

THE ECONOMICS OF TAX MANAGEMENT OF THE TYPES
OF FARM ORGANIZATIONS FOR OKLAHOMA
COMMERCIAL FARMS

By

MERLE ROY BUSS

Bachelor of Science
Oklahoma State University
Stillwater, Oklahoma
1965

Master of Science
Oklahoma State University
Stillwater, Oklahoma
1966

Submitted to the Faculty of the Graduate College
of the Oklahoma State University
in partial fulfillment of the requirement
for the Degree of
DOCTOR OF PHILOSOPHY
May, 1971

1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
1990
1991
1992
1993
1994
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021
2022
2023
2024
2025

THE UNIVERSITY OF CHICAGO
DIVISION OF THE PHYSICAL SCIENCES
DEPARTMENT OF CHEMISTRY

Thesis
1971D
B981e
Cop. 2

PHYSICAL CHEMISTRY
BY
JAMES H. HARRIS
PH.D. 1971
DEPARTMENT OF CHEMISTRY
UNIVERSITY OF CHICAGO
CHICAGO, ILLINOIS
1971

Abstract: The study of the reaction of
hydrogen with ethylene on a nickel
surface. The reaction is first order
in hydrogen and zero order in ethylene.
The activation energy is 12.5 kcal/mole.
The pre-exponential factor is 1.5 x 10¹¹ s⁻¹.

OKLAHOMA
STATE UNIVERSITY
LIBRARY
AUG 11 1971

THE ECONOMICS OF TAX MANAGEMENT OF THE TYPES
OF FARM ORGANIZATIONS FOR OKLAHOMA
COMMERCIAL FARMS

Thesis Approved:

Odell L. Walker

Thesis Adviser

Richard H. Lutzick

L. A. Parcher

Vernon R. Edman

D. D. Durham

Dean of the Graduate College

788137

PREFACE

I sincerely thank Dr. Odell L. Walker, graduate committee chairman, for his advice, encouragement, and assistance not only in this study but during my entire graduate program. Appreciation is also expressed to the other committee members, Dr. Vernon R. Eidman, Dr. Loris A. Parcher, and Dr. Richard H. Leftwich for their interest and assistance in the preparation of the final manuscript.

Special appreciation is extended to Cecil Maynard for his counsel and advice during the development of this study.

I wish to thank Mr. Jon Ford, Attorney at Law in Enid, for his invaluable assistance in the early development of the law portion of this study. A note of thanks is also extended to Mr. Timothy Crowley, Attorney at Law in Enid, Mr. John Patterson and Mr. Dewitt Kirk, Attorneys at Law in Oklahoma City, for their legal advice and counsel.

I am grateful to the Department of Agricultural Economics for financial assistance during my graduate program. I also express appreciation to the numerous faculty members of the Department of Agricultural Economics who have contributed time and knowledge to insure an advancing graduate program.

Finally, special gratitude is expressed to my fiance, Miss Karen Reid, and my parents, Mr. and Mrs. Roy H. Buss, for their enthusiastic support, encouragement, understanding and inspiration.

TABLE OF CONTENTS

Chapter	Page
I. INTRODUCTION.	1
The Problem.	1
Objectives	5
Method and Organization of Thesis.	6
II. FORMS OF BUSINESS ORGANIZATIONS FOR FARM AND RANCH OWNERSHIP	8
Introduction	8
Non-Tax Factors in Choosing the Type of Business Organization	9
Limitations of Choice	9
Capital Requirements and Accessibility.	9
Continuity of Existence	10
Extent of Ownership Liability for Debts of the Business	11
Extent of Ownership Participation in Management.	11
Transferability of Proprietary Interests	12
Complexity and Expense of Organizing the Business.	12
Disclosure Required	12
General Characteristics of the Alternative Forms of Business Ownership Coupled With General Tax Consequences	13
Sole Proprietorship	13
Partnership	14
Business Trust.	15
Regular Corporation	16
Subchapter S Corporation.	19
III. INCOME TAX FACTORS RELATED TO THE TYPES OF BUSINESS ORGANIZATIONS.	22
Sole Proprietorship.	23
Who Must File a Return.	23
Gross Income Defined.	23
Adjusted Gross Income Defined	24
Personal Exemptions	25
Standard or Itemized Deductions	25
Taxable Income.	26

Amount of Federal Income Tax and Surcharge	26
Self-Employment and Social Security Tax.	26
Capital Gain Tax Treatment.	27
Oklahoma Income Tax Differences	28
Partnerships	29
Method of Taxing.	29
Elections of Partnerships	30
Guaranteed Payments to Partners	30
Net Operating Loss Deduction of Partners.	31
Partner's Distributive Share of Income.	31
Purchase or Sale of Partnership Interests	32
Family Partnership.	33
Trusts	34
Simple Trust.	34
Complex Trusts.	35
Taxation of Beneficiaries	35
Throwback Rule.	37
Trusts as Taxable Entities.	37
Gross Income of Trusts.	38
Credits and Deductions of Trusts.	39
Expenses, Depreciation, and Depletion	40
Regular Corporations	41
Corporation Defined	41
Return Required	42
Tax Rates	42
Capital Gain Tax.	42
Due Date of the Tax Return.	43
Estimated Tax	44
Special Deductions for Corporations	45
Dividends Received and Paid by a Corporation	46
Other Oklahoma Income Tax Factors	46
Subchapter S Corporation	47
Definition.	47
Partial Distribution.	48
Making the Election	48
Restrictive Clauses	48
Deferring Income by Use of a Different Tax Year.	49
Deductions Created by Incorporation	50
Sick and Accident Benefits.	50
Charitable Contributions.	51
Additional First-Year Depreciation.	51
Pension or Profit-Sharing Benefits.	52
Depletion Allowance	52
How Income is Taxed to Shareholders	53
Other Oklahoma Income Tax Factors	53

Chapter	Page
IV. GIFT TAX LAW FACTORS.	54
Corporations Not Included.	55
Elements of a Gift	55
Specific Exemptions.	56
Annual Exclusion	57
Marital Deduction for Gifts Between Husband and Wife	57
Gift Splitting	58
Present Interest	59
Future Interest.	59
Gifts to Minors.	59
Gifts of Trust Income.	60
Uniform Gifts to Minors Act.	61
Charitable Transfers	61
Indirect Gifts	62
Insurance.	63
Insurance Trusts	63
Powers of Appointment.	64
Life Estate.	65
Joint Ownership.	65
Donor's Dominion and Control	66
Rules of Valuation	66
Oklahoma Gift Tax Considerations	68
V. ESTATE TAX LAW FACTORS.	69
Introduction	69
The Federal Estate Tax	69
Tax Computation Steps.	70
Gross Estate and Taxable Estate.	70
State Death Tax and Gift Tax Paid Credits.	72
Property in Which Decedent Had an Interest at His Death.	72
Future Interests	74
Remainders.	74
Reversionary Interests.	75
Transfers During Decedent's Lifetime May be Subject to Estate Tax	76
Complete and Incomplete Gifts.	76
Gifts in Contemplation of Death.	76
Marital Deduction Allowed for Property Passing to the Surviving Spouse.	77
What the Executor Must Prove	78
Decedent Must be Survived by Spouse.	79
Computation of Adjusted Gross Estate	79
Decreasing Estate Tax with Charitable Gifts without Reducing Maximum Marital Deduction.	80

Chapter	Page
Formula and Nonformula Bequest for the Marital Deduction.	81
Interest Passing to Spouse	82
Life Estate and Other Terminable Interests.	83
Income for Life Plus the Power of Appointment.	83
Trusts Which Qualify for the Marital Deduction.	86
Reservation of Rights and Powers	87
Power Limited by External Standard	88
Transfers Taking Effect at Death	90
Power to Revoke or Change Disposition.	91
Jointly Held Property.	91
Life Insurance Includible in Gross Estate.	94
Life Insurance Trusts.	95
Annuities and Pensions	96
Alternate Valuation (Option to Value Estate One Year After Death)	96
Alternate Valuation in Particular Cases.	97
Oklahoma's Primary Differences in Estate Tax Computations	98
 VI. MODEL FARMS	 100
Introduction	100
Model Farm A	100
Model Farm B	103
 VII. EVALUATION OF INCOME TAX LIABILITY BY FORM OF BUSINESS ORGANIZATION.	 107
Farm A	112
Sole Proprietorship	112
Partnership	112
Corporation	113
Subchapter S Corporation.	115
Trust	116
Income Tax Comparison between Types of Ownership for Farm A	117
Farm B	119
Sole Proprietorship	119
Partnership	119
Corporation	124
Subchapter S Corporation.	125
Trust	126
Income Tax Comparison between Types of Ownership for Farm B	126
Difference in Income Taxes from the Sole Proprietorship.	127

Chapter	Page
Comparison of Income Taxes between Farm A and Farm B	128
Tax Savings Over a Period of Years	129
VIII. ANALYSIS OF ESTATE AND GIFT PLANNING TECHNIQUES AS APPLIED TO THE MODEL FARMS	135
Introduction	135
Farm A	137
Estate Taxes.	137
Gift Taxes.	147
Farm B	151
Estate Taxes.	151
Gift Taxes.	153
Life Insurance and Life Insurance Trust . . .	159
Charitable Bequests	162
Comparison in Estate Planning Techniques between Farm A and Farm B.	163
Other Considerations	164
IX. SUMMARY AND CONCLUSIONS.	165
A SELECTED BIBLIOGRAPHY.	171
APPENDIX	174

LIST OF TABLES

Table	Page
I. Comparison of Farm Business Organizations	21
II. Determination of Estimated Tax Paid by Corporations	45
III. Model Farm A	101
IV. Investment Value of Farm A	102
V. Model Farm B	104
VI. Investment Value for Farm B.	105
VII. Farm A, Federal and State Taxes by Type of Business Organization, 1969.	108
VIII. Farm B, Federal and State Taxes by Type of Business Organization.	120
IX. Accumulated Income Tax Savings for Farm A with a 6% Compound Interest Rate for 10 Years and 20 Years	130
X. Accumulated Income Tax Savings for Farm B with a 6% Compound Interest Rate for 10 Years and 20 Years	132
XI. Estate Taxes and Administration Expenses for Farm A	138
XII. Gift Taxes, Estate Taxes, and Administration Expenses for Farm A.	148
XIII. Estate Taxes and Administration Expenses for Farm B	154
XIV. Gift Taxes, Estate Taxes, and Administration Expenses for Farm B.	160
XV. Computations Using the Charitable Contribution to Incur No Estate Tax	163

Table	Page
XVI. Returns and Costs of Enterprises Used in Model Farms A and B.	175
XVII. Depreciation Schedules for Farm A.	176
XVIII. Depreciation Schedules for Farm B.	177
XIX. 1969 Tax Rate Schedule for Single Person (Not Head of Household) and Married Person Filing Separate Return (The surcharge has to be added to the tax from this table)	178
XX. 1969 Tax Rate Schedule for Married Taxpayers Filing Joint Returns and Certain Widows and Widowers (The surcharge has to be added to the tax from this table)	181
XXI. Oklahoma Income Tax Rates Schedule I Single Taxpayers, Heads of Families, and Married Persons Filing Separate Returns; Schedule II Married Taxpayers Filing Joint Returns	184
XXII. Federal Estate Tax Rates	185
XXIII. Computation of Maximum Credit for Oklahoma Estate Tax Against Federal Estate Tax	187
XXIV. Oklahoma Estate Tax Rates.	188
XXV. Federal Gift Tax Rates	189
XXVI. Oklahoma Gift Tax Rates.	190

CHAPTER I

INTRODUCTION

The Problem

The structure of agriculture, its organization and control, has changed considerably in the past twenty years and will continue to change, maybe more rapidly, in the future. Although the changes now perceived are not sudden developments, they will determine the nature of tomorrow's agriculture. Farms and ranches in Oklahoma, as well as in other parts of the United States, have continuously grown in the number of acres, value of products sold, and capital requirements per economic unit. Farms and ranches have increased to the extent that a relatively few supply a large proportion of the agricultural production.

The 1964 Census data [38] shows the growing importance of large-scale farming. The number of farms grossing \$100,000 or more in farm product sales increased from about 20,000 in 1959 to 31,000 in 1964. This group accounted for 24 percent of gross sales in 1964 as compared with 16 percent in 1959.

The 1964 Oklahoma Census [42] shows an increase of 15 percent more farms of 1,000 to 2,000 acres and an increase of 9 percent in numbers of farms with 2,000 or more acres in contrast to 1959. For example, farms in north central Oklahoma in counties such as Garfield and Grant [39, 40] had much growth in value and size. Census figures for 1959 and 1964 indicate an increase of almost two and one half times as

many farms with 2,000 acres or more in Garfield county.

Increases in farm real estate value accentuate increases in capital required per economic unit. Using 1957-1959 as the base period [37], the farm real estate index of average value per acre in the United States has increased from an index of 65 in 1950 to 139 in 1965 and to 179 in March 1969. Oklahoma's index, however, has grown at a faster rate from 67 in 1950 to 158 in 1960 and from 199 in 1965 to 207 in March 1969. Grant county, for example, had a farm real estate value increase of 35 per cent during the latter five year period.

With a decreasing number of farms expected, and a concomitant increase in average size, it is apparent that many presently existing farm businesses will terminate during the next decade. At the same time, a limited number of presently existing and growing firms will continue as viable economic entities, with impressive capital values.

Farm business organizations have typically been of the sole proprietorship type in Oklahoma. But since the farm sizes and capital requirements have increased by such a large amount to continuously enhance the existing commercial farm as an economical unit and provide the path for growth over time, other types of business organizations are being investigated by commercial farmers to carry on their farm business. Accompanying this increased size of business are all kinds of financial and legal complexities. Taxes, both state and federal, are of such magnitude that the consideration of taxes must enter into almost every business decision. Consequently, taxes and tax management have become important parts of the commercial farm organization. Furthermore, tax management will play an even more important role in the farm business in the future.

Oklahoma commercial farms have grown, however the farm operators and estate owners are caught in a dilemma because they lack the vast amount of knowledge concerning taxes and tax management. Accompanying this lack of knowledge of the legal framework, is the inability to determine how the various tax consequences can affect their economic unit. Moreover, farmers are also trying to find out how the alternative business organizations, along with the tax consequences, may affect their businesses. Again, they lack the general knowledge of both the legal consequences and the effects of the type of organization on their farm units. If the farmer is to manage his resources and business interests effectively, he must be aware of the various legal tools at his disposal, and have the knowledge with which to select these tools.

The large commercial farmer, therefore, has a need to acquire a working knowledge of the alternative business organizations available to his economic unit and the advantages and disadvantages of each so that he may adapt them to his goals and desires. Each form of organization has its own characteristics. In order to decide upon a certain form of organization, the state and federal income taxes, gift taxes, and estate taxes need to be studied. Farmers and ranchers, all too often, pay higher income taxes than necessary, simply because they aren't aware of the alternatives available to them.

The farmer is subject to the same tax laws as other estate owners. Many commercial farms have grown and increased in size to the extent that the operator is faced with a tremendous estate tax when he dies. Many times farmers, especially the older generation, don't realize the actual taxable estate they will have at their death. Furthermore, very few estate owners realize the impact that the combination of

probate and administration expenses along with federal and Oklahoma estate taxes will make upon the shrinkage of their estate. Large estate tax savings may be accomplished through estate planning. Presumably, the farmer would like to plan his estate so that his property is eventually distributed to persons he desires to benefit and by means which result in maximum tax savings.

The farmer usually has two general problems not found in the same degree in planning estates for other persons. First, most of the time the farmer has a serious lack of liquid funds with which to pay estate taxes. Nearly all of his money is tied up in land, machinery, and equipment to operate the land. This is an investment which has been coerced by changes in technology and increasing prices that have forced expansion of the size of the farm to obtain efficiency and profitable enterprises. Secondly, many farmers want to keep the farm operation substantially intact, perhaps under a centralized management, and passed down within the family.

With the size of estates of Oklahoma commercial farms and under the present inflationary tendencies, gifts and gift taxes need to be understood by the estate owner. Sometimes gifts made only within the allowable annual exclusions by law may do little to reduce an estate because of the inflationary pressures. For this reason, some farm families may well consider making larger gifts to reduce the estate size even though gift taxes must be paid. Gift taxes are only three-fourths of estate taxes. Both are progressive taxes. Thus property that may have been taxed in a higher bracket of the estate tax would be taxed in a lower bracket of the gift tax.

Objectives

This study is designed to increase the knowledge available to farmers and set forth the legal and applicable facts so that they may have a more acute awareness of the alternative forms of business organizations available.

Also, a working knowledge of the income tax, gift tax, and estate tax laws and their effects will be set forth.

More specifically, the major objective of this study is to investigate the economics of taxes, tax savings, and tax management for large Oklahoma commercial farms organized under the four major types of farm organizations. The four types of organizations include the sole proprietorship, partnership, trust, and corporation. Both the regular form and the pseudo type of corporations will be considered. Alternative structural arrangements and case studies will be developed for analysis and illustrative purposes. Tax management will be analyzed with regard to farm production operations, liability, estates, prevention of estate erosion from one generation to the next, continuity of the operation, and future trends. Therefore, the primary objectives of this study are:

- 1) To compare the four types of farm organizations;
- 2) To determine how the type of farm organization affects the income and social security taxes;
- 3) To investigate the effects of estate taxes on the farm business;
- 4) To discover the effects of the gift tax on the farm organization.

Method and Organization of Thesis

Previous research efforts have concentrated on one specific form of organization or type of tax. Harl [13] did research on farm corporations which involved a study of the legal and economic aspects of farm corporations in Iowa. He listed the advantages and disadvantages of incorporating the farm business and presented an analysis of implied policy and performance features. Weigle [46] investigated the methods of business organization, with emphasis on the corporate form, to facilitate family control of the capital, to provide acceptable income from the farm business to its owners, to maintain continuity of the business for inter-generation and inter-family transfers, and to provide equitable distribution of income and assets to the farm family members for farms in Indiana.

Books, bulletins, and law articles have been written on the forms of organizations, taxes, and general estate planning either in specific technical terms or many generalities. Krausz and Chapman [22] discuss the farm partnership in estate planning. Bowe [2] discusses tax saving techniques by use of estate planning.

Much of the literature on farm business organizations and taxes is concerned with discussions of advantages and disadvantages of certain forms of organization without the benefits of empirical research for actual comparison purposes. The results are not presented such that the farmer can easily benefit from and adapt to his farm business. Perhaps the most widely used publication for estate planning is by Maynard, Jeffrey, and Laughlin [26]. That bulletin discusses estate planning along with gift and estate taxes in Oklahoma and provided some of the basic foundations for estate planning in this study.

Much time and consultation with tax lawyers was also involved in organization and approach for this study to accomplish the objectives as set forth in this chapter. Short courses in income tax and estate planning at the Oklahoma University College of Law were attended by the author.

Chapter II explains the major forms of business organizations. Tax and non-tax factors are discussed.

Chapter III represents an explanation of the income tax laws as applicable to the model farms and their different business organizations. The legal structure for gifts is ascertained in Chapter IV. Chapter V covers the estate tax laws and their applicability.

Two model farms, developed for analysis in the study, are discussed in Chapter VI. To represent the commercial farms in economic class II as defined by the 1964 United States Census, model farm A with gross sales of \$83,511.23 was developed. Likewise, model farm B was developed to represent a farm in economic class I. In developing the model farms, the gross income was first considered, then the amount and value of resources necessary to generate that amount of income were found. The farm family was assumed to be the husband and wife with two children.

An analysis of the income tax laws as applied to the different organizational structures of the model farms was presented in Chapter VII. Chapter VIII includes case studies as the estate tax consequences of the different laws are imposed on the model farms. The summary, conclusions, and implications of the study plus recommendations for further study are contained in Chapter IX.

CHAPTER II

FORMS OF BUSINESS ORGANIZATIONS FOR FARM AND RANCH OWNERSHIP

Introduction

The purpose of this chapter is to investigate the alternative types of business organization available for managing and operating farms and ranches in Oklahoma. Non-tax and some tax considerations are related to the following forms of organizations: sole proprietorship, partnership, business trust, regular corporation, and subchapter S corporation.

First, an outline of eight non-tax factors considered in choosing the appropriate type of business organization is discussed. Then for each type of organization the general characteristics and tax treatment is developed separately. Finally, a table comparing each method of ownership is shown.

Many details have been omitted because of the complexity involved.

The objective is to demonstrate the alternative forms of organizations available to today's farmers and ranchers and enhance knowledge concerning different business organizations. Each farmer and rancher is encouraged to seek professional legal and farm management counsel to help solve his own particular problems. This chapter emphasizes the many alternatives available in tax planning as well as the complexities encountered when income tax planning is meshed with gift tax

planning and estate tax planning to yield a complete tax package for the farmer and rancher.

Non-Tax Factors in Choosing the Type of Business Organization

Non-tax factors are and should be very important considerations involved in choosing a business organization. In some cases they are the most important considerations. Therefore, so that the tax planning suggestions in this study are not overemphasized in the reader's mind, some of the most important non-tax factors which must be considered by a farmer before he changes his type of legal ownership of assets to reap available tax advantages are set forth.

Limitations of Choice

A multitude of limitations are imposed by state and federal statutes. Some of these relate primarily to the person, such as requirements of local citizenship or absence of a criminal record as prerequisites to the privilege of engaging in certain businesses. Others are concerned primarily with the nature of the business, such as corporate ownership of farm land.

Capital Requirements and Accessibility

For many businesses requiring large capital expenditures, the sole proprietorship may be eliminated from consideration simply because few persons possess sufficient resources, or, when they do, they are reluctant to commit their total assets so completely to the perils of the market.

Partnerships provide the opportunity for two or more persons to invest their resources together and conduct a more economical unit, and yet share in the management [22, p. 3]. However, at some large scale commercial size the fund-gathering capabilities of such an organization are inherently limited. Therefore, at some level of investment and management, the organization will profit by incorporation. The need to obtain additional capital or credit to build and maintain an efficient farm business was continuously mentioned in studies by Harl [14] and Weigle [46] as being the most important reason for farm incorporation.

Continuity of Existence

This factor is of great concern to the farmer simply because the value of a "going concern" of any enterprise is almost certain to be greater than its value in dissolution.

The lack of this factor is one of the disadvantages of a sole proprietorship. Likewise, the death of a general partner dissolves the partnership. However, the business trust allows a change in membership in the trustees and beneficiaries without dissolution as a matter of law [35, Sec.171-4]. This is one advantage of the trust and its life can be perpetual if desired.

The corporation is the classic device for assuring the continuity of existence of a business organization as long as the shareholders desire it and it fulfills the requirements of the law. Oklahoma Statutes limit its legal life to fifty years, but its said life can be renewed. It can continue to function throughout the changes in ownership caused by one generation replacing another through the

exchange of shares of stock.

Extent of Ownership Liability for Debts of the Business

Sole proprietors face unlimited liability for all debts of the business as do the general partners of a partnership.

The trustees of a business trust are bound personally for all debts of the trust.

The most complete coverage against personal liability is offered by the corporation, although it is not a complete insulation. For instance, shareholders are liable for unpaid taxes and wages in some states but not in Oklahoma. Oklahoma shareholders are liable only to the extent of the shares of stock each owns. Shareholder directors may be held liable for fraud or undercapitalization.

Extent of Ownership Participation in Management

In a sole proprietorship, the owner has complete control. A general partner's voice is equal to all other partners in a partnership as is a trustee's in a business trust. The trust is often used when the owner wants to be relieved of the burden of management or at death of the owner to relieve the spouse from the estate's management. A corporation presents the ultimate in versatility with respect to ownership, management, and control. Oklahoma requires at least a three-man directorship. Also, the proportion of shares and type of shares owned by each shareholder has an effect on the management of the entity.

Transferability of Proprietary Interests

The proprietary rights in a business are freely alienable by a sole proprietor, shareholders in a public corporation and beneficiaries in a business trust. Partners can transfer their interest only upon unanimous consent of all the other partners. Close corporation restrictions on alienation depend on the particular articles of incorporation involved. In general, restriction against alienation is not favored in the law. Therefore, courts have construed against such clauses when they are ambiguous.

Complexity and Expense of Organizing the Business

The sole proprietorship is the simplest and least expensive enterprise to form. A partnership is usually formed by an express written contract, however, it does not have to be written. The business trust usually is more similar to a corporation and, thus, requires greater legal fees. The corporation is the most expensive and complex organization to form and operate because of the quantity of paperwork both at the inception and periodically after the business is operating. Records and reports are required in the corporate form of business. Oklahoma imposes an annual franchise tax on the net capital assets of the corporation.

Disclosure Required

Sole proprietorship requires no disclosure of business records. Partnership laws require disclosure of only the names and addresses of the partners, the place of doing business and notice of dissolution. Corporate laws require filing of the articles of incorporation and by-laws with the Secretary of State as well as notice of all special

meetings unless waived.

General Characteristics of the Alternative
Forms of Business Ownership Coupled
With General Tax Consequences

The farmer and rancher need to have a working knowledge of the general characteristics of each business organization as well as each entity's tax consequences. Therefore, the general characteristics of each entity are described. The general tax consequences of each are outlined and compared to point out specific differences. Subsequent chapters will deal more technically with what the tax laws provide under each form of organization.

Sole Proprietorship

The simplest structure for conducting business is the individual or sole proprietorship. In this form of business enterprise the individual carries on his business for himself as sole owner.

There are three characteristics of the sole proprietorship:

- 1) Debts and risks of this business entity are the personal liabilities of the individual proprietor. His financial risk encompasses all of his assets whether involved in his business or not.
- 2) The credit potential of the business is equivalent to the credit limitations of the individual proprietor. The size of his business will be limited by his assets and the amount of dollars that can be borrowed. He is not able to obtain capital by a public offering.

- 3) The business entity will terminate as a legal unit upon the proprietor's death. Thus, it is essential that he emphasizes sound estate planning.

The sole proprietorship offers two primary tax advantages in certain situations. If the business operates at a loss, the best treatment of capital loss is available to this entity. Also, if the owner is in a low income tax bracket, he will benefit from private ownership as opposed to a more expensive and complex legal structure.

Partnership

The partnership is defined as "an association of two or more persons to carry on as co-owners a business for profit" [1]. The mere co-ownership of property does not make partners of the owners because they must be engaging in a trade or business for profit [36, Sec. 1.761-1(a)(1)].

In a partnership, the income passes through to the individual partners. The partnership itself is not a tax paying entity. Income and expenses of the partnership keep their identity when each partner receives his proportionate share. For example, long-term capital gains to the partnership are equal to each partner. Therefore, the unique income tax treatment of this entity is that:

- 1) The partnership files a return which reports each partners distributive share of partnership income; and
- 2) Each partner, in turn, reports his share individually, whether or not the income is actually distributed to him.

Business Trust

A business trust, many times called a Massachusetts Trust, is an entity created by a declaration of trust (written contract) by the terms of which property is transferred to trustees. The property is held and managed by the trustees for the benefit of persons holding transferable certificates representing the beneficial interest in the trust estate and assets.

There are three essential characteristics of the business trust:

- 1) Transfer of legal title to property to a trustee or group of trustees who are liable for obligations incurred by them;
- 2) Vesting of power in the trustees to manage and control both the property and the business affairs of the trust, free from control by the beneficiaries; and
- 3) The right of the beneficiaries or shareholders to share proportionately in the profits of the enterprise and, on termination of the trust, in the proceeds [6, p. 14]. The chief advantages of trusts are that they escape some of the exactions of corporations such as records and necessary written reports, burden of management, statutory liability of directors, and multi-forms of taxation.

The business trust must be distinguished from both a common-law trust and a corporation. A common-law trust seeks to conserve a clearly defined corpus, while a business trust provides a business vehicle whose sole purpose is to earn a profit for its settlor-beneficiaries. A corporation conducts its business through directors who act as its agents, but who neither own corporate property nor assume liability for corporate obligations.

A business trust differs from a partnership in the following ways:

<u>Partnership</u>	<u>Business Trust</u>
Both legal title and beneficial interest are in partners.	Trustees hold title and act as principal; beneficial interest is in beneficiaries.
New partner requires mutual consent of present partners to enter.	Beneficial interests are freely transferable.
Death of a partner terminates the partnership.	Death of a beneficiary does not cause dissolution of the trust; nor does death of a trustee.

In making the determination as to whether the beneficiaries of the trust are analogous to partners, for the purpose of imposing liability upon them as to outside parties, Oklahoma examines the extent of control which the beneficiaries have in the management and operation of the trust. Under the "control test," if the trust instrument reserves to the trustees the title to trust property and the right to manage the trust affairs, free from the control of the beneficiaries, the enterprise is a valid trust. However, if the power to substantially manage the business is vested in the beneficiaries so that the trustees amount to little more than their agents, the Oklahoma courts may impose partnership liability on the beneficiaries.

Regular Corporation

Section 301.7701-2(a)(1) of the Internal Revenue Regulations [36] sets forth six characteristics that mark a corporation.

- 1) Associates (defined below);
- 2) Objective is to carry on a business and divide its gain;
- 3) Continuity of life;

- 4) Centralization of management;
- 5) Limited liability; and
- 6) Free transferability of interest.

"Associates" are defined in a reverse way by the Regulations. "If the responsibility for the protection and conservation of property is vested in trustees for beneficiaries who cannot share in the discharge of that responsibility, the beneficiaries are not associates." [36, Sec. 301.7701-4(a)].

The type of corporate structure many times used by a farmer or rancher is the close corporation which vests practical control of the management of the corporation in the hands of the beneficial owners.

The usual characteristics of the close corporation are:

- 1) Stockholders are few;
- 2) Stockholders know one another well;
- 3) Most of them are active in the business;
- 4) Each of them assumes some affirmative obligations;
- 5) There is no ready market for their shares; and
- 6) The identity of the other shareholders is important to each of them.

Despite such partnership characteristics, the close corporation is recognized as a separate entity with all the distinctive corporate characteristics listed above, separate and distinct from its shareholders. It is unaffected by changes in the identity of the shareholders.

The business trust was discussed earlier in this chapter. The corporation is similar to the business trust in the following ways:

<u>Corporation</u>	<u>Business Trust</u>
Capital	Corpus
Board of Directors	Trustees
Shareholders	Beneficiaries
Shares	Beneficial interest in the trust
Corporate Charter	Declaration of trust
Title vests in corporation	Title vests in trustees
Free transfer of shares	Free transfer of beneficial interest
Limited liability for shareholders	Limited liability for beneficiaries

The ordinary business corporation pays income tax at the regular corporate normal rate and surtax rates on its taxable income. Taxable income is gross income less deduction. The normal tax is 22% of taxable income. The surtax is 26% of taxable income over \$25,000. Therefore, the corporate tax rate in 1969 was 22% of the first \$25,000 taxable income and 48% on the excess. Capital gains are also treated differently as to corporations. They are not allowed the usual 50% deduction for long-term gains. Rather, they are limited to the usual maximum tax on long-term capital gains of 25% but may not deduct from gross income an amount equal to 50% of the net long-term capital gains as the individual taxpayer may.

Handling long and short-term gains will be discussed in more detail in Chapter III.

The tax disadvantage of the corporate form of ownership of assets is that the owner-shareholder pays a corporate tax on the taxable income to the corporation, and then a second tax on his individual tax

return to the extent of salary or dividends received from the corporation.

Subchapter S Corporation

A subchapter S election may be made by any corporation that does not:

- 1) Have more than 10 shareholders;
- 2) Have as a shareholder a person (other than an estate) who is not an individual;
- 3) Have a nonresident alien as a shareholder;
- 4) Have more than one class of stock;
- 5) Get more than 20% of its annual gross receipts from personal-holding-company type income, other than personal services;
- 6) Get more than 80% of its gross receipts from foreign sources; and
- 7) Belong to an affiliated group of corporations. [18,Sec. 1371(a)]

A subchapter S corporation, sometimes called a psuedo or tax-option corporation, pays no tax on its earnings. Instead, its income is taxable pro rata to its shareholders, whether distributed to them or not, somewhat like partnership income. However, earnings other than capital gains and exempt income that are not distributed are also ordinary income to the shareholder.

If there is a change in ownership of shares during the taxable year, the person who owns the shares on the last day of the taxable year is regarded as the recipient of all the undistributed taxable income of that year, whereas, normally, such as in a partnership, the

income is prorated between the transferor and transferee.

Losses are deductible pro rata by the shareholder, but the deduction is limited to the basis of the shareholder's stock plus his loans to the corporation. Such losses are pro rated on a daily basis rather than to owners at the end of the year as income is.

If a subchapter S corporation experiences an unusually good year, a controlling shareholder can shift the tax burden for the entire year's income to a low tax bracket member of his family as late as the last day of the taxable year, merely by transferring some of his shares of stock. If a partner made a similar gift to a partnership interest, he would not shift the tax burden on any income earned up to the day of the transfer.

The gift of a minority stock interest in a subchapter S corporation can leave the donor in complete control of the corporation and still provide the above tax advantages.

The various fringe benefits, such as sick pay exclusions and qualified pension and profit-sharing plans available to large corporations are also available here. The 1969 tax reform bill limits the retirement plan of the subchapter S corporation to the lesser of 10% of its earnings or \$2500.

The different characteristics of the alternative business organizations are summarized and compared in Table I.

TABLE I

COMPARISON OF FARM BUSINESS ORGANIZATIONS

	Sole Proprietor	Partnership	Business Trust	Regular Corporation	Subchapter S Corporation
Nature of Entity	Single Individual	Aggregate of 2 or more	Legal entity separate from the beneficiary & trustee	Legal person separate from shareholders	Legal person separate from shareholders
Life of Business	Terminates on Death	Agreed term; terminates at death of a partner	Perpetual or fixed term of years	Perpetual or fixed term of years (50 in Okla.)	Perpetual or fixed term (50 in Okla.)
Liability	Personally Liable	Each general partner is liable for all partnership obligations; limited partner extent contributed	Trustees personally liable for obligations; beneficiaries are not	Shareholders not liable for corporate obligations	Shareholders not liable for corporate obligations
Source of Capital	Personal investment; loans	Partners' Contributions; loans	Contribution of settlor	Contribution of Shareholders for stock; sale of stock; bonds & other loans	Contribution of Shareholders for stock; sale of stock; bonds and other loans
Management Decisions	Proprietor	Agreement of general partners	Trustees	Shareholders elect directors who manage business	Shareholders elect directors who manage business
Limits on Business Activity	Proprietor's discretion	Partnership agreement	Declaration of trust & fiduciary duty	Articles of incorporation & State incorporation law	Articles of incorporation & State incorporation law.
Transfer of Interest	Terminates proprietorship	Dissolves partnership; new partnership may be formed if all agree	Free transfer of beneficial interest	Transfer of stock does not affect continuity of business even to outsiders	Transfer of stock does not affect continuity of business even to outsiders
Effect of Death	Liquidation	Liquidation or sale to surviving partners	Death of trustee or beneficiary have no effect on trust	No effect on corporation. Stock passes by will or inheritance	No effect on corporation. Stock passes by will or inheritance
Income Taxes	Income taxed to individual; 50% deduction for long-term capital	Partnership pays no tax. Each partner reports share of income or loss,	Trust is treated substantially like an individual taxpayer	Corporation pays tax on income (salaries to shareholder-employees deductible) No 50% deduction for capital gains. Rate: 22% on first \$25,000 48% on excess. Shareholders taxed on dividends paid	Corporation pays no tax. Each shareholder reports share of income, operating loss, & long-term capital gain.

CHAPTER III

INCOME TAX FACTORS RELATED TO THE TYPES OF BUSINESS ORGANIZATIONS

The Internal Revenue Code defines its own classifications of taxpayers and sets tax standards. This chapter sets forth the income tax factors as related to each form of business organization. Differences in the computations for deductions and taxable income for Oklahoma and federal income taxes are discussed. Differences in the classification of a particular organization for income tax computations are explained where they exist.

Each type of business organization is considered separately as the tax laws apply. Some quotes from the Internal Revenue Code and the Treasury Regulations are used. In other cases, words are added or deleted to better explain the meaning of the law. In setting forth the law as done in this thesis, technicality must be kept in mind because the various sections of the law are very specific as to what and how they pertain to a given situation.

The Internal Revenue Code is the law as enacted by Congress. The Treasury Regulations are an interpretation of the Code by the Commissioner of the Internal Revenue Service. When citing and making reference to the particular sections of the law, careful consideration should be given to the particular sections of the law because of the technicality involved. In this thesis, such citations are used.

These citations also give a summary or an outline of the income tax, gift tax, and estate tax laws as applied to the different business organizations which is an objective of this study.

Sole Proprietorship

This section discusses the income tax laws as applied to the sole proprietorship form of organization. The Form 1040 filed by individuals is used as a general outline of the order that the different sub-parts are discussed. First gross income and adjusted gross income are defined. The deductions and computations of the income tax, self-employment and social security taxes are discussed. Capital gains are mentioned followed by any changes in treatment of the income or deductions for Oklahoma tax purposes.

Who Must File a Return

A return must be filed by each citizen of the United States each taxable year he has a gross income of \$600 or more. However, if the person is 65 years of age or older before the end of the taxable year, he must receive \$1200 or more in gross income to be required to file a federal return. Form 1040 is the principal return form used. Married persons may elect to file a joint return or separate returns.

Gross Income Defined

Gross income is defined as all income from whatever source derived, except for those specific exclusions which are in the Code [18, Sec. 61]:

- " 1) Compensation for services, including fees, commissions, and similar items;
- 2) Gross income derived from business;
- 3) Gains derived from dealings in property and [includes capital gains];
- 4) Interest;
- 5) Rents;
- 6) Royalties;
- 7) Dividends;
- 8) Alimony and separate maintenance payments;
- 9) Annuities;
- 10) Income from life insurance and endowment contracts;
- 11) Pensions;
- 12) Income from discharge of indebtedness;
- 13) Distributive share of partnership gross income;
- 14) Income in respect of a decedent; and
- 15) Income from an interest in an estate or trust."

Adjusted Gross Income Defined

The adjusted gross income for the individual is generally gross income minus business deductions. The deductions are as follows [36, Sec. 1.62-1]:

- 1) Deductions encountered by the trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee;
- 2) Trade and business deductions of the employees while performing services for the business;

- 3) 50% of the excess of net long-term capital gain over net short-term capital loss;
- 4) Losses from the sale or exchange of property;
- 5) Deductions attributable to rental or royalty property;
- 6) Depreciation or depletion allowed to a life tenant of property or to an income beneficiary of property held in trust, or to an heir, legatee, or devisee of an estate;
- 7) Deductions for contributions by self-employed persons to pension, profit-sharing, annuity, and bond purchase plans, and
- 8) Employee's moving expenses.

In addition a \$100 dividend deduction is allowed and if a joint return is filed, a \$200 dividend deduction is applicable to include the spouses.

Personal Exemptions

Each individual taxpayer is allowed a personal exemption deduction from his adjusted gross income of \$600. In addition, another \$600 per dependent is allowable. However, if the husband and wife file separate returns then the husband cannot claim an exemption for his wife or vice-versa.

Standard or Itemized Deductions

The individual is allowed either a standard deduction or an itemized total deduction to be deducted from his adjusted gross income. The standard deduction is 10 per cent of the adjusted gross income or the minimum standard deduction is \$200 plus \$100 for each dependent.

The standard deduction shall not exceed \$1,000, except that in the case of married persons filing separate returns the standard deduction is limited to \$500.

Itemized deductions consist of such items as alimony, taxes, interest, a specified portion of medical and dental expenses, child care expenses, and charitable contributions. However, the charitable contributions deduction for the individual is limited to 20% of the taxpayer's adjusted gross income for that year.

Taxable Income

Taxable income is defined as adjusted gross income minus the itemized nonbusiness expenses (or the standard deduction) and minus the personal exemptions. The taxable income is the amount for which the federal income tax is determined by using the income tax rates.

Amount of Federal Income Tax and Surcharge

A surcharge of 10% of the computed income tax using the regular tax tables based on the individual's taxable income is added to arrive at the total federal income tax levied for 1969. Credits are then allowed for retirement income, credit, investment tax credit, foreign tax credit, and if any taxes had been withheld to arrive at the net income tax payable.

Self-Employment and Social Security Tax

A person who is in business for himself, or is self-employed, is subject to the self-employment tax. The purpose of the tax is to provide social security benefits [18, Sec. 1402]. The first \$7800 of

income is subject to a 6.9% tax rate for 1969. Any amount over is excluded from this particular tax.

Employees employed by sole proprietors, partnerships, and corporations are subject to social security taxes. The employer is subject to a 4.8% tax rate on the first \$7800 of wages and salaries paid. Therefore, a total of 9.6% social security tax is payable. If an employee has had social security taxes withheld on as much as \$7800 in wages, he is not liable for additional self-employment tax on self-employment income.

It should be noted that the self-employment or social security tax applies only to wages, salaries and any productive labor income. Rent, royalties, and dividends are not subject to the social security or self-employment tax.

Capital Gain Tax Treatment

Capital assets are treated differently in computing income taxes on the income derived from such assets. Capital assets held for six months or less are classified as short-term. If held for more than six months, the asset is a long-term capital asset. Thus short-term and long-term capital gains or losses result and must be kept separate for computational purposes.

If a taxpayer has both gains and losses on sales of capital assets during the year, he must first subtract his long-term losses from his long-term gains to arrive at a net long-term gain or loss. He does the same to arrive at a net short-term gain or loss. If the net long-term capital gain exceeds the net short-term capital loss, an income tax deduction equal to 50% of the excess is claimed [18, Sec. 1202].

If there is no net short-term capital loss, the capital gain deduction is 50% of the net long-term capital gain. However, if the net short-term capital gain exceeds the net long-term capital loss, there is no capital gain deduction because short-term capital gain is treated as ordinary income and is fully taxable.

If the sum of all the capital losses exceed the sum of all the capital gains, then the excess of such capital losses can be deducted from the gross income but only to the extent of \$1000. If the capital loss is greater than \$1000 then that portion can be carried to succeeding tax years.

The law provides an alternative capital gain tax computation method where the entire amount of the excess of the net long-term capital gain over the net short-term capital loss is taxed at a 25% tax rate. Ordinary rates are applied to other ordinary income of the taxpayer. The alternative tax is used only where it results in a lower tax than that computed under the usual method.

It will usually be advantageous to use the alternative method if the taxpayer is filing (1) a separate return with taxable income exceeding \$26,000 or (2) a joint return, or as a surviving husband or wife with taxable income exceeding \$52,000, or (3) as a head of the household with taxable income exceeding \$38,000 [44, p. 29].

Oklahoma Income Tax Considerations

Married persons receiving at least \$2200 combined gross income must file an Oklahoma Income Tax Return Form 511. Likewise, a single person or married persons not living together must file a return if each has a gross income of at least \$1100.

The taxpayer is allowed a personal exemption of \$1000 for himself and \$1000 for his spouse if a joint return is filed. In addition, a \$500 deduction is allowed for each dependent. Furthermore, a deduction is allowed for the federal income tax paid for that tax year in arriving at taxable income.

However, dividends received from Oklahoma based corporations are exempt from state income taxes to the individual if 5% or more of the gross income of the corporation for the preceding year was subject to Oklahoma income tax. Dividends from all Oklahoma banks, Oklahoma abstract companies, and Oklahoma Building and Loan Associations are not taxable. Dividends from corporations outside Oklahoma are taxable just as they are for federal purposes.

Partnerships

In this section the method of taxation by partnerships is set forth. The treatment of the operating loss is discussed as well as the acquisition and disposition of a partnership interest.

Method of Taxing

A partnership is not taxable as such. Only the members are taxable in their individual capacities. The tax is levied on their distributive shares of the partnership taxable income, whether distributed to them or not [18, Sec. 701].

A partnership return on Form 1065 is required even though the firm has no taxable income for the taxable year. No tax is ever paid by a partnership. Thus, Form 1065 is merely an information return.

The taxable income of a partnership must be computed in the same way and on the same basis as the taxable income of an individual, except that certain items such as gain or loss (described later), are separately stated. The credits and deductions allowed to individuals are not allowed to figure the partnership's taxable income.

Elections of Partnerships

The law provides that elections affecting the computation of taxable income derived from a partnership be made by the partnership [36, Sec. 1.0703-1]. Thus, elections as to methods of accounting, the use of the installment sales provision, and other elections, must be made by the partnership and must apply to all partners, insofar as the partnership transactions are concerned. The partnership must also make the election to take the additional first year 20% bonus depreciation. The deduction for each partner is determined separately by taking 20% of his share of the cost of the property and is limited to a \$2,000 deduction (\$4,000 on a joint return) [36, Sec. 1.48-3(c)(3)].

Guaranteed Payments to Partners

Any fixed or guaranteed payments made to partners for services or for the use of capital are generally treated as though they were paid to an outsider [18, Sec. 707].

The above rule applies only to the extent that the salaries or interest are in fact guaranteed payments, that is, payments determined without regard to the income of the partnership. Such payments will be taxed as salary or interest income to the partners and allowed as business deductions to the partnership. The partner must report the

salary or interest in his return for the taxable year within which ends the partnership year in which the partnership deducted the payments.

The guaranteed salary is includible in self-employment income for the purpose of the self-employment tax along with the partner's share of ordinary income of the partnership which is not required to be segregated under IRC [18, Sec. 702].

Net Operating Loss Deduction of Partners

The benefit of the deduction for a net operating loss [18, Sec 172 (b)] is not allowed to the partnership, but is allowable only to the members. Each partner takes into account his distributive share of partnership income or loss as if each item were realized directly from the source from which it was realized by the partnership, or incurred in the same manner as incurred by the partnership. This is the "conduit rule" described above. Thus, a partner uses his proportionate share of the partnership's loss to arrive at his individual net operating loss [36, Sec. 1.702-2].

The Code generally limits the amount of partnership loss, including capital loss, which may be allowed to a partner to the amount of the adjusted basis of his interest in the partnership at the end of the partnership taxable year in which the loss occurred [36, Sec. 1.704-1(d)].

Partner's Distributive Share of Income

Each partner must include, as separate items, in his return for his taxable year within which or with which the taxable year of the partnership ends, whether or not distributed, his share of the following partnership items under the IRC [18, Sec. 702]:

- 1) short-term capital gains and losses;
- 2) long-term capital gains and losses;
- 3) gains and losses from sales or exchanges of property described in Code Sec. 1231;
- 4) charitable contributions;
- 5) dividends for which there is provided an exclusion under IRC Sec. 116,
- 6) other items of income, gain, loss, deduction, or credit, to the extent provided by the Regulations.

"Other Items" within the meaning of (6) above, required by the Regulations to be separately treated, include the following [36, Sec. 1.702-1]:

- "1) amounts recovered on account of bad debts;
- 2) soil and water conservation expenditures;
- 3) nonbusiness expenses (medical, etc.); and
- 4) additional first year depreciation."

Purchase or Sale of Partnership Interests

Although a partnership interest is a capital asset, there are limitations governing the extent to which proceeds from the sale of a partnership interest can be treated as a capital gain. The effect is to prohibit a selling partner from applying capital gain treatment to profits on his share of inventoriable items or his share of uncollected and untaxed partnership income, which would have been ordinary income had they been received by the partner through the medium of the partnership. Any amount received by a selling partner on his share of unrealized receivables or substantially appreciated inventory, as these

terms are defined below, is ordinary gain or loss [18, Sec. 741 & 751].

The term unrealized receivables, as used above, applies to any rights to income which have not been included in gross income under the method of accounting employed by the partnership, such as a contractual or legal right to income for goods or services.

Inventory items are "substantially appreciated" only if their fair market value is more than 120% of their adjusted basis to the partnership property other than money.

Family Partnership

A common device for splitting income among family members and avoiding the high tax brackets, is the family partnership.

A person is recognized as a partner for income tax purposes if he owns a capital interest, such as land or cattle, in a partnership in which capital is a material income-producing factor (as in a family farm), whether or not he purchased the interest. The validity of the partnership depends upon whether there has been an effective gift of the partnership interest. To be an effective gift, the donor (usually the father) must give up all control over the property. If capital is not a material income-producing factor, a partnership resulting from gift of an interest might be disregarded as an invalid attempt to assign income, as contrasted with assignment of property from which income is derived. In any event, if all the income is attributable to the personal efforts of the donor, the donor will be taxed on the entire income under rule (1) below [18, Sec. 704(e)].

- 1) the family member's share must be determined by allowance of reasonable compensation for services

rendered to the partnership by the donor (father);
and

- 2) the share of the income allocated to the family member donee must not be proportionately greater than the share of the donor attributable to the donor's capital.

The Regulations require that the family member donee must have control over the partnership consistent with his status as a partner. He must have reasonable authority as to management, control over the distributions, and authority to liquidate his interest [36, Sec. 1.704-1 (e)(2)]. All of this implies that the family member must have sufficient maturity and understanding to serve in the capacity of a partner, or that the control of the property must be exercised by a trustee for the sole benefit of a child. If these tests are met, the fact that he is a minor and subject to disability under state law will not invalidate the partnership.

Trusts

Simple and complex trusts are first defined in the initial portion of this section. A discussion of how the beneficiaries are taxed is presented and then the taxation of the trusts as taxable entities is explained.

Simple Trusts

A trust which is required by the terms of its governing instrument to distribute all of its income currently, without paying, permanently setting aside, or using any amount for charitable purposes, is referred to as a simple trust. A simple trust is allowed to deduct the amount

of income which is required to be distributed currently, limited only by the distributable net income for the taxable year [18, Sec. 651-2]. A \$300 deduction in lieu of the deduction for personal exemptions is also allowed to simple trusts [18, Sec. 642 (b)].

Complex Trusts

Trusts which accumulate income, distribute corpus, or use funds for charitable purposes are called complex trusts. The deduction for distributions is the sum of the income plus any other amounts (such as those made in the trustee's discretion) which are paid, credited or required to be distributed, but limited to the amount of distributable net income. Also, any amounts which are treated as exempt income in the hands of a beneficiary, under the conduit rule, are to be excluded from the distributions deduction [18, Sec. 661-3].

Taxation of Beneficiaries

Income which is required to be distributed to beneficiaries is taxable to them, whether distributed or not during the taxable year, up to the amount of distributable net income. If the income required to be distributed exceeds distributable net income, only a proportionate part of each item is includible in the beneficiaries' income. In making this apportionment, each item retains the same character (such as rent, dividends, and capital gains) as it had in the hands of the trust [18, Sec. 652(b) & 662(b)].

Distributable net income, which limits the amount deductible by a trust and the amount taxable to beneficiaries, means the taxable income with some modifications [18, Sec. 643(a)(1-6)]. Since the

distributable net income concept is used to determine the character of amounts distributed to beneficiaries, it is necessary to adjust the taxable income by adding to it items which are not includible in the gross income of the trust but which may nevertheless be available for distribution to the beneficiaries, such as tax-exempt interest and excluded dividends. The deductions for personal exemptions [18, Sec. 642 (b)] and for amounts paid, credited or required to be distributed to beneficiaries [18, Sec. 651 & 661] are not taken into account, thus restricting the benefit of these deductions to the trust.

Gains from the sale or exchange of capital assets are ordinarily excluded from distributable net income, and are not ordinarily considered as paid, credited, or required to be distributed to any beneficiary unless they are:

- 1) allocated to income under the terms of the governing instrument by the trustee on its books or by notice to the beneficiary;
- 2) allocated to corpus and actually distributed to beneficiaries during the taxable year; or
- 3) utilized (pursuant to the terms of the governing instrument or the practice followed by the fiduciary) in determining the amount which is distributed or required to be distributed [18, Sec. 643 (a) (3)].

The 50% deduction for the excess of net long-term capital gains over net short-term capital loss under section 1202 does not enter into the computation of distributable net income. However, the deduction is available to the trust for the purpose of computing its taxable income if the capital gains are accumulated. Of course, if the capital gains are distributed, the beneficiaries are entitled to

the 50% long-term capital gain deduction.

Throwback Rule

In order to prevent accumulation of income with distribution in a low income year of a beneficiary so as to avoid taxes, a five year throwback rule is provided in IRC Sec. 665-668 for accumulation trusts. It has the effect of carrying back to the five preceding years distributions in excess of distributable net income for the distribution year, putting the same amounts into taxable income of the beneficiary as he would have done if they had been distributed in the prior year. This additional income is taxed as part of his distributive share in the distribution year, but the tax cannot be more than it would have been if he had actually received the additional amounts in the prior years. There are five exceptions to the throwback rule set out in IRC [18, Sec. 665 (b)]:

- 1) the first \$2000 over the distributable net income in the year of distribution;
- 2) amounts accumulated before the beneficiaries' 21st birthday;
- 3) distributions for emergency needs;
- 4) up to four distributions at specified ages at least four years apart; and
- 5) final distributions at least nine years after the last transfer to the trust.

Trusts as Taxable Entities

For federal income tax purposes, inter vivos and testamentary trusts are regarded as distinct and separate taxable entities. They

are subject to the same income taxes, other than the tax on self-employment income, as individuals, with some differences in the computation of credits and deductions. A trust is not allowed any exemption for dependents although it is allowed a personal exemption.

The gross income of a trust is determined in the same manner as that of an individual. The principle for taxing trusts is that all income of whatever kind and from whatever source derived, other than exempt income, is taxable to someone, either to the trustee or to the beneficiary. Regardless of who is taxed, the income retains its same character and the taxpayer is allowed the credits, exclusions, capital gains benefits and other privileges attached to the income on which the tax is imposed. This is the "conduit" rule.

The trusts which are taxed in the same manner as an individual are those created by will or a trust instrument where the trustee is primarily engaged in conserving or protecting the property, collecting the income and distributing it to named beneficiaries, or holding it as directed by the will or trust instrument. Some trusts which take effect during the lifetime of the grantor may not be recognized as a separate entity because, under the declaration of trust, the grantor in effect remains the owner of the trust income. In such a case, the trust income is taxed to him [18, Sec. 671].

Gross Income of Trusts

Section 641(a) provides that the gross income of a trust includes, but is not limited to: (1) Income accumulated in trust for unborn, unascertained or contingent beneficiaries, and income accumulated or held for future distribution under the terms of the trust, (2) income

currently distributable to the beneficiaries and income collected by a guardian for an infant and held for distribution under court order, and (3) income which may be distributed or accumulated in the discretion of the fiduciary.

Some of the foregoing items, however, may be taxed to the beneficiary in whole or in part instead of to the trust. All of the income specified in (1) is taxed to the trust; all of the income in (2) is deductible by the trust [18, Sec. 661(c)], and is taxed to the beneficiary. [18, Sec. 652], whether distributed or not; and the income in (3) may be eventually taxed to the trust or to the beneficiary, depending upon the amount which is properly paid or credited to the beneficiary.

Credits and Deductions of Trusts

In general, trusts compute their taxable income in much the same manner as individuals as stated above. Some special rules, however, apply to the deductions and credits allowed to trusts. The \$100 dividend exclusion allowed for an individual is available to trusts. Dividends allocable to a beneficiary are deemed to have been received by the beneficiary on the same day that they were received by the trust.

Instead of the deduction for personal exemptions, other deductions are allowed to trusts. A trust which is required to distribute all of its income currently is allowed a \$300 deduction in lieu of the deduction for personal exemptions, and all other trusts are allowed a deduction of \$100 [18, Sec. 642 (b)].

An unlimited deduction for charitable contributions is allowed to a complex trust. The contributions are deductible even though made

to an individual [18, Sec. 642 (c)]. The unlimited deduction does not apply to simple trusts distributing current income only [18, Sec. 651].

Expenses, Depreciation, and Depletion

In general, a trust is allowed the same expense deductions as an individual, that is those incurred in carrying on a trade or business or in the production of income.

The depreciation allowance is prorated between a trust and its beneficiaries. Apportionment of the deduction will be made in accordance with the pertinent provisions of the instrument creating the trust, or in the absence of such provision, on the basis of the income allocable to the trust and its beneficiaries [18, Sec. 167(h)]. Thus, a simple trust which is required to distribute all of its income currently will not be allowed a deduction for depreciation in the absence of specific provisions in the governing instrument providing for keeping the trust corpus intact.

The depletion allowance must be apportioned between the trust and beneficiaries in accordance with the provisions of the trust instrument. In the absence of such provisions, it is apportioned on the basis of trust income allocable to each. The Regulations [36, Sec. 1.641(b)-2] state:

"In many instances the contract under which oil or mineral operating rights are assigned calls for the payment of a lump sum or bonus on execution of the contract, as well as royalties. Royalties are subject to depletion since they are dependent upon production. Treatment of the cash payment depends on the intent of the parties ... The Commissioner requires that cash payments be treated as advance royalties subject to depletion in every case where the assignor retains a royalty interest, i.e., an interest which extends to the entire production."

The tax return of a trust must be filed by the fiduciary on Form 1041. He must also pay the tax shown to be due. A trustee is personally liable for taxes of which he had notice prior to distribution of the assets. Also, liability for taxes follows the assets of the trust.

Regular Corporations

In this section the corporation is defined and then the tax rates applicable to corporations are explained. The capital gain tax treatment, the tax returns, special deductions, dividends, and Oklahoma considerations for the corporation are discussed.

Corporation Defined

For purposes of the Code a "corporation" is not limited to the artificial legal entity commonly known as a corporation, but includes associations and trusts which are classed as associations [18, Sec. 7701 (3)].

As defined earlier in this thesis an organization will be treated as an association (and taxed as a corporation) if its characteristics are such that it more closely resembles a corporation than a partnership or trust. The characteristics, as defined in Chapter II, of a corporation are:

- 1) Associates;
 - 2) An objective to carry on business and divide the profits;
 - 3) Continuity of life;
 - 4) Centralization of management;
 - 5) Liability for corporate debts limited to corporate property;
- and

6) Free transferability of interest.

Return Required

Every domestic corporation not expressly exempt from tax must file an annual income tax return. The return is required even though there is no income or no tax. The return is on Form 1120. The return must be signed by a duly authorized officer of the corporation

Tax Rates

The normal tax rate on all taxable income is 22%. The surtax rate on taxable income over \$25,000 is an additional 26%. In addition, a 10% annual surcharge tax is imposed on the total normal tax and surtax, before credits, for the period beginning January 1, 1968. The terms surtax and surcharge should be used only in the above sense as they are words of art but are easily confused.

In completing the corporate tax return, it is necessary to make separate determinations for the normal tax and for the surtax. First, a 22% tax is taken against all taxable income. Then the \$25,000 surtax exemption is subtracted from the taxable income, and the 26% surtax rate is applied.

Capital Gain Tax

A corporation is entitled to the same capital gain benefits that an individual taxpayer has; but it cannot take advantage of the special 50% capital gain deduction [18, Sec. 1201(a)]. A corporation computes its capital gain tax in the following manner. First, the excess of net long-term capital gain over net short-term capital loss

is included in income and a tax at the regular normal tax and surtax rates is computed. Then the alternative tax is determined by:

- 1) computing a tax at normal tax and surtax rates on the corporation's taxable income minus the excess of long-term capital gain over net short-term capital loss; and
- 2) adding to this 25% of such excess.

The method producing the lower result should be used. The corporate surcharge is then added.

A corporation, like an individual, offsets its capital losses against its capital gains. But if it has an overall capital loss, the corporation, unlike an individual, may not offset it against ordinary income to any extent in the year the loss was incurred [18, Sec. 1211 (a)]. Instead, the corporation's excess capital loss is subject to the carryover provisions which state that any excess of capital losses which cannot be deducted in the taxable year may be carried forward by the corporation for five years to offset any net capital gains in those years. The carryover is treated as a short-term capital loss for the year to which it is carried.

If a corporation has only capital losses and no capital gains, it may not deduct any part of the losses in the taxable year. There is no \$1,000 additional allowance as in the case of individuals.

Due Date of the Tax Return

The due date of the return for a calendar year corporation is the 15th day of March following the close of the calendar year. If the corporation is on a fiscal year basis, the due date is the 15th day of the third month following the close of the fiscal year

[18, Sec. 6072(d)].

Estimated Tax

In 1968 Congress passed Public Law 90-364 which eliminated the necessity of filing a formal declaration of estimated tax by a corporation and it increased the amount of tax which a corporation must pay in its estimated installment payments. Previously the first \$100,000 taxable income was exempt from estimated tax payments. Under the new system, the former \$100,000 exemption [18, Sec. 6016] will be phased out over 10 years so that by 1977 a corporation will be making current payments of its full expected tax liability if such liability exceeds \$40 [18, Sec. 6154(a)].

The date on which a corporation first meets the above requirement determines the number of installments, the due dates of such installments, and the minimum percentage of estimated tax to be paid with each installment. The following table shows the determination and payment dates and the percentages of tax to be paid.

TABLE II

DETERMINATION OF ESTIMATED TAX PAID BY CORPORATIONS

Determination dates	Percentages of the estimated tax to be paid by the 15th of the			
	4th mo.	6th mo.	9th mo.	12th mo.
Income earned prior to the 4th month of the taxable year. . . .	25	25	25	25
Income earned prior to the 6th month of the taxable year but after the 3rd month.33	33	33
Income earned prior to the 9th month of the taxable year but after the 5th month.50	50
Income earned prior to the 12th month of the taxable year but after the 8th month.100

Source: Internal Revenue Code Regulations, Sec. 1.6154-b.

Corporations must deposit their estimated income taxes with Form 503 in authorized commercial bank depositories or Federal Reserve Banks on or before the payment dates.

Special Deductions for Corporations

In computing the taxable income of a corporation, special deductions are allowed. For a farm oriented corporation, only the organizational expenditures receive special treatment. Organizational expenditures of a corporation may be treated as deferred expenses and deducted ratably over such period of not less than 60 months as may be selected by the corporation [18, Sec. 248]. Organizational

expenditures are those which:

- 1) are incident to the creation of the corporation;
- 2) are chargeable to capital account; and
- 3) are of a character which would be amortizable over the life of the corporation if its life were limited by its charter.

If the election to amortize is not made, the corporation cannot deduct many of its organizational expenses because they are considered to be capital expenditures, without a determinable useful life. However, they may be deducted as a loss in the year the corporation dissolves [18, Sec. 248].

Dividends Received and Paid by a Corporation

A corporation is entitled to a special deduction of 85% of dividends received from a domestic taxpaying corporation which is subject to income tax [18, Sec. 243].

A corporation may not deduct the dividends it pays to its shareholders as an expense. However, when the dividend is paid to the shareholder it will be included in the shareholder's ordinary taxable income. Thus, the corporation first pays tax on the income it receives and the shareholder later pays tax on the income received in the form of a dividend. This is the double taxation that makes corporate ownership a potential tax disadvantage.

Other Oklahoma Income Tax Factors

Corporations in Oklahoma are subject to a 4% tax rate on all their net taxable income. Dividends from other Oklahoma based corporations

which may be included in the said corporation are non-taxable income if the corporations from which the dividends are received had 5% or more of their gross income for the preceding year subject to Oklahoma income tax.

In addition, Oklahoma imposes an annual franchise tax of \$1.25 per \$1000 of the corporation's net capital asset value.

Subchapter S Corporation

The subchapter S corporation is defined and the taxation of that entity is discussed in this chapter. Furthermore, some of the tax advantages as compared to the regular corporation are given in this section.

Definition

A "subchapter S" corporation is one which has elected, by unanimous consent of its shareholders, to avoid paying any corporate tax on its income, choosing instead to have the shareholders pay taxes on it in much the same way they would have if the income had been received by them, (instead of the corporation), in proportion to their shareholdings. The income actually distributed to them becomes taxable to them as of the day they receive it. The undistributed corporate income is taxed to the shareholders as though it were distributed on the last day of the corporation's taxable year.

The shareholders treat all these amounts much like dividends and not like income which they themselves have earned; for example, it is not self-employment income. The shareholders get no dividend exclusion or retirement income credit on the basis of such income. However,

they do get the benefit of long-term capital gain treatment for most corporate long-term capital gains, and they can themselves deduct corporate operating losses [36, Sec. 1.1378.3].

Partial Distribution

To relieve the stockholders from hardship by reason of their payment of tax on undistributed earnings, the corporation could distribute an amount sufficient to reimburse them for the taxes they have paid on the undistributed income and retain the balance as working capital. In later years, when the corporation has excess funds, it can distribute to the stockholders, tax-free, earnings on which the stockholders have already paid tax by reason of having made the election.

Making the Election

The election to not be taxed as a corporation must be filed with the district director for the district in which the corporation's principal place of business is located. The election is made by filing Form 2553, with the consents of all shareholders.

Restrictive Clauses

A group organizing a corporation with the idea of taking advantage of the tax-option provisions might wish to insure that the election be perpetuated. To this end the stockholders might contract with each other that a stockholder must sell his stock only to the corporation or to the other stockholders if he decides to sell his stock. A new shareholder coming in could be required to sign such a contract

if he wants the stock.

A similar provision might be made a part of the corporation's charter to which all stockholders and future purchasers of shares become a party when they buy in. Since the stock certificate itself is usually given effect only as a document evidencing the holder's ownership and as a way to transfer title, a restrictive clause incorporated only in the stock certificates would probably not be sufficient. A shareholders' contract or a stock purchase contract is probably a better means to express the necessary contractual relationship between the shareholders.

Deferring Income by Use of a Different Tax Year

Individuals may be able to defer income and postpone payment of tax by incorporating a new business or an existing business and electing to have the subchapter S option apply. This can be accomplished by selecting a taxable year for the corporation different from that of the individual stockholders.

Say that X and Y operated a farm as partners. They and the partnership were on the calendar year basis. Most of the partnership income was derived during May and June from wheat harvest. In May, 1968, X and Y incorporated the business, with a fiscal year of May 1 to April 30. They elected to have the corporation's income taxed to them. During May and June of 1968, the corporations realized income on which its tax would be \$10,000. X and Y do not report this income until they file their returns for 1969 (their taxable year in which the corporation's first taxable year ended) in April, 1970. If they had not incorporated and made the election, the income would be taxable

to them in 1968. The result is, in effect, an interest-free loan of an amount equal to the taxes which they would have had to pay on this income for 1968.

It should be understood that deferment of income by incorporating with a different taxable year can occur only once; however, especially where maximum working capital is needed, it could be very important.

Deductions Created by Incorporation

In addition to the usual deductions available to businesses, a corporation is entitled to deductions for its organizational expenses, which may be amortized over a period of five years or more as described earlier in this thesis. There are several other expenses deductible only through the corporate structure discussed below.

Sick and Accident Benefits

A sole proprietor or partners might consider incorporating their business and then electing to be a subchapter S corporation, from the standpoint of achieving sick and accident benefits not otherwise obtainable under their present form of doing business. Contributions by the corporation to an accident and health plan, to provide compensation for the employees in the event of personal injuries or sickness, would be deductible by the company and would not be taxable to the employees. Under the corporate setup, the former sole proprietor or former partners would become employees and therefore eligible for the exclusion [18, Sec. 105(d)].

Charitable Contributions

A corporation's charitable contribution deduction is limited to 5% of its taxable income, whereas its individual stockholders' contributions deductions can be as high as 30% of adjusted gross income. Under a subchapter S election, the total allowable deduction for contributions equals 33 1/2%. It is computed as follows:

- 1) Assume \$30,000 was given to a church by the corporation. The deduction would be \$1,500 ($\$30,000 \times 5\%$).
- 2) The stockholders will then receive the entire \$28,500 as gross income ($\$30,000 - \$1,500$). Their total maximum charitable contribution deduction will then be \$8,550 ($30\% \times \$28,500$).

Data illustrating the charitable gift deduction advantage of incorporating and of making the election under subchapter S are as follows:

	No election made	Election made	Not in- corporated
Sole proprietor			\$9000
Corporation	\$1,500	\$1,500	
Stockholder		<u>8,550</u>	
Total deductions			<u>9000</u>
available for taxable year	1,500	10,050	9000

Therefore, given that the above types of contributions are made, a greater tax deduction is achieved by the subchapter S corporation.

Additional First-Year Depreciation

Any business corporation may elect to write off 20%, up to \$10,000, of the cost of new or used tangible personal property in the year of acquisition, plus taking regular depreciation of the balance.

There is presently an unresolved conflict as to whether a subchapter S corporation may take the additional write off on as many \$10,000 units of property as it has shareholders (arguing that the shareholder is the "taxpayer" to whom the additional first-year depreciation is allowed rather than the corporation) or whether the corporation, the tax reporting entity, may take only one write-off. The latest court ruling should be consulted.

Pension or Profit-Sharing Benefits

If ownership is in a sole proprietorship or partnership, the owner may not deduct money set aside for himself in an employee retirement plan. However, if the owner of a business has established an exempt pension or annuity plan for all employees, he can get the same benefits his employees are getting under the plan by incorporating [36, Sec. 1.1378-3]. He would be eligible for a reasonable salary as an officer and would qualify for pension benefits as do his other salaried employees. He would thus be able to convert part of his nondeductible retirement investment expenditures into deductible business expenses. If the corporation also elects to be a subchapter S corporation, the owner would get these benefits, although the corporate income would be taxed only once, as was the income of his proprietorship or partnership.

Depletion Allowance

Both individuals and corporations which have an economic interest in oil or minerals in place are entitled to a depletion deduction from income derived from such natural resources [36, Sec. 1.1373-1(g)].

How Income is Taxed to Shareholders

In general, the income of a subchapter S corporation is taxed to its shareholders in proportion to their shareholdings. The corporation is not taxed on anything except certain capital gains discussed below. Actual cash dividends are taxed to the shareholders as of the time they are received by them under the customary rules governing dividends.

Undistributed corporate income is taxed to the shareholders as though it were distributed on the last day of the corporation's taxable year. But none of the foregoing income is eligible for the dividend exclusion. Only distributions out of accumulated earnings are eligible for the exclusion.

Once the earnings and profits of a taxable year have been taxed to the shareholders, then distributions out of accumulated earnings and profits can become eligible for the dividend exclusion or for the retirement income credit [36, Sec. 1.1378-3]. In no case are they treated as self-employment income to the shareholders.

Other Oklahoma Income Tax Factors

Oklahoma does not recognize the subchapter S corporation for tax purposes. The subchapter S corporation pays the normal 4% income tax rate just as if it were a regular corporate tax-paying entity. The corporation is subject to the annual franchise tax.

CHAPTER IV

GIFT TAX LAW FACTORS

The purpose of this chapter is to discuss the gift tax laws. Section 2501 of the Internal Revenue Code imposes a tax on the lifetime transfer of property by gift by an individual. Like the estate tax, the gift tax is an excise tax levied upon the transfer of property. It is imposed upon the donor, the person making the transfer. If, however, the donor does not pay the tax when due, the donee may be called upon to pay it to the extent of the value of the property received by him [36, Sec. 25.2501-1]. Being a tax upon the transfer rather than upon the property itself, application of the gift tax is generally not affected by the nature of the property or by any tax exemptions.

The federal gift tax law subjects to tax every transfer of property by individuals by gift to the extent that the transfers are not supported by an adequate and full consideration in money or money's worth, and to the extent that they are not specifically deductible or excludible.

The chief purpose of the gift tax is the deterring of gifts to avoid estate taxes, although the rates are only three-fourths of the estate tax rates.

In this chapter the components of a gift are set forth. The annual exclusion and the lifetime specific exemption are explained. Gifts of present and future interests are considered as well as gifts

to minors. Then the use of insurance trusts and other gift arrangements are discussed. The Oklahoma gift tax laws are mentioned at the end of the chapter.

Corporations Not Included

The gift tax applies only to transfers of property by gift by individuals. The tax is not applicable to transfers by corporations or other persons not classified as individuals, such as trusts of all kinds. A transfer by a corporation for less than full consideration will be considered a gift by the stockholders. If the donee is a stockholder, the transfer is a gift to him from the other stockholders to the extent that it exceeds his own interest as a stockholder in the amount of the gift property [36, Sec. 25.2511-1(h)(1)].

Elements of a Gift

Gifts of property to members of a family, frequently motivated by a desire to spread the income and thereby reduce the donor's taxes, are not invalid but are carefully scrutinized in every instance.

Essential elements of a valid intra-family gift are [36, Sec. 25.2503-1(a)]:

- "1) a donor competent to make a gift;
- 2) a donee capable of taking the gift;
- 3) a clear and unmistakable intention on the part of the donor to divest himself of title, dominion and control of the subject matter of the gift, immediately, absolutely and irrevocably;

- 4) the irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so the donor can exercise no further control over it;
- 5) a delivery to the donee of the subject of the gift or of the most effectual means of commanding dominion over it; and
- 6) acceptance of the gift by the donee."

In determining whether these conditions have been satisfied in a litigated case, it is customary for the court to consider subsequent developments as to who received the income, whether or not it was used for the donor's benefit, and whether or not the donor later exercised any actual control over the property. Income or any capital gain from the sale of gift securities (defined below in the section on Uniform Gift to Minor's Act) which are the legal property of a minor is taxable income to the minor even though the securities may be registered in the name of a parent; and even though the custodian-parent was also the donor.

The gift itself results in no income to the recipient and is not deductible by the donor in the absence of a transaction on which gain or loss is recognized or a deductible contribution occurs, but may result in liability of the donor for a gift tax.

Specific Exemption

There is available to each donor against gift taxes otherwise payable, a specific exemption of \$30,000 [18, Sec. 2521]. Although the exemption is not an annual allowance, it has a certain flexibility which arises from the option of the donor to use the exemption entirely

in one calendar year or to spread it over the period of his lifetime in such amounts as he chooses. Once the full \$30,000 exemption has been exhausted, no further exemption is available.

Annual Exclusion

A donor may exclude from taxable gifts each year, the first \$3,000 in gifts of present interests to each donee to whom he made gifts during that year [36, Sec. 25.2521-1(a)]. No exclusion is permitted for gifts of future interests as defined later.

This annual exclusion is in no way limited as to the number of donees with respect to whom it may be taken or as to the number of years in which it may be taken.

The specific exemption and the annual exclusion are completely independent of each other. The \$3,000 annual exclusion is not reduced in either amount or frequency by the use of the \$30,000 specific exemption in one year or over many years. Furthermore, the \$30,000 specific exemption is in no way affected by the fact that the donor has also claimed one or more annual exclusions.

In the case of gifts made in trust, the trust beneficiary, rather than the trustee, is regarded as the donee. Thus, an exclusion is allowable for each beneficiary who receives a present interest. If a beneficiary receives interests in more than one trust, or if he receives other interests as well, only one exclusion is allowable.

Marital Deduction for Gifts Between Husband and Wife

The marital deduction allowed in computing taxable gifts is one half the value of the gift property. It is allowed only for gifts

from husband to wife, or vice versa [18, Sec. 2523].

A gift will not qualify for this deduction unless it is the kind of transfer that would qualify for the estate tax marital deduction. However, here the interest passes during the donor's life instead of at his death. The estate tax requirements will be set out in the estate tax section.

The amount of the gift tax marital deduction is one half the amount given away. This is in addition to the \$30,000 exemption and the \$3,000 exclusion. An example is as follows:

Gift		\$100,000
Less: Marital deduction		<u>50,000</u>
Balance		50,000
Less: Special exemption	\$30,000	
Exclusion	<u>3,000</u>	<u>33,000</u>
Amount subject to tax		17,000
Tax		\$952

Gift Splitting

The IRC [18, Sec. 2513] permits gifts by one spouse to a person not his spouse to be treated for gift tax purposes as though he and his spouse had each made a gift of one half the total value of the gifts. This right is an optional one which may be taken or ignored in any year.

When the gift-splitting privilege is taken, the fraction of one half must be adhered to even if one spouse has previously made gifts in excess of the specific \$30,000 exemption while the other has used no exemption [36, Sec. 25.2513-1(d)].

The privilege of treating gifts to a third person as being one half from each spouse is an important factor in estate planning. It permits the application of two \$30,000 gift tax exemptions and increases the effective annual exclusion to \$6,000 on account of each person to whom a gift is made.

Present Interest

An unrestricted gift to the immediate use, possession or enjoyment of property or the income from property is a present interest in property. An exclusion is allowable with respect to a gift of such an interest.

Future Interest

The annual exclusion per donee is available only for gifts of present interests. The annual exclusion is not available for gifts of future interests, with the exception of certain gifts to minors where the trustee can expend the entire property for the minor donee's benefit prior to his reaching age 21 when he will receive the entire property. The term future interests is a legal term as used in property law. Future interest includes "reversions, remainders, and other interests or estates, whether vested contingent, and whether or not supported by a particular interest or estate, which are limited to commence in use, possession or enjoyment at some future date or time [36, Sec. 25.2503-3(a)]."

Gifts to Minors

Under the Code [18, Sec. 2503(c)], if a gift may be expended by,

or for the benefit of, the minor donee prior to his attaining the age of 21 years, and to the extent not so expended, will pass to him at that time, such gift will not be regarded as the gift of a future interest even though it comes within the above definition. It must also be provided, however, that in the event of the donee's death prior to attaining the age of 21, the property will pass to his estate or to persons whom he appoints under his exercise of a general power of appointment. The above provisions are necessary to comply with the completed gift requirements.

Gifts of Trust Income

The gift of an immediate life interest in income is regarded as a gift of a present interest. An interest in trust income is immediate if payments of income are to start immediately and are not to be postponed until some future date or at the discretion of the trustee. Immediately does not mean, however, the date of consummation of the gift, or the day after. It usually means that income be payable at fairly regular intervals or reasonable length. A gift of a present right to receive trust income will not be considered a gift of a future interest solely because of discretion in the trustee.

If the trustee is given the power to divert the trust income from the beneficiaries to other purposes, such as for payment of debts or taxes on trust property or of premiums on insurance policies, the gift of trust income is regarded as a gift of a future interest.

Similarly, a trustee's power to determine whether to accumulate or distribute trust income to the beneficiaries or to determine how much of trust income to distribute to them will classify the

beneficiaries income interests as future interests. An exception has been provided in the IRC [18, Sec. 2503(c)] in the case of gifts to minors as discussed above.

Uniform Gifts to Minors Act

Oklahoma Statutes, Title 60, Sections 401-410 (1967), permits gifts of money for investment under a "prudent man" rule which is prescribed within the Act. This Act tends to ease even further the qualification for annual exclusion of gifts to minors.

Gifts made in the prescribed manner become irrevocable and indefeasibly vest in the minor the legal title to the securities or money given. The guardian of the minor has no power and control over the securities unless the guardian also happens to be the custodian of the securities. The custodian is entrusted with the management of the property, which includes the collection and investing of income and the reinvesting of proceeds of the original securities. He may expend so much of the property as he alone deems desirable for the support, education and general welfare of the minor. The property, or the remainder, must be turned over to the minor upon his reaching the age of 21, or to his estate in the event the minor dies before reaching majority.

Charitable Transfers

No gift tax is imposed upon charitable transfers [18, Sec. 2522]. The entire amount of a qualified contribution is deductible from gifts made during a calendar year. There is no percentage limitation on gift tax deductions as in the case of the federal income tax the

IRC [18, Sec. 170].

Indirect Gifts

The gift tax also applies to gifts indirectly made. There are many ways to make a transfer to, or to confer benefits on, another person that will be deemed a taxable gift [36, Sec. 25.2511-1]. Examples of gifts that can be made are:

- 1) transfer pursuant to a declaration of trust;
- 2) forgiveness of a debt;
- 3) assignment of a judgment of insurance contract benefits;
- 4) designation of a person other than the donor or his estate as beneficiary of an insurance contract;
- 5) payment of premiums on insurance owned by another;
- 6) conveyance of title to another and the donor as joint tenants or to the donor's spouse as tenants by the entirety; and
- 7) permission to withdraw funds from a joint bank account deposited by the donor.

There is an exception to 6) above. The Code makes it unnecessary to treat the creation of a tenancy by the entireties in real property as a gift. Joint tenancies with rights of survivorship are included in the definition of tenancies by the entireties where the joint tenants are husband and wife. The IRC [18, Sec. 2515] provides that the creation of such ownership will not be treated as a gift unless the donor elects to report it as a gift at the time of creation. If the donor does not so elect, no gift need be reported until the tenancy is terminated other than by death.

Insurance

The transfer of life insurance is subject to gift taxes to the same extent as the transfer of any other kind of property. If the insured relinquishes his rights under a policy in favor of another or others without receiving adequate and full consideration for his action, he makes a gift, which subject to allowable exemptions, is subject to tax.

However if an insured relinquishes only a portion of his rights, there is no gift unless the rights which he has retained give him no control over the policy or proceeds thereof. Thus, if an insured relinquishes all rights except a right to change the beneficiary, he has made no taxable gift. On the other hand, if he retains only the right to reacquire ownership if all the beneficiaries predecease him, he has retained no right to control the vesting of the proceeds, and there is a completed gift, the entire value of which is taxable.

Insurance Trusts

The transfer of insurance in trust is taxable in the same manner as any other transfer in trust and the fact that the transfer is in trust does not cause the application of rules different from those that are applicable to other transfers of insurance. It does, however, increase the probability that the transfer will be classed as one of future interests, thereby rendering inapplicable the \$3,000 annual exclusion.

Although a transfer of insurance and the payment of premiums thereon are not per se gifts of future interests, where the rights of the beneficiaries are restricted, by a trust agreement, to a right

to receive the proceeds or other interests at some future time, the gift is a future interest. However, where there is an outright assignment of a policy of insurance which entitled the transferee to cash in the policy at any time, the transfer would seem to be of a present interest to which the \$3,000 exclusion would apply [36, Sec. 25.2511-1].

Powers of Appointment

It is not always necessary that the subject of a taxable gift be property which belonged to the person deemed to be the donor for gift tax purposes. If the property was transferred by some other person and the taxpayer was given a general power of appointment over the property, a taxable gift occurs if the taxpayer exercises the power during his lifetime. The mere release of a general power will constitute a taxable gift. However, a disclaimer or renunciation of a power will not be treated as a release if effected within a reasonable time after learning of the existence of the power [36, Sec. 25.2514-3].

The term, power of appointment, includes all powers which are in substance powers of appointment regardless of what name they may have been given, either by the creating instrument or by local law. But it does not include powers reserved by a donor to himself.

A general power means any power of appointment exercisable in favor of the possessor of the power, his estate, his creditors, or the creditors of his estate. Thus, it includes a power of appointment exercisable to meet the estate tax, or any other taxes, debts, or charges which are enforceable against the possessor or his estate.

A power to consume or appropriate income or corpus, or both, for the benefit of the possessor which is limited by an ascertainable standard relating to health, education support, or maintenance of the possessor of the power is not a general power of appointment.

Life Estate

Section 2523 of the Code gives the donor a marital deduction under the gift tax law for transfers to his spouse of a legal life estate in property coupled with a general power of appointment. The deduction, however, is limited in extent to that portion of the property over which the spouse has the power of appointment. Since 1954 the transfer need no longer be in trust in order to qualify for the marital deduction.

The gift tax marital deduction is not allowable if the gift to the spouse is only a life estate (or an interest which will terminate or fail upon the occurrence of an event or contingency, or upon the failure of an event or contingency to occur) if the reversionary or remainder interest is in the donor or any transferee other than the spouse [36, Sec. 25.2523(a)-1].

Joint Ownership

Gifts by the donor to his spouse as joint tenant with the donor or as tenant by the entirety may qualify for the marital deduction. Thus, only one half of the gift is subject to gift tax[36,25.2523(d)-1].

The creation of a joint tenancy, with rights of survivorship, between spouses or a tenancy by the entirety in real estate, and the improvements thereon, need not be treated as a gift unless the donor spouse so elects. If the election is not made, termination of

the tenancy, other than by death of a spouse, is subject to gift taxes.

Donor's Dominion and Control

Before the gift tax can be imposed on any transfer, the gift must be complete. If the intention to make a gift is expressed at one time, but the delivery of the property and acceptance of the gift take place at a later date, the later date will govern. As will be recalled, five requirements of a completed gift were set forth earlier.

The donor must have parted with all dominion and control of the transferred property, so that he is left with no power to change the disposition of the property transferred, whether for his own benefit or for the benefit of another. Otherwise the gift is incomplete.

A gift is also incomplete in every instance where a donor reserves the power to revest the beneficial title to the property in himself, or to the extent that a reserved power gives the donor the right to name new beneficiaries or to change the interests of the beneficiaries as between themselves.

A gift will not be incomplete merely because the donor reserves the power to change the manner or time of the beneficiaries' enjoyment of the property [36, Sec. 25.2511-2(i)].

Rules of Valuation

The value of gifts of property at the date of the gift is the amount of the gift for gift tax purposes [36, Sec. 25.2512-1]. This value is the price at which the property would be sold by a willing seller to a willing buyer, both having reasonable knowledge of relevant facts.

The Regulations contain no section devoted specifically to the valuation of gifts or real estate. Therefore, the general valuation principles in Reg. Sec. 25.2512-1 govern. The value of real property, each parcel of which is unique in the eyes of the law, cannot be determined by formula or rule. Each valuation must be fixed individually, in accordance with the requirements and circumstances of the particular situation. Expert testimony is desirable in most cases, not only to apply a local or general market situation to the piece of land involved, but often to provide the primary means of establishing the value for purposes of the tax.

The Regulations [36, Sec. 25.2512-2(e)] provide that the value of stock listed and traded upon exchanges should be listed as the mean between the highest and the lowest prices for which it was sold upon the applicable valuation date.

The fair market value of gifts of notes, secured or unsecured, is the amount of unpaid principal, plus accrued interest to the date of the gift, unless the donor establishes a lower value or proves that the note is at least in part uncollectible and that any security given is insufficient to satisfy the unpaid or uncollectible amount.

The fair market value of gifts of annuities, life estates, terms for years, remainders and reversions is their present value.

The value of a gift of life insurance is deemed to be equal to the cost of replacing the policy on the date of the gift. If the particular kind of policy is not presently available, the value may be established by the replacement cost of comparable policies. The replacement cost of a policy may be obtained from the insurance company. For each policy of life insurance given to a donee, the donor

must obtain a statement by the insurance company on Form 938 and file it with the gift tax return.

Oklahoma Gift Tax Considerations

In most respects, Oklahoma Gift Tax Law is comparable to the Federal Law. However, two major differences exist. There is no lifetime \$30,000 exemption for the donor. However, the annual \$3,000 exemption per donee is allowed. The gift tax rates are also less than the federal rates (Appendix Tables XXV and XXVI).

CHAPTER V

ESTATE TAX LAW FACTORS

Introduction

Previous chapters have discussed the relevant provisions of income and gift taxes. An individual with a substantial estate should also consider the provisions of federal estate tax in comparing alternative forms of farm business organizations. This final tax is discussed in this chapter.

The first part of the chapter explains estate tax and the computational process used to determine the taxable estate. Items included in the gross estate and exemptions, deductions, and credits are discussed. Specific discussions of the various parts of the estate laws pertaining to this study are given. Future interests, remainders, gifts and gifts in contemplation of death are examined in detail. The effects of jointly held property, life insurance, and the use of the power of appointment, and other areas are discussed to demonstrate their use in estate planning. Finally, Oklahoma's changes from the Federal computations are explained at the end of the chapter.

The Federal Estate Tax

The federal tax is imposed on the transfer of an individual's property at his death and on certain other transfers deemed to be the

equivalent of transfers at death. The tax is imposed at progressive rates on the taxable estate [36, Sec. 20.0-2].

Tax Computation Steps

When a person dies, an estate tax is imposed at graduated rates on the value of the taxable estate transferred. The rates range from 3% on taxable estates not over \$5,000 to 77% on taxable estates over \$10,000,000. It is the responsibility of the executor to see that the tax is paid.

The five general steps needed to arrive at the estate tax liability are:

- 1) determine the total value of the gross estate at the date of death or one year later;
- 2) subtract statutory deductions such as:
 - a) expenses, debts, taxes and losses,
 - b) the marital deduction,
 - c) charities;
- 3) deduct the specific exemption from the gross estate;
- 4) the balance is the taxable estate to which is applied the estate tax rates,
- 5) subtract from the computed tax, the credits allowed for:
 - a) state death taxes,
 - b) gift tax paid on transfers by the decedent-donor; and
- 6) the balance is the estate tax due.

Gross Estate and Taxable Estate

The estate tax is imposed on the decedent's taxable estate at graduated tax rates. The tax so computed is reduced by credits as listed in (5) above.

The gross estate consists of property within the following categories:

- 1) property owned by the decedent at his death;
- 2) lifetime gifts made by the decedent in contemplation of death;
- 3) lifetime transfers with life estate retained by the decedent;
- 4) transfers taking effect at death;
- 5) revocable transfers;
- 6) interests in jointly owned property owned by decedent at his death;
- 7) property subject to certain powers of appointment; and
- 8) life insurance on the decedent's life.

These categories will be discussed and defined individually later.

The exemption and other deductions taken from the gross estate to arrive at the taxable estate are as follows:

- 1) specific exemption. There is a \$60,000 exemption from the gross estate given to every estate of a citizen [18, Sec. 2052];
- 2) debts, expenses and losses. Certain debts, expenses and losses of the estate are also deductible in determining the size of the taxable estate. Among these are:
 - a) funeral and administration expenses,
 - b) claims against the estate, and
 - c) unpaid mortgages or indebtedness with regard to property included in the gross estate.
- 3) charities. The net amount of all bequests to charitable, religious or educational institutions may be deducted from the value of the gross estate [18, Sec. 2055];

- 4) marital deduction. This deduction is for the value of any property included in the estate which passes from the decedent to his surviving spouse [18, Sec. 2056]. Its effect can be to reduce the estate by as much as 50%. This will be explained in greater detail later.

State Death Tax and Gift Tax Paid Credits

Estates subject to federal estate tax are usually also subject to state death taxes. In order to minimize multiple taxation of the estate, the Code provides for reduction of the estate tax by a credit for state death taxes paid with respect to property in the gross estate [18, Sec. 2011(a)]. A table is provided by the Regulations for computation of the credit.

A decedent may, during his lifetime, make gifts of property on which gift tax was paid, and on his death the same property may have to be included in his gross estate. In such cases, the estate tax is reduced by a credit for the gift tax paid. The credit is applicable wherever the decedent is held to have retained sufficient interest in the gift property to justify its inclusion in his estate or where the gift is held to have been in contemplation of death [18, Sec. 2012].

Property in Which Decedent Had an Interest at His Death

The main category of property included in the decedent's gross estate is that in which the decedent had full or partial ownership when he died. The property is included only to the extent of the interest which he owned when he died. This category includes all kinds of property both real and personal and tangible and intangible

[18, Sec. 2033].

All household furnishings and personal effects of the decedent are part of his gross estate, including property used exclusively by the members of his family, unless any of such property actually belongs to the members of his family. The furniture and furnishings in the rooms of a decedent's children in his household must be included in the estate if the children had only the use of them rather than ownership. The controlling factor is holding the title, not use [36, Sec. 20.213-1].

Cash belonging to the decedent at the date of his death is part of his gross estate. Bank deposits owned by the decedent are also included in the estate [36, Sec. 20.2031-5].

The value of corporate stock is included in the decedent's gross estate to the extent that he had a beneficial interest in the stock at his death. If the decedent had only bare legal title, such as that held by a trustee, the stock is not includible. Local law determines the extent to which decedent had a beneficial interest in property.

If a partner dies, the value of his interest in the partnership which is transmitted at death forms part of his gross estate. If the partnership agreement does not specifically provide for continuation of the firm after the partner's death, his estate is ordinarily entitled to receive the amount shown to be due on a liquidation and accounting. This will include the deceased partner's share of capital as well as profits earned to the date of death.

Insurance policies transferred by the decedent during his lifetime may also be includible in his gross estate. For example, the transfer may be:

- 1) in contemplation of death;
- 2) a revocable transfer;
- 3) a transfer taking effect at death; or
- 4) a transfer under which the decedent retained possession or enjoyment of the policy during his life.

Future Interests

In this section certain kinds of future interests are defined to determine whether such interests are included in the gross estate or not.

A future interest in property arises when the property is transferred in such a way that its possession or enjoyment by one of the transferees is deferred until a future time. In general, the value of the future interest must be included in the gross estate where it is not extinguished by the holder's death and passes under his will or by intestacy.

Remainders

A remainder is a future interest in property which depends on the termination of a prior interest in the same property created at the same time. A common example is a remainder interest in real property which arises on the death of a person entitled to enjoyment of the property for life, known as the life tenant. The person entitled to the remainder interest is known as the remainderman and is always someone other than the person who created the remainder and the prior interest.

A vested remainder is a remainder interest that is not made subject to any condition or contingency by the terms of the trust, will, or other instrument creating it. Once a remainder is vested, it survives the death of the remainderman and its value is includible in his gross estate if he dies before he obtains possession or enjoyment of the property. Whether or not a remainder is vested is determined under applicable local law.

A contingent remainder is one which gives the remainderman the future right to enjoyment or possession of the property only if a certain event occurs or a certain condition is fulfilled. Most contingent remainders are dependent on the survival of the remainderman so that if he dies before obtaining the property his interest is extinguished. In this situation nothing is includible in his gross estate.

Reversionary Interests

Reversionary interests embrace the various kinds of future interests under which the transferor of property may regain its possession or enjoyment of some future time. The reversionary interest may remain in the transferor either by the terms of the instrument at transfer or by the operation of local law. If the reversionary interest survives the decedent's death and passes to his heirs under his will, or by intestacy, its value is includible in the gross estate. The interest is includible even though it can be defeated by an event which can occur after the decedent's death. However, if the reversionary interest is contingent on the decedent's survival or is otherwise extinguished before his death, it is not includible in the gross estate.

Transfers During Decedent's Lifetime
May Be Subject to Estate Tax

Gift tax rates are lower than corresponding estate tax rates. But benefits of the lower rate is denied to certain gifts of a testamentary nature:

- 1) gifts made in contemplation of the donor's death;
- 2) gifts not taking full effect before the donor's death;
- 3) gifts which the donor may modify throughout his life; and
- 4) gifts through operation of the survivorship element in joint ownership.

These transfers are drawn into the donor's estate, except to the extent they were made for adequate and full consideration[18,Sec.2035-2038].

Complete and Incomplete Gifts

In order to divest himself of title to property by gift so that it will not constitute part of his estate upon his death, the donor must make a complete and valid transfer, without reservations. There is included as part of the decedent's estate any property which was the subject of an incomplete gift. The validity and completeness of a gift will depend in each case upon the particular facts, since the distinction between a completed gift and one which is incomplete is at times very close.

Gifts in Contemplation of Death

Property transferred in contemplation of the transferor's death

must be included not only in the estate of the transferee who dies while owning the property, but also in the estate of the transferor.

Any property or interest in property transferred by the decedent within the three-year period preceding his death is presumed to have been made in contemplation of death and is includible in the decedent's gross estate unless it can be shown to the contrary. But this rule does not apply to the extent that the transfer was for a full and adequate consideration in money [18, Sec. 2035].

On the other hand, no transfer made more than three years before the decedent's death can be made in contemplation of death for federal tax [36, Sec. 20.2035-1(a) and (b)].

Of course, even if a gift is held to be in contemplation of death, there may still be an estate tax saving. Any previous gift tax paid on the transfer reduces the estate, while the gift tax is treated as a prepaid estate tax. The result is a saving equal to the estate tax otherwise payable on the amount of gift tax paid and therefore taken out of the estate. However, the decedent has given up the earning power of the gift tax paid for some years.

In contemplation of death means that the thought of death as distinguished from purposes associated with life, is the impelling cause of the transfer.

Marital Deduction Allowed for Property

Passing to the Surviving Spouse

One of the most important features of the estate tax is the marital deduction which allows the estate of a deceased to deduct the value of property passing to his (or her) surviving spouse. Because the ceiling

on the deduction is one half of the adjusted gross estate, the marital deduction in effect permits a decedent to transfer roughly half of his estate to his surviving spouse free of federal estate tax [18, Sec. 2056(a)]. The following important requirements for and limitation on the marital deduction are discussed in paragraphs below:

- 1) the property interest passing to the surviving spouse must be included in the gross estate for federal estate tax purposes [36, Sec. 20.2056(a)-2(b)(1)];
- 2) the marital deduction cannot exceed
 - a) the net value of the property passing to the surviving spouse and qualifying for the deduction [18, Sec. 2056(b)(4)]; or
 - b) 50% of the adjusted gross estate, whichever is less [36, Sec. 20.2056(a)-1(b)];
- 3) the property interest received by the surviving spouse must pass from the decedent;
- 4) the property interest received by the surviving spouse must be one which qualified for the deduction; and
- 5) the marital deduction may be limited to specific kinds of items in a decedent's estate.

What the Executor Must Prove

The Treasury Regulations specify that in order to obtain the marital deduction with respect to any property interest, the executor must establish these facts:

- 1) the decedent was survived by his spouse;
- 2) the property interest passed from the decedent to his spouse;
- 3) the property interest is a deductible interest;
- 4) the value of the property interest; and

5) the value of the decedent's adjusted gross estate.

Decedent Must Be Survived by Spouse

A decedent's estate is not entitled to the marital deduction unless the estate can establish that the decedent was survived by his spouse [36, Sec. 20.2056(a)-1(b)]. If the order of deaths of the decedent and his spouse cannot be established by proof, a presumption that the spouse survived the decedent satisfies this requirement to the extent that the spouse receives an interest in property includible in her gross estate. The presumption is supplied by local law or the decedent's will.

To simplify the following discussion, reference is generally made to property passing from a deceased husband to his wife as surviving spouse.

Computation of Adjusted Gross Estate

If the net value of the property interests passing to the surviving spouse and qualifying for the marital deduction exceeds 50% of the adjusted gross estate, the 50% is the operative ceiling. The adjusted gross estate is to be distinguished from the taxable estate as well as from the actually distributable net estate. It is arrived at by subtracting from the gross estate the sum of all debts, expenses, taxes, and losses but only to the extent that these debts, expenses, taxes, and losses are allowed as deductions for federal estate tax purposes. Charitable bequests and the \$60,000 estate tax exemption are not subtracted for this purpose. [36, Sec. 20.2056(c)-1(b)]. The same is true for such nondeductible taxes as the federal estate tax

which is not even taken into account in computing the taxable estate.

A pledge to charity made by the decedent during his lifetime may constitute an enforceable debt under the applicable estate law, despite lack of consideration. Therefore, it would reduce the adjusted gross estate. For marital deduction purposes it may therefore be preferable to make the contribution through a bequest to charity rather than through a pledge, since a charitable bequest does not reduce the adjusted gross estate.

Decreasing Estate Tax with Charitable
Gifts without Reducing Maximum
Marital Deduction

A lifetime transfer to charity can be used to reduce estate tax without any reduction in the amount of the allowed marital deduction. This can be accomplished if the donor keeps a sufficient interest in the transferred property and power over the property to require its inclusion in his gross estate when he dies. Its value will then be included as part of the adjusted gross estate to which the maximum deduction is geared. Yet the same value will not be subject to estate tax since it can be deducted as a charitable deduction.

This technique has been used when property is donated to a private foundation whose selection of charitable beneficiaries can be influenced by the donor. In addition to giving the donor an immediate income tax deduction, the transfer requires the value of the property to be included in the adjusted gross estate because of the donor's retained power to designate beneficiaries of income or principal. Therefore, no reduction in the amount of the allowable marital

deduction occurs. Nevertheless, there is no estate tax on the value of the property since it qualifies for the charitable deduction.

Formula and Nonformula Bequests for the Marital Deduction

A testator frequently wishes to make the utmost use of the tax reduction which can be accomplished by means of the marital deduction.

There are two general approaches to the problem of obtaining the maximum marital deduction. One approach is the nonformula bequest of a dollar amount, specified property, or fractional share of the residue and other such items. The other is the formula bequest.

In the case of the nonformula bequest in the decedent's will transfer to his wife a specified dollar amount, specified property, or a fractional share of the residue or some other fund, on a basis which qualifies for the marital deduction.

The bequest is set at a figure which together with the value of qualifying property transmitted outside of the will equals the maximum marital deduction.

The formula approach is designed to eliminate a disadvantage in the nonformula bequest. The maximum deduction may not be obtained by the nonformula approach if the composition of the estate changes or the values of the existing assets change. By using the formula approach, the amount of the bequest is determined by a formula expressed in terms of the maximum federal estate tax deduction, or 50% of the adjusted gross estate. Thus this formula automatically fixes the amount of the bequest at a figure which will produce the maximum deduction, whatever may be the value or composition of the estate.

Interest Passing to Spouse

Only property interests which pass or have passed from the decedent to the surviving spouse are entitled to the marital deduction. [36, Sec. 20.2056(e)-2(a)]. The interests must have passed to the surviving spouse as beneficial owner, not merely as trustee or subject to a binding agreement by the survivor to dispose of it in favor of third persons.

Property may pass from the decedent to the surviving spouse in a variety of ways. They include:

- 1) will bequest or devise;
- 2) inheritance under intestacy laws;
- 3) transfer during decedent's life such as by gift in contemplation of death, transfer taking effect at death, transfer with reserved rights to income or to designate beneficiaries, and revocable transfers;
- 4) transfer of jointly owned property to surviving spouse as co-owner under any form of joint ownership with survivorship rights;
- 5) transfer under a power of appointment held by decedent whether as a result of exercise, nonexercise, lapse or release of the power;
- 6) insurance proceeds received under policy on the life of decedent; and
- 7) transfers under a qualifying marital deduction trust or life insurance settlement where the widow receives the required life income interest, plus a board power of appointment.

Joint ownership with rights of survivorship is one of the recognized instances of property interests passing to the surviving

spouse and eligible for the marital deduction as is any interest which has been transferred to the surviving spouse at any time [18, Sec. 2056 (e)(4)] provided, of course, these interests are part of the decedent's gross estate.

Life Estate and Other Terminable Interests

The marital deduction is a concession made in view of the possibility of another estate tax being due when the recipient spouse dies. Upon death of a life tenant there is no estate tax on the shifting of benefits from the life tenant to the remainderman. For this reason the marital deduction is denied with respect to a life estate and certain other terminable interests passing to the surviving spouse, if upon the life tenant's death or some other event an interest, such as a remainder, passes for less than full consideration from the decedent to another person who may possess or enjoy any part of the property [18, Sec. 2056 (b) (1)].

Income for Life Plus the Power of Appointment

If the marital deduction could be secured only by leaving the property to the surviving spouse outright and with no strings attached, its usefulness would in many cases be dubious.

The cost of foregoing the marital deduction is calculable. The potential damage from mismanagement after an outright transfer is infinitely greater and its actual size unpredictable. The Code has, however, devised a kind of economic ownership to be vested in the surviving spouse which will enable the deceased's estate to claim the benefit of the marital deduction and yet surround the administration

and conversation of the property with certain safeguards, wherever such protection may be deemed desirable.

The essence of this economic ownership qualifying for the marital deduction is the combination of income for life and a general power of appointment, both vested in the surviving spouse. Each of these two elements, as defined by the Code and Regulations, will be explained in detail in the following paragraphs. For instance, the surviving spouse must receive the income at intervals not to exceed one year and must be enabled to rid herself, at some time and without requiring anybody's consent, of all legal restrictions on her ownership by appropriating the property to herself or at least to her estate.

Thus by allowing this combination of life income and the power to appoint to qualify for the marital deduction, the law makes it clear that it does not object to limiting the surviving spouse's control effectively enough to protect the decedent's estate from waste or dissipation. For instance, if the testator's main fear is the possibility of losses through lack of investment experience, he may settle the property in trust, select a competent trustee, reduce the widow's interest to quarterly payment of income for the duration of her life, designate the children as remaindermen, and give his widow the power through her last will only to make the property a part of her estate, should she desire or deem it necessary to deviate from the testator's original estate plan.

It is not necessary to impose these restrictions through a marital deduction trust. A legal life estate, if coupled with the power of appointment, is equally qualified for the marital deduction. However, where a husband is anxious to provide as amply as consistent with

conservative management for the support of his spouse and at the same time to protect the interests of his children, he will usually supply that management through a qualified trustee and equip the trustee with adequately limited discretionary powers of invasion to meet emergencies. Therefore, an arrangement can be accomplished more effectively than the standardized legal life estate which operates without a trustee and the exact scope of which is not always spelled out by state law. Consequently, even under the 1954 Code the marital trust is still a popular estate planning tool for securing the benefit of the marital deduction. This is particularly true after the 1954 Code made it possible to set up a trust comprising more than is designed to pass to the surviving spouse and to limit her income interest and power of appointment to a specific portion of the trust, which the regulations interpret to mean a fractional or percentile share. This possibility is of practical significance especially where most of the estate consists of assets which by their nature or because of the testator's intentions are to be kept intact.

Life insurance or annuity payments may likewise be settled in accordance with the life estate plus the power of appointment and thereby qualify for the marital deduction, despite the restrictions on the surviving spouse's enjoyment of the full proceeds. This exception from the terminable interests principle is closely similar to the marital trust exception. Thus, it is not necessary that the surviving spouse's interest relate to the entire insurance or annuity contract. She may be entitled only to a specific portion, which in this case may be expressed not only in terms of a fraction or percentage but also of a specific sum.

Trusts Which Qualify for the
Marital Deduction

Under the rules disqualifying life estates to the spouse with the subsequent remainder to others, a transfer by a testamentary trust giving the income to the widow for life and the remainder to the children would likewise not qualify. But the law permits the marital deduction with respect to any interest in property passing from the decedent to his surviving spouse in the form of a trust if:

- 1) the spouse is entitled for life to all the income from the entire interest or all the income from a specific portion of the entire interest; and
- 2) the spouse has a power of appointment to appoint the whole interest or a specific portion.

However, this concept is true provided that all of the following five conditions are met [18, Sec. 2056(b)(5)]:

- 1) The surviving spouse must be entitled for life to all of the income from the entire interest or from a specific portion of the entire interest, or to a specific portion of all the income from the entire interest;
- 2) the income must be payable annually or at more frequent intervals;
- 3) the surviving spouse must have the power to appoint the entire interest (or a specific portion) free of the trust to either herself or to her estate;
- 4) the power in the surviving spouse must be exercisable by her alone and (whether exercisable by will or during life) must be exercisable in all events;

- 5) no person other than the surviving spouse may have a power of appointment over the interest or the specific portion enabling him to appoint any part to any person other than the surviving spouse.

Transfer of Family Corporation for Lifetime Payments

If upon transfer of stock in a family corporation the transferor reserves a payment by the corporation to himself for life, the nature of that payment must be examined. It may be tantamount to the expected income from the stock, in which case the stock would be includible in the transferor's estate. However, it may be a mere continuation of the existing salary arrangement in which case the stock would not be includible.

Reservation of Rights and Powers

The estate of a decedent upon his death includes not only property which he owned or in which he had an interest at the time of his death, but also any property of which he may have divested himself completely during his lifetime without adequate consideration if he reserved any power, exercisable up to the time of his death, to designate who shall possess or enjoy the property or any income derived from it [18, Sec. 2036(a)].

The grantor may reserve the right to designate and change beneficiaries without saying so explicitly. In fact, he may not even realize that by the reservation of a certain control over the distribution, not necessarily for his own benefit, he may, in fact, reserve the right to designate beneficiaries. The most common instance of this sort is a trust created for the benefit of the grantor's wife or

child for life, with the right reserved to the grantor, individually or as trustee, to invade the principal to supplement the possibly inadequate income. Or, on the contrary, the income may perhaps be deemed more than ample, so that the grantor reserves the right to withhold distribution of income and to add some of the income to principal.

Powers of management, such as the authority to allocate receipts and disbursements as between income and principal, or the authority to invest or reinvest in property which produces no income, or to vote the stock of a closely held corporation, may be themselves be no more than means of facilitating sound and flexible management for the benefit of all concerned. But the combination of several such powers may amount, in effect, to an over-all power to decide from time to time who shall receive how much, and whether the benefits should flow primarily to the income beneficiary or to the remainderman. Unless clearly limited, seemingly managerial powers may thus constitute a power to designate who shall enjoy income or possession, and if reserved to the grantor for life, whether personally or in his capacity as trustee or as cotrustee, they will result in inclusion of the trust property in his gross estate. Thus, it can be seen that merely the leaving of the power to invest and/or manage the corpus of the decedent is not the cause of inclusion of the corpus in the decedent's estate.

Power Limited by External Standard

The courts have limited inclusion in the grantor's estate in several respects. They do not include any part of the property subject

to a reserved power to invade principal in favor of the life beneficiary if the trust instrument reserves no real discretion but clearly establishes an external standard or conditions under which a court of equity could enforce the beneficiary's right to have the property invaded in his favor. Similarly, property is not included in the grantor's estate where the retained power to invade is conditioned on an event such as prolonged illness or financial misfortune which had not occurred before the grantor's death. Such a restriction places the change in distribution beyond the grantor's control.

The following powers are sufficiently limited by external standards and thus not included in the grantor's estate:

- 1) power to invade where necessary for the beneficiary's support, maintenance and education;
- 2) power of grantor-trustee in his uncontrolled discretion, to invade corpus when the beneficiary's income from all sources was insufficient to provide for the proper care, support and medical attention of such beneficiary during the period of any illness or other incapacity insufficient to provide for the suitable support, education and maintenance of any such beneficiary;
- 3) power of grantor and his co-trustee, in their sole discretion, to invade the corpus for the income beneficiary's benefit in the event of sickness, accident, misfortune or other emergency.

The point is that it does not matter that the decedent's power is discretionary as long as it can duly be exercised within the limits of an external standard fixed by the agreement itself. However, a truly discretionary power in the grantor to accumulate income rather than distributing it results in inclusion in his estate. For example,

a power in a trustee to distribute income to beneficiaries if in their best interests is a discretionary power since it carries no real limitation.

Transfers Taking Effect at Death

In making lifetime gifts, donors frequently attach conditions and qualifications which have the effect of postponing the time when the recipient can obtain full possession or enjoyment of the property. If possession or enjoyment of the property is deferred until the donor's death, or some later time, the lifetime gift may be regarded as a substitute for a testamentary transfer of the property and for that reason included in the donor's estate.

A decedent's gross estate includes the value of property or of an interest in property transferred by the decedent whether in trust or otherwise, except to the extent that the transfer was made for an adequate and full consideration, if all the following three conditions exist [18, Sec. 2037]:

- 1) possession or enjoyment of the property can be obtained by the donee through ownership of the transferred interest only by surviving the decedent;
- 2) the decedent retained a reversionary interest in the transferred property. The reversionary interest can arise expressly or by operation of law;
- 3) the value of the reversionary interest immediately before the decedent's death exceeded 5% of the value of the transferred property.

Property can be transferred in trust for the grantor's lifetime without fear of estate tax under the above provision. Even though the beneficiary must survive the grantor in order to obtain the property, tax can be avoided by carefully drafting the trust instrument to eliminate the possibility that a reversionary interest will arise in favor of the grantor.

Power to Revoke or Change Disposition

A property interest transferred by the decedent at any time during his life, except for full and adequate consideration, is includible in his gross estate if at the time of the decedent's death the enjoyment of the interest was subject to change through certain powers of the decedent which made the transfer revocable by him. It does not matter whether the right was exercisable by the decedent alone or in conjunction with any other person [18, Sec. 2038(a)(1)].

Transfers which are taxable by reason of reserved powers to change are generally referred to as revocable transfers. This term is used simply for brevity since the kind of power which brings about taxability includes any power affecting the time or manner of enjoyment of property or its income, even though the decedent could not benefit from its exercise and even though the identity of the beneficiary is unaffected [36, Sec. 20.2038-1(a)].

Jointly Held Property

Despite its widespread use throughout the country as a method of property ownership, jointly held property may create problems of property law, estate planning, estate administration, and gift and

estate taxes. It should be used with the utmost caution and not on the erroneous assumption that it will save estate taxes.

A decedent's gross estate includes the entire value of jointly held property except that part, if any, attributable to the consideration furnished by the other joint owner. But where the property was acquired by the decedent and the other joint owner by gift, devise, bequest, or inheritance, only the decedent's fractional share is included [18, Sec. 2040].

Special estate tax rules apply to jointly held property and joint interests in property. But the special rules apply only to these three types of interests [36, Sec. 20.2040-1(b)]:

- 1) joint tenancies;
- 2) tenancies by the entirety; and
- 3) joint bank accounts.

What the estate tax attempts to reach is, of course, only the decedent's interest in these types of ownership, but care is taken to give his interest the broadest possible definition.

All three forms of ownership have in common the predominant element of survivorship, that is, that upon the decedent's death his interest in the property, real or personal, terminates and that of his joint co-tenant automatically expands to the same extent, without necessity for any act of transfer or distribution. While tenancy by the entirety is possible only between husband and wife under Oklahoma Statutes, joint tenancy may be shared by two or more persons, related or unrelated. The main difference between these otherwise essentially similar forms lies in the individual tenant's right to sever the ties of joint ownership.

The joint ownership rule does not apply to property held by the deceased as tenant in common [36, Sec. 20.2040-1(b)]. As a result, the value of his undivided share of property held under a tenancy in common will be taxed as part of his estate. Under Oklahoma Statutes co-tenants are deemed to have entered into a tenancy in common rather than a joint tenancy or tenancy by the entirety unless a contrary intent is clearly expressed.

After the death of a joint owner, the value of the entire property is prima facie regarded as part of his gross estate, the burden of proving that some portion of the property originally belonged to the other owner or was acquired by the joint owners through gift, bequest, or inheritance is on the legal representative of the decedent.

The difficulties in proving the contribution made by surviving tenants render it frequently inadvisable, for estate tax purposes, to hold property as joint tenants or tenants by the entirety. However, a number of advantages derived from joint ownership by husband and wife may outweigh estate tax considerations. For example, on the death of one spouse, the survivor immediately acquires sole ownership of the property without the cost and delay of probate proceedings. In addition, the property is ordinarily free from the claims of the deceased's creditors.

In many cases the desirable benefits of a joint tenancy may be achieved by creating an inter-vivos trust, which is equally independent of probate administration, is a more flexible instrument of estate planning, and is free from the problems of evidence and the risks of a "wrong sequence of deaths."

If joint ownership is thought advisable, detailed records should be maintained. The source of funds expended in acquiring and improving jointly held real estate, as well as of deposits in joint bank accounts, should be established and recorded together with the specific amounts attributable to each co-tenant. Moreover, amounts withdrawn by each participant in joint accounts should be carefully entered.

Life Insurance Includible in Gross Estate

The proceeds of insurance on the decedent's life are includible in his gross estate under a special provision of the Code [18, Sec. 2042]. This includes proceeds receivable by the executor of the decedent's estate. It also includes proceeds receivable by other beneficiaries but only if the decedent possessed one or more incidents of ownership in the policy at his death. Thus, it is possible to keep insurance proceeds out of the decedent's estate by naming a beneficiary other than the insured's estate and giving up all incidents of ownership in the policy. The proceeds of life insurance policies receivable by or for the benefit of the estate, its executor or administrator, are includible in the insured's estate, no matter who took out the policy, or who paid the premiums. However, existing policies can be kept out of the estate if the insured irrevocably assigns the policy and all rights under it during his lifetime to the beneficiary or some other person. For new policies, it is usually feasible to have the policy taken out and owned by a person other than the insured.

If the proceeds are includible in the insured's estate because at his death he held an incident of ownership in the policy, the

proceeds receivable as insurance are includible in full, irrespective of the value of the incident of ownership or of the fact that some of the premiums may have been paid by the beneficiary.

The Regulations say that incidents of ownership refer to retention of the economic benefits of the policy by the insured or his estate. They include a power to change the beneficiary reserved to a corporation of which the insured decedent is sole stockholder [36, Sec. 20. 2042-1(c)(2)]. Other examples are the power to:

- 1) change beneficiaries;
- 2) surrender or cancel the policy;
- 3) obtain cash surrender value of policies otherwise irrevocably assigned to trust for benefit of children;
- 4) change beneficial ownership in insurance or its proceeds, or the time or manner of enjoyment, under the terms of a policy held in trust; and
- 5) assign the policy.

An insured ordinarily divests himself of his incidents of ownership in a policy by assigning his rights in the policy. In some cases, a particular incident of ownership may be divested by making a provision of the policy, such as the designation of a particular beneficiary, irrevocable. Policies usually require that such changes in the rights of the insured are not binding on the insurance company until it has received written notice from the insured.

Life Insurance Trusts

Life insurance may be kept out of the insured's gross estate by placing the policies in trust. However, the insured must not retain

any incidents of ownership in the policies. Where insurance owned by a person other than the insured is placed in trust, the insured should not be designated trustee or co-trustee of the trust if the trustee is to have powers over the insurance that may be held to constitute incidents of ownership; otherwise, the insurance will be includible in the insured's gross estate [18, Sec. 676 and 677].

Annuities and Pensions

An ordinary annuity payable to the decedent for his life is not includible in his gross estate since it terminates when he dies. But an annuity may be includible in the decedent's gross estate if it is for a term of years which has not expired when the decedent dies, or for the life of another who survives the decedent, or for joint lives and other annuitant survives.

Alternate Valuation (Option to Value Estate One Year After Death)

A decedent's gross estate is valued as of the date of his death unless the executor elects to use the alternate valuation [18, Sec. 2031(a)]. Under the alternate valuation method, the assets comprising the gross estate are valued as of the date of distribution of other disposition or as of one year after death, whichever occurs first. This value must be adjusted to eliminate any changes in value due to mere lapse of time after the date of death. Care must be taken to exclude items that merely represent post-death income from property included in the gross estate. Election of the alternative valuation

may be advantageous where:

- 1) the market value of assets in the gross estate declines after the date of death. Here the alternative valuation may reduce the estate tax;
- 2) after the date of death, the market value increased for assets sold, by the estate or the distributee, or for depreciable assets. Here the higher alternate valuation may produce income tax savings, because of reduced or completely eliminated gain on sale or increased depreciation deductions, in excess of the additional estate tax due to higher valuation of the gross estate;
- 3) increase in value of stock of close corporation may qualify estate for Code Section 303 nondividend redemption of stock to pay estate tax;
- 4) increase in value of decedent's closely held business may qualify estate for Code Section 6166 election to pay tax in up to 10 annual installments at 4% interest cost;
- 5) a disproportionate increase or decrease in the post-death value of marital deduction property left to the decedent's spouse in relation to other property. Here the alternate valuation may result in a smaller net taxable estate or in a taxable estate not substantially larger than under date of death values plus desirable higher income tax bases for property distributed or sold and depreciable property.

Alternate Valuation in Particular Cases

Harvested crops delivered before death to a cooperative for sale are not part of the gross estate. The gross estate includes instead the right to receive the sales proceeds from the cooperative at a future date. This right was in existence on the date of death.

Under the alternate valuation method, the value of this right is discounted to the date of death since the delay in receiving the proceeds has no relationship to the alternate valuation date.

Growing crops delivered to a cooperative for sale when they matured after death are part of the gross estate. Under the alternative valuation the growing crops are included in the gross estate at its value upon disposition at maturity.

Revenue Ruling 68-154 has important income tax implications. Since the growing crop is property, its higher value at maturity under the alternate valuation date eliminates any income tax on sale of the crop. Also, the costs of raising the crop are deductible. It may therefore be advisable to use the optional one year after death date even if it causes a higher estate tax. The income tax saving can exceed the higher estate tax. The same principle also would appear to permit elimination of income tax on post-death increment in value of young cattle whose value increases rapidly in their early years.

Oklahoma's Primary Differences in Estate Tax Computations

Estate tax laws for Oklahoma are covered in Oklahoma Statutes Sections 801 to 825. The primary differences from the federal tax deductions and allowances are mentioned in this discussion.

Oklahoma does not allow the marital deduction to be taken. A statutory exemption of \$15,000 is allowed instead of the \$60,000 exemption for federal computations. However, a \$20,000 life insurance deduction is available usually at time of husband's death, considering he dies first. A \$5,000 homestead exemption is allowed at the

deceased's death providing the homestead passes to the surviving spouse and/or a minor child. Both the \$20,000 life insurance and the \$5,000 homestead exemptions are allowed once, whereas the \$15,000 statutory exemption is allowed at both deaths.

Oklahoma requires the value of gifts made in contemplation of death within two years prior to death be included in the gross estate.

A deduction from the gross estate is allowed equal to the value of property received from an estate of a person whose death was within five years before the decease'd death, or property transferred to the deceased by gift within five years before his death [34, Sec. 801-825].

CHAPTER VI

MODEL FARMS

Introduction

Two model farms were developed for analysis in this study. One farm is representative of economic class II with gross sales of \$40,000 to \$100,000 as classified by the 1964 census. Model farm A with gross sales of \$83,511.23 was selected to be representative of this class. A second farm, model farm B was developed to represent a farm in economic class I which has gross sales of \$100,000 or more. Model farm B has a gross sales of \$177,509.46. Both farms represent the size and type of crop and livestock activities typical of farms in north central Oklahoma.

Model Farm A

The composition of farm A is presented in Table III. A gross income of \$83,511.23 was calculated for the 1440 acre farm A. Farm A has 1,110 acres of farm land with 700 acres planted to wheat and 330 acres of barley as shown in Table III. There are 320 acres of pasture land. Livestock consists of 30 cows and 223 steers to utilize the pasture land and winter small grain grazing. The resources and activities are based on profit maximizing farms linear programmed by Flaskerud [11] for north central Oklahoma.

TABLE III

MODEL FARM A

I. 1440 acres

- A. 1110 acres farm land
 - 1. 700 acres wheat
 - 2. 330 acres barley
 - 3. 80 diverted acres
- B. 320 acres pasture land
- C. 10 acres farmstead
- D. 30 cows
- E. 223 steers for wheat pasture

INCOME

Wheat (700 acres) (30. bu.) (\$1.30)	= \$23,023.00
Barley (330 acres) (35 bu.) (\$.90)	= 10,395.00
Government Payments	= 9,800.00
Cows (30 cows) (\$119.25)	= 3,577.50
Steers (223 steers) (\$157.41)	= 35,102.43
Cull Cows (t cows) (\$77.66 cap. gain) ^{1/}	= 338.30
Int. and Div. (savings, stocks, and life ins.)	= 1,225.00
Gross Income	<u>\$83,511.23</u>

EXPENSES

Cash Production Expenses:

Cow expenses (30 (\$18.62)	\$ 558.60
Steer costs (223) (\$138.07)	30,789.61
Wheat costs (700) (\$15.80)	11,060.00
Barley expenses (330 (\$16.05)	5,296.50
Diverted acres expenses (80) (\$4.55)	364.00
Int. on annual operating capital (7%) (\$18,000)	<u>1,260.00</u>

Total Cash Production Expenses \$49,468.71

Depreciation:

Cows	\$ 724.80
Bull	64.00
Machinery	1,887.78
Buildings	720.00
Pick-up and Truck	729.55
Total Depreciation	<u>\$ 4,126.13</u>
Total Cash Production Expenses & Depreciation	<u>\$53,594.84</u>

^{1/}The type of business organization determines how this long-term capital gain income is taxed.

Farm A has variable expenses of \$49,468.71 and a depreciation expense of \$4,126.13 (Table III). Therefore, farm A has a net income of \$29,916.39. A summary of the budgets for the enterprises and depreciation schedules for Farm A is shown in Appendix Tables XVI and XVII. These figures will be used in the income tax analysis portion of this study.

TABLE IV

INVESTMENT VALUE OF FARM A

Pasture land (\$185.00 (320 acres)	\$ 57,350.00
Farm land (\$343.75) (1110 acres)	381,562.50
Farmstead (\$200.00) (10 acres)	2,000.00
Buildings	15,000.00
House	25,000.00
Pick-up	1,700.00
Truck	1,650.00
Machinery	15,495.50
Cows (30) (\$225)	6,750.00
Steers (223) (\$127.35)	28,399.05
	<u>\$534,907.05</u>
Life Insurance	\$ 25,000.00
Car	2,300.00
Savings and Stocks	10,000.00
	<u>\$572,207.05</u>

Table IV shows the resources and their value, a total investment of \$572,207.05, to be used in the estate planning part of this project. The land has a value of \$440,912.50. The machinery value was based on average values and costs necessary over time to operate a farm

this size.

For analysis in this study, it is assumed the land is mortgage free because it is assumed that the farmer has always taken his savings and income and applied it back into his real estate holdings. This assumption also helps to explain why the farmer has only \$10,000 in savings and stocks. In the estate tax computations, savings and stocks are treated the same as other kinds of property. Thus, the relative amounts of savings and stocks owned have no effect on tax calculations, but might affect the estate liquidity. However, in this study the emphasis is on the tax calculations. The savings and stocks figure is a small proportion of the total investment holdings, but his real estate is debt free. It is assumed the farmer has a life insurance policy of \$25,000.

Model Farm B

The second model farm developed in this study is represented in Table V and is 2880 acres in size. It generates \$177,509.46 annually in gross income. The farm is twice as large in total acres as model farm A. The breakdown of the different sources of income and expenses is shown in Table V. The variable expenses of \$103,549.42 plus the depreciation expenses of \$6,778.06 represent total expenses of \$110,327.48. Therefore, the net income per year for this farm is \$67,181.98. One hired man was employed.

The same budgets used for farm A were used, but the total figures and specific enterprise numbers were adapted for this size of farm. The depreciation schedules for farm B may be seen in Appendix Table XVIII.

TABLE V

MODEL FARM B

I. 2880 acres

- A. 2220 acres farm land
 - 1. 1400 acres wheat
 - 2. 600 acres barley
 - 3. 160 diverted acres
- B. 640 acres pasture land
- C. 20 acres for 2 farmsteads
- D. 60 cows
- E. 446 steers for wheat pasture

INCOME

Wheat (1400 acres) (30 bu.) (\$1.30)	\$ 54,600.00
Barley (660 acres) (35 bu.) (\$.90)	20,790.00
Government Payments	19,600.00
Cows (60 cows) (\$119.25)	7,155.00
Steers (446 steers) (\$157.41)	70,204.86
Cull Cows (10 cows) (\$77.66 capital gain) ^{1/}	776.60
Bull Sales (\$108.00 capital gain)	108.00
Interest and Dividends (savings, stocks, & life ins.)	<u>4,275.00</u>
Gross Income	\$177,509.46

EXPENSES

Cash Production Expenses:

Cow expenses (60) (\$18.62)	\$ 1,009.20
Steer costs (446) (\$138.07)	61,579.22
Wheat costs (1400) (\$15.80)	22,120.00
Barley expenses (660) (\$16.05)	10,593.00
Diverted acres costs (160) (\$4.55)	728.00
Interest on annual operating capital (\$36,000) (7%)	2,520.00
Hired Labor	<u>5,000.00</u>
Total Cash Production Costs or Expenses	\$103,549.42

Depreciation:

Cows (60) (\$24.16)	\$ 1,449.60
Bulls (3) (\$64)	192.00
Machinery	2,913.78
Buildings	1,056.00
Pick-ups and trucks	1,166.68
Total Depreciation	<u>\$ 6,778.06</u>
Total Cash Production Expenses & Depreciation	<u>\$110,327.48</u>

^{1/}The type of business organization determines how this long-term capital gain income is taxed.

TABLE VI

INVESTMENT VALUE FOR FARM B

Pasture land (\$185.00) (640 acres)	\$118,400.00
Farm land (\$343.75) (2220 acres)	763,125.00
Farmsteads (\$200.00 (20 acres)	4,000.00
Buildings	22,000.00
Houses	35,000.00
Pick-ups	3,400.00
Trucks	2,550.00
Machinery	23,870.50
Cows (60) (\$225)	13,500.00
Steers (446) (\$127.35)	56,798.10
	<u>\$1,042,643.60</u>
Life Insurance	75,000.00
Car	2,300.00
Savings and Stocks	40,000.00
	<u>\$1,159,943.60</u>

The total investment items used in the estate planning portion of this study are shown in Table VI. The total land has a value of \$885,525. It is assumed the estate owner has total life insurance valued at \$75,000. Furthermore, he has \$40,000 in savings and stocks. A second farmstead for the hired labor is included. Therefore, model farm B has a total estate value of \$1,159,943.60.

Farm B also has land mortgage free. The life insurance included for farm B is \$75,000 in contrast to \$25,000 for farm A. This also will help to demonstrate the point very common to most farmers and ranchers who build large estates and at the time of death have few liquid funds to help pay the expenses incurred without impairing the

continuity of the estate. The large life insurance value in farm B will help also to illustrate an additional estate planning technique.

It is assumed that the farm family is the farm couple and two children.

CHAPTER VII

EVALUATION OF INCOME TAX LIABILITY BY FORM OF BUSINESS ORGANIZATION

In Chapter III the legal framework of taxable and nontaxable income items was discussed for each type of ownership. Deductions for each form of ownership were also considered. In this chapter, an analysis of the total federal and state income taxes paid by both model farms is made and discussed. Variations in financial structural arrangements of each major type of ownership and their impact on the farm family are also considered. This chapter enables the prudent taxpayer to re-examine his form of business organization to decide which is the most advantageous. A decision such as whether or not to incorporate requires consideration of numerous factors other than those dealing with income taxes. But, income taxes may be the deciding factor.

The amount of federal income tax, Oklahoma income tax, and self-employment of social security tax, whichever is applicable, was computed for twenty alternatives shown in Table VII for model farm A. Table VIII shows the same for twenty-one arrangements for farm B.

First each major type of business organization is analyzed. Then different types are compared.

TABLE VII
 FARM A, FEDERAL AND STATE TAXES BY TYPE
 OF BUSINESS ORGANIZATION, 1969

Line	Type of Business Organization	Entity Taxed	Federal Income Tax	Oklahoma Income Tax	Self-Employment or Social Security Tax	Total Tax
1	Sole Proprietorship	Individual	7,066	657	538	8,262
2	Partnership ^{/3} (H and W)	Individual	7,066	717	1,076	8,860
3	Partnership ^{/4} (H and W)		7,066	657	1,076	8,800
4	Partnership ^{/5} (H,W & 2 children)	Individual	4,970	343	2,023	7,355
5	Partnership ^{/6} (H,W & 2 children)	Individual	5,125	356	1,550	7,031
6	Corporation ^{/7} Owner-Operator	Corporation Individual Total	8,560 3,901 12,461	1,479 1,479		13,941
7	Corporation ^{/8} Salary & Cash Rent H and W	Corporation Individual Total	1,650 6,283 7,933	293 318 611	374 374 748	9,292
8	Corporation ^{/9} Salary & Cash Rent-No Profit H and W	Corporation Individual Total	 7,196 7,196	86 667 753	374 374 748	8,698
9	Corporation ^{/10} Salary & Cash Rent H,W, and 2 children	Corporation Individual Total	1,650 5,393 7,043	293 518 811	374 374 748	8,603
10	Corporation ^{/11} Cash Rent H,W, and 2 children	Corporation Individual Total	3,676 4,402 8,078	547 177 724		8,803
11	Subchapter S ^{/12} Corp. All Farm Assets H and W	Corporation Individual Total	 6,345 6,345	1,822 1,822	 1,076 1,076	9,243

TABLE VII CONT'D

Line	Type of Business Organization	Entity Taxed	Federal Income Tax	Okla-homa Income Tax	Self-Employment or Social Security Tax	Total Tax
12	Subchapter S/ ¹³ Corp. Land not in Corp. H and W	Corporation Individual Total	 6,539 <u>6,539</u>	1,283 <u>1,283</u>	 538 <u>538</u>	 8,360
13	Subchapter S/ ¹⁴ Corp. Land not in Corp. H, W, and 2 children	Corporation Individual Total	 5,141 <u>5,141</u>	1,283 <u>1,283</u>	 1,516 <u>1,516</u>	 7,940
14	Subchapter S/ ¹⁵ Corp. Cash Rent H, W, and 2 children	Corporation Individual Total	 5,734 <u>5,734</u>	694 139 <u>833</u>	 1,051 <u>1,051</u>	 7,617
15	Subchapter S/ ¹⁶ Corp Cash Rent & Salary - No Profit H,W, and 2 children	Corporation Individual Total	 7,622 <u>7,622</u>	86 708 <u>794</u>	374 374 <u>748</u>	 9,165
16	Trust/ ¹⁷ (All Farm Assets)	Trust	11,986	833		12,823
17	Trust/ ¹⁸ Distribute 4/5 Income to H and W	Trust Individual Total	 3,938 2,438 <u>6,376</u>	389 173 <u>562</u>		 6,938
18	Trust/ ¹⁹ Distribute 4/5 In- come to H,W, and 2 children	Trust Individual Total	 1,139 3,804 <u>4,943</u>	91 233 <u>324</u>		 5,267
19	Trust/ ²⁰ Land in Trust Receives Cash Rent	Trust Individual Total	 3,667 2,657 <u>6,324</u>	365 195 <u>560</u>	 538 <u>538</u>	 7,422
20	Trust/ ²¹ Salary and Cash Rent Distribute 1/2 In- come to H, W, and 2 children	Trust Individual Total	 886 5,952 <u>6,838</u>	64 523 <u>587</u>	 374 374 <u>748</u>	 8,174

FOOTNOTES

- /1 Includes Oklahoma franchise tax for the corporations.
- /2 Total tax may not exactly equal the total of the federal income tax, Oklahoma income tax, and self-employment or social security tax due to rounding to the nearest dollar.
- /3 Husband and wife are full partners filing separate returns.
- /4 Husband and wife are full partners filing a joint return.
- /5 Husband, wife and 2 children are equal partners, each filing a separate return (4 partners).
- /6 Husband and wife are considered as one partner receiving one-half of the net income. Two children each receive one-fourth. Husband and wife file a joint return.
- /7 Corporation is sole owner of all assets. All profit is distributed as dividends to husband and wife as shareholders. Corporation pays franchise tax on all assets. Husband is an employee of the corporation but receives no salary.
- /8 Corporation pays \$13,500 cash rent for the land and an \$8,000 salary to the man. Husband and wife also receive the miscellaneous income (income generated from the savings, stocks, and life insurance.)
- /9 Corporation has no net profit, all is paid in cash rent of \$18,000 and a \$10,300 salary. Husband and wife are shareholders. Husband and wife receive the miscellaneous income.
- /10 Corporation pays cash rent of \$13,500 and an \$8,000 salary to the husband. Dividends are divided one-half to the husband and wife and one-fourth to each child. The farm couple receive the miscellaneous income.
- /11 Corporation pays \$13,500 cash rent. Dividends go one-half to farm couple and one-fourth to each child. Farm couple receives the miscellaneous income. Husband is an employee of the corporation but receives no salary.
- /12 Corporation is complete owner. Husband and wife are shareholders. Corporation pays franchise tax on all farm assets.
- /13 Land is taken out of corporation. Husband and wife are joint shareholders with only the husband subject to self-employment tax. Farm couple receives miscellaneous income.
- /14 Income distributed one-half to farm couple and one-fourth to each child. Farm couple receives the miscellaneous income. Land not in corporation.

- /15 Husband and wife and two children shareholders. Corporation pays \$13,500 cash rent to farm couple. Farm couple receives the miscellaneous income.
- /16 Husband and wife receive \$18,000 cash rent, husband a \$10,300 salary and miscellaneous income. Corporation has no net profit.
- /17 The whole farm is held in trust. Husband is an employee of the trust and receives no salary. No franchise tax is included. However, this type of operating trust may be subject to Oklahoma franchise tax.
- /18 Trust distributes one half of net income to the farm couple. Farm couple receives the miscellaneous income. Husband is an employee of the trust and receives no salary.
- /19 Trust distributes four-fifth of net income, two-fifth to farm couple and one-fifth to each child. Farm couple receive miscellaneous income. Husband is an employee of the trust and receives no salary.
- /20 Land in trust. Husband and wife own machinery. Trust receives a cash rent of \$13,500. The trust does not distribute any income.
- /21 Trust holds machinery. Trust pays a cash rent of \$13,500 and a salary to husband of \$8,000. Trust distributes one half of net income. Farm couple and children split the distributed income.

Farm A

Sole Proprietorship

The most common form of farm business organization for model farm A, the sole proprietorship, would incur an annual income tax liability of \$8,262 (line 1, Table VII). This assumes the husband and wife file a joint return. The farmer is subject to a 6.9% self-employment tax on the first \$7,800 taxable income. Therefore, a \$538 self-employment tax is assessed.

Partnership

The partnership arrangements in Table VII show effects of partnerships and different combinations of income splitting for farm A. The footnotes should be checked to see how the ownership of the property is vested. If only the husband and wife are full partners (line 2), more taxes are generated than for other arrangements. If the husband and wife file separate returns, both are subject to self-employment taxes and also have a \$60 greater tax liability than if they file a joint return (line 3). The difference between the partnership with husband and wife filing a joint return, and the sole proprietorship form is an additional \$538 self-employment tax incurred by the wife as a full partner.

Income splitting shows its usefulness when the two children share equally in the net farm income. The tax liability decreases from \$8,800 when the husband and wife file a joint return to \$7,031 when the two children are equal partners (line 5). Therefore, a substantial tax saving is created. Some of the tax saving is lost

if the wife is considered a full partner and files a separate return, mainly because of the additional self-employment tax incurred (line 4).

In summary, the partnership with broad income splitting cuts income tax, compared to the sole proprietorship.

Corporation

The corporation may be organized in several ways, with resulting wide differences in income taxes. If a corporation distributes its profit as dividends then the well-known concept of double taxation results. The earnings are ordinarily taxed twice, once to the corporation when earned and again to the stockholders when received in the form of dividends. The above pertains primarily to federal income taxes. However, in Oklahoma, if more than 5% of the individual's gross income results from dividends from an Oklahoma based corporation, then those dividends are nontaxable for Oklahoma income tax purposes. Dividends from corporations outside Oklahoma are taxable. On the other hand, Oklahoma imposes a franchise tax on the net value of the assets held in the corporation. This tax is included in the figure in the Oklahoma income tax column in Table VII.

The issue of double taxation is clearly demonstrated on line 6 by the \$13,941 tax incurred when the corporation is the owner-operator and distributes the net profit as dividends to the husband and wife as shareholders. The amount of tax assessed can be reduced by paying a reasonable salary to the man for operating the farm, taking the land out of the corporation whereby the corporation pays cash rent for the use of the land, and dividing the net profit among the children to create more taxpaying entities. The level or amount of each above

mentioned factor is very important because of the double taxation and the tax bracket of each taxpayer. For instance, when the husband and wife are owners, the tax burden is least when the corporation operates without profit, thus paying a higher cash rent and salary to the owner of the land. Use of high cash rent and salary is illustrated in Table VII where farm A has a tax liability of \$8,698 (line 8) as opposed to \$9,292 (line 7) when a smaller cash rent and salary are paid and a net profit exists. On line 9, the amount of total tax may be decreased further by paying a smaller salary and cash rent to the husband and distributing dividends to the children. However, to accomplish this, the parents may have to make gifts of shares of stock to the children equal in proportion to the income the children receive. The man and wife are moved to a lower income tax bracket. However, the farm couple is still in a high enough tax bracket that it is still profitable to have double taxation on the dividends distributed. Thus, it is better to pay tax on the dividends and the children sharing in the income rather than on a larger salary and rent to the farm couple. Consequently, for farm A the least tax liability of \$8,603 occurs for line 9. However, the above concept can result in a fallacy without careful consideration. For example, the tax is increased for farm A by \$200 (line 10) if the cash rent and salary are reduced too much. Some taxpayers are moved to higher income tax brackets while placing others in lower tax brackets. The balance of the taxpayers are such that more dividends paid by the corporation creating double taxation is no longer profitable.

It is clear that the internal financial arrangements for the corporation can result in substantial tax savings each year of opera-

tion. The range in income tax on the alternative corporate organizations of farm A is approximately \$5,300 per year.

Subchapter S Corporation

The subchapter S corporation operates its business the same as any other corporation. The only difference from any other ordinary corporation is that the subchapter S corporation distributes to its shareholders their proportionate shares of the taxable income of the corporation. Additionally, the long-term capital gains over net short-term capital losses of the corporation retain their identity when reported on the returns of the shareholders. However, Oklahoma does not recognize the subchapter S corporation. Consequently, the corporation's taxable income is subject to the 4% Oklahoma income tax.

For farm A the subchapter S corporation is subjected to the greatest income tax when it holds all assets and the husband and wife are full partners (line 11). The tax is \$9,243. If the land were taken out of the corporation and the farm couple file a joint return as joint shareholders, then the tax is reduced about \$900 (line 12).

The more significant tax reduction occurs when the children share in the net income as full partners. Line 13 shows the tax is reduced to \$7,940 because of the income splitting whereby more taxable entities are created. However, the tax is further reduced if a reasonable cash rent is paid to the farm couple for use of the land as shown on line 14. The latter reduces the taxable income to the corporation for Oklahoma taxes and decreases the amount of distributable income subject to self-employment tax. Those factors overshadow the increase in

taxable income to the husband and wife.

Under the subchapter S arrangement it is less profitable taxwise to increase the amount of cash rent and salary paid because the income splitting effect is reduced and completely lost when the corporation makes no profit (line 15). Hence, with the subchapter S corporation a different combination of income splitting, cash rent paid, and salary paid is most profitable to achieve minimum taxes and the correct balance of taxpaying entities as compared to the regular corporation.

Trust

The trust is increasing in popularity among farmers, especially the older generation. It is assumed the trust will be taxed as a trust and not as an association or corporation as discussed in Chapter II. Having the whole farm in a trust creates a very large income tax of \$12,823 (line 16). More taxpayers are created when the trust distributes one half of its taxable income to the husband and wife, thus reducing the taxes by \$5,885 to \$6,938 (line 17). Further diminution of taxes to \$5,267 is accomplished by distributing four-fifth of the taxable income to the farm couple and the two children as on line 18. Consequently, by creating five taxpayers the taxes are greatly subsided.

Under a common situation where the land is held in trust for trust-holding purposes and the trust receives only rent, the amount of taxes is \$7,422 (line 19). A review of the line 19 organization reveals a self-employment tax assessed, fewer taxpayers, and higher income tax brackets of each taxpayer. The tax is increased if the trust employs the husband as farm manager with a salary and cash rents

the land (line 20). Such an organization increases the amount of taxes, even though the trust distributes one half of its net income to the farm couple and their children. Social security taxes have to be paid and the farm couple is subjected to a higher income tax bracket. Thus taxes increase.

Income Tax Comparison between Types Of Ownership For Farm A

The trust arrangement where the trust distributes four-fifths of the net income to the farm family (line 18) reduces the income tax liability to the minimum of alternatives considered. The major reasons are that five tax-paying entities exist, lower tax brackets are inherent in this case, and no self-employment or social security taxes are incurred because the employees receive no salary. The total tax liability is \$5,268.

The second lowest tax liability also is incurred by a trust arrangement where one half of the taxable income is distributed to the farm couple (line 17). Almost \$1,700 more taxes are due, but again no self-employment or social security tax is due. Fewer taxpayers are taxed at higher income tax rates. Income splitting under a partnership increases taxes by \$100 with the farm couple and their two children dividing the taxable income (line 5). In the latter situation a \$1,550 self-employment tax is levied. The partnership arrangement in which the wife is considered a separate and full partner (line 4) increases the total tax bill about \$300, primarily due to a large increase in the self-employment tax.

Next in tax level is the case represented by line 19 in which the land is held in trust and receives a cash rent as income to the trust, with the remaining income going to the farm couple. The subchapter S corporation arrangements would be considered next. Income is split between the corporation, the farm couple and their two children. An Oklahoma income tax is levied on the corporation itself and a self-employment tax is levied.

The sole proprietorship form has a tax approximately \$3000 greater than the lowest tax liability case considered. A larger tax is assessed because the farm couple bears the taxable income in a higher tax bracket. The fact that only the husband is subject to the self-employment tax, helps reduce the tax burden to some extent as compared to some other forms of organizations.

All forms of the regular corporation tended to have relatively high taxes. Paying a large salary and cash rent and creating more taxpayers by including the two children reduces total taxes. Primary reasons for the regular corporation's higher taxes are the corporation is subject to federal income taxes and Oklahoma income taxes as is the individual receiving dividends. On the other hand, the subchapter S corporation is only subject to Oklahoma income taxes. However, if the children were not considered as shareholders in the subchapter S corporation when it makes no profit, then its taxes would be the same as the regular corporation's taxes when it likewise makes no profit. The difference is accounted for by the number of exemptions for both federal and Oklahoma taxes and the resulting tax rates.

A few of the above organizational alternatives incur no social security or self-employment tax. In such cases, the individual loses

the retirement and disability benefits which are based on the amount of social security or self-employment tax the individual pays. Smaller amounts paid each year decrease the amount of retirement income which will be obtained upon retirement. The amount of social security and self-employment tax may be an important consideration to some business owners and affect the choice of business organization.

Farm B

One hired farm worker is employed by farm B for \$5000 per year. Consequently, a social security tax is encountered by the employer and the farm worker. However, since these figures will remain constant regardless of the form of business organization, these amounts for social security were not included in Table VIII. Unless, otherwise designated, all references to line numbers will pertain to Table VIII unless otherwise stated in this section.

Sole Proprietorship

Model farm B organized as a sole proprietorship with the farm couple filing a joint return is required to pay \$28,605 total tax as exhibited in Table VIII line 1. The farm couple is subjected to a \$26,346 federal income tax, \$1,721 Oklahoma income tax, and \$538 self-employment tax.

Partnership

Farm B is required to pay total taxes of \$29,143 when the husband and wife are full partners (line 2). Each has a self-employment tax. The tax bill is reduced to \$21,512 when all four members of the family

TABLE VIII

FARM B, FEDERAL AND STATE TAXES BY TYPE OF
BUSINESS ORGANIZATION

Line	Type of Business Organization	Entity Taxed	Federal Income Tax	Okla-homa Income Tax	Self-Employment or Social Security Tax ^{/1}	Total Tax ^{/2}
1	Sole Proprietorship	Individual	26,346	1,721	538	28,605
2	Partnership ^{/3} (H & W)	Individual	26,346	1,721	1,076	29,143
3	Partnership ^{/4} (H,W and 2 children)	Individual	17,739	1,620	1,615	20,974
4	Partnership ^{/5} (H,W and 2 children)	Individual	17,739	1,620	2,153	21,512
5	Corporation ^{/6} Owner-Operator	Corporation Individual Total	25,544 10,960 <u>36,504</u>	2,934 <u>2,934</u>		39,438
6	Corporation ^{/7} Salary and Cash Rent H and W	Corporation Individual Total	4,727 23,204 <u>27,931</u>	755 754 <u>1,509</u>	374 374 <u>748</u>	30,189
7	Corporation ^{/8} Salary and Cash Rent H, W, and 2 children	Corporation Individual Total	 26,498 <u>26,498</u>	163 2,207 <u>2,370</u>	374 374 <u>748</u>	29,616
8	Corporation ^{/9} Salary and Cash Rent H, W, and 2 children	Corporation Individual Total	4,727 20,686 <u>25,413</u>	692 1,018 <u>1,710</u>	374 374 <u>748</u>	27,871
9	Corporation ^{/10} Cash Rent H,W, and 2 children	Corporation Individual Total	6,833 18,703 <u>25,536</u>	965 745 <u>1,710</u>		27,247
10	Corporation ^{/11} Cash Rent H,W, and 2 children	Corporation Individual Total	11,585 15,369 <u>26,954</u>	1,135 434 <u>1,569</u>		28,524

TABLE VIII CONT'D

Line	Type of Business Organization	Entity Taxed	Federal Income Tax	Oklahoma Income Tax	Self-Employment or Social Security Tax ¹	Total Tax ²
11	Subchapter S ^{/12} Corp. All Farm Assets H and W	Corporation Individual Total	22,073 22,073	3,956 3,956	1,076 1,076	27,105
12	Subchapter S ^{/13} Corp. Land not in Corp. H and W	Corporation Individual Total	22,659 22,659	2,850 2,850	538 538	26,047
13	Subchapter S ^{/14} Corp. Land not in Corp. H,W, & 2 children	Corporation Individual Total	16,725 16,725	2,679 2,679	1,615 1,615	21,019
14	Subchapter S ^{/15} Corp. Cash Rent H,W, & 2 children	Corporation Individual Total	19,380 19,380	1,599 297 1,896	1,615 1,615	22,890
15	Subchapter S ^{/16} Corp. Cash Rent H,W, & 2 children	Corporation Individual Total	20,946 20,946	1,239 652 1,891	1,424 1,424	24,260
16	Subchapter S ^{/17} Corp. Cash Rent & Salary H,W, & 2 children	Corporation Individual Total	22,073 22,073	999 905 1,904	374 1,048 1,422	25,400
17	Trust ^{/18} (All Farm Assets)	Trust	36,205	1,601		37,806
18	Trust ^{/19} Distribute 1/2 Income to H & W	Trust Individual Total	12,918 9,486 22,404	900 859 1,759		24,164
19	Trust ^{/20} Distribute 4/5 In- come to H,W, & 2 Children	Trust Individual Total	3,269 12,804 16,074	328 814 1,142		17,216
20	Trust ^{/21} Land in Trust Receives Cash Rent	Trust Individual Total	10,458 11,443 21,901	767 996 1,763	538 538	24,202
21	Trust ^{/22} Salary & Cash Rent Distribute 1/2 In- come to H,W, and 2 children	Trust Individual Total	2,296 19,152 21,448	222 1,388 1,610	374 374 748	23,806

FOOTNOTES

- /1 Includes Oklahoma franchise tax for the corporation.
- /2 Total tax may not exactly equal the total of the federal income tax, Oklahoma income tax, and self-employment or social security tax due to rounding to the nearest dollar.
- /3 Husband and wife are full partners filing a joint return.
- /4 Husband and wife are considered as one partner receiving one half of the net income. Two children each receive one-fourth. Husband and wife file a joint return.
- /5 Husband, wife and 2 children are equal partners, each filing a separate return (4 partners).
- /6 Corporation is owner of all assets. All profit is distributed as dividends to husband and wife as shareholders. Corporation pays franchise tax on all assets. Husband is an employee of the corporation but receives no salary.
- /7 Corporation pays \$27,000 cash rent for the land and a \$16,000 salary to the man. Husband and wife also receive the miscellaneous income (income generated from the savings, stocks and life insurance).
- /8 Corporation has no net profit, all is paid in cash rent of \$36,000 and a \$26,500 salary. Husband and wife are shareholders. Husband and wife receive the miscellaneous income.
- /9 Corporation pays cash rent of \$27,000 and a \$16,000 salary to the husband. Dividends are divided one half to husband and wife and one-fourth to each child. The farm couple receives the miscellaneous income.
- /10 Corporation pays \$36,000 cash rent. Dividends go one half to farm couple and 1/4 to each child. Farm couple receives the miscellaneous income. Husband is an employee but receives no salary.
- /11 Corporation pays \$27,000 cash rent. Dividends go one half to farm couple and one fourth to each child. Farm couple receives the miscellaneous income. Husband is an employee but receives no salary.
- /12 Corporation is complete owner. Husband and wife are shareholders. Corporation pays franchise tax on all farm assets.
- /13 Land is taken out of corporation. Husband and wife are joint shareholders with only the husband subject to self-employment tax.

- /14 Income distributed one half to farm couple and one-fourth to each child. Farm couple receives the miscellaneous income.
- /15 Husband and wife and two children shareholders. Corporation pays \$27,000 cash rent to farm couple. Farm couple receives the miscellaneous income.
- /16 Husband and wife and two children are shareholders. Corporation pays \$36,000 cash rent to farm couple. Farm couple receives the miscellaneous income.
- /17 Husband and wife receive \$18,000 cash rent, husband a \$10,800 salary, and miscellaneous income. Corporation has no net profit.
- /18 The whole farm is held in trust. Husband is an employee of the trust and receives no salary. No franchise tax is included. However, this type of operating trust may be subject to Oklahoma franchise tax.
- /19 Trust distributes one half of net income to the farm couple. Farm couple receives the miscellaneous income. Husband is an employee of the trust and receives no salary.
- /20 Trust distributes four-fifths of net income, two-fifths to farm couple and one-fifth to each child. Farm couple receives miscellaneous income. Husband is an employee of the trust and receives no salary.
- /21 Land in trust. Husband and wife own machinery. Trust receives a cash rent of \$27,000. The trust does not distribute any income.
- /22 Trust holds machinery. Trust pays a cash rent of \$27,000 and a salary to husband of \$16,000. Trust distributes one half of net income. Farm couple and children split the distributed income.

share equally (line 4). In the latter case, all four are subject to self-employment tax. The total income tax is reduced to \$20,974 when the husband and wife file jointly and receive one half of the taxable income (line 3) and the children receive one-fourth each. Thus, a substantial tax savings, \$7,631, is encountered when income splitting is introduced as compared to a farm couple partnership. Income tax is reduced an additional \$537 by treating the farm couple jointly as a single partner to decrease the amount of self-employment tax.

Corporation

The magnitude of income taxes for farm B varies a great deal with the specific structural organization of the corporation. Farm B as a regular corporation holding all assets with the husband and wife as principal shareholders, incurs an income tax of \$39,438 (line 5). On line 6, the tax is reduced to \$30,189 when a reasonable salary of \$16,000 and a \$27,000 cash rent is paid to the husband. The tax saving results because the land is taken out of the corporation's assets, thus reducing the Oklahoma franchise tax. Also, the reduced net profit to the corporation decreases the amount of taxable income subject to the corporation's 26% surtax and diminishes the amount of double taxation. The tax bill goes down slightly when the corporation shows no net profit (line 7).

The tax saving is impressive when a smaller salary and cash rent are paid to the husband and the two children are included as shareholders (line 8). The case, line 9, where a cash rent is paid, the husband receives no salary, and the children are shareholders saves an additional \$624 over line 8. A better balance of tax rates between

a greater number of shareholders results, no longer does the special capital gains treatment have to be employed, and no social security taxes are charged under this arrangement. Table VIII, on line 10, further reveals that if a smaller cash rent is paid the tax bill increases because no longer does the relationship between these taxpaying entities exist to minimize income taxes. Thus, the corporation could afford to pay more tax rather than the individuals. The individuals are subsequently taxed at lower rates which more than offset the increased tax paid by the corporation.

Subchapter S Corporation

The subchapter S corporation exhibits greater possibilities for income tax savings than the regular corporation for the larger commercial farm. Table VIII shows a variation from \$27,105 to \$21,019 in income tax liabilities incurred by alternative subchapter S arrangements. The largest tax occurs when all farm assets are in the corporation with only the man and wife as shareholders (line 11). The farm organization where no salary or rent is paid to the husband and the net income is divided between the farm family, results in the smallest income tax liability (line 13). For the latter case, each taxpayer is in the lowest tax bracket because of the balance in distributed income to each taxpayer. The Oklahoma income tax paid by the corporation itself is made smaller as rent or salaries are paid, (lines 14, 15, and 16 vs. line 13) but the decrease does not offset the decrease in taxable income to the farm couple. Hence more income is taxed at higher rates.

Trust

The whole farm organized as a trust creates a very high income tax of \$37,806 (line 17). The holding trust with only the land included and receiving a cash rent of \$27,000 decreases the tax liability to \$24,202 (line 20). When the trust distributes one half of its income to the farm couple a \$24,164 tax is incurred (line 18). The trust arrangement whereby the husband is hired as the farm manager and the trust pays cash rent for use of the land with one half of the net income distributed to the farm family results in an additional tax saving (line 21 vs. line 18). However, the amount of income going to the farm couple is so great that a larger tax is induced than if the amount of taxable income were divided more equally between the children and trust.

The trust arrangement where the trust pays tax on one-fifth of the income and distributes the remaining part to the farm family incurs a tax of \$17,216 (line 19). In contrast to the other trust arrangements, this is a substantial tax savings. Income splitting is the main factor causing the taxes to be reduced. With the large amount of taxable income, relatively small shifts in income from one tax rate to a lower one create substantial tax savings.

Income Tax Comparison between Types of Ownership for Farm B

A review of Table VIII indicates that case 19 in which the trust is a taxpayer and distributes four-fifths of its net taxable income to the farm family members holds the income tax to the minimal amount.

The income tax is increased from \$17,216 to \$20,974 under the family partnership organization (line 3). However, the income tax is only \$45 greater when the firm is organized as a subchapter S corporation with the whole farm family as shareholders dividing the taxable farm income (line 13).

Table VIII can be further analyzed to rank organizational arrangements with respect to holding the income tax to a minimum. In addition, several general conclusions can be advanced.

As stressed in preceding sections, the farm businesses dividing taxable income more equally, thus holding income in minimum tax brackets, have the least amount of tax to pay. Table VIII discloses that the trust with income dividing techniques, the family partnership, and the subchapter S corporation were more useful in saving income taxes than the regular corporation or proprietorship. In general, the regular corporation is taxed on its taxable income before the profit is distributed creating double taxation on a large amount of income. The shareholders receiving dividends also are in high tax brackets. Likewise, the farm couple is subjected to a very high tax rate on the large taxable income from the commercial farm. Thus more taxes are paid in general by the regular corporation and the sole proprietorship.

Difference in Income Taxes from the Sole Proprietorship

The net difference in total income taxes paid by each business organization using the sole proprietorship as the base was calculated for ten alternative organizations for both model farms (see Table IX for farm A and Table X for farm B). The difference or tax saving

(a positive number) each year (in column 3) represents the amount of decrease in income taxes paid if the indicated organization is used rather than the sole proprietorship. A negative number represents additional taxes incurred by not being organized as a sole proprietorship.

Comparison of Income Taxes between
Farm A and Farm B

Farm B has approximately twice as much taxable income as farm A. Data in Tables VII and VIII allow evaluation of the type of business organization most appropriate according to a larger versus a smaller farm business.

The trust arrangement with a greater number of taxpaying entities minimized income tax for both farms. The sole proprietorship was less favorable because of the larger taxable income to only the farm couple. In addition, the regular corporation also created double taxation on the larger farm while the taxpayers remained in high tax brackets. If the corporation itself makes little or no profit and splits the income for dividends, the regular corporation is more favorable for the larger farm than the sole proprietorship (Table VIII, line 5 vs. line 1). In the case for farm A (Table VII, line 1 vs. lines 6-9), the proprietorship has a lower income tax than any corporate organization.

Column 2 in Tables IX and X ranks the amount of income taxes paid for ten alternative organizations for farms A and B respectively. The ten alternatives were chosen to demonstrate the range in income taxes paid as well as the specific comparable characteristics of the organizational farm for both farm sizes. For both farms the family income splitting technique for the partnership which incurs a \$7,031

tax ranks second. However, the second subchapter S and the second trust alternatives reverse their ranks as the farm increases in size.

The sole proprietorship ranks fifth in both case, and the regular corporation last in both instances. For farm B the subchapter S corporation in which the husband and wife are shareholders incurs a \$27,105 income tax. The above mentioned subchapter S corporation gains in rank in contrast to the regular corporation which pays no profit and the regular corporation which pays cash rent and a salary to the farm couple as compared to farm A. The reason for the rank changes as the farm size changes is because more double taxation occurs as the farm income increases. Consequently, the individuals are taxed in higher tax brackets.

The net differences for farm A are small in magnitude as contrasted to the magnitudes for farm B. Moreover, the figures which are negative for farm A and remain negative for farm B decrease by approximately twice as much. However, the positive numbers increase in magnitude much more than twice as much. Thus, a much greater tax saving results when the size of farm and net income is twice as large using the considered alternatives.

Tax Savings Over a Period of Years

The accumulated tax savings were compiled for a 10 year and a 20 year period of time for model farm A (see Table IX) and B (see Table X). A 6% compound interest rate was used.

Relatively small tax savings each year accumulate to represent important amounts over time. For instance, the family partnership for

TABLE IX

ACCUMULATED INCOME TAX SAVINGS FOR FARM A
 WITH A 6% COMPOUND INTEREST RATE FOR
 10 YEARS AND 20 YEARS

Form of Business Organization	Rank in Tax (lowest)	Income Tax Paid	Difference or Tax Sav- ings Each Year Compar- ed to Sole Proprietor- ship	Compounded Values of Income Tax Savings	
				10 Years	20 Years
Sole Pro- prietorship	5	8,262	--	--	--
Partnership ^{/1}	8	8,800	-538	-7,091	-19,791
Partnership ^{/2}	2	7,031	1,231	16,226	45,284
Corporation ^{/3}	10	13,941	-5,679	-74,855	-208,908
Corporation ^{/4}	7	8,698	-436	-5,747	-16,039
Corporation ^{/5}	6	8,603	-341	-4,495	-12,544
Subchapter S ^{/6}	9	9,243	-981	-12,931	-36,087
Subchapter S ^{/7}	4	7,617	645	8,502	23,727
Trust ^{/8}	1	5,267	2,995	39,477	110,174
Trust ^{/9}	3	7,422	840	11,072	30,900

FOOTNOTES

- /1 Husband and wife are full partners filing a joint return.
- /2 Husband and wife are considered as one partner receiving one half of net income. Two children each receive one-fourth. Husband and wife file a joint return.
- /3 Corporation is sole owner of all assets. All profit is distributed as dividends to husband and wife as shareholders. Corporation pays franchise tax on all assets.
- /4 Corporation has no net profit, all is paid in cash rent of \$18,000 and a \$10,300 salary. Husband and wife are shareholders. Husband and wife receive the miscellaneous income.
- /5 Corporation pays cash rent of \$13,500 and an \$8,000 salary to the husband. Dividends are divided one half to husband and wife and one-fourth to each child. The farm couple receives the miscellaneous income.
- /6 Corporation is complete owner. Husband and wife are shareholders. Corporation pays franchise tax on all farm assets.
- /7 Husband and wife and two children are shareholders. Corporation pays \$13,500 cash rent to farm couple. Farm couple receive miscellaneous income.
- /8 Trust distributes four-fifths of net income, two-fifths to farm couple and one-fifth to each child. Farm couple receive miscellaneous income.
- /9 Land in trust. Husband and wife own machinery. Trust receives a cash rent of \$13,500.

TABLE X
 ACCUMULATED INCOME TAX SAVINGS FOR FARM B
 WITH A 6% COMPOUND INTEREST RATE FOR
 10 YEARS AND 20 YEARS

Form of Business Organization	Rank in Tax (lowest)	Income Tax Paid	Difference or Tax Sav- ings Each Year Compar- ed to Sole Proprietor- ship	Compunded Values of Income Tax Savings 10 Years	20 Years
Sole Pro- prietorship	5	26,605	--	--	--
Partnership ^{/1}	8	29,143	-538	-7,091	-19,791
Partnership ^{/2}	2	20,974	7,631	100,584	280,714
Corporation ^{/3}	10	39,438	-10,833	-142,790	-398,503
Corporation ^{/4}	9	29,616	-1,011	-13,326	-37,191
Corporation ^{/5}	7	27,871	734	9,675	27,001
Subchapter S ^{/6}	6	27,105	1,500	19,772	55,179
Subchapter S ^{/7}	3	21,019	7,586	99,991	279.059
Trust ^{/8}	1	17,216	11,389	150,118	418,956
Trust ^{/9}	4	24,202	4,403	58,036	161,969

FOOTNOTES

- /1 Husband and wife are full partners filing a joint return.
- /2 Husband and wife are considered as one partner receiving one half of the net income. Two children each receive one-fourth. Husband and wife file a joint return.
- /3 Corporation is owner of all assets. All profit is distributed as dividends to husband and wife as shareholders. Corporation pays franchise tax on all assets.
- /4 Corporation has no net profit, all is paid in cash rent of \$36,000 and a \$26,500 salary. Husband and wife are shareholders. Husband and wife receive the miscellaneous income.
- /5 Corporation pays a \$27,000 cash rent and a \$16,000 salary to the husband. Dividends are divided one half to husband and wife and one-fourth to each child. The farm couple receive the miscellaneous income.
- /6 Corporation is complete owner. Husband and wife are shareholders. Corporation pays franchise tax on all farm assets.
- /7 Income is distributed one half to farm couple and one-fourth to each child. Farm couple receive the miscellaneous income.
- /8 Trust distributes fourth-fifths of net income, two-fifth to farm couple and one-fifth to each child. Farm couple receive miscellaneous income.
- /9 Land in trust. Husband and wife own machinery. Trust receives a cash rent of \$27,000.

farm A represents a tax saving in contrast to the sole proprietorship of \$1,231 per year. But over 10 years a tax saving of \$16,226 results and \$45,284 over 20 years.

For farm B which has approximately twice as much gross income as farm A, for the small family partnership arrangement (see Table X) a tax saving of \$7,631 per year yields a savings of \$100,584 in 10 years and \$280,714 after 20 years. Other positive and negative savings can be seen in the tables.

As mentioned previously in this thesis, the trend towards larger-scale farms will continue in the future. The tax savings, over a period of time, can help build the size of the farm business. Additional land can be acquired with the accumulated income tax savings. Therefore, the form of organization can be an important factor for the amount of income a farm business may save by careful attention to the form of organization.

CHAPTER VIII

ANALYSIS OF ESTATE AND GIFT PLANNING TECHNIQUES AS APPLIED TO THE MODEL FARMS

Introduction

In this chapter, an analysis of estate planning techniques along with gift tax planning for both model farms is discussed. The legal framework for estate and gift taxes was discussed in Chapters IV and V. Deductions, exemptions, and tax computation steps for the various estate planning techniques are developed to arrive at the net taxable estate for both federal and Oklahoma estate and gift taxes. This chapter demonstrates the amounts of federal estate tax, Oklahoma estate tax, and administration expenses for alternative methods of estate planning. This chapter also shows economic considerations which the estate owner should take into account along with his personal goals and desires for transferring his property in order to provide for the requirements of his family in the most economical way.

The amount of the federal estate tax, Oklahoma estate tax, total estate tax, administration expenses, total estate taxes and administration expenses, and the amount of the estate left passing to the children was computed for alternative estate plans for farm A in Table XI and farm B in Table XIII. Then, a gift program for each farm is shown in Tables XII and XIV.

The gross investment value for each model farm represents the gross estates to which alternative estate planning techniques are applied in this chapter. Therefore, the techniques can be compared. The alternative cases in this chapter which are closely associated with the alternative organizational structures in Chapter VII for income tax computations are mentioned when applicable. However, the forms of organizations, such as the sole proprietorship, the corporation, or the trust, may or may not affect the gross estate. If the gross estate is not affected, then the same estate planning techniques apply. However, gifts of, say, stock to accomplish income splitting objectives affect the gross estate. Alternatively, gifts for estate planning purposes affect income taxes. Gift programs are discussed in this chapter both for estate planning purposes and to show how some of the organizational structures with the children receiving income as mentioned in the previous chapter are accomplished. In that case, an interaction of income tax and estate planning results. All interactions are not traced out.

The administration expense item is assumed equal to 5% of the gross estate when applicable. The 5% figure is an approximation of expenses incurred in administration of the estate, including items such as attorney fees, actual executor and administrator fees, estate tax return preparations, and probate costs. The analysis further assumes that the husband is survived by his spouse. For simplicity and analysis, it is assumed the wife's estate is the amount transferred to her at the husband's death or what she has title to in the farm business, whatever is the case.

The tax rates for figuring the federal and Oklahoma estate taxes,

as well as the gift taxes, are in Appendix Tables XXII - XXVI.

Farm A

Estate Taxes

Model farm A has a gross estate of \$572,207. Table XI represents alternative estate plans for cases for this farm. The footnotes define how the estate is owned and the estate planning techniques used.

In many instances, the husband just makes a simple will instrument and leaves the property to his wife. Subsequently, she leaves the property to her children in her will. This is case 1 for farm A. The property incurs at both deaths a federal estate tax of \$150,515, and an Oklahoma estate tax of \$53,272. Therefore, the total estate taxes are \$203,787. Also, since the estate has two administration fees totaling \$51,764, one fee at each death, only \$316,656 of the original estate passes to the couple's children at time of wife's death. It is assumed the wife survives the husband by at least ten years. Case 1 can apply to the sole proprietorship and both corporate forms of organizations mentioned in Chapter VII where the husband owns the stock.

With reference to the amount of the estate tax liability, perhaps the estate planning tool most overworked by farmers and ranchers is the ordinary joint tenancy with rights of survivorship illustrated in Case 2, Table XI. The large estate tax liability results from the fact that under both the Federal and Oklahoma Estate tax laws, the joint tenancy property is fully taxable in the estate of the joint tenant dying first, except to the extent that the surviving joint

TABLE XI

ESTATE TAXES AND ADMINISTRATION EXPENSES FOR FARM A

Case Number		Federal Estate Tax	Oklahoma Estate Tax	Total Estate Taxes	Administration Expenses	Total Estate Taxes and Admin. Expenses	Net Estate Left Passing to Children
<u>1.</u> /	Husband's Death	51,317	29,202		28,610		
	Wife's Death	99,198	24,070		23,154		
	Total	150,515	53,272	203,787	51,764	255,551	316,656
<u>2.</u> /	Husband's Death	55,265	31,204				
	Wife's Death	105,396	25,469		24,286		
	Total	160,661	56,672	217,303	24,286	241,620	330,587
<u>3.</u> /	Husband's Death	128,707	29,292	157,909	28,610		
	Wife's Death						
	Total	128,707	29,202	157,909	28,610	186,519	386,688
<u>4.</u> /	Husband's Death	51,317	29,202		28,610		
	Wife's Death	51,317	13,142				
	Total	102,634	42,344	144,978	28,610	137,588	398,619

TABLE XI CONT'D

Case Number		Federal Estate Tax	Oklahoma Estate Tax	Total Estate Taxes	Administration Expenses	Total Estate Taxes and Admin. Expenses	Net Estate Left Passing to Children
55./	Husband's Death	51,317	29,202		28,610		
	Wife's Death	47,566	11,693		13,590		
	Total	98,883	40,895	139,778	42,200	181,978	390,229
66./	Husband's Death	51,317	29,202		28,610		
	Wife's Death	47,566	11,693		13,590		
	Total	98,883	40,895	139,778	42,200	181,978	390,220
77./	Husband's Death	51,317	11,608		14,305		
	Wife's Death	51,317	13,142		14,305		
	Total	102,634	24,750	127,384	28,910	155,994	416,213
88./	Husband's Death	13,665	11,608		14,305		
	Wife's Death	89,917	21,975		21,458		
	Total	103,582	33,583	137,165	35,763	173,928	399,279

TABLE XI CONT'D

Case Number	Federal Estate Tax	Oklahoma Estate Tax	Total Estate Taxes	Administration Expenses	Total Estate Taxes and Admin. Expenses	Net Estate Left Passing to Children
<u>9.</u> /						
Husband's Death	76,870	29,202		28,610		
Wife's Death	26,161	7,672				
Total	103,031	36,874	139,905	28,610	168,515	403,692

FOOTNOTES

(Table IX)

1. Husband has complete ownership of the whole estate. At his death he gives the property outright to his wife. The wife in her will leaves the property to the children at her death.
2. The property is held in joint tenancy or joint ownership with rights of survivorship. The wife cannot prove any contribution to the estate.
3. At husband's death his estate is placed in one trust. The income is directed to be paid to his wife for life. Subsequently, at the wife's death the property is to be distributed to the children. There is no estate tax at the wife's death.
4. The two part marital deduction trust technique is used. One half of the husband's estate goes into a marital deduction trust for the wife. The wife has a general power of appointment over this trust. The other one half goes into another trust for the wife from which she receives the income over this life and the children the remainder interest. This portion is not taxed at her death. The maximum marital deduction is allowed in this case. It is assumed the wife does not exercise her general power of appointment on the marital deduction trust portion.
5. The marital deduction two trusts method is used where two trusts are created at the husband's death. One trust is equal in value to the maximum marital estate tax deduction. In this trust the wife has a general power of appointment over the trust property. In the second trust, which is the balance of husband's property, the wife receives the income for life and the children receive the remainder at her death. The second trust is not taxed at her death. It is assumed the wife exercises her power of appointment in favor of her estate on the first trust. Therefore, that part is subject to administration expenses also.
6. At husband's death one half of the estate is left to wife outright and complete and the other one half is left in a life estate with the wife receiving income for her life with a remainder interest to the children. The marital deduction is allowed at time of husband death. At wife's death the life estate portion is not included in the wife's estate.

FOOTNOTES CONT'D

(Table XI)

7. The wife owns one half of the estate and the husband owns one half. At the husband's death he leaves the property to his wife in a life estate with a remainder interest to the children. There is no tax on the life estate portion left to the wife at wife's death. The marital deduction is not allowed. The property at the husband's death could also have been left in a trust with the same estate tax treatment.
8. The wife owns one half of the original estate and the husband owns one half of the estate. At the husband's death he sets up a two part trust plan. Part A which is one half of his estate goes to the wife's marital deduction trust. The remaining one half of his estate, part B, goes into another trust with the wife receiving income for life and the children the remainder interest.
9. The two part marital deduction trust plan is used. In this case the marital deduction trust portion is equal to only one third the value of the husband's gross estate. Therefore, this case is the same as case 4 except the marital deduction is one third instead of one half. The difference in federal estate taxes is usually greater than in this case. However, the same tax rate applies to a taxable estate from \$100,000 to \$250,000.

tenant can prove contribution to the acquisition of the property in the estate. Most often, it is impossible for the surviving joint tenant to provide sufficient proof. If the husband dies first, the entire joint tenancy property is placed in his estate and it is difficult to prove the wife furnished any consideration because in most families the husband is the income producer. Then upon the wife's subsequent death the whole estate is subject to a second estate tax. Thus, it is possible to incur unnecessary estate tax simply because the property is held in joint tenancy. Consequently, farm A incurs a \$160,661 federal estate tax and an Oklahoma estate tax of \$56,672. A larger estate tax of each type is required at both deaths of the husband and wife. Case 2 pays \$13,516 more estate taxes than by the outright method, case 1, because no administration expenses are incurred at the husband's death which increases his taxable estate. Likewise, the wife has a larger taxable estate. Since joint tenancy avoids regular probate at time of the husband's death, the total estate taxes and administration expenses are smaller for case 2 than case 1.

Case 2 may also represent a partnership, a coporation, or a subchapter S corporation where the surviving spouse, usually the wife, cannot prove contribution to the acquisition of the property in the estate. Therefore, case 2 may be interpreted as an estate plan for the partnership organizations where the husband and wife own the property (lines 2 and 3), the first three corporate organizations (lines 6, 7, and 8) and the two subchapter S corporations (lines 11 and 12) in Table VII.

A total estate tax saving of \$59,394 can be achieved when the estate is placed in a trust at the husband's death, case 3, in compari-

son to the joint tenancy with rights of survivorship (case 2). In case 3, there are no taxes or administration expenses at the death of the surviving spouse. Even though the marital deduction is not allowed in the computations for case 3, \$386,688 of the original \$572,207 estate is passed to the children versus \$330,587 by the joint tenancy method. That represents a considerable portion of the initial estate. The single trust technique is compatible with the first two trust organizational structures in Table VII.

Case 4 represents the two part trust estate planning technique where the maximum marital deduction for the federal estate tax computation is employed. The maximum marital deduction is equal to one half of the adjusted gross estate. Consequently, the husband's net taxable estate is taxed at a lower tax rate for the federal estate tax computation. Also, an amount equal to the maximum marital deduction is placed in a marital deduction trust for the wife and she has a general power of appointment. The husband also names the beneficiaries and how the trust is to be distributed at the spouse's death if she does not exercise her general power of appointment in favor of her estate. Case 4 assumes she does not. Therefore, at her subsequent death that portion of the original estate is taxable in her estate which incurs a \$51,317 federal estate tax and a \$13,142 Oklahoma estate tax. Also, there are no administration expenses at her death.

The second trust created represents the portion of the original estate remaining after the maximum marital deduction portion, estate taxes and administration expenses are deducted. This trust is not taxable at the wife's death, even though the wife receives the income from it for life and the children have a remainder interest.

The estate planning technique represented by case 4 is becoming more useful because the minimum federal estate taxes are levied, the same amount of federal taxes are paid at each death, the wife still receives income for life from the whole estate, and a trustee may be used for the management of the trusts. Compared to any of the previously discussed alternatives, this case transfers more to the children after taxes and administration expenses. For instance, in comparison to the joint tenancy, \$68,032 more is transferred to the children.

The biggest advantage case 4 has in contrast to case 3 is that the estate is taxed at two different times, thus allowing the wife use of more money during her lifetime. However, in case 4 the wife incurs an Oklahoma estate tax at the time of her death.

Case 5 represents the same alternative as case 4 except the wife exercises her general power of appointment or in some way makes a move in favor of her estate. Therefore, an administration fee is imposed at the wife's death. Consequently, the administration expense item is deductible from the gross estate and both the federal estate tax and Oklahoma estate tax are less than for case 4. However, the total administration expenses and estate taxes are greater. Only a \$390,229 estate is left after the wife's death.

Instead of creating trusts, case 6 represents the situation where one half of the estate is given outright by deed and one half is left in a life estate for the wife with a remainder interest to the children. Case 6 also assumes the marital deduction portion is taxable in the wife's estate at her death. Therefore the estate expenses for case 5 and 6 are the same. Cases 4, 5, and 6 can represent estate planning techniques for the sole proprietorship and both types of corporations

where the husband owns the stock as set forth in the previous chapter.

Case 7 explores what the estate expenses would be if the wife owned one half of the estate as well as the husband having title to one half. Since the wife is left a life estate or a trust which is not taxable at her death, the husband's estate is smaller, thus encountering less Oklahoma estate taxes, and the total administration expenses are only slightly increased over case 4. An estate of \$416,213 is passed to the children.

Case 8 is the same as alternative 7 except the husband employs the two part marital deduction technique for his one half of the original estate. He also gets the benefit of the marital deduction whereas in case 7 he did not. However, the spouse's estate increases in size; thus subjecting it to higher rates for both Oklahoma and federal estate taxes as well as increasing the administration expenses at the spouse's death. This example conveys the idea that the size of the wife's estate before the husband's death is the deciding factor of whether a person would want the maximum marital deduction or not to help minimize the total taxes levied on the total estate. If the wife has a large estate with sufficient income, then total estate taxes are increased when a greater portion of the husband's estate is passed to the wife.

Cases 7 and 8 distinctly demonstrate the importance of record keeping and being able to prove the wife's ownership share of the property. These two cases can represent estate plans for property held in joint ownership with rights of survivorship also. The organizational structures used for figuring income tax liabilities to which cases 7 and 8 are applicable can be the same as mentioned for cases 1 and 2 in

which the whole estate is taxable at the husband's death and the property is held in joint tenancy respectively. Thus, tremendous estate tax and administration expenses savings are clearly demonstratable.

The two part marital deduction trust alternative was used in case 9 but the marital deduction trust portion represented only one-third instead of the maximum one half of the adjusted gross estate. In contrast to case 4, more federal estate taxes are paid because less than the maximum marital deduction was used. However, less total Oklahoma estate taxes are levied and the total Oklahoma and federal estate taxes liability is decreased. This helps to illustrate the point that while planning an estate both the federal and Oklahoma estate taxes need to be considered.

Gift Taxes

Table XII represents further estate planning by using gifts as a means to minimizing total taxation, thus passing more of the estate to the children. However, the gift is a proper device for minimizing taxes only if the transfer is economically sound. Certain basic factors determine the practicality of the living gift as a means of tax reduction. Economically, the gift usually should be given provided that the gift tax to be incurred, weighted by a compound interest factor for the life expectancy of the donor, remains less than the expected total death tax savings as a result of the transfer by gift.

Through the use of a gift program, the farm couple can transfer property in the form of gifts to represent other combinations of the internal structure of the different types of organizations as represented in the previous chapter. The farm couple uses this plan for a

TABLE XII

GIFT TAXES, ESTATE TAXES, AND ADMINISTRATION
EXPENSES FOR FARM A

Case Number		Federal Gift Tax	Oklahoma Gift Tax	Federal Estate Tax	Oklahoma Estate Tax	Total Taxes	Administration Expenses	Total Estate Taxes, Admin. Exp. and Gift Taxes	Net Estate Left Passing to Children
10 ^{1./}	Husband's Death			39,517	23,626		24,110		
	Wife's Death			39,517	10,543		-0-		
	Total		1,700	79,034	34,169	114,903	24,110	139,013	433,194
11 ^{2./}	Husband's Death			22,213	8,045		17,610		
	Wife's Death			22,222	6,838		-0-		
	Total	9,116	4,420	44,435	14,883	72,854	17,610	98,018	474,189

FOOTNOTES

(Table XII)

1. The two part estate plan is used as explained in case 4. It is assumed the husband and wife give the two children the \$6,000 lifetime exemption in property the first year plus the \$6,000 annual exemption. The four subsequent years \$3,000 per year is given per child.
2. The two part estate plan is used as explained in case 4. In addition the husband and wife use their \$60,000 lifetime gift exemption the first year. In addition \$16,000 per child is given the first year as well as four subsequent years.

corporation or trust for which the income is split with the children.

Case 10 in Table XII represents an alternative where only the \$60,000 federal lifetime exemption for husband and wife the first year and the \$6,000 exclusion per year to each of the two children was employed over a five year period. The two trusts estate planning technique using the maximum marital deduction was employed along with the alternative gift tax program for this case. An Oklahoma gift tax of \$1700 was levied because there is no \$30,000 lifetime exemption per spouse.

The total estate and gift taxes are \$114,903, a saving of \$30,075 from the estate tax liability of the same estate if the gift program were not included (case 10 vs. case 4).

When about one half of the land value, or \$220,000, is given to the two children in a five year gift program, case 11 reveals that only \$72,854 in taxes are levied. A \$474,189 estate is passed to the children at the wife's death.

These examples clearly demonstrate that for farm A which has a \$572,207 estate, estate planning techniques can save a big portion of the estate which ultimately passes to the two children. For instance, case 1 leaves only a \$316,656 in contrast to \$474,189 as in case 11. This is a total tax and administration expense saving of \$157,503. This figure represents approximately 27% of the original estate. The saving would be impressive for other alternatives to case 1.

Farm B

Estate Taxes

Model Farm B has a total estate value of \$1,159,944. Land represents \$885,525 of the gross estate. Table XIII shows the estate taxes and administration expenses for the same estate planning techniques used for model farm A.

The larger size farm B should increase the amount of estate taxes and administration expenses. The importance of estate planning is expected to be demonstrated more clearly because higher tax brackets are encountered by the larger estate. Thus, a greater proportion of farm B's gross estate may be diminished because of the estate tax liability. Therefore, a smaller percentage of the estate is passed to the next generation. The liquidity problem mentioned earlier in this study should be noticed because of the magnitude of the estate tax liability.

The different cases for farm B can be related to the alternative business organizational plans in Table VIII similar to the way the estate tax examples for farm A were related to Table VII previously in this chapter. The types of estate plans are associated with the same alternative business organizations and will not be emphasized in this section. However, the gift program employed for farm B will be given special attention.

Case 1 in which the whole estate is left to the spouse and then it passes to the children at her death incurs a \$478,849 total estate tax. Only \$578,045, or about 50% of the original \$1,159,944 estate is passed to the children at the wife's death.

If the farm is held in joint tenancy with rights of survivorship the federal estate tax and Oklahoma estate tax combined increase to \$508,664 as compared to case 1. However, there is not a regular administration expense at the husband's death. Consequently, the adjusted gross estate is larger. Moreover, a larger estate tax is levied.

When the farm is left in a trust (case 3) there is an estate tax saving of \$135,374 in contrast to case 2 and a \$728,657 estate passes to the children. This is an 11% increase in the estate passing to the children compared to the joint tenancy technique.

Case 4 represents the two part trust method which utilizes the maximum marital deduction. The estate taxes are decreased to \$363,170. In contrast to case 3, the wife has use of more money during her lifetime because a smaller federal estate tax is levied at the husband's death. However, the wife has an Oklahoma estate tax payable at her death. Consequently, an estate of \$739,777 is passed to the two children which represents 64% of the original gross estate.

Case 5 is the situation where the wife exercises her general power of appointment in her marital deduction trust or in favor of her estate. Thus that portion is subject to administration expenses.

Consequently, the total taxes and administration expenses are \$441,874 in contrast to case 4 of \$421,167.

When the two part trust method is not used, usually about the same type of estate plan and the same estate taxes and expenses are incurred as in case 6. One half of the estate is left to the wife outright and complete and one half in a life estate with a remainder interest to the children.

If one half of the estate is owned by the wife before the husband's death, as represented by case 7, then more tax savings may be achieved. The amount passing to the children increases to \$780,966. But in case 8, where the husband leaves his one half in a two part marital deduction trust plan, the total taxes and administration expenses increase by \$41,851 over case 7. The increase is because the wife already has one half of the original estate and then at her death one half of the husband's estate is taxed again in her estate. Thus, cases 7 and 8 show the importance of considering the size of the wife's estate while planning an estate this large because of the high estate tax rates to which it is subjected.

Case 9 represents a situation where less than the maximum marital deduction is employed. On this size of estate, the decrease in Oklahoma estate more than offset the increase in federal estate taxes. Thus \$8,219 more is passed to the children than in case 4.

Gift Taxes

Table XIV represents gift alternatives for farm B. Cases 10 and 11 for farm B represent the same gift program as discussed previously in cases 10 and 11 for farm A. Case 10 incurs taxes and administration expenses of \$384,744. Case 11 decreases the total taxes and expenses to \$357,944 by reducing the estate over a five year period by \$220,000 which is about one-fourth of the land value.

Case 12 allows a further reduction in total estate taxes and gift taxes to \$281,208 and the total expenses to \$320,206. The reduction is achieved because the portion of the estate tax to the lower brackets of the gift tax. Thus, more of the estate passes to the children

TABLE XIII

ESTATE TAXES AND ADMINISTRATION EXPENSES FOR FARM B

Case Number		Federal Estate Tax	Oklahoma Estate Tax	Total Estate Taxes	Administration Expenses	Total Estate Taxes and Admin. Expenses	Net Estate Left Passing to Children
1 ^{1./}	Husband's Death	130,773	70,156		57,997		
	Wife's Death	224,722	53,198		45,051		
	Total	355,495	123,354	478,849	103,048	581,897	578,045
2 ^{2./}	Husband's Death	139,491	73,995				
	Wife's Death	238,615	56,509				
	Total	378,106	130,504	508,610	47,322	555,932	604,012
3 ^{3./}	Husband's Death	303,134	70,156		57,997		
	Wife's Death						
	Total	303,134	70,156	373,290	57,997	431,287	728,657
4 ^{4./}	Husband's Death	130,773	70,156		57,997		
	Wife's Death	130,773	31,468				
	Total	261,546	101,624	363,170	363,170	421,167	738,777

TABLE XIII CONT'D

Case Number		Federal Estate Tax	Oklahoma Estate Tax	Total Estate Taxes	Administration Expenses	Total Estate Taxes and Admin. Expenses	Net Estate Left Passing to Children
<u>5.</u> /	Husband's Death	130,773	70,156		57,997		
	Wife's Death	125,859	29,540		27,549		
	Total	256,632	99,696	356,328	85,546	441,874	718,070
<u>6.</u> /	Husband's Death	130,773	70,156		57,997		
	Wife's Death	125,859	29,540		27,549		
	Total	256,632	99,696	356,328	85,546	441,874	718,070
<u>7.</u> /	Husband's Death	130,772	29,718		28,999		
	Wife's Death	130,772	29,718		28,999		
	Total	261,544	59,436	320,980	57,998	378,978	780,966
<u>8.</u> /	Husband's Death	52,334	29,718		28,999		
	Wife's Death	215,220	51,060		43,498		
	Total	266,554	80,778	347,332	72,497	420,829	739,115

TABLE XIII CONT'D

Case Number		Federal Estate Tax	Oklahoma Estate Tax	Total Estate Taxes	Administration Expenses	Total Estate Taxes and Admin. Expenses	Net Estate Left Passing to Children
<u>99</u> /	Husband's Death	187,159	70,156				
	Wife's Death	78,286	19,350				
	Total	265,445	89,506	354,951	57,997	412,948	746,996

FOOTNOTES

(Table XIII)

1. Husband has complete ownership of the whole estate. At his death he gives the property outright to his wife. The wife in her will leaves the property to the children at her death.
2. The property is held in joint tenancy or joint ownership with rights of survivorship. The wife cannot prove any contribution to the estate.
3. At husband's death his estate is placed in one trust. The income is directed to be paid to his wife for life. Subsequently, at the wife's death the property is to be distributed to the children. There is no estate tax at the wife's death.
4. The two part marital deduction trust technique is used. One half of the husband's estate goes into a marital deduction trust for the wife. The wife has a general power of appointment over this trust. The other one half goes into another trust for the wife from which she receives the income for life and the children the remainder interest. This portion is not taxed at her death. The maximum marital deduction is allowed in this case. It is assumed the wife does not exercise her general power of appointment on the marital deduction trust portion.
5. The marital deduction two trusts method is used where two trusts are created at the husband's death. One trust is equal in value to the maximum marital estate tax deduction. In this trust his wife has a general power of appointment over the trust property. The second trust, which is the balance of husband's property, in which the wife receives the income for life and the children receive the remainder at her death. The second trust is not taxed at her death. It is assumed the wife exercises her power of appointment in favor of her estate on the first trust. Therefore, that part is subject to administration expenses also.
6. At husband's death one half of the estate is left to wife outright and complete and the other one half is left in a life estate with the wife receiving income for her life with a remainder interest to the children. The marital deduction is allowed at time of husband's death. At wife's death the life estate portion is not included in the wife's estate.

FOOTNOTES CONT'D

(Table XIII)

7. The wife owns one half of the estate and the husband owns one half. At the husband's death he leaves the property to his wife in a life estate with a remainder interest to the children. There is no tax on life estate portion left to wife at wife's death. The marital deduction is not allowed. The property at the husband's death could also have been left in a trust with the same estate tax treatment.
8. The wife owns one half of the original estate and the husband owns one half of the estate. At the husband's death he sets up a two part trust plan. Part A which is one half of his estate goes to the wife's marital deduction trust. The remaining one half of his estate, part B, goes into another trust wife and wife receiving income for life and the children the remainder interest.
9. The two part marital deduction trust plan is used. In this case the marital deduction trust portion is equal to only one-third the value of the husband's gross estate. Therefore, this case is the same as case 4 except the marital deduction is one-third instead of one half.

through gifts. For instance, case 12 passes \$839,738 as compared to case 4 of \$738,777.

When the children own property as in case 12, the case is closely comparable to alternatives in Table VIII where the children receive one half of the income. Case 12 demonstrates how estate taxes can be greatly reduced with a larger percentage of the gross estate passing to the children.

Lines 13 and 19, Table VIII, represent business organizational structures comparable to case 12. Lines 13 and 19 which represent a subchapter S corporation and a trust respectively, are relatively desirable in minimizing the income tax liability to farm B. Thus, through income tax management and estate planning, a tremendous amount of income received by the firm can be retained while at the same time the estate tax can be reduced. Therefore, a larger estate can be passed to the children. Thus, the mentioned cases demonstrate that income tax management and estate planning techniques work together for estate owners; that is, through efficient management the farm business does not have to sacrifice income tax minimization techniques to achieve estate tax savings.

Life Insurance and Life Insurance Trust

Another estate planning tool may be employed for farm B since there is a \$75,000 life insurance policy. By having the wife as the policy owner and beneficiary on the husband's life with the policy in a trust, the insurance amount does not enter into the husband's estate. The husband has no incidents of ownership. Case 13 is the same as 12 except that the life insurance trust is added. The result is that

TABLE XIV
GIFT TAXES, ESTATE TAXES, AND ADMINISTRATION
EXPENSES FOR FARM B

Case Number		Federal Gift Tax	Oklahoma Gift Tax	Federal Estate Tax	Oklahoma Estate Tax	Total Administration Taxes	Administration Expenses	Total Estate Taxes, Admin. Exp. and Gift Taxes	Net Estate Left Passing to Children
10 ^{1./}	Husband's Death			118,802	63,433		53,497		
	Wife's Death			118,802	28,510		-0-		
	Total		1,700	237,604	91,943	331,247	53,497	384,744	775,200
11 ^{2./}	Husband's Death			117,659	54,171		46,997		
	Wife's Death			101,085	24,496		-0-		
	Total	9,116	4,420	218,744	78,667	310,947	46,997	357,944	802,000
12 ^{3./}	Husband's Death			79,196	43,016		38,997		
	Wife's Death			79,196	19,556		-0-		
	Total	48,984	11,260	158,392	62,572	281,208	38,997	320,206	839,738
13 ^{4./}	Husband's Death			68,837	38,029		35,247		
	Wife's Death			90,536	22,115				
	Total	48,984	11,260	159,373	60,144	279,761	35,247	315,008	844,936

FOOTNOTES

(Table XIV)

1. The wife owns one half of the original estate and the husband owns one half of the estate. At the husband's death he sets up a two part trust plan. Part A which is one half of his estate goes to the wife's marital deduction trust. The remaining one half of his estate, part B, goes into another trust wife and wife receiving income for life and the children the remainder interest.
2. The two part marital deduction trust plan is used. In this case the marital deduction trust portion is equal to only one third the value of the husband's gross estate. Therefore, this case is the same as case 4 except the marital deduction is one third instead of one half.
3. The two part estate plan is used as explained in case 4. The husband and wife give \$60,000, property the first year plus \$32,000 per child. In each of four subsequent years the couple gives \$64,000 to the children per year. Therefore, the estate is reduced by \$380,000. A \$779,944 estate is left to husband and wife.
4. This case is the same as case 3 except the \$75,000 insurance policy on the husband's life is owned by the wife in a \$75,000 trust. This reduces the estate further to \$704,944 at the husband's death.

estate taxes and administration expenses are decreased, and a larger estate is passed to the children.

Case 13 also serves to illustrate another very important point. Most farmers and ranchers have spent a life time building large estates. Most of their property is tied up in fixed capital assets and other non-liquid items. Consequently, the need for immediate cash during the critical period following death could mean a heavy financial loss to the estate as a result of a forced sale. Case 13 provides \$75,000 cash at the time of the husband's death. Also, in this particular instance, the life insurance is not a part of the husband's estate.

Life insurance also may be obtained just to provide liquidity at the time of death and be included in the decedent's estate. This accomplishes the same purpose but does increase the size of the decedent's estate. However, the decedent still has the privileges of the incidents of ownership. Life insurance has the obvious advantage of providing instant liquidity upon the death of the insured. Therefore, persons with larger estates should consider life insurance to provide liquidity at time of death if cash of some form is not available.

Charitable Bequests

Another estate planning tool is the use of charitable contributions. Unlike the income tax deduction, there is no limitation on the amount of the estate tax deduction. The full amount of any property passing to a qualified charity is tax-free. Thus if a person wants to make a large contribution to charity, the estate taxes are reduced substantially because it is a deduction from the adjusted gross estate. If the decedent wants to pay no federal estate tax, he may give an

amount equal to \$60,000 less than the marital deduction which enters into his wife's estate. Therefore, his taxable estate has a zero basis as illustrated in Table XV for model farm A.

TABLE XV
COMPUTATIONS USING THE CHARITABLE CONTRIBUTION
TO INCUR NO ESTATE TAXES

Gross estate	\$572,207
Less approximate administration expenses	28,610
Adjusted gross estate	<u>543,597</u>
Less marital deduction	271,799
Less charitable bequests	<u>211,799</u>
Net estate	60,000
Less specific statutory exemption	<u>60,000</u>
Net taxable estate	<u>-0-</u>

Subsequently, if the wife leaves her whole estate to charity at her death, then no estate tax is levied at that time either. Charitable contributions may be used in estate planning to help reduce estate taxes and satisfy some desires of the settlor.

Comparison in Estate Planning Techniques
between Farm A and Farm B

The different estate planning techniques had about the same general effects on each model farm. However, a larger proportion of the estate left to pass to the children is exhibited in the computations

for farm A in contrast to farm B. For example, case 5 for each farm shows that 68% of the original estate is passed to the children in farm A and only 62% for farm B. This is because the larger farm's estate is subjected to higher tax rates.

When gifts were introduced, very noticeable effects were exhibited in the decrease in taxes. Farm A had a 9% increase, as compared to farm B, in the estate passed to the children after both spouse's death (case 10 vs. case 4). However, farm B showed only a 5% increase between case 10 and case 4. Then for case 12 another 3% increase more than case 10 was exhibited, but the increase from case 10 to case 12 was \$64,538. This is accounted for because farm B is about twice the size of A and is subjected to higher estate tax brackets.

Other Considerations

There are other estate plans which may be used depending on the specific situation and goals of the estate owner. Cases in this chapter were selected after much time, consideration, and consultation with estate planners and legal counsel. Earlier in this research report other combinations of ownership were used to compute income taxes. However, good estate planning must be fitted to the needs and objectives of the estate owner, and this may vary from person to person.

A given amount of case studies in this chapter represents farm business organizational structures as given in the previous chapter. Computing the estate tax, using the estate planning techniques set forth, for each combination of organizations as given in Chapter VII would require extensive computation. Such computations are beyond the scope of this study.

CHAPTER IX

SUMMARY AND CONCLUSIONS

The economics of tax planning and management have become an essential aspect of any progressive farmer's operation and will continue to play a larger role in the future as the size and capital requirements per economic unit grow. Thus, the major objective of this study was to investigate the economics of income, gift, and estate taxes, tax savings, and tax management for large Oklahoma commercial farms organized under the four major types of farm organizations. The tax laws are set forth in such a manner to enable the large scale commercial farmer to evaluate the alternative forms of business organization. Implications of alternative business entities were examined within the tax law framework to determine which organizational form is likely to be most advantageous to particular situations. Finally, two model farms were used to demonstrate effects of the business organization and estate planning.

The basic characteristics of the forms of business organizations, the sole proprietorship, partnership, business trust, regular corporation, and subchapter S corporation, were discussed. Some emphasis was placed on the non-tax considerations because they may be the deciding factors in selection of the business structure. Comparisons of the non-tax factors, as well as some basic tax factors, were made by form of organization.

The application of the tax laws and their meaning were discussed. The income tax laws were discussed, with each form of business organization treated separately. The gift tax laws were analyzed and then the interpretation of the estate laws and their applicability to estate owners were set forth. It was intended that the interpretation would provide the basis for extension educational programs for the farmer to gain a greater insight into what the various laws mean to him and his business organization.

Two model farms were used in this study to represent large scale commercial farms today and in the future. Model farm A had a gross income per year of \$83,511.23 and an investment value of \$572,207.05. The second model farm, farm B, had a gross investment of \$1,159,943.60 and generated a gross income of \$177,509.46 per year. These farms were representatives of farms in economic classes II and I respectively as classified by the 1964 Census. These farms represented farms in north central Oklahoma in accordance with the respective investment values and gross income figures generated from the farms.

The federal and Oklahoma income tax laws were applied to both model farms for alternative structural arrangements of the different forms of organizations. It was important to consider the total tax liability due to the federal income tax, Oklahoma income tax, and self-employment or social security tax when minimizing the total tax liability according to the type of organization. In minimizing the total income tax liability, the structural arrangements and type of business entity affected the amount of taxable income subject to the different kinds of taxes. In some structural arrangements of the corporation and trusts, no self-employment or social security tax was

due on the asset owners.

The lower income tax liabilities were encountered, in general, where the larger number of taxpaying entities or individuals was created. Along with the above factor was the structural and financial arrangements where the taxable income was distributed to create a balancing effect between the taxpayers helped to reduce the income tax. Consequently, the lower tax brackets were applicable. In general, larger tax liabilities were encountered by the sole proprietorship and the regular corporation business organization.

Double taxation was the primary reason for larger income taxes due on regular corporation. The regular corporation is taxed on its taxable income before the profit is distributed. The shareholders receiving the dividends are taxed again, many times in high tax brackets. Likewise, the farm couple is subjected to a very high tax rate on the large taxable income from the corporate far. Tax liability decreased when the children were taken into consideration as shareholders and a salary and rent were paid by the corporation.

The trust with income dividing techniques, the family partnership, and the subchapter S corporation were more useful in minimizing income taxes than the regular corporation or the sole proprietorship. However, the regular corporation became more important in tax saving in contrast to the sole proprietorship as the amount of taxable income increased from farm A to farm B.

To gain a comprehensive understanding of estate shrinkage and estate costs, the amount of the federal estate tax, Oklahoma estate tax, administration expenses, and the amount of estate remaining to pass to the children was computed utilizing alternative estate planning

techniques applied to model farms A and B. It was found that each kind of tax and administration expenses needed to be computed to demonstrate the full effects on the portion of the estate left passing to the next generation. Frequently, only federal taxes are analyzed. The result may be misleading because the amount of Oklahoma estate tax or the general administration tax bill may be such that minimization of estate taxes is not accomplished. Another estate planning method therefore may more nearly satisfy the estate owner's goals and desires.

The estate tax computations exhibited the fact that a large percentage of the original estate is never passed to the next generation simply because of the tax due at death of the large estate owner and his spouse. Utilizing estate planning techniques such as the two part marital deduction trust plan decreases the total estate tax as compared to the frequently used outright method of bequeathing the estate at the deaths of each spouse. It was further noted that the commonly known and used joint tenancy with rights of survivorship method was one of the most expensive methods of transferring property.

The alternative estate planning techniques had about the same effects on both model farms. However, as the size of estate increased, the percentage of the original estate which was passed on to the farm couple's children decreased. The incorporation of a gift program profoundly decreased the total estate tax costs. The larger estates benefit more from some kind of gift tax planning, primarily because federal gift tax rates are three-fourths of the federal estate tax rates. Thus, that portion of the estate which is given as gifts is subject to the lower gift tax brackets rather than the higher estate tax rates.

Simple minimization of the total tax bill may not satisfy the desires and the goals of the estate owner. As each particular estate owner and farm operator investigates his situation, he should consult a competent attorney and tax consultant. As farms and ranches continue to increase in size in the future, the complexities of the economics of tax management and alternative business organizations will become better understood.

Further research is needed in the area of this study. Future studies should consider in depth the facets of fringe benefit tax implications associated with each type of business organization. Pension and profit sharing plans should be investigated. More knowledge and data is needed to determine the effects on obtaining credit and capital according to the form of business organization. Obtaining data from farmers and ranchers operating under each form of organization would be helpful in determining the reasons why each type of organization was chosen.

Studies involving the determination of which kinds of assets to put in the alternative farm business organizations is needed. For instance, families should avoid putting assets with a low cost basis in a corporation if the corporation expects to sell its assets soon after incorporation. The kinds of assets and property given in gifts to the next generation have different tax implications to the person receiving the gifts. The same applies to other aspects of how the estate assets should be handled most advantageously to fit the estate owner's desires.

A study involving a dynamic analysis showing varying levels of income and income taxes paid each year would enhance knowledge in this research area. The different amounts of income taxes over time could be compared to the results in this study. Also, the effects on firm growth could be analyzed.

As more work is done in this area, studies showing a single farming operation divided into different types of business organizations for different sectors of the economic unit should be investigated.

A closer working relationship between economists, lawyers, and tax specialists is suggested to better disseminate educational material to farmers and ranchers. There is an educational need to extend tax information to farm businesses and show the operators how their organization is affected during the present generation and future generations. Also, the farm operator needs to be kept abreast of the changes in tax laws over time.

Such research and dissemination of the information may well determine the degree of control the next generation of farm operators and managers will have on the resources of agriculture.

A SELECTED BIBLIOGRAPHY

- [1] Beck, Robert and Philip M. Raup. Incorporating The Family Farm Business. Minnesota Ag. Exp. Sta. Bulletin 461, St. Paul, 1962.
- [2] Bowe, William J. Tax Savings Through Estate Planning. Nashville: Vanderbilt University Press, 1963.
- [3] Brosterman, Robert. The Complete Estate Planning Guide. New York: McGraw-Hill Book Co., 1964.
- [4] Casey, William J. Estate Planning. New York: Institute for Business Planning, Inc., 1956.
- [5] Casey, William J. Estate Planning Desk Book, 2nd ed. New York: Institute for Business Planning, August, 1965.
- [6] Cavitch, Zolman. Business Organizations. Vol. 1 and 3 New York: Matthew Bender, 1963.
- [7] Connor, Larry J. et al. Alternative Crop Enterprises on Clay and Loam Soils of North Central Oklahoma. Oklahoma State University Processed Series P-550, Stillwater, 1966.
- [8] Federal Estate and Gift Tax Reporter. Vol. 1, 2. Washington: Commerce Clearing House, Inc., 1966.
- [9] Federal Taxation. Vol. 1 Washington: Commerce Clearing House, Inc., 1965.
- [10] Federal Taxes. Vol. 1, 2, 4, 7. Englewood Cliffs: Prentice-Hall, Inc., 1968.
- [11] Flasherud, George Kenneth. "Firm Growth Simulation As A Farm Management and Credit Evaluation Device." Unpublished Ph.D. thesis, Oklahoma State University, Stillwater, 1970.
- [12] Geratenberg, Charles W. Financial Organization and Management of Business. New York: Prentice-Hall, 1934.
- [13] Harl, Neil E. "Identification and Measurement of Selected Legal-Economic Effects of the Corporate Form of Business Organization Upon a Small, Closely-Held Firm." Unpublished Ph.D. Thesis, Iowa State University, Ames, 1965.

- [14] Harl, Neil E. Technical Legal and Economic Aspects of Farm Corporations. Iowa Cooperative Extension Service Publication Law-Econ. 19, Ames, 1968.
- [15] Harl, Neil E., N. G. P. Krausz, and John C. O'Byrne. The Farm Corporation. Iowa Cooperative Extension Service Pub. Pm-273 (North Central Regional Extension Publication No. 11), Ames, 1967.
- [16] Hill, Elton B. and Marshall Harris. Family Farm Transfers and Some Tax Implications. Michigan Ag. Exp. Sta. Special Bulletin 436, East Lansing, 1967.
- [17] Hubbard, Deon W. and Grant E. Blanch. The Farm - Ranch Corporation A Tool for Financial Planning and Management. Oregon Ag. Exp. Sta. Bulletin 576, Corvallis, 1961.
- [18] Internal Revenue Code of the United States of America.
- [19] Krausz, N. G. P. Corporations in the Farm Business. Illinois Agricultural Extension Circular 797, Urbana, 1968.
- [20] Krausz, N. G. P. Inheritance and Gift Taxes On Illinois Farm Property. Illinois Agricultural Extension Circular 728, Urbana, 1968.
- [21] Krausz, N. G. P. and A. R. Allen. Family Planning of Titles and Taxes in the Transfer of Farm Property. Illinois Agricultural Extension Circular 885, Urbana, 1968.
- [22] Krausz, N. G. P. and Howard Chapman. The Farm Partnership in Planning. Illinois Agricultural Extension Circular 965, Urbana, 1967.
- [23] Lasser, J. K. Farmer's Tax Handbook, 2nd ed. New York: Prentice-Hall, Inc., 1951.
- [24] Lasser's J. K. Estate Tax Techniques. Vol. 1 New York: Matthew Bender and Company, 1968.
- [25] Leach, W. Barton, and James K. Logan. Future Interests and Estate Planning. Brooklyn: The Foundation Press, Inc., 1961.
- [26] Maynard, Cecil D., D. B. Jeffrey, and Glenn Laughlin. Estate Planning. Oklahoma State University Extension Service Circular E-726, Stillwater, 1968.
- [27] Maynard, Cecil D., D. B. Jeffrey, and Glenn Laughlin. Farm Partnerships and Father-Son Agreements. Oklahoma Ag. Exp. Sta. Circular E-710, Stillwater, 1960.

- [28] Maynard, Cecil D. and Glenn E. Laughlin. "The Oklahoma Farm-Ranch Corporation." Unpublished Manuscript, Oklahoma State University, Stillwater, 1969.
- [29] Maynard, Cecil D. and Odell L. Walker. Costs and Returns to Beef Cow-Calf Systems. OSU Extension Facts Sheet No. 112, Stillwater, 1965.
- [30] Plaxico, James S. and Daniel Capstick. Optimum Wheat-Beef Farming Systems in North Central Oklahoma. Oklahoma Ag. Exp. Sta. Bul. B-532, Stillwater, 1969
- [31] Sobering, Fred. The Farm and Ranch Corporation. North Dakota Cooperative Extension Service Circular A-508, Fargo, 1968.
- [32] Standard Federal Tax Reporter. Vol. 3, 4, 5. Washington: Commerce Clearing House, Inc., 1968.
- [33] Successful Estate Planning Ideas and Methods. Englewood Cliffs: Prentice-Hall, Inc., 1968.
- [34] Tax Coordinator. Vol. 1, 2, 4, 5. New York: Tax Research Institute of America, Inc., 1968.
- [35] Title 60, Oklahoma Statutes. 1961.
- [36] Treasury Regulations to the Internal Revenue Code.
- [37] United States Department of Agriculture. Farm Real Estate Market Developments. Washington: Economic Research Service, CD-73, August, 1969.
- [38] _____. United States Department of Commerce, Bureau of Census. 1964 Census of Agriculture. Vol II. Washington: Government Printing Office, 1966.
- [39] _____. United States Census of Agriculture, Garfield County. Series AC64-P1, Washington, 1964.
- [40] _____. United States Census of Agriculture, Grant County. Series AC 64-P1, Washington, 1964.
- [41] _____. United States Census of Agriculture, Large-Scale Farming in the United States. Vol. 7, Part 7, Special Report, Washington, 1959.
- [42] _____. United States Census of Agriculture, Oklahoma. Vol. 1, Part 36, Washington, 1964.

- [43] United States Master Tax Guide. Chicago: Commerce Clearing House, Inc., 1969.
- [44] United States Treasury Department, Internal Revenue Service. Farmer's Tax Guide. Pub. No. 225, Washington, 1969.
- [45] Walker, Odell, James Plaxico, and Cecil Maynard. Stocker Cattle Costs and Returns. OSU Extension Facts Sheet No. 104, Stillwater, 1965.
- [46] Weigle, Richard Norval. "The Economics of the Family Farm Corporation in Indiana." Unpublished Ph.D. Thesis, Purdue University, Lafayette, 1967.
- [47] Wills, Estates and Trust Service. Vol. 1, Englewood Cliffs: Prentice-Hall, Inc., 1965.

APPENDIX

TABLE XVI

RETURNS AND COSTS OF ENTERPRISES
USED IN MODEL FARMS A AND B

Enterprise	Total Receipts	Cash Costs	Net Returns
Wheat	\$ 39.00	\$ 15.80	\$ 23.20
Barley	31.50	16.05	15.45
Summer Fallow		4.55	
Cow-calf ^{/1}	119.25	18.62	100.63
Steers ^{/2}	157.41	138.09	19.34

^{/1}Calves born in fall; cows wintered on native pasture and small grain pasture (taken off March 1); calves sold off native pasture in summer as good-choice calves; 95% calf crop; cow and bull depreciation was left out of these figures.

^{/2}Producing good 600 lbs. feeder steers; fall buy in October; winter ration of small grain pasture with prairie hay and cottonseed cake when off small grain; sell in March.

TABLE XVII

DEPRECIATION SCHEDULES FOR FARM A

Implement or Animal	Cost	Salvage Value	Useful Life in Years	Animal Depreciation	Number of Implements or Animals	Total Depreciation per year
Tractor	\$7724	\$2000	10	\$572.40	2	\$1144.80
Plow	1210	300	10	91.00	2	182.00
Spring-tooth	945	100	9	93.89	1	93.89
Chisel or field cultivator	827	200	8	78.38	2	156.76
Disc	1144	300	12	70.33	1	70.33
Grain drill	1600	400	10	120.00	2	240.00
Pick-up ^{/1}	2800	600	6	336.67	1.5	504.55
Truck	3000	300	12	225.00	1	225.00
Cow ^{/2}	225	80	6	24.16	30	724.80
Bull ^{/3}	400	80	5	64.00	1	64.00

^{/1} It is assumed that one half of a pick-up expense is equivalent to account for one half of a car.

^{/2} It is assumed that all production cows will be purchased ready to calve with a six year useful life remaining.

^{/3} All bulls will be purchased at breeding age with a five year useful life remaining.

TABLE XVIII

DEPRECIATION SCHEDULES FOR FARM B

Implement or Animal	Cost	Salvage Value	Useful Life in Years	Annual Depreciation	Number of Implements or Animals	Total Depreciation per year
Tractor	\$7724	\$2000	10	\$572.40	3	\$1717.20
Plow	1210	300	10	91.00	3	273.00
Spring-tooth	945	100	9	93.89	2	187.78
Chisel or field cultivator	827	200	8	78.38	3	235.14
Disc	1144	300	12	70.33	2	140.66
Grain drill	1600	400	10	120.00	3	360.00
Pick-up ^{/1}	2800	600	6	336.67	2.5	841.68
Truck	3000	300	12	225.00	1	225.00
Truck	1500	300	12	100.00	1	100.00
Cow ^{/2}	225	80	6	24.16	60	1449.60
Bull ^{/3}	400	80	5	64.00	3	192.00

^{/1} It is assumed that one half of a pick-up expense is equivalent to account for one half of a car.

^{/2} It is assumed that all production cows will be purchased ready to calve with a six year useful life remaining.

^{/3} All bulls will be purchased at breeding age with a five year useful life remaining.

TABLE XIX

1969 TAX RATE SCHEDULE FOR SINGLE PERSON (Not Head
of Household) AND MARRIED PERSON FILING SEPARATE
RETURN (The surcharge has to be added to the
tax from this table)

Taxable Income	Tax on Column 1	% on Excess
\$	\$	14
500	70	15
1,000	145	16
1,500	225	17
2,000	310	19
2,500	405	19
3,000	500	19
3,500	595	19
4,000	690	22
5,000	910	22
6,000	1,130	25
7,000	1,380	25
8,000	1,630	28
9,000	1,910	28
10,000	2,190	32
11,000	2,510	32
12,000	2,830	36
13,000	3,190	36

TABLE XIX CONT'D

Taxable Income	Tax on Column 1	% on Excess
14,000	3,550	39
15,000	3,940	39
16,000	4,330	42
17,000	4,750	42
18,000	5,170	45
19,000	5,620	45
20,000	6,070	48
21,000	6,550	48
22,000	7,030	50
23,000	7,530	50
24,000	8,030	50
25,000	8,530	50
26,000	9,030	53
27,000	9,560	53
28,000	10,090	53
29,000	10,620	53
30,000	11,150	53
31,000	11,680	53
32,000	12,210	55
34,000	13,310	55
36,000	14,410	55
37,000	14,960	55
38,000	15,510	58

TABLE XIX CONT'D

Taxable Income	Tax on Column 1	% on Excess
40,000	16,670	58
44,000	18,990	60
50,000	22,590	62
52,000	23,830	62
60,000	28,790	64
64,000	31,350	64
70,000	35,190	66
76,000	39,150	66
80,000	41,790	68
88,000	47,230	68
90,000	48,590	69
100,000	55,490	70
120,000	69,490	70
140,000	83,490	70
160,000	97,490	70
180,000	111,490	70
200,000	125,490	70

TABLE XX

1969 TAX RATE SCHEDULE FOR MARRIED TAXPAYERS
 FILING JOINT RETURNS AND CERTAIN WIDOWS AND
 WIDOWERS (The surcharge has to be added
 to the tax from this table)

Taxable Income	Tax on Column 1	% on Excess
\$	\$	14
500	70	14
1,000	140	15
1,500	215	15
2,000	290	16
2,500	370	16
3,000	450	17
3,500	535	17
4,000	620	19
5,000	810	19
6,000	1,000	19
7,000	1,190	19
8,000	1,380	22
9,000	1,600	22
10,000	1,820	22
11,000	2,040	22
12,000	2,260	25
13,000	2,510	25

TABLE XX CONT'D

Taxable Income	Tax on Column 1	% on Excess
14,000	2,760	25
15,000	3,010	25
16,000	3,260	28
17,000	3,540	28
18,000	3,820	28
19,000	4,100	28
20,000	4,380	32
21,000	4,700	32
22,000	5,020	32
23,000	5,340	32
24,000	5,660	36
25,000	6,020	36
26,000	6,380	36
27,000	6,740	36
28,000	7,100	39
30,000	7,880	39
32,000	8,660	42
34,000	9,500	42
36,000	10,340	45
38,000	11,240	45
40,000	12,140	48
44,000	14,060	50
50,000	17,060	50

TABLE XX CONT'D

Taxable Income	Tax on Column 1	% on Excess
52,000	18,060	53
60,000	22,300	53
64,000	24,420	55
70,000	27,720	55
76,000	31,020	58
80,000	33,340	58
88,000	37,980	60
90,000	39,180	60
100,000	45,180	62
120,000	57,580	64
140,000	70,380	66
160,000	83,580	68
180,000	97,180	69
200,000	110,980	70
300,000	180,980	70
400,000	250,980	70
500,000	320,980	70

TABLE XXI

OKLAHOMA INCOME TAX RATES

SCHEDULE I

SINGLE TAXPAYERS, HEADS OF FAMILIES AND
MARRIED PERSONS FILING SEPARATE RETURNS

Over	Taxable Income Not Over	Pay	+	Tax Rate	On Excess Over
	\$1,500			1%	
1,500	3,000	\$ 15.00		2%	\$1,500
3,000	4,500	45.00		3%	3,000
4,500	6,000	90.00		4%	4,500
6,000	7,500	150.00		5%	6,000
7,500	----	225.00		6%	7,500

SCHEDULE II

MARRIED TAXPAYERS FILING JOINT RETURNS

Over	Taxable Income Not Over	Pay	+	Tax Rate	On Excess Over
	\$ 3,000			1%	
\$3,000	6,000	\$ 30.00		2%	\$3,000
6,000	9,000	90.00		3%	6,000
9,000	12,000	180.00		4%	9,000
12,000	15,000	300.00		5%	12,000
15,000	----	450.00		6%	15,000

TABLE XXII

FEDERAL ESTATE TAX RATES

Taxable Estate		Tax on lowest amount in first column	Plus this % of excess
From	To		
\$ 0	\$ 5,000	\$ --	3%
5,000	10,000	150	7
10,000	20,000	500	11
20,000	30,000	1,600	14
30,000	40,000	3,000	18
40,000	50,000	4,800	22
50,000	60,000	7,000	25
60,000	90,000	9,500	28
90,000	100,000	17,900	28
100,000	140,000	20,700	30
140,000	240,000	32,700	30
240,000	250,000	62,700	30
250,000	440,000	65,700	32
440,000	500,000	126,500	32
500,000	640,000	145,700	35
640,000	750,000	194,700	35
750,000	840,000	233,200	37
840,000	1,000,000	266,500	37
1,000,000	1,040,000	325,700	39
1,040,000	1,250,000	341,300	39
1,250,000	1,500,000	423,200	42
1,500,000	1,540,000	528,200	45
1,540,000	2,000,000	546,200	45
2,000,000	2,040,000	753,200	49
2,040,000	2,500,000	772,800	49
2,500,000	2,540,000	998,200	53
2,540,000	3,000,000	1,019,400	53
3,000,000	3,040,000	1,263,200	56

TABLE XXII CONT'D

Taxable Estate		Tax on lowest amount in first column	Plus this % of excess
From	To		
\$ 3,040,000	\$ 3,500,000	\$ 1,285,600	56%
3,500,000	3,540,000	1,543,200	59
3,540,000	4,000,000	1,566,800	59
4,000,000	4,040,000	1,838,200	63
4,040,000	5,000,000	1,863,400	63
5,000,000	5,040,000	2,468,200	67
5,040,000	6,000,000	2,495,000	67
6,000,000	6,040,000	3,138,200	70
6,040,000	7,000,000	3,166,200	70
7,000,000	7,040,000	3,838,200	73
7,040,000	8,000,000	3,867,400	73
8,000,000	8,040,000	4,568,200	76
8,040,000	9,040,000	4,598,600	76
9,040,000	10,000,000	5,358,600	76
10,000,000	10,040,000	6,088,200	77
10,040,000		6,119,000	77

TABLE XXIII

COMPUTATION OF MAXIMUM CREDIT FOR OKLAHOMA
ESTATE TAX AGAINST FEDERAL ESTATE TAX

Taxable Estate		Credit on amount in first column	Rate of credit on excess over amount in first col.
From	To		
\$ 0	\$ 40,000	\$ 0	none
40,000	90,000	0	0.8%
90,000	140,000	400	1.6
140,000	240,000	1,200	2.4
240,000	440,000	3,600	3.2
440,000	640,000	10,000	4.0
640,000	840,000	18,000	4.8
840,000	1,040,000	27,600	5.6
1,040,000	1,540,000	38,800	6.4
1,540,000	2,040,000	70,800	7.2
2,040,000	2,540,000	106,800	8.0
2,540,000	3,040,000	146,800	8.8
3,040,000	3,540,000	190,800	9.6
3,540,000	4,040,000	238,800	10.4
4,040,000	5,040,000	290,800	11.2
5,040,000	6,040,000	402,800	12.0
6,040,000	7,040,000	522,800	12.8
7,040,000	8,040,000	650,800	13.6
8,040,000	9,040,000	786,800	14.4
9,040,000	10,040,000	930,800	15.2
10,040,000	----	1,082,800	16.0

TABLE XXIV

OKLAHOMA ESTATE TAX RATES

Value of Net Taxable Estate		Tax on lowest amount in first column	Plus this % of excess
From	To		
\$ 0	\$ 10,000	\$ 0	1%
10,000	20,000	100	2
20,000	30,000	300	3
30,000	40,000	600	3
40,000	50,000	900	4
50,000	60,000	1,300	4
60,000	80,000	1,700	5
80,000	100,000	2,700	5
100,000	150,000	3,700	6
150,000	250,000	6,700	6
250,000	500,000	12,700	6.5
500,000	750,000	28,950	7
750,000	1,000,000	46,450	7.5
1,000,000	----	65,200	8.0

TABLE XXV

FEDERAL GIFT TAX RATES

Value of Net Taxable Gift		Tax on lowest amount in first column	Plus this % Excess
From	To		
\$ 0	\$ 5,000	\$ 0	2.25%
5,000	10,000	112.50	5.25
10,000	20,000	525.00	8.25
20,000	30,000	1,650.00	10.50
30,000	40,000	3,150.00	13.50
40,000	50,000	5,400.00	16.50
50,000	60,000	8,250.00	18.75
60,000	100,000	11,250.00	21.00
100,000	250,000	21,000.00	22.50

TABLE XXVI

OKLAHOMA GIFT TAX RATES

Value of net Taxable Estate		Tax on lowest amount in first column	Plus this % of excess
From	To		
\$ 0	\$ 10,000	\$ 0	1%
10,000	20,000	100	2
20,000	30,000	300	3
30,000	40,000	600	3
40,000	50,000	900	4
50,000	60,000	1,300	4
60,000	80,000	1,700	5
80,000	100,000	2,700	5
100,000	150,000	3,700	6
150,000	250,000	6,700	6
250,000	500,000	12,700	6.5
500,000	750,000	28,950	7
750,000	1,000,000	46,450	7.5
1,000,000	----	65,200	8.0

VITA

Merle Roy Buss

Candidate for the Degree of

Doctor of Philosophy

Thesis: THE ECONOMICS OF TAX MANAGEMENT OF THE TYPE OF FARM ORGANIZATIONS FOR OKLAHOMA COMMERCIAL FARMS

Major Field: Agricultural Economics

Biographical:

Personal Data: Born in Enid, Oklahoma, April 30, 1943, the son of Roy H. and Bernice L. Buss.

Education: Graduated from Hunter High School, Hunter, Oklahoma, May, 1961; received the Bachelor of Science degree from Oklahoma State University with a major in Agricultural Economics in May, 1965; received the Master of Science degree from Oklahoma State University in Agricultural Economics in August, 1966; completed requirements for the Doctor of Philosophy degree at Oklahoma State University in May, 1971.

Professional Experience: Student Trainee, Oklahoma Crop and Livestock Reporting Service, Summer 1963; Student Trainee, Wilson and Company, Summer 1964; Graduate Research Assistant, Oklahoma State University, September, 1965 to February, 1970.

Professional Organizations: American Agricultural Economics Association, Phi Kappa Phi, Omicron Delta Kappa, Alpha Zeta.