



# Developing an Estate Plan

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Developing a satisfactory estate plan requires a great deal of thought and planning. This fact sheet is designed to help individuals begin to develop plans that meet their needs. Discussion will focus on planning procedures and alternative estate planning tools. A more thorough discussion of some aspects of estate planning may be found in Extension Circular E-726, "Estate Planning." Fact sheets dealing with probate, trusts and wills are also available. Refer to the end of this article for the publication numbers for these fact sheets.

## Identifying goals, priorities and constraints

An initial step in estate planning involves consideration of planning goals, priorities and constraints. These goals, priorities and constraints establish the framework for the plan. Initially, a list of goals should be developed. Frequently cited goals include:

1. Minimizing estate and gift taxes,
2. Providing adequate retirement security (avoiding unnecessary dependency on others),
3. Treating heirs fairly,
4. Providing for special needs of some heirs,
5. Continuation of a family business,
6. Continuing family ownership of a farm or other possession,
7. Maintaining maximum flexibility to meet changing needs and situations and
8. Maintaining control of a business as long as possible.

In some cases, some goals may conflict with other goals. It may not always be possible to achieve all of the goals. Consequently, it becomes necessary to rank the goals according to priority so any plan that is developed will place greatest emphasis on achieving the most important goals.

Any constraints, such as unwillingness to consider certain planning tools, should also be identified. These constraints will have an impact on the type of plan chosen. It may be helpful to consider what types of impact these constraints will have on the ultimate plan chosen. By comparing the best plan with the constraints to the best plan without the constraints, the individual can determine the cost of imposing the constraints. It then becomes possible to decide whether it is worthwhile to impose the constraint.

## Evaluating your situation

### Identification of assets and forms of ownership

The next step in the estate planning process involves identification of all assets. Assets should be listed and the type of ownership should be specified for each asset. In the case of real

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property, you should designate whether surface rights, mineral rights or both are owned. Ownership may be classified according to type of estate and, if two or more persons share ownership, type of co-ownership. The type of ownership will affect what property will be available for distribution at death and may also have tax consequences.

Types of estates include fee simple ownership, life estates, reversions or remainders (ownership which follows a life estate) or conditional ownership, which may be terminated by violation of the condition. Fee simple ownership is full and complete ownership. A life estate involves the right to use property as your own during a designated lifetime. Generally, the lifetime designated is the life of the life tenant. Such life estates terminate at the holder's death so there is nothing available for distribution in the estate. When a life estate is created, someone may be designated to become the full owner at the end of the life estate. If the future owner is not specified, it is presumed that the grantor has retained the future interest. If the grantor retains the ownership at the end of the life estate, his interest is called a reversion. If the future ownership right is given to someone else, the future interest is called a remainder.

Property which is owned in fee simple and reversionary or remainder interests are available for distribution in the estate of the owner. Conditional ownership rights may or may not be available for distribution at death. If they are available, they will probably still be subject to the conditions specified. Life estate interests are not available for distribution in an estate unless the lifetime used to measure the term of the life estate has not yet ended.

Forms of co-ownership include joint tenancy, tenancy in common and tenancy by the entirety. Joint tenancy ownership includes a right of survivorship. At the death of one joint tenant, ownership rights are automatically transferred to the surviving joint tenant(s). This property will not be transferred under the will and will not need to go through a full-blown probate process at death. In contrast, the rights of a tenant in common may be transferred by will at death. Tenancy by the entirety is similar to joint tenancy. However, tenants by the entirety must be husband and wife. Deeds to real property, bank account agreements and other documents of ownership will usually designate the type of co-ownership.

In order to help develop a good plan, your attorney will need to know:

1. How is title held? (What is the ownership interest or estate? If property is jointly owned, what type of co-ownership applies?)
2. What is the source of the property? (Did you buy it, receive it as a gift, etc.? How long have you owned it?)

3. What is the income tax basis of the property?
4. Does the property produce income?
5. How liquid are the assets?
6. Are there restrictions on transfers?
7. Will management assistance be needed?

### Identification of recipients

Next, a list should be made of family members, charitable organizations or others you wish to include in your estate plan. If there are certain assets that you particularly want to go to certain individuals, this should be specified either on the list of recipients or on the list of assets. Any heirs you specifically wish to exclude should also be identified with a note to that effect.

### Evaluation of tax consequences of current situation

By analyzing the tax consequences of their current situation, individuals can determine the tax cost of retaining ownership of assets until death or of making gifts. Estate and gift taxes are both imposed by the federal government. Currently, a unified estate and gift tax system exists, which means the tax consequences of gifts are, in most instances, the same as the tax consequences of estate transfers.

Two exceptions to this arise. First, assets may inflate in value between the present (when a gift might be made) and the future (when the estate may be settled). In evaluating the estate and gift tax consequences of a plan, it is important to estimate the impacts of inflation (if any) on estate value. A second exception arises from the fact that the federal government allows gifts of up to \$15,000 per recipient per year to be made free of gift tax consequences. If spouses agree to combine their gifts (gift-splitting), they may give up to \$30,000 per recipient per year without owing any gift taxes, even if the property actually belongs to only one spouse.

In addition to the \$15,000/recipient/year gift tax exclusion, as a result of the unified credit, lifetime gift or estate transfers may total \$11,400,000 without incurring any estate or gift tax liability. This credit applies to all estates settled in 2019. This means that a significant amount of assets may be transferred tax-free if gifts are regularly made to future heirs. Both the unified credit and the annual gift tax exclusion are adjusted for inflation therefore it is important to determine these for future years.

Transfers to spouses are not taxed under current estate and gift tax law. There is a 100 percent marital deduction. While this does help to balance an estate by equalizing what each spouse owns, the portability of the estate tax credit introduced in Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010, has significantly reduced the need for the marital deduction. This provision allows the unused portion of the first spouse's unified credit to be available for use by the surviving spouse's estate. This is an election that must be made on a timely filed federal estate tax return. In this way a husband and wife can transfer a total of \$22,800,000 of assets free of estate tax.

Oklahoma has repealed the estate tax and the gift tax that became effective in 2010 and thereafter. Extension Circular E-726, "Estate Planning" includes federal estate tax tables and an explanation of how to compute potential estate and gift taxes.

## Planning strategies

### Providing liquidity

Lack of liquidity is a problem in many farm estates and small businesses. There are several strategies which may help increase liquidity including:

1. Installment payment of estate taxes;
2. Using actual use valuation and other strategies that decrease estate taxes;
3. Purchase of life insurance; and
4. Conversion of illiquid assets to liquid assets.

Assets may be converted through installment sales of some assets (especially useful with land sales), borrowing money on the asset value, or exchange of assets for annuities.

### Minimizing taxes

Various estate planning strategies may be implemented, depending upon the desired goals of the individual. Options to minimize taxes include 1) taking maximum advantage of unified credit; 2) making annual gifts of \$15,000 per recipient (\$30,000 if spouses pool their exclusion); 3) making gifts of larger amounts to freeze asset values in times of inflation; 4) making gifts of income-producing property to children or other family members in lower tax brackets to minimize total income tax and to prevent increases in the size of the estate; and 5) making gifts to grandchildren rather than children (by-passing one generation). Be aware of the generation-skipping transfer tax, which may eliminate this benefit for some gifts.

### Minimizing estate settlement costs

This is likely to be more important than minimizing estate taxes. These items include the cost of the probate court, attorney fees, accountant fees, appraisal fees, and executor fees.

To reduce the cost of probate, it is possible to use a trust payable on death (POD) or transfer on death (TOD) registration on checking and savings accounts. Another tool is the transfer on death deed for real estate, Oklahoma made this available in 2009.

A trust is a way of owning assets, and at death, the trust document provides the means to transfer the assets, avoiding the probate process for all of the assets put into the trusts name. Proper legal assistance is needed to establish the trust to ensure probate will be avoided.

## Summary

This fact sheet is designed to provide a basic understanding of some of the fundamental concepts involved in estate planning. It is important to evaluate your goals and situation, then discuss possible alternatives with an attorney who can help develop a plan that will meet your needs.

### Additional Resources

- "Estate Planning, A Simplified Guide for Oklahoma Farm and Ranch Families" OSU Extension Circular E-726.
- "Probate," OSU Extension Facts AGEC-773.
- "Trusts, Uses and Considerations" O.S.U. Extension Facts AGEC-771.
- "Wills: Requirements and Considerations", OSU Extension Facts AGEC-782.

Credit is extended to Marcia Tilley, former agricultural economics professor, for the original content of this fact sheet.

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