See* INT. REV. CODE OF 1954, § 2056 relating to the federal estate tax marital deduction. A detailed discussion of the federal estate tax marital deduction is beyond the scope of these materials; however, for a review of the basic principles relating thereto see Wright, *Life Insurance and Its Use in Estate Planning*, 23 OKLA. L. REV. 125, 161 (1970).

ability of principal value in the event of need. All of this benefit may be provided to a successor to the property through proper implementation of trusts but without subjecting the estate to double taxation.

To illustrate the basic advantage of dividing estate ownership, the federal estate tax saving with respect to various sized estates is as follows:

Adjusted Gross Estate	*Federal Estate Tax Saving*
$120,000	$9,340
150,000	16,165
200,000	25,335
240,000	30,620
300,000	36,770
400,000	47,125
500,000	58,150

It is not only critical to plan estate tax reduction by avoidance of double estate taxation, but it is equally as critical to plan the estate in such a manner that the estate tax is not accelerated on the death of the first decedent. Acceleration of the estate tax normally arises in those instances in which less than ½ of the adjusted gross estate is passed to the surviving spouse.

Of course, estate tax reduction may be accomplished by reduction of the estate assets through inter vivos transfers, or acquisition through other family members; but if either of these avenues is chosen, it must be chosen with extreme care and caution to avoid the problems that may be caused by "deeding," shifting of income for tax purposes, or retention of life estates (directly or indirectly).

With proper planning, additional relief from the estate tax burden may be found in payment of federal estate taxes in installments.[37] If the value of an interest in a closely-held business which is included in the gross estate exceeds either 35% of the value of the gross estate or 50% of the taxable estate, the executor may elect to pay part or all of the federal estate tax in installments. The number of installments may be as few as two but may not exceed ten and the same must be equal and paid annually.[38] Installment payments of the tax bear interest at the rate of 4% per annum[39] payable annually at the same time as, and as a part of, each installment of the tax.[40] The term "interest in a closely-held business" means an interest as a proprietor in a trade or business carried on as a proprietorship, or an

[37] INT. REV. CODE OF 1954, § 6166.

[38] *Id.* § 6166(a); Treas. Reg. § 20.6166-1(c) (1960).

[39] INT. REV. CODE OF 1954, § 6601(b).

[40] Treas. Reg. § 20.6166-1(f) (1960).

interest as a partner in a partnership carrying on a trade or business if 20% or more of the total capital interest in the partnership is included in determining the gross estate of the decedent, or the partnership has ten or less partners; or stock in a corporation carrying on a trade or business if 20% or more in value of the voting stock of the corporation is included in determining the gross estate of the decedent or the corporation had ten or less shareholders.[41] Interests in two or more closely-held businesses may be treated as an interest in a single closely-held business if *more than* 50% of the total value of each business is included in the value of the decedent's estate.[42]

In order for an interest in a partnership or the stock of a corporation to qualify as an "interest in a closely-held business," it is required that the partnership or the corporation be engaged in carrying on a trade or business at the time of decedent's death; however, it is not necessary that all of the assets of the partnership or the corporation be utilized in carrying on the trade or business.[43] On the other hand, in the case of a trade or business carried on as a proprietorship, the interest in the closely-held business includes only those assets of the decedent which were actually utilized by him in the trade or business.[44]

It should be noted, however, that the installment payment relief provision of the Internal Revenue Code applies only to that portion of the federal estate tax represented by the ratio of the value of the interest in the closely-held business included in the gross estate to the value of the total gross estate. For example, if the gross estate of the decedent is $300,000 and the value of an interest in a closely-held business which is included in the gross estate is $240,000, 80% of the federal estate tax may be paid in installments as elected by the executor.[45]

The agricultural estate will, in most instances, qualify for installment payment of federal estate taxes to a major extent except in those instances in which a substantial interest in the business has been transferred to other members of the family by inter vivos gift, or sale. Most assuredly, it is much easier to qualify for the benefit if the business is conducted as either a partnership or corporation rather than as a sole proprietorship. Combining the installment payment privilege with other planning techniques is sound and the estate should be programmed to maximize this opportunity.

[41] INT. REV. CODE OF 1954, § 6166(c).

[42] *Id.* § 6166(d).

[43] Treas. Reg. § 20.6166-2(c)(1) (1960).

[44] *Id.* § 20.6166-2(c)(2).

[45] *Id.* § 20.6166-1(b).

The Agricultural Corporation. Legislative authorization to conduct farming and ranching operations through a domestic corporation and for the corporation to own real property for agricultural purposes may very well provide the most latently dangerous technique of "family estate planning" ever afforded to the Oklahoma farmer. Heretofore agricultural interests in Oklahoma have been fairly well protected and insulated from what might be termed "sophisticated tax problems," but Senate Bill No. 9 has not only removed the shield but encouraged a "leap into the unknown."

The conduct of farming and ranching operations in corporate form has never been prohibited by either the Oklahoma statutes or the Constitution of the state of Oklahoma. Instead, the prohibition has existed with respect to buying, acquiring or dealing in real estate.[46]

It is difficult to find either a past or present business need for the incorporation of agricultural realty, at least not on the terms authorized by the Oklahoma Statutes. Under the Oklahoma law, the corporation must be domestic; shareholders are limited to natural persons, estates, trustees of trusts for the benefit of natural persons if the trustees are either natural persons or banks or trust companies having their principal place of business in Oklahoma or organized under the laws of the state of Oklahoma, or corporations owned by natural persons, estates, trustees of such trusts, etc.; there may not be more than ten shareholders unless the shareholders in excess of ten are related as lineal descendants or are or have been related by marriage to lineal descendants or persons related to lineal descendants by adoption or any combination thereof; and, not more than 20% of the corporation's annual gross receipts may be from any source other than farming or ranching or both, or allowing others to extract from the cor-

[46] Section 2 of Article XXII of the Constitution of the state of Oklahoma in pertinent part provides: "Corporations—Buying, Acquiring or dealing in Real Estate.—No corporation shall be created or licensed in this state for the purpose of buying, acquiring, trading or dealing in real estate other than real estate located in incorporated cities and towns and as additions thereto; nor shall any corporation doing business in this State buy, acquire, trade or deal in real estate for any purpose except such as may be located in such towns and cities and as additions to such towns and cities, and further except as shall be necessary and proper for carrying on the business for which it was chartered or licensed; and provided further that under limitations prescribed by the legislature, any corporation may acquire real estate for lease or sale to any other corporation, if such latter corporation could have legally acquired the same in the first instance; . . . ." Section 1.9 of Title 18 of the Oklahoma Statutes (1961) in pertinent part provides: "PURPOSES.—Any corporation, except corporations created for the purpose specifically prohibited by Article XXII, Section 2, of the Constitution of Oklahoma, and those excluded from the terms of this Act by the provisions of Section 3 [18 OKLA. STAT. § 1.3] hereof, may be formed hereunder for any lawful purpose or purposes; provided, that in all instances where other statutes prescribe a special procedure for incorporation for designated purposes, corporations being created for such purposes shall be formed under such statutes and not under this Act." Section 1.20 of Title 18 of the Oklahoma Statutes (1961) provides for limitations upon real estate ownership, not germane to the principal issue.

porate lands any minerals underlying the same, including, but not limited to, oil and gas.[47]

The Oklahoma Act further provides that the corporate franchise of any domestic corporation formed under the Oklahoma Business Corporation Act for the purpose of farming or ranching or for the purpose of owning or leasing any interest in land to be used in the business of farming or ranching and permitted to engage in such activity under the act shall be promptly vacated where the corporation has persistently violated the requirements set out in section 1 of the Act.[48] And, any resident of the county in which the land is situated, who is of legal age, may initiate an action for the divestment of an interest in land held by a corporation in violation of the Act in the county in which the land is situated.[49] It is interesting to note that section 3A. provides an organizational test in its provision that no corporation organized for a purpose other than farming or ranching shall own, lease or hold, directly or indirectly, agricultural lands in excess of that amount reasonably necessary to carry out its business purpose; however, the application of section 3B. is not limited to such corporations.

Because of the strict enforcement provisions of the Oklahoma Act, such as vacation of the corporate franchise and divestment of an interest in land held in violation of the Act, the potential federal income tax problems alone are of such magnitude that farming and ranching operations may no longer be conducted in corporate form in Oklahoma with any reasonable degree of security. Let us consider just a few of the potential tax problems.

Let us assume that Farmer Brown who served as our example regarding the cost and tax impact on the agricultural estate forms a corporation under the Oklahoma Act by simultaneously conveying all of the land held in his sole name, the equipment and machinery and the cattle to the corporation in exchange for 100% of the initial stock issued by the corporation. For federal income tax purposes no gain or loss will be recognized by Farmer Brown incident to incorporation of the business.[50] The corporation will then have title to assets having a current fair market value of $350,000 subject to mortgage indebtedness of $50,000, or a net value of $300,000. Farmer Brown's basis in the corporate stock will be equal to his basis in the land plus his basis in other assets transferred to the corporation (which we will assume to be equal to fair market value).[51] The basis

[47] Senate Bill No. 9, § 1, 1., 2., and 3. *Supra* note 2.

[48] *Id.* § 2., C.

[49] *Id.* § 3., B.

[50] INT. REV. CODE OF 1954, § 351(a).

[51] *Id.* §§ 1011-1017.

to the corporation in the assets received from Farmer Brown is the same as it would be in the hands of Farmer Brown.[52] In other words, Farmer Brown has a basis in the corporate stock of $203,000, and the corporation has a basis in the transferred assets of $203,000.

Since no cash was transferred to the corporation, assume that Farmer Brown loans the corporation $5,000 to meet initial expenses. If during the year the corporation does not realize at least $25,000 of gross receipts from other sources, the Oklahoma law will have been violated, and vacation of the corporate franchise may be mandatory.[53] In this event, the court may order dissolution of the corporation in accordance with the provisions of Section 1.198 of Title 18 of the Oklahoma Statutes, and incident to the dissolution, taxable gain of $97,000 may be recognizable by Farmer Brown for federal income tax purposes.[54]

Or, assume that during a particular year the corporation sells a quarter section of land owned by it at a cash price of $90,000. Unless the corporation receives in excess of $450,000 of gross receipts from farming or ranching during the year, the same problem exists. Or, what if Farmer Brown dies and his wife is no longer able to farm the land, as such, but instead either leases it for agricultural purposes or as wheat and grass pasture?

As an alternative to the gross receipts problem, assume that Farmer Brown transfers a single share of stock in the corporation to his son, Joe, who, in turn, sells the stock to a foreign corporation. In this instance the corporation has violated the shareholder qualification test of the Oklahoma Act, and vacation of the corporate franchise is again mandatory, involuntary dissolution is possible, and tax disaster is imminent.

Similarly, assume that Farmer Brown pledges the stock as collateral security for a personal loan made by a Texas bank, and in default of payment the Texas bank forecloses on the stock. Again the corporate franchise must be vacated, and involuntary dissolution may occur.

The potential of violating the "not more than ten shareholders" limitation contained in the act is equally as probable particularly if a principal motive for incorporating the agricultural business was to utilize the stock as a means of effecting inter vivos transfers. When the family becomes scattered through marriage or change of job location, the death of a shareholder and distribution of the stock to the spouse or spouse's family places entirely too great a burden of being aware of the Oklahoma law on the individual.

[52] *Id.* § 362.

[53] Section 2., C. of the Oklahoma Act is not permissive, but mandatory.

[54] INT. REV. CODE OF 1954, §§ 331, 1001, 1002.

Of considerably more significance than the potential of involuntary dissolution of the corporation is the practical problem of withdrawing corporate profits. Normally the corporate profits will be withdrawn by the controlling stockholders in the form of salaries and as ordinary income[55] with a corresponding deduction being taken by the corporation[56] thereby reducing the corporate income to zero. However, corporate profits in excess of reasonable compensation for services rendered (which may be distributed to shareholders) will be taxed as dividend distributions[57] which are not deductible by the corporation though taxed as gross income to the recipient.[58] In this event, assuming that distribution is from current operating income, corporate tax will be imposed at the corporate level[59] as well as at the individual level. This is particularly a problem in the event of disability of the individual, or unusually high earnings during a particular taxable year, or in the event of substantial gain by the corporation on the sale of its property.

An excellent alternative to the problem of "double taxation" of corporate earnings and a basis on which the same may be passed "through" the corporate entity to the shareholders is found in Subchapter S of the Internal Revenue Code.[60] Subchapter S of the Internal Revenue Code is a "tax relief" provision applicable to small business corporations.[61] The small business corporation may elect to be exempt from taxes imposed generally on corporations,[62] provided all shareholders of the corporation consent to the election,[63] with the effect that the undistributed taxable income of the corporation is includable in the gross income of the shareholders[64] to the extent each would have received a dividend, if on the last day of the taxable year of the corporation there had been distributed pro rata to the shareholders of such corporation an amount equal to the corporation's undistributed taxable income for the corporation's taxable year.[65]

[55] *Id.* § 61(a).

[56] *Id.* § 162(a)(1).

[57] *Id.* § 301.

[58] *Id.* § 61(a)(7).

[59] *Id.* § 11(a).

[60] INT. REV. CODE OF 1954, §§ 1371-1379.

[61] The term "small business corporation" means a domestic corporation which is not a member of an affiliated group as defined in section 1504 and which does not have more than ten shareholders; have as a shareholder a person (other than an estate) who is not an individual; have a nonresident alien as a shareholder; and have more than one class of stock. INT. REV. CODE OF 1954, § 1371(a).

[62] INT. REV. CODE OF 1954, § 1372.

[63] *Id.*

[64] *Id.* § 1373(a).

[65] *Id.* § 1373(b).

To illustrate the general application of the provisions of Subchapter S to an agricultural corporation engaged in business in the state of Oklahoma, assume that the stock is owned 80% by Farmer Brown, 10% by son Joe, and 10% by daughter Mary. If at the end of the taxable year the corporation has undistributed taxable income of $10,000, the same will be taxed $8,000 to Farmer Brown, $1,000 to Joe and $1,000 to Mary, whether distributed or not. However, subject to certain limitations, each shareholder to whom undistributed taxable income has been taxed has the right to subsequently withdraw the money without further taxation.

While Subchapter S seems to be a very logical cure-all to the corporate income tax problem, it is not without very real pitfalls. First, the corporation election pursuant to the provisions of Subchapter S may be involuntarily terminated if the corporation ceases to be a small business corporation, i.e. stock is transferred into trust or to an eleventh shareholder;[66] or a person becomes a shareholder during the taxable year and does not consent to the election;[67] or the corporation has gross receipts more than 20% of which are passive investment income;[68] or if the corporation derives more than 80% of its gross receipts from sources outside the United States.[69] If the election of the corporation is involuntarily terminated, the corporation is not eligible to make another election pursuant to the provisions of Subchapter S for a period of five years.[70]

Additional problems arise in the event of termination of the corporation's election pursuant to Subchapter S in the form of a "lock-in" of previously taxed but undistributed corporate earnings[71] and conversion of long-term capital gains which would ordinarily pass through the corporation to the shareholders, in kind, into ordinary income.[72]

Assuming the corporation can continue to meet the requirements of the Oklahoma Act and all of the profits can be withdrawn by the principal stockholder either in the form of salary or through the corporation's election pursuant to the provisions of Subchapter S, what happens when the principal stockholder dies? If the corporation has elected pursuant to the provisions of Subchapter S, the first problem is to preclude involuntary termination of the election. Invariably the stock will pass to the decedent's

[66] *Id.* § 1372(e)(3).

[67] *Id.* § 1372(e)(1).

[68] *Id.* § 1372(e)(5).

[69] *Id.* § 1372(e)(4).

[70] *Id.* § 1372(f).

[71] Distributions of previously taxed income are treated as nondividend distributions only in those years in which the corporation election is valid and in effect. *See* INT. REV. CODE of 1954, § 1375 and Treas. Reg. § 1.1375-4(a) (1968).

[72] *See* INT. REV. CODE OF 1954, § 1375(a)(1).

estate which becomes a new shareholder and must consent to the election within thirty days after the executor or administrator has qualified to perform his duties, but in no event later than thirty days following the close of the corporation's taxable year in which the estate became a shareholder.[73] The next problem is getting income from the corporation to the surviving spouse. If the corporation has elected pursuant to the provisions of Subchapter S and the administrator or executor properly consented to the election, the share of income which would otherwise have become distributable to the decedent will become distributable to the estate. In this event very careful planning for distributions by the estate to the surviving spouse will be required. In the event the corporation has not elected pursuant to the provisions of Subchapter S, the surviving spouse will probably be confronted with dividend treatment of all distributions by the corporation to him thus realizing economic shrinkage occasioned by double taxation of corporate profits. The next problem will be to provide a means of withdrawing sufficient funds from the corporation to meet costs of administration of the decedent's estate as well as federal and Oklahoma estate taxes. Fortunately, substantial relief is provided to meet this problem by the corporation redeeming its own stock in accordance with the provisions of section 303 of the Internal Revenue Code, as amended.[74] However, in order for the corporation to provide sufficient funds to meet these costs and expenses, it must be legally qualified to make the redemption and must either have funds available or obtain the funds through a sale of its properties, loans, or by other means. Naturally, if a sale of corporate properies is required to provide sufficient funds to effect the redemption, any gain realized must be recognized by the corporation for federal income tax purposes.

Hopefully, after the decedent's estate has been administered, the stock distributed, administration expenses paid, taxes paid, and a continuing source of income provided for members of the family in the desired proportions, the operations of the agricultural corporation will continue harmoniously and uninterrupted. However, if we assume that there is no

[73] Treas. Reg. § 1.1372-3(b) (1969).

[74] Pursuant to the provisions of section 303 of the Internal Revenue Code of 1954, if the value (for federal estate tax purposes) of all of the stock of the corporation which is included in determining the value of the decedent's gross estate is either more than 35% of the value of the gross estate or more than 50% of the taxable estate of the decedent, a distribution of property by the corporation in redemption of part or all of the stock included in determining the gross estate of the decedent is treated as a distribution in full payment or exchange for the stock so redeemed (and not as a dividend distribution) provided the distribution does not exceed the sum of the estate, inheritance, legacy and succession taxes imposed because of the decedent's death and the amount of funeral and administration expenses allowable as deductions to the estate under § 2053 of the Internal Revenue Code.

sible continuing means for existing shareholders to withdraw corporate
rnings other than as dividends (rendering the cost of conducting farming
erations in corporate form exorbitantly expensive), or for some other
son the shareholders desire to dissolve and liquidate the corporation,
entirely new set of tax problems must be faced.

Tax-free incorporation of assets is very easily accomplished pursuant
the provisions of section 351 of the Internal Revenue Code; however,
x-free liquidation of the corporation is virtually impossible except under
cumstances in which 100% of the issued and outstanding capital stock
he corporation is included in the estate of a deceased stockholder and
olution and liquidation is immediate. In this latter instance, the stock
take a new basis for purposes of determining gain or loss equal to its
r market value at the date of the decedent's death or at the alternate
uation date provided by Internal Revenue Code section 2032.[75] Conse-
ntly, no gain or loss will be recognized on liquidation of the corporation
e the value of the stock will equal the value of the assets distributed
quidation of the corporation.

In all other instances and with respect to stock acquired from the
edent but not included in the decedent's gross estate, it is probable that
n will be recognized on liquidation of the corporation, particularly if
corporation owns land which was substantially appreciated in value at
time the corporation was formed.

In general, corporate liquidations follow one of the two patterns for
poses of determining gain or loss in the event of liquidation. If the
oration is liquidated pursuant to the provisions of section 331 of the
rnal Revenue Code, amounts distributed in complete liquidation of the
oration are treated as full payment in exchange for the stock, and the
s of the amount realized over the adjusted basis in the stock must be
gnized as gain.[76] In this event, the shareholders take a "stepped-up"
s in the property received incident to the liquidation equal to the fair
rket value of the property at the time of the liquidating distribution.[77]

To illustrate (in simplest form), if on the day next succeeding the
rporation of Farmer Brown's farming operations the corporation had
n liquidated subject to the provisions of section 331, Farmer Brown
d have realized and recognized gain of $97,000 though not one cent
sh would have been received incident to the liquidation.

As an alternative to section 331 of the Internal Revenue Code, section
provides a special election as to recognition of gain in certain liquida-

75 INT. REV. CODE OF 1954, § 1014.

76 *Id.* §§ 1001-02.

77 *Id.* § 334.

tions. Essentially section 333 provides that if the corporation is liquidated during a one-month period, each shareholder may elect to recognize gain on the liquidation to a limited extent only. In this event, each shareholder shall recognize and treat as a dividend so much of the gain as is not in excess of his ratable share of the earnings and profits of the corporation determined as of the close of the month in which the transfer in liquidation occurs and there shall be recognized and treated as short-term or long-term capital gain, as the case may be, so much of the remainder of the gain as is not in excess of the amount by which the value of that portion of the assets received by him which consist of money, or of stock or securities acquired by the corporation after December 31, 1953, exceeds his ratable share of such earnings and profits.[78]

Applying the provisions of section 333 to the situation of Farmer Brown, above, since the corporation at the time of liquidation had not engaged in business, had no earnings and profits and no cash to distribute, no gain or loss would be recognized by Farmer Brown incident to the liquidation; however, his basis in the property received will be the same as his basis in the stock.[79]

By comparison, if the corporation has operated for an extended period of time and has accumulated earnings and profits as well as cash, a very different tax result might occur under section 333. If the corporation, for example, has accumulated earnings and profits of $50,000 and cash of $100,000 at the time of liquidation pursuant to the provisions of section 333 and Farmer Brown owns all of the issued and outstanding capital stock of the corporation, he will be required to treat the $50,000 of accumulated earnings and profits as a dividend (ordinary income) and an additional $50,000 (the excess of money distributed to him over his ratable share of earnings and profits) as long-term capital gain (assuming the stock has been held for a period in excess of six months). This could be quite a disastrous undertaking because of the substantial amount of ordinary income ostensibly "stockpiled" in the current taxable year.

The income tax complexities of conducting farming and ranching operations and owning agricultural realty through a corporation subject to the limitations imposed by the Oklahoma Statutes should represent a very special caveat to those who would tread carelessly in the estate planning field. Most particularly a corporation should be formed to engage in agricultural operations only after very careful consideration of all aspects

[78] *Id.* §§ 333(a), (e)(1) and (2). Note: Liquidation of a corporation pursuant to the provisions of § 333 of the Internal Revenue Code has been overly simplified for illustrative purposes and should be carefully reviewed before undertaken.

[79] *Id.* § 334(c).

of taxation bearing on its creation, operation and liquidation and only as a last resort when other alternatives are not available. Finally, to form an agricultural corporation under the Oklahoma law for the principal or sole purpose of providing a tool to effect inter vivos transfers of an interest in the family estate will accomplish little more than provide a continuing basis for valuation contests with the gift tax authorities.[80]

Principal Tools for Planning the Agricultural Estate

The agricultural estate is not particularly distinguishable from any other when viewed from an estate planning standpoint except in two particulars: (1) the lack of liquidity leaves extremely little, if any, margin for error; and (2) compared with investment in other businesses or assets, yield on fair market value of business capital is critically low. In other words, the marginal utility of cash in an agricultural estate is many times greater, for example, than that of the estate consisting of stocks in publicly held corporations. Under these circumstances the obligation of the estate planner is significantly greater since he is charged not only with minimization of costs but also maximization of cash flow for continued family subsistence.

To effect an optimum family estate plan for the Oklahoma farmer, the estate planning tools and techniques employed must be chosen to accomplish specific goals of the plan and to do so with very specific economic results. Obviously, such an estate plan will not be "unsophisticated," and if it is to be successfully implemented, it must be understood by the estate owner. To effect a better understanding between the estate planner and the estate owner, the principal tools of the agircultural estate plan should be discussed, not in technical language, but in generally accurate layman's terminology. The following discussion is illustrative of the author's approach to meet this need.

[80] In making gifts of stock in closely-held corporations, it is always advisable to file federal and Oklahoma gift tax returns in order to start the period of limitations for adjustments to value. Incident to the preparation of the federal gift tax return and valuation of the stock transferred, the fair market value is determined by taking into consideration the company's net worth, prospective earning power and dividend-paying capacity together with other relevant factors. Some of the "other relevant factors" include the goodwill of the business, the economic outlook in the particular industry, the company's position in the industry and its management, the degree of control of the business represented by the block of stock to be valued, and the values of securities of corporations engaged in the same or similar lines of business which are listed on a stock exchange. However, the weight to be accorded such comparisons or other evidentiary factors considered in the determination of a value depends upon the facts in each case. Complete financial and other data upon which the valuation is based should be submitted with the return, including copies of reports of any examinations of the company made by accountants, engineers, or any technical experts as of or near the date of the gift. Treas. Reg. § 25.2512-2(f) (1958).

Inter Vivos Trusts. There is probably more misconception regarding the trust than any other tool of the estate plan, and this is especially true in the agricultural community. Invariably the term "trust" connotes a technique used for incompetents, spendthrifts, or minors. Perhaps this was at one time true; however, at the present time the trust represents one of the most flexible business and estate planning tools and techniques available.

In providing a basis for understanding the trust, a good starting point is to demonstrate the separation of legal and equitable title to property much in the same manner as mineral interests and surface rights are separated. The principal difference is that the owner of bare legal title has no economic interest in the property while the owner of the equitable title receives the complete and full benefit from the property. An excellent analogy (though nominally inaccurate) is a checking account in the bank. When a depositor opens a bank account, title to the money deposited vests in the bank subject to the "equitable" right of the depositor to direct its distribution, withdraw the full amount deposited, make additions to the account, or remove the titleholder (bank) by closing the account and moving to another bank.

A revocable trust is really nothing more than a "bank account" of both cash and noncash assets. The property owner deposits his assets with his chosen trustee and retains the right to withdraw the assets, add to the deposit, direct distribution of the assets, remove the trustee and substitute another in his stead, modify the terms on which the property is held, or terminate the relationship altogether. The creator of the trust relinquishes absolutely no interest in the property other than the bare legal title, which may be reacquired at any time he may desire.

The irrevocable trust is created by a transfer of assets to a trustee to be held for the use and benefit of a third person on predetermined terms and provisions and subject to the occurrence of certain contingencies. It is distinguished from the revocable trust in that the creator gives up all right to recover the assets, modify or amend the trust, or terminate the same otherwise than by its terms. In this respect the irrevocable trust is an outright gift of property the same as if transferred directly to the trust beneficiary.

When a revocable trust is utilized as a tool of the estate plan, it is normally created by the owner of the estate assets (the trustor) transferring the estate assets to himself and his wife (the trustees) for the benefit of themselves and other members of their family (the beneficiaries). The trustor normally reserves the right to receive all income, to add additional assets to the trust, to withdraw assets from the trust, to modify or amend the trust terms, to remove and appoint successor trustees and to terminate the trust altogether. The creation of a revocable trust does not give rise to a federal tax event since the trustor is treated as the substantial owner for federal income tax purposes,[81] all of the property held by the trustees continues to be includable in the gross estate of the transferor by reason of his retained life estate,[82] and because the transfer is revocable,[83] no transfer takes effect until the time of the trustor's death,[84] an interest exists in the trustor at the time of his death,[85] and no transfer has been made which might be reached by the provisions of Internal Revenue Code section 2501, et seq. The only material change in asset status is the manner in which title is held which is very comparable to the change in status of money taken out of the individual's pocket and deposited in a bank checking account.

However, by reason of the shift in title from the individual to the trustees, even though the trustor has retained all economic benefits in the property, two very specific objectives are accomplished. First, in the event of mental disability of the trustor during his lifetime, there is no necessity for the appointment of a guardian or a committee of conservators of his property since the trustees are not disabled nor is the trust estate. Should such a catastrophe occur, the extremely high costs of guardianship of the property such as court costs, bond costs, attorney's fees, and accounting fees, are completely eliminated, and there is no "tie-up" of the family assets pending court approvals, and orders. Instead, the co-trustee (the wife) or successor trustee continues to manage the trust assets for the benefit of the designated beneficiaries, normally the trustor, his wife and children. Second, and most significant, in the event of death of the trustor all assets held by the trustees may be distributed (or continued in trust, as may be desired) to specific persons, in specific proportions or assets, and at a specific time or times without the necessity of administration or probate. Here then lies the first solution to the economic problem involved in the agricultural estate plan—elimination of administration and probate expenses.

The same costs may be eliminated with respect to the spouse's presumed subsequent estate merely by continuing the assets in trust rather than distributing the same outright with the result that the saving may very well be doubled.

81 Int. Rev. Code of 1954, §§ 671-677.

82 *Id.* § 2036.

83 *Id.* § 2038.

84 *Id.* § 2037.

85 *Id.* § 2033.

When the revocable trust is utilized as a principal tool of the family estate plan and as a means of avoiding guardianship or conservatorship of estate assets in the event of disability and administration and probate expenses at the time of death, it is advisable for the trust to become "irrevocable" upon the death of the trustor. Since the trust assets may be distributed by the trustees, the trust replaces the will as to those assets held in trust and provides a pattern for estate distribution, estate tax savings, and allocation of income among family members.

If at the death of the trustor the trust becomes irrevocable, it may nonetheless continue throughout the lifetime of the surviving spouse with increased economic savings. First, the surviving spouse is protected from the potential high costs of guardianship or conservatorship in the event of mental disability; second, the administration and probate expense that would otherwise be attributable to these assets is completely avoided; third, the trust may be made "spendthrift" and generally exempted from claims of the spouse's creditors; and fourth, properly planned, the maximum marital deduction for federal estate tax purposes may be obtained with respect to the trustor's estate and only one-half of the total trust assets ultimately will be includable in the estate of the surviving spouse. In passing a $300,000 estate from husband to wife to children, these techniques can save as much as $25,000 in total administration and probate costs and $36,000 in federal estate taxes. This is a total of $51,000 or 17% of the total fair market value of the entire estate. Equally as important, the estate assets are insulated from liquidation and mortgages, to meet $51,000 of required liquidity.

As previously noted, during the lifetime of the trustor of a revocable trust, there is no federal income tax event but instead, the trustor treats the trust income the same as if received by him directly. At the time the trust becomes irrevocable and establishes the general estate plan, the trust becomes a new "taxpayer" and the trust entity and its beneficiaries become subject to very special tax treatment. Generally speaking, the taxable income of a trust is computed in the same manner as in the case of an individual,[86] though a trust which is required to distribute all of its income currently is allowed a deduction of only $300 and all other trusts are allowed a deduction of $100.[87]

With regard to allocation of trust income between the trust entity and its beneficiaries, if all of the trust income is required to be distributed currently, no portion of the income may be paid or permanently set aside for charitable purposes and the trust does not distribute any amount other

[86] *Id.* § 641(b).
[87] *Id.* § 642(b).

han its current income during the taxable year, the trust is allowed a deduction in computing its taxable income equal to the amount required to be distributed currently;[88] however, the amount of the deduction cannot exceed the distributable net income of the trust for the taxable year.[89] Correspondingly, with regard to such a trust, the beneficiary is required to include in his income the amount required to be distributed currently, whether distributed or not.[90] The amounts which must be included in the income of the beneficiary retain the same character as in the hands of the trust,[91] and if there is more than one beneficiary, each beneficiary includes in income an amount which bears the same ratio to distributable net income of the trust as the amount of income required to be distributed to him bears to the amount of income required to be distributed to all beneficiaries.[92]

To illustrate the income tax ramifications involved in a trust which is required to distribute all of its income currently to the beneficiaries thereof, assume that all of the trust income is required to be distributed, ⅓ to Beneficiary *A* and ⅔ to Beneficiary *B*. If during the taxable year the trust has distributable net income of $9,000 of which $3,000 is tax exempt interest and $6,000 is from rents, Beneficiary *A* will include in income, whether distributed or not, a total of $3,000, consisting of $1,000 tax exempt interest and $2,000 taxable rents. Beneficiary *B* will include $6,000 in income, consisting of $2,000 tax exempt interest and $4,000 taxable rents. The trust will have no taxable income and pay no tax since it is entitled to a deduction for the amount of income required to be distributed currently and all of the income was so distributable.

Following the same general pattern, if the trustee is authorized either to accumulate income during the taxable year or to distribute principal of the trust, the trust is entitled to a deduction equal to the sum of any amount of income required to be distributed currently and any other amounts properly paid, credited, or required to be distributed for the taxable year, not in excess of the distributable net income of the trust.[93] Each beneficiary of such a trust includes in income the amount required to be distributed to him currently, whether distributed or not and all other amounts properly paid, credited, or required to be distributed to him during the taxable year.[94] The same general rules apply as to the character of

[88] *Id.* § 651(a).

[89] *Id.* § 651(b).

[90] *Id.* § 652(a).

[91] *Id.* § 652(b).

[92] *Id.* § 652(a).

[93] *Id.* § 661(a).

[94] *Id.* § 662(a).

amounts distributed and allocation of the same among multiple beneficiaries.[95]

To illustrate the federal income tax ramifications to a trust which accumulates income during the taxable year and distributes part to the beneficiaries, and to the beneficiaries who receive that income, assume that the trustee of the trust is directed to accumulate the income of the trust during each taxable year but may, in the exercise of discretion, distribute so much of the income as he deems advisable to Beneficiary *A* and to Beneficiary *B*. Further assume that the distributable net income of the trust during the current taxable year is $9,000, consisting of $3,000 tax exempt interest and $6,000 taxable rents. If the trustee distributes $3,000 each to *A* and *B* and retains $3,000, the trust will be taxed on the $3,000 retained which will consist of $1,000 tax exempt interest and $2,000 taxable rents. *A* and *B* each will include $3,000 in income consisting of $1,000 tax exempt interest and $2,000 taxable rents.

Notably, in the latter example $9,000 of net income has been "sprinkled" and "sprayed" for federal income tax purposes among three taxpayers—the trust, Beneficiary *A*, and Beneficiary *B*.

Though nominally complicated, it is not uncommon for the trustee of a trust to be required to accumulate trust income each year but authorized to distribute the same to or among multiple beneficiaries as deemed necessary for care, support, and maintenance.

Under this set of circumstances it is not uncommon for the trust to accumulate the entire income for a period of years and then, in a subsequent year, to distribute to the beneficiaries an amount substantially in excess of the distributable net income of the trust for the current year. This is known as an "accumulation distribution," and the same is subject to special income tax provisions.[96] Generally speaking, the amount distributed to beneficiaries in excess of the distributable net income of the trust during the current year is treated as having been distributed to the beneficiary in the year in which it was accumulated, and in addition, the amount of tax previously paid by the trust during the accumulation year is also deemed to have been distributed,[97] and a credit for the same is allowed to the beneficiary.[98]

The general income tax pattern applicable to trusts and trust beneficiaries affords a very substantial degree of latitude in planning overall income tax reduction or temporary deferral of the tax obligation.

[95] *See* INT. REV. CODE OF 1954, § 662(b).

[96] *See* INT. REV. CODE OF 1954, §§ 665-669.

[97] INT. REV. CODE OF 1954, § 666(b).

[98] *Id.* § 668.

Partnerships. A partnership is an association of two or more persons to carry on as co-owners a business for profit.[99] The term "person" includes individuals, partnerships, corporations, and other associations, and the term "business" includes every trade, occupation, or profession.[100] Similarly, a limited partnership is a partnership formed by two or more persons and having as members one or more general partners and one or more limited partners.[101] A principal distinction between the partnership, or general partnership as it is normally termed, and a limited partnership is the fact that under Oklahoma law, limited partners, as such, are not bound by the obligations of the partnership[102] unless, in addition to the exercise of rights and powers as a limited partner, such a partner takes part in the control of the business.[103]

Both general and limited partnerships are easily formed under the Oklahoma law which, when coupled with an entirely different income tax pattern, renders either or both an ideal tool for developing the estate plan involving agricultural interests. This is fortified by the fact that the partnership may hold title to realty while the interest of either a general[104] or limited[105] partner is personal property and the same is assignable.[106]

Unlike the corporation and the trust, a partnership, whether general or limited, is not subject to income tax,[107] but instead, persons carrying on business as partners are liable for income tax in their separate or individual capacities.[108] The general rule is that in determining his income tax, each partner takes into account separately his distributive share of the partnership's income.[109] A partner's distributive share of income, gain, loss, deduction or credit is, however, generally determined by the partnership agreement.[110]

For income tax reporting purposes, the taxable year of a partnership is determined as though the partnership were a taxpayer,[111] and in computing the taxable income of a partner for a taxable year the amount in-

99 54 OKLA. STAT. § 206(1) (1961).
100 *Id.* § 202.
101 *Id.* § 142.
102 *Id.*
103 *Id.* § 148.
104 *Id.* § 226.
105 *Id.* § 159.
106 The assignment of a general partner's interest is governed by 54 OKLA. STAT. § 227 (1961), and the assignment of a limited partner's interest is governed by 54 OKLA. STAT. § 160 (1961).
107 INT. REV. CODE OF 1954, § 701.
108 *Id.*
109 *Id.* § 702.
110 *Id.* § 704.
111 *Id.* § 706(b).

cluded in income is based on the income, gain, loss, deduction or credit of the partnership for the taxable year of the partnership ending within or with the taxable year of the partner.[112] A common misconception with regard to partnerships is that partners are required to share in profits and losses in proportion to their respective capital accounts. This is simply not the case, but instead, absent avoidance or evasion of income taxes the partners may share in net profits or losses to any agreed extent.[113] This particular aspect of taxation of partnerships provides the facility for equal sharing of profits under circumstances in which one person contributes required capital and another performs required services.

Family partnerships are, for federal income tax purposes, subject to special scrutiny;[114] nonetheless, the same are recognized.[115]

If the partnership is to constitute a principal tool of the estate plan developed for agricultural interests, special consideration must be given to the aspects of federal income taxation peculiar to family partnerships. The production of income by a partnership is attributable to the capital or services, or both, contributed by the partners, and the federal income tax statutes set forth in Subchapter K of Chapter I of the Internal Revenue Code are to be read in the light of their relationship to section 61, which requires, *inter alia*, that income be taxed to the person who earns it through his own labor and skill and the utilization of his own capital.[116]

With respect to partnerships in which capital is a material income producing factor, a person shall be recognized as a partner for income tax purposes if he owns a capital interest in the partnership whether or not such interest is derived by purchase or gift from another person,[117] and the distributive share of the donee under the partnership agreement is includable in his gross income except to the extent that it may be determined without allowance of reasonable compensation for services rendered to the partnership by the donor and except to the extent that the portion of his distributable share attributed to donated capital is proportionately greater than the share of the donor attributable to the donor's capital.[118]

Capital is a material income producing factor if a substantial portion of the gross income of the business is attributable to the employment of capital in the business conducted by the partnership;[119] hence, it would

112 *Id.* § 706(a).
113 *Id.* § 704(b).
114 Treas. Reg. § 1.704-1(e)(1)(iii) (1964).
115 INT. REV. CODE OF 1954, § 704(e)(1).
116 Treas. Reg. § 1.704-1(e)(1)(i) (1964).
117 *Id.* § 1.704-1(e)(1)(ii).
118 *Id.*
119 *Id.* § 1.704-1(e)(1)(iv).

appear that a partnership holding agricultural realty would easily meet the test.

The Treasury Regulations promulgated under section 704 of the Internal Revenue Code of 1954 clearly provide that a trustee may be recognized as a partner for income tax purposes under the principles relating to family partnerships generally as applied to the particular facts of the trust-partnership arrangement.[120] However, if the grantor is the trustee or if the trustee is amenable to the will of the grantor, the provisions of the trust instrument, the provisions of the partnership agreement, and the conduct of the parties must all be taken into account in determining whether the trustee in a fiduciary capacity has become the real owner of the partnership interest.[121]

As a general rule, however, a minor child will not be recognized as a member of a partnership unless control of the property is exercised by another person as fiduciary for the sole benefit of the child and unless there is judicial supervision of the conduct of the fiduciary as is required by law.[122] However, if a minor child is shown to be competent to manage his own property and participate in the partnership activities in accordance with his interest in the property, he will be considered as a partner notwithstanding the absence of a fiduciary.[123]

Expanding the family partnership concept, to be recognized for federal income tax purposes, a limited partnership must be organized and conducted in accordance with the requirements of the applicable state limited partnership law.[124] Clearly, the absence of services and participation in management by a donee in a limited partnership is immaterial if the limited partnership meets all other prescribed requirements.[125]

It is important, however, that in allocating income of the family partnership among the respective partners that the allocation take into consideration an allowance for reasonable compensation for services rendered to the partnership by the donor of any interest in the partnership; otherwise, income may be reallocated for federal income tax purposes to provide such a reasonable allowance for services.[126]

Similar to the formation of a corporation pursuant to the provisions of section 351, no gain or loss is recognized to the partnership or to any of its partners in the case of a contribution of property to the partnership in

120 *Id.* § 1.704-1(e)(2)(vii).
121 *Id.*
122 *Id.* § 1.704-1(e)(2)(viii).
123 *Id.*
124 *Id.* § 1.704-1(e)(2)(ix).
125 *Id.*
126 *Id.* § 1.704-1(e)(3).

exchange for an interest in the partnership,[127] and the basis of a partner's interest in a partnership acquired by a contribution of property, including money, to the partnership is the amount of the money plus the adjusted cost basis of the property at the time of the contribution.[128] The partnership's basis in property contributed to it by a partner is the adjusted cost basis of the property to the contributing partner at the time of the contribution.[129]

Distinguished from the corporation, however, is the fact that in the case of a distribution by a partnership to a partner, gain is not recognized to the partner except to the extent that money distributed exceeds the adjusted basis of such partner's interest in the partnership immediately before the distribution.[130] Also, except with respect to payments to a retiring partner or a deceased partner's successor in interest and certain unrealized receivables and inventory items, no gain or loss is recognized to a partnership on a distribution to a partner of property, including money.[131]

To illustrate the general concepts of federal income taxation applicable to family partnerships, assume that Farmer Brown grants an undivided 5% interest in the assets previously assumed to have been incorporated to his wife and an undivided 5% interest to an unrelated third party as trustee for and on behalf of a minor grandchild. Then, pursuant to the provisions of the limited partnership act of Oklahoma, assume that Farmer Brown, as a general partner, and Mrs. Brown and the trustee, as limited partners, form a limited partnership in which it is agreed that they will share in profits in proportion to their initial capital accounts, i.e. 90% to Farmer Brown, 5% to his wife, and 5% to the trustee.

As the general partner, Farmer Brown will have the full obligation to manage the partnership business; however, he will have corresponding authority. Also, since Farmer Brown is solely charged with the obligation of rendering services to the partnership, and since it is a "family partnership," it is necessary that provision be made to provide reasonable compensation to Farmer Brown for his services rendered to or on behalf of the partnership entity.

Assume that during the taxable year of the partnership the business earns net profits of $12,000 and allocates $4,000 to Farmer Brown for services rendered. The remaining $8,000 is distributable and taxable as follows: Farmer Brown, $7,200; Farmer Brown's wife, $400; and the trustee, $400.

If the partnership is then dissolved and distributed to the partners in

127 INT. REV. CODE OF 1954, § 721.

128 *Id.* § 722.

129 *Id.* § 723.

130 *Id.* § 731(a).

131 *Id.* §§ 731(b) and (c).

rdance with the value of their respective capital accounts, no gain or will be recognized to any of the partners or to the partnership entity. ead, the dissolution is entirely tax free, and the basis of each partner istributed property is equal to his liquidated capital account.

Had Farmer Brown died during the existence of the partnership, the rtnership might have been dissolved and liquidated, or if the articles partnership so provide, his interest in the partnership may be continued a successor having a step-up in basis of the partnership interest. Business profits will continue to "flow-through" the partnership entity to the espective partners with none of the problems attending corporate operaons, and ultimate dissolution will in all probability be tax free.

Through the implementation of the partnership technique, whether he general or limited partnership is employed, the business may be conucted through a continuing entity in which all members of the family may articipate and which has the inherent flexibility to both meet family financial requirements and avoid the multitude of "tax traps" involved in corporate operations.

Inter Vivos Gifts. What could be a more ideal way of avoiding administration and probate expenses as well as high estate taxes than transferring the estate to the family during lifetime? Certainly, this cures the problem but it also brings about an entirely new group of considerations. The principal deterrent to inter vivos gifts is the estate owner's loss of control and income produced by the estate assets. In addition, granting undivided interests in real property renders the property virtually inalienable and always poses the problem of valuation for gift tax purposes. Further, when substantial amounts of property are involved, the tax cost of making lifetime gifts can become as serious a question as the estate tax cost of not doing so.

Estate planning for agricultural interests will not be solved by "giving the estate away" prior to death; yet, proper planning for inter vivos transfers, tempered with a reasonable degree of discretion, can afford substantial relief.

In undertaking and implementing an inter vivos gift program it is necessary that federal and Oklahoma gift tax exclusions, exemptions and deductions be maximized and that the property be transferred in such a manner as to cause the least reduction in income to the transferor.

Federal gift tax exclusions, exemptions and deductions include: deductibility of gifts to charitable organizations;[132] an annual exclusion of \$3,000 if the gift is of a present interest;[133] a lifetime exemption of \$30,-

132 *Id.* § 2522.
133 *Id.* § 2503(b).

000;[134] gift splitting by husband and wife with respect to gifts to third parties;[135] and the federal gift tax marital deduction with regard to transfers between husband and wife.[136] Also, if a gift is made in trust and the provisions of the trust meet the requirements of section 2503(c) of the Internal Revenue Code of 1954, an annual exclusion is available even though the gift is ostensibly one of a future interest.

The Oklahoma law affords only an annual exclusion of $3,000 per donee, per year, regardless of whether the gift is one of a present or future interest.[137] Also, certain charitable, municipal, and other gifts are exempt from application of the Oklahoma gift tax law.[138]

To illustrate the substantial value of land that may be transferred in a single year, let us revert to Farmer Brown and assume that neither he nor Mrs. Brown has ever made any taxable gifts and that Mrs. Brown will consent to "gift-splitting." During the current taxable year Farmer Brown could transfer $66,000 to Mrs. Brown and $24,000 to his four children, a total of $90,000, without incurring federal gift tax and without utilizing any portion of Mrs. Brown's $30,000 lifetime exemption. As an alternative, $84,000 of gifts may be made to the four children and $6,000 of gifts to Mrs. Brown without the incurrence of federal gift taxes; however, Mrs. Brown's $30,000 lifetime exemption would be consumed under these circumstances.

For Oklahoma gift tax purposes, only $12,000 of annual exclusions would be allowed under either set of circumstances, $78,000 of taxable gifts would be effected, and $2,420 in gift tax would be due and payable to the Oklahoma Tax Commission.

By removing $90,000 from Farmer Brown's gross estate, savings in probate costs alone will be approximately $2,250, and savings in federal and Oklahoma estate taxes will be an additional $18,100! The amount invested in Oklahoma gift taxes produces such an unprojected high yield when compared to the amount invested in the agricultural unit that a means of making inter vivos gifts must be found and implemented on an objective basis.

Life Insurance. Life insurance and its use in estate planning has pre-

[134] *Id.* § 2521.

[135] *Id.* § 2513. In those instances in which husband and wife make gifts to third parties the same may be treated as made one-half by each for purposes of the $3,000 annual exclusion and the $30,000 lifetime exemption even though the gift may be made by property owned entirely by either husband or wife.

[136] *Id.* § 2523. Generally, one-half of the amount of gifts made by one spouse to the other may be deducted in computing the amount of taxable gifts made during the year.

[137] 68 OKLA. STAT. § 903(a)(3) (Supp. 1970).

[138] *Id.* §§ 903, 909.

viously been discussed in Volume 23, No. 2 of the *Oklahoma Law Review*, May, 1970, and no repetition is necessary here. However, there are specific applications of the life insurance product having specific value in the agricultural estate plan that are worthy of note.

Life insurance in any quantity is rarely found in the stockpile of assets of the Oklahoma farmer primarily because cash flow during the early and intermediate years of estate accumulation simply is not sufficient to provide the luxury of a sound program of protection. Instead, virtually the entire cash flow is consumed with family living expenses, acquisition of agricultural realty, equipment and machinery acquisitions, and the creation of a cash reserve for crop failure years. The theory of most farmers is that during those years in which the estate is being accumulated, the tax problem is nominal and in later years, the value of the estate assets should be sufficient to meet the cost obligations that will arise. While the theory is generally accurate, the practicalities of the theory overlook unrealized appreciation in land values, increasing interest rates, general economic inflation, cash flow for continued subsistence of the family, preservation of the assets for the second generation and expansion, not contraction, of the agricultural unit.

To anticipate a sound program of life insurance for implementation in the agricultural estate plan is no small task because of the dynamic nature of the estate, change in family status and objectives, and inability to presently determine fair market values at a future time. Thus, with the exception of the larger agricultural units in which cash flow is not marginal, life insurance planning invariably becomes a late-in-life process.

Uniquely, life insurance as a tool of the agricultural estate plan is rarely considered in its proper perspective nor is it fairly presented to accomplish a particular goal. This probably accounts for absence of life insurance in the agricultural estate as much as any other cause. However, realistically examined, life insurance is an extremely rewarding asset if coordinated with the overall estate plan.

When Farmer Brown takes an initial look at the value of his estate, the dispositive pattern, his true objectives to pass it to the family and the cost of so doing, he will find (under present circumstances) that in the event he predeceases Mrs. Brown it will cost approximately $45,500 to administer and pass the estate. Then, assuming that the estate (including joint tenancy property) is divided equally between Mrs. Brown and the children, at the time of Mrs. Brown's presumed subsequent death, it will cost another $26,625 or a total of $73,125 to pass the estate to the children. If Mrs. Brown does not survive Farmer Brown, the federal estate tax marital deduction will be "lost," and the cost is accelerated to $84,600 or

$11,475 more than passing the estate in a two-step process. This means that the children receive an economic benefit of $11,475 if they can guarantee that Mrs. Brown will survive. How is this "guaranty" obtained? The simple answer is life insurance on Mrs. Brown's life.

If Mrs. Brown's life is insured for $12,000 at a presumed cost of $50 per $1,000, an annual premium of $600 will be required. Spread among the four children, this amounts to a cost of $12.50 per month as an "investment" which guarantees to each child a return of $3,000 at some future time. If Mrs. Brown lives another twenty years, the children are still at a "break-even" point.

Under the circumstances outlined, the "full marital deduction" has not been funded through life insurance on Mrs. Brown's life; however, it has been reasonably hedged. Should the children be in a financial position to do so, by insuring Mrs. Brown's life for $40,000 the children are protected against the loss of the marital deduction in Farmer Brown's estate, and also have completely funded what would otherwise be the estate tax cost with regard to Mrs. Brown's presumed subsequent estate.

With regard to the estate of Farmer Brown, the magic number is $45,000. The entire amount of projected estate taxes, administration and probate expenses, with regard to Farmer Brown's estate may be funded through life insurance in this approximate amount. If we assume that insurance will cost approximately $50 per $1,000, this will require an annual outlay of $2,250. While this is not an insignificant annual sum, what are the alternatives? In the event of Farmer Brown's death, perhaps the family could sell one quarter section of the land for the required $45,000.[139] The economic loss to the family by sale of the land will be $3,000 per year—forever. Viewed in this perspective, the cost of insurance appears to be a reasonably sound investment.

Another alternative available to the family is to utilize the agricultural realty as security and borrow the $45,000 at the bank. At the present time interest on the loan would be approximately $3,600 per year or 160% of the cost of the insurance.

Still another alternative is to insure that at least a major portion of the estate is held in such a manner as to qualify for installment payment of federal estate taxes pursuant to the provisions of Internal Revenue Code of 1954 section 6166. If the full ten-year period is elected, the first installment will be due on the due date of the estate tax return, and thereafter an equal installment will be due annually together with interest at

139 Granted, we have valued the land at $75,000 per quarter; however, when the family is confronted with a forced sale to meet liquidity needs of the estate, the value will drop considerably.

rate of 4% per annum. While this affords some relief to the problem, ust be noted that funeral expenses, Oklahoma estate taxes, and ad- istration or probate expenses, are not payable in installments, rather a mp sum" is still required. Also, depending on what Farmer Brown ht do with regard to his estate plan during the interim years, there is absolute assurance that section 6166 will be available at the time of his ath.

This brings us to consideration of the "proper perspective." Why pay ate taxes in installments bearing interest at the rate of 4% per annum r a ten-year period after the principal income earner has died, when tead they may be paid in installments, without interest, over the re- ining lifetime of the estate owner and while the earning capacity of estate assets is at its peak? This is the real answer afforded by life urance. Also, life insurance affords the opportunity to pay not only federal estate taxes, but all other expenses in exactly the same install- nts. To illustrate, if Farmer Brown makes installment payments of 1,250 per year, the entire costs attributable to his estate will have been nded and cash will be available to meet the same at the very moment ey accrue. In the event of premature death, a substantial saving is orded to the family measured by the difference between the maturity oceeds of the life insurance policy and the aggregate of annual pre- iums paid.

In many instances it may not be feasible to insure the full amount of he family financial needs for meeting costs, and taxes, etc.; however, it invariably feasible to insure at least part of these needs and re-plan the tate to find the balance. For example, if one-half of the projected cost with regard to Farmer Brown's estate is funded by life insurance, the family in a position to meet immediate, nondeferrable costs, and the federal state tax may still be paid in installments over a period as long as ten years. Also, perhaps the family is willing to gamble that Mrs. Brown will urvive and therefore the federal estate tax marital deduction will be available. In this event, it would be remiss indeed to fail to fund projected costs, at the time of Mrs. Brown's death in the amount of $12,500 since it would cost each of the children only $13 per month.

Regardless of the "quantum" of life insurance that might be selected for either Farmer or Mrs. Brown, it is sheer folly to pay estate taxes on the funds developed for the payment of estate taxes. Life insurance acquired to provide estate liquidity should be owned, premium paid and beneficially received outside the gross estate of the insured.

At the time the maturity proceeds of the policy are received by the owner or beneficiary, the same may be utilized to acquire assets from the estate or may be loaned to the estate to provide the immediate cash required.

The flexibility inherent in life insurance planning to meet the needs of the agricultural estate is virtually unlimited. By utilizing a split-dollar concept, the estate owner may retain the right to control the cash values of the insurance policy; life insurance may represent a substitute share of the estate, for example, land devised to sons and cash provided through life insurance for the benefit of daughters; if the requirements of Internal Revenue Code section 264 are met, policies may be maintained on a "minimum deposit" basis reducing the amount required annually for premium payments; and the policies themselves represent an excellent savings account which, in the event of unanticipated longevity, will reduce the cost of pure insurance to virtually nothing.

Life insurance is the antithesis of other techniques of estate planning in that it is not concerned with estate reduction but rather with providing a source of funds to eliminate economic loss through retention of estate assets or expansion of the agricultural unit. The long-range preservation of the agricultural estate will depend to a large extent on the foresight of the estate owner and recognition of the value of life insurance as part of his economic portfolio. Particularly, if life insurance is acquired at younger ages in anticipation of estate growth and budgeted together with family living expenses and real property acquisitions, it becomes a "way of life" and a guaranty of long-range family security.

Practical Implementation

Not every problem that faces the Oklahoma farmer can be solved through estate planning and this should not be the goal of the estate planner. In reality, the estate planner's objective should be to guide his client in such a manner that existing problems can be met and solved and that potential problems will either be eliminated or carry a predesigned solution with them.

Farmer Brown's problems are not uncommon and are basic: substantial wealth has been accumulated most of which is attributable to unrealized appreciation in agricultural land values; cash flow from operating the economic unit is marginal; interim mistakes may have been made by the creation of joint tenancies, "deeding," and transfers with retained life interests; he feels that if everything accumulated during his lifetime is passed to his wife he has met his obligation to the family; administration or probate expenses have been accepted as inevitable; the impact of federal and Oklahoma estate taxes is virtually unknown or at least not accepted as ality; he has not anticipated the potential of his wife or one or more of children predeceasing him; other people may become mentally disabled, not him; he does not believe in life insurance; and if the children re-e anything, that is more than was ever left to him (though he does not y believe this).

If we can really step into Farmer Brown's subconscious, we will find he is really concerned with taking care of himself and his wife for ng as either survives, providing a good farm for those of his children wish to continue in the family business, and providing for the benefit is entire family—estate substance that is meritorious of a life's work.

At this point there is very little that Farmer Brown "can do wrong," wrong is found in doing nothing. Assuming Farmer Brown is willing something, just what can and should be done follows no fixed pattern instead the opportunities are many and varied. Illustrative of this ential is the following suggested estate plan for Farmer Brown.

In order to provide a reasonable comparison, assume that Farmer Mrs. Brown currently have a "mutual and conjoint will" in which the ire estate is bequeathed and devised to the survivor and thereafter ueathed and devised to the children, in equal shares. Under these cir-stances, if Farmer Brown predeceases Mrs. Brown, estate costs will regate approximately $45,525 at the time of his death, and at the time Mrs. Brown's subsequent death, costs will aggregate $75,850 or a total $121,375!

This, of course, is the most costly type of estate planning that Farmer d Mrs. Brown can effect, and as demonstrated in the preceding section garding "Life Insurance," by dividing the estate equally between Mrs. rown and the children a substantial saving is effected.

By comparison, let us consider a 15-step estate planning process for armer and Mrs. Brown:

Step 1: Create irrevocable inter vivos trusts for a period certain for he benefit of each of the four children authorizing discretionary distribu-n of income and/or principal for care and support, and providing for stribution to the beneficiary, if living, otherwise to successive bene-ciaries, upon the expiration of the period certain.

Step 2: Transfer (by gift) an undivided interest in the land having fair market value of $15,000 to each of the trusts created for the benefit the children.

Step 3: Transfer (by gift) an undivided interest in the land having a air market value of $6,000 to each of the children, individually.

Step 4: Transfer (by gift) an undivided interest in the land having a air market value of $6,000 to Mrs. Brown, individually.

Step 5: Form an Oklahoma limited partnership (Brown Farms, Ltd.) in which Farmer Brown is the sole general partner and Mrs. Brown, each of the children and each of the trusts for the benefit of the children are limited partners. Capitalize the limited partnership by each partner's contribution of his interest in the land and by Farmer Brown's additional contribution of machinery, equipment, and cattle. Each partner should initially share in net profits or losses, after providing reasonable compensation for services rendered by Farmer Brown, in proportion to his initial capital account.

Step 6: Create a revocable trust for Farmer Brown, to become irrevocable at the time of his death. This trust will be funded with the checking account and certificate of deposit presently held in joint tenancy.[140]

The general pattern of this trust will be to provide full economic benefit for Farmer and Mrs. Brown as well as their children during Farmer Brown's lifetime and then, upon his death, to divide into a standard marital deduction trust and family trust. Mrs. Brown will receive all of the income from the marital deduction trust and have a testamentary general power of appointment with respect to its principal. The family trust will be designed to accumulate income but sprinkle or spray the same among the wife and other members of the family in the event of need for care, support, and maintenance.

Step 7: Create a revocable trust for the benefit of Mrs. Brown funded by an initial principal of $10. This trust will be for the benefit of Mrs. Brown, Farmer Brown and the children so long as Mrs. Brown is living. Thereafter, the trust will become irrevocable and provide a life estate for Farmer Brown with remainder to the children, in equal shares.

Step 8: Provide a revised Last Will and Testament for Farmer Brown, pouring any assets held by him at the time of his death into his revocable trust.

Step 9: Provide a revised Last Will and Testament for Mrs. Brown, pouring any assets held by her at the time of her death into her revocable trust.

Step 10: Farmer Brown should then assign his interest in Brown Farms, Ltd. to the trustees of his revocable trust.

Step 11: Mrs. Brown should then assign her interest in Brown Farms, Ltd. to the trustees of her revocable trust.

Step 12: Insure Farmer Brown's life in the amount of $20,000, the

140 The Co-op stock should not be passed into trust since it is customarily redeemable only upon the death of the certificate holder. Also, "miscellaneous personalty" may be assigned to the trust; however, because of Oklahoma homestead exemption laws, the residence should probably continue to be held in the names of Farmer and Mrs. Brown as joint tenants with right of survivorship.

insurance to be premium paid, owned and beneficially receivable by the children.

Step 13: Insure Mrs. Brown's life in the amount of $20,000, the insurance to be premium paid, owned and beneficially receivable by the children.

Step 14: Provide a buy and sell agreement between the trustees of Farmer Brown's trust and the children to sell to the children, at the time of Farmer Brown's death, an additional partnership interest having a fair market value equal to the amount of life insurance proceeds to be received by the children.

Step 15: Plan annual gifts from Farmer Brown to Mrs. Brown in the amount of $6,000, annual gifts by Farmer Brown to each of the children in the amount of $3,000, and annual gifts by Mrs. Brown to each of the children in the amount of $3,000, all of the same to consist of interests in Brown Farms, Ltd.

Immediate Results of the Estate Plan. By reprogramming the ownership of the estate assets, with the exception of Farmer Brown's Co-op stock and his personal residence, all assets of the family have been aggregated in Brown Farms, Ltd., a continuing business entity, and in the revocable trusts created by Farmer and Mrs. Brown. The partnership will have the effect of holding the income production of the agricultural unit together while interests in the same may be easily transferred inter vivos through gifts of a partnership interest constituting personal property.

The principal asset of Farmer Brown's estate is now an interest in Brown Farms, Ltd. rather than the land, machinery and equipment. Since this asset is held by the trustees of his revocable trust, and since the trust continues for the benefit of Mrs. Brown's lifetime, there will be no administration or probate of that interest in either estate. Also, by Farmer and Mrs. Brown contributing virtually all of their other assets to their respective revocable trusts, administration or probate of these assets is similarly eliminated in both estates.

As the general partner in Brown Farms, Ltd., Farmer Brown will continue to "control" all of the estate assets during his lifetime, and because of substantial services to be performed by him for and on behalf of the partnership, he will similarly have "control" of the partnership income. Not only is this permissible for federal income tax purposes, it is mandatory.

In the event of Farmer Brown's mental disability, or incompetency, there will be no legal interruption to the business or need for guardianship of his property, or conservatorship of his assets. Since his co-trustee, or successor trustee as the case may be, will continue to administer Farmer

Brown's revocable trust and, through the trust, Brown Farms, Ltd., the same benefit has been provided for Mrs. Brown and her interest in the limited partnership since the same is held by her trustees.

No taxable event has occurred to any of the parties involved by reason of the creation of the revocable trusts or the partnership; however, taxable gifts have been made by reason of the transfers set forth in Steps 2, 3 and 4. As previously discussed, allowable exemptions, exclusions, deductions and gift-splitting will preclude taxability of the transfers for federal gift tax purposes, but $2,420 in gift tax will be due and payable to the Oklahoma Tax Commission. It is also interesting to note that net profits from agricultural operations will pass through the partnership entity to the respective partners and through the revocable trusts directly to Farmer and Mrs. Brown. For the present, their right to receive net farm income has been unaltered other than to the extent it becomes distributable to the limited partners by virtue of their respective partnership interests.

The revised wills of Farmer and Mrs. Brown insure completion of the overall estate plan as well as aggregation of the entirety of their assets in trust for the benefit of the children to be ultimately distributed on the basis of the dispositive pattern selected by them.

The income interests of the children have been split between them, individually, and irrevocable trusts created for the benefit of each of them. By so doing, new taxpayers have been created in the form of the trusts for income tax purposes and the income split in a program of tax deferral. Of course, at any time one of the trusts makes a distribution to a beneficiary, to the extent of distributable net income for the current year the same will be includable in the income of the beneficiary recipient. If the distribution is in excess of distributable net income for the current taxable year, there may an accumulation distribution subject to "throwback."

In the event of premature death of any of the children, that portion of a child's interest in the partnership which is held in the trust is planned for the benefit of successive beneficiaries and will be eliminated from administration or probate in the child's estate and will not be included in the gross estate for estate tax purposes. In this instance Farmer Brown has had the opportunity to provide a benefit for each of his children which they would not otherwise be in a position to provide for themselves—the equivalent of a transfer with a retained life estate.

From an estate tax standpoint, the estate has been reduced by $84,-000 of gifts to the children, and Farmer Brown's estate has been reduced by the $6,000 gift to Mrs. Brown. Also, $13,000 of joint tenancy property has been eliminated. Assuming that Farmer Brown predeceases Mrs. Brown, federal and Oklahoma estate taxes with respect to his estate should

- : exceed $16,700, and if it is necessary to probate his pour-over will, ·at expense should not exceed $500. This is a total of $17,200. Mrs. : ·wn's subsequent estate will consist of approximately $12,000 of joint ·ancy property, $6,000 received from Farmer Brown as a gift, and $110,- : received through Farmer Brown's revocable trust. Federal and Okla- ·ma estate taxes with respect to her subsequent estate should be ·roximately $21,000 with not more than $500 required for probate of her · ·ur-over will. Total cost with respect to Mrs. Brown's estate is $21,500 ·ich, when coupled with $17,200 of costs in Farmer Brown's estate, ·gregates $38,700 total costs to pass the estate to the children. This is a ·ing over the mutual and conjoint will of $82,675—all for the benefit ·the children!

Should Mrs. Brown predecease Mr. Brown and the marital deduction · federal estate tax purposes be "lost," no federal or Oklahoma estate ·xes should be incurred at the time of her death and probably it will be ·necessary to probate her will since all assets in which she has an interest ·· either held by her trustees or in joint tenancy with Farmer Brown. ·wever, without the benefit of the marital deduction, federal and Okla- ·a estate taxes with regard to Farmer Brown's estate increase to ap- · ximately $47,500.

Through the insurance owned by the children, $20,000 of costs with ·pect to each estate have been funded with the result that the only re- ·ining "economic risk" to the estate is $7,500 which might arise in the ·nt Mrs. Brown should predecease Farmer Brown. This is a risk that ·e estate can afford. Also, by reason of the buy and sell agreement the life ·urance owned by the children is assured to revert to Farmer Brown's · ·cable trust and in all events will be available to meet the needs of estate ·idity. By reason of each child's direct and indirect ownership of a ·.000 interest in the partnership, sufficient funds from this source will · made available for life insurance premium payments and for payment · the increased income tax obligation of each of the children and each ·ust.

During Farmer Brown's lifetime, because of his indirect control of ·· partnership and the partnership income, he is placed in a position of ·king gifts among family members of a substantially greater proportion ·an would otherwise be considered feasible. Recognizing too that it is · : necessary that partners share in profits or losses in proportion to ·ital accounts, a substantial degree of latitude is afforded though the · blem of a transfer with retained life income must not be overlooked. ·aturally, with each transfer of an interest in the partnership there is a ·uction in potential estate taxes.

It is probable that Farmer Brown's interest in the partnership, even though held in his revocable trust, will be of such quantity and so included in his gross estate that installment payment of federal estate taxes will be available in the event of his death. It is immaterial that the estate taxes may have been "funded" or that the estate has sufficient cash to meet the estate tax obligation. The election of the executor is unequivocal and the right to make the election is vested in the executor's discretion.

After the death of Farmer Brown, the principal interest in the partnership will continue through his revocable trust and all income attributable to that interest will be available to Mrs. Brown for her support and maintenance. In the event she has need of cash in excess of the income produced by the combined interests in the partnership owned by trusts for her benefit, additional distributions may be made by the partnership to the extent of the aggregate adjusted cost basis of the partnership interest held by each of the respective trusts, and with a reasonable degree of advance planning, the same may be made available to Mrs. Brown on a tax-free basis.

After the death of both Farmer and Mrs. Brown, absent a distribution of cash in excess of a partner's basis in his partnership interest, the partnership may be dissolved and liquidated, and the assets distributed among the children again tax free.

There are any number of other benefits involved in the illustrative estate plan for Farmer Brown which are too numerous to discuss in any depth. Also, the particular plan proposed is certainly not the only manner in which Farmer Brown's estate might be planned or is it necessarily represented as the best. It is intended, however, to reflect that there is a very feasible way of both eliminating and funding those expenses which might cause a complete financial disaster to the agricultural unit in Oklahoma.

Conclusion

Throughout its history Oklahoma has been primarily an agricultural state serving interests far beyond those of the individual farmer. However. it is the general consensus of opinion among Oklahoma farmers that the agricultural community cannot continue to exist in Oklahoma unless the problems which have been discussed are solved on a sound and feasible economic basis. If the Oklahoma farmer is costed and taxed out of existence, which may very well occur, what is to become of Oklahoma farmland? Who will own it? How will it be farmed? What effects will be felt by the urban community? Can we build cities on every square inch of Oklahoma? Does Oklahoma have the resources to become an industrial state? Where will it end?

The answers to these questions are certainly beyond even the imagina-
n of the author but is not the real solution to eliminate the potential ever having to answer these questions? The problem is more real than yone is willing to admit and it is not going to be solved by mutual and joint wills or agricultural corporations. The responsibility must be knowledged and borne by the farmer himself, members of the Oklahoma ar Association, and a somewhat more informed and imaginative legisla- re. The farmer must "stop doing nothing"; the attorney must increase expertise in planning for the agricultural estate or refer the job to a rce where it can be accomplished; and the legislature must react by a utory preference.

Regardless of the economic size of the agricultural unit, the problems, cepts, techniques and needs are the same, varying only in degree. The rney providing estate planning for agricultural interests will meet one his greatest challenges and receive his greatest satisfaction in actually ing the success and achievement of his ideas.