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Estate Planning for Farmers and Ranchers

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ARTICLES

ESTATE PLANNING FOR FARMERS AND RANCHERS

John M. Dietrich*

I. Introduction ........................................ 191
II. Current Operational Considerations .................... 192
   Selection of Business Organizational Form ........... 192
   1. Continuity of Enterprise ......................... 192
   2. Transferability of Interests ..................... 192
   3. Limited Liability ................................ 193
   4. Centralization of Management and Control ........ 193
   5. Income Tax Considerations Involved in Formation .. 194
      a. Partnerships: Liabilities in Excess of Basis .... 194
      b. Corporations .................................. 195
         (1) Liabilities in Excess of Basis ............... 195
         (2) Stock for Services and General Nonrecognition of Gain Matters 196
         (3) Assignment of Income ...................... 196
         (4) Loss Carryover ............................. 197
         (5) Recapture .................................. 197
   6. Miscellaneous Income Tax Considerations Involved in the Selection of a Business Entity .... 197
   7. Ability of Entity Selected To Enable Debt Retirement and Support of Family Units .............. 200
III. Estate and Gift Tax Considerations .................. 201
   A. Determination of Potential Shrinkage from Estate and Inheritance Taxes .................. 201
      Application of 1976 Tax Reform Act Provisions Relating to Unified Gift and Estate Tax Credit .... 201
   B. Minimization of Federal Estate Tax ............... 204
      1. Gifts ........................................... 204
      2. Estate Tax Marital Deduction ................... 205
      3. Orphan’s Deduction ............................ 205
      4. Testamentary Dispositions Designed To Minimize Federal Estate Tax .................. 206
      5. Selection of Business Entity or Other Form of Ownership To Enable Effective Transmission of Estate ............. 208

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Much has been written during the past several years on farm and ranch estate planning. The topic has appeared on the agenda of many continuing legal education seminars or their equivalent throughout the western United States. Some may even feel that the extent of such attention has resulted in a degree of "over-kill." For these reasons I have approached my task with some reservations about the ability to add any new dimension or to treat the subject...
in any original or unique manner. This would be particularly presump
tuous in view of various recent publications, such as Jon
Wheeler's *Tax Desk Book for Farming and Ranching* and numer-
ous articles by Donald H. Kelley, a North Platte, Nebraska, attor-
ney.¹ Those interested in the refinements of this topic should study
the most recent American Law Institute—American Bar Associa-
tion (ALI-ABA) resource materials for the course study on *Tax
Planning for Agriculture* edited by Alfred J. Olsen and Thomas L.
Schoaf. This work contains lecture outlines and related study mate-
rials prepared by an impressive list of authors whose combined ex-
dpertise on the subject is monumental.

Rather than presenting observations in the more conventional
academic style of a law review article, I have chosen the "expanded
outline" approach with the hope that this format may enable the
reader to use the material as a checklist in his practice. At the same
time there has been a genuine attempt to avoid a skeletal presenta-
tion which often leaves more to the imagination than is warranted
or desirable. Nor has this work been geared to the highly refined tax
practitioner. It is intended, however, to give more than a superficial
treatment of the subject sufficient to lead the reader into areas
where further exploration may be dictated by particular facts and
to raise the "red flag" where some obvious traps may be inherent
in an estate plan.

I. INTRODUCTION

Were we to confine our attention to a narrow definition of
"estate planning" as the exploration of techniques for the transmis-
sion of economic wealth to successive generations, our subject mat-
ter could be treated much more succinctly. The emphasis on estate
and gift taxation of farms and ranches has captured the imagination
and attention of a host of professionals. The team approach to solu-
tions is consistently espoused by attorneys, accountants, trust offi-
cers and life underwriters—perhaps more by lip service than in ac-
tual practice; nevertheless, those who recommend the team ap-
proach are, in effect, recognizing that the enormous increase in land
values has made this aspect of estate planning particularly impor-
tant. The impact of death on agricultural families is of primary
concern to a nation which must maintain a rural community in
order to meet not only its own subsistence needs but to contribute

¹. See J. Wheeler, *Tax Desk Book for Farming and Ranching* (2d ed. 1978) and D.
Kelley, *The Farm Corporation as an Estate Planning Device*, 54 Neb. L. Rev. 897 (1976);
*Estate Planning for Farmers and Ranchers*, 20 The Practical Lawyer 13 (1974). See also
Brugh, *Structuring the Farm and Ranch Operation for Business Planning*, 54 Neb. L. Rev.
262 (1975).
to the needs of the world. Thus, the uninterrupted passage of such assets through generations of owners with as little economic loss as possible is vital to agriculture's well being and to the nation.

But planning for death must also include planning for the living. The family who seeks a lawyer at a time when death is imminent obviously has reduced the choice of available alternatives. In such situations even greater attention is required in order to select a business entity best suited to current operations as well as provide for the devolution of real and personal property interests.

II. CURRENT OPERATIONAL CONSIDERATIONS

Selection of Business Organizational Form

1. Continuity of Enterprise

The ease with which a farm and ranch operation can continue with minimum interference occasioned by death or retirement has always been important. However, during those earlier years of modest land values when much of agriculture was "self financed," continuity may not have been paramount. Father and mother died. Few estate and inheritance taxes were paid. The local lending institution had not become a part owner of the venture. The farm family regrouped with, typically, a son continuing the operation without any significant deterioration of net worth.

With increased cost of operations, lower prices for farm products and the inability to meet annual overhead, long term land debt rose dramatically through successive refinancing of short term carryover loans. No longer could the local banks or livestock production credit associations (PCA) assume the full burden of financing agriculture. Outside sources of substantial capital were needed if agriculture was to survive. Institutional lenders, such as life insurance companies and the Federal Land Bank, arrived on the scene. These sophisticated lenders were not content to allow the future of the family to be left to chance, should a death occur. Consideration of continuity as an important characteristic of the borrower crept into discussions.

2. Transferability of Interests

Not only should the form selected be able to withstand the trauma of death, but it should also accommodate anticipated withdrawals of family members or the admission of additional co-

2. Throughout this article the terms "farm" and "ranch" will be used interchangeably solely at the whim and caprice of the writer without any intention of resurrecting historical differences between those involved in either setting!
owners. Again, lending institutions have shown increased interest in the presence (or absence) of this characteristic in their decisions whether to extend credit. The rise or fall of prices for farm products may determine the intensity of such interest, but in times of high interest rates and limited loan funds, the local banks or PCA's look to management resourcefulness. One indication of its presence is the selection of a business entity that will permit freedom of entrance or withdrawal.

3. **Limited Liability**

Considerable emphasis has been placed on this feature of a farm-ranch operation. But the concern may be more academic than real, except in those situations involving nonactive investors concerned with "tax-shelter." In most other situations the availability of broad insurance coverage will protect the family from exposure to third-party causes of action. If the ranch borrower is seeking to hide behind the skirt of "limited liability" in order to shield some of his personal assets from the claims of his banker, he will fail. Most lending institutions require the personal signatures of all principals in the business to be affixed to the promissory notes or other evidences of indebtedness, or require personal guarantees of any corporate or limited partnership debt. Finally, the consolidation of all operating assets in a single business entity is much more simplistic than an attempt to have more than one business entity which may have been prompted by a desire to insulate certain assets from the claims of creditors.

The principal exception to this rather cavalier dismissal of limited liability as an important characteristic is in the farm feedlot operations which also engage in "custom feeding" for third-party investors. Here, limited exposure to those assets solely required to carry on the feeding business is desirable, recognizing that a degree of insulation can also be obtained through a rental or lease arrangement of facilities by the operator from the underlying ownership interests. Since livestock feeding is an intensively capital-oriented business, there may be little that an owner-operator can do to shield assets involved in the feeding operation from third-party claims. The concept of multiple entities, such as corporate or limited partnerships, as the operator, and other entities as the owner, must be considered as available alternatives.

4. **Centralization of Management and Control**

Two parties essentially dictate whether this business feature is critical. First are the concerns related to the principal owner of the farm—his age, health and philosophy. Centralization of manage-
ment and control is more often much closer to the heart of the middle-aged rancher at a time when he is fully capable of giving the operation his full attention, than to the rancher who has already attained retirement age and who may recognize the necessity to provide incentive for gradual family entrance into the business. The advice given will always be a “judgment call” after careful consideration of each family setting. No simple answer is available. The attitudes of the parents are highly subjective considerations; but, generally, parents will be concerned with developing a plan which allows for a gradual transition in farm management as maturity develops in younger family members. Frequently, however, there will be a virtual insistence by the sons that “the place should be turned over.” This alternative is being fostered by some estate planners who convince their clients that immediate disposition of assets is the only way to avoid confiscatory taxes that will dictate the ultimate sale of the farm.

The second party whose concerns must be considered is, again, the lending institution. Never before has good farm and ranch management been as important a criterion for the extension of farm credit. It will continue to be high on the list of lenders’ concerns. Thus any form of business entity which fosters the “two-headed monster” that renders the decision-making process more difficult will be looked at askance.

Having shared the above observations, let me emphasize that in this area of business management, legal structure is not nearly as important as the attitudes of people. A primary task, as part of the team, is to be certain that the form selected does not act as a breeding ground for intrafamily ill will. A formal, legalistic management structure cannot accomplish for the parties what they resist from within.

5. Income Tax Considerations Involved in Formation of the Business Entity

Income tax consequences are important in the selection of an entity for the farm-ranch business. By this is not meant the discussion of income taxation of farming and ranching generally. Rather, if in the creation of a new business form as a successor to a sole proprietorship there are certain immediate and adverse income tax consequences, this prospect could and should dictate a choice of alternatives.

a. Partnerships: Liabilities in Excess of Basis

Should the desire of the owner be to form a partnership with a son or sons, and to transfer to such partnership personal property
needed in its operation, including livestock, there is ordinarily no adverse income tax result unless there is debt against these assets which is being assumed by the partnership and which exceeds their adjusted tax basis. The formula is essentially defined as "cost plus capital improvements less depreciation." To the extent that such liabilities do exceed basis the transferor-owner will realize income on the premise that it is a distribution of money by the partnership to a partner.

A determination of basis immediately should bring the accountant onto the scene for two reasons. First, the agricultural owner, who has had the option of either selecting a cash or accrual basis for income tax reporting, has quite possibly been reporting income as a cash basis taxpayer, and may have on hand livestock with a zero tax basis which are the subject of a loan from his bank or PCA. Second, because of the extraordinary inflation of land values and the need to refinance short-term debt any mortgage against the land may well far exceed his adjusted cost. This is a condition which exists in much of eastern Montana where acquisition costs of land have been minimal until recent years.

While the "liability in excess of basis" problem may be alleviated to some extent by deliberately holding out certain liabilities from partnership assumption, often this does not reflect the realities of "cash flow" available for retirement of debt and partnership distributions. If the short- and long-term debt requirement exceeds the owner's distributive share of profit, then there is no practical way for the partnership to make such monies available except through a debit to the owner's capital account.

b. Corporations

(1) Liabilities in Excess of Basis.

The problems referred to above regarding the transfer of low-basis property to a partnership are of equal concern in the formation of and transfer to a corporation of such assets. Taxable gain is generated to the owner-transferor to the extent of the difference between the total liabilities and the tax basis of the assets transferred. However, the 1978 Revenue Act (1978 R.A.) has amended the Internal Revenue Code (I.R.C.) § 357(c) and § 358(d) by per-

6. I.R.C. § 357(c).
mitting the exclusion of certain liabilities to the extent that pay-
ment of such liabilities by the owner-transferor would have given
rise to a deduction. This amendment is minor in most instances,
since it relates primarily to "accounts payable." The same amend-
ment also pertains to partnership formation and the problem of
liabilities in excess of basis and includes, in addition, payments to
deceased partners.\(^7\)

(2) Stock for Services and General Nonrecognition of Gain
Matters.

Stock issued to an individual for services rendered prior to in-
corporation will generate income to the recipient. The general rule,
as in the case of a partnership, is that "no gain or loss shall be
recognized if property is transferred to a corporation by one or more
persons solely in exchange for stock or securities in such corporation
and immediately after the exchange such person or persons are in
control . . . of the corporation."\(^8\)

Note the reference to "or securities" in § 351(a). This has given
rise to a host of cases involved with defining a "security." See
Pinellas Ice & Cold Storage Co. v. Commissioner\(^9\) for a discussion
of maturities required, "thin capitalization" (the ratio of debt to
equity), fixed provisions to pay, interest rate and other tests to
determine if there is a true "security" within the § 351(a) and § 385
definition.

The 80 percent control requirement of § 351(a) and § 368(c) has
not presented problems in the typical farm and corporation setting
where stock is issued to members in exchange for property. How-
ever, practitioners should be cautioned to avoid shortcuts if the
owner-transferor intends gifting shares immediately after the ex-
change. Complete the transfer and then proceed with the gift and
reissuance of remaining stock to the donor, rather than cause the
shares to be issued by the corporation directly to donees. Again,
remember that "services" are not "property" within the meaning of
this section. Therefore, avoid attempting to compensate a son for
past services to the ranch venture by the issuance of stock to him
at time of incorporation, or at any other time for that matter, unless
there is a recognition of ordinary income tax consequences to the
extent of the fair market value of the stock issued.

(3) Assignment of Income.

I.R.C. § 482 addresses the allocation of income and deductions

\(^7\) I.R.C. § 736(a).
\(^8\) I.R.C. § 351(a) (emphasis added).
\(^9\) 287 U.S. 462 (1933).
among taxpayers. If, in the formation of a corporation and the transfer to it of growing crops, the result has been a deduction by the taxpayer of expenses incurred prior to incorporation followed by a sale by the corporation, recognize the implications of § 482! In Rooney v. United States the I.R.S. reallocated expense deductions forward to the corporation, citing I.R.C. § 482. In Adolph Weinburg the Commissioner reallocated income back to the transferor (as contrasted with Rooney). These and other cases cited often contain the familiar terms of "sham," "tax avoidance," "assignment of income," and "tax benefit," in finding a basis for disallowance. Obviously, careful consideration is required. There clearly is the obligation to call attention to such consequences and to consider alternatives such as a Subchapter "S" election and the adoption of fiscal years ending concurrently with that of the transferor-taxpayer if substantial adverse consequences might result from a reallocation.

(4) Loss Carryover.

A facet often overlooked by counsel is in the area of "loss carryovers" from the owner-transferor's earlier operations. Accountants have been much more sensitive to this feature, recognizing that such loss may be erased forever and that the timing of any formation of a new venture is critical. It may or may not be important to your client, but most assuredly deserves to be considered.

(5) Recapture.

While the act of incorporating does not trigger recapture of depreciation under I.R.C. § 1245, or investment tax credit under § 38, remember that the transferor(s) must retain a substantial interest in the corporation, and that substantially all of the § 38 personal property necessary to operate the farm must be transferred. Otherwise, there may be a recapture of investment tax credit.

6. Miscellaneous Income Tax Considerations Involved in the Selection of a Business Entity

Part 5, supra, has discussed the income tax consequences, if any, at the time of the formation of the business entity and the transfer to it of assets. The following are income tax considerations

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10. 305 F.2d 681 (9th Cir. 1963).
11. 44 T.C. 233 (1965).
which should be anticipated in the selection of the entity:

(a) **The utilization of “business loss” for reduction of other taxable income of family members within the available limits considering the concepts of “hobby farmers,” “capital at risk” and other strings to the I.R.S. bow.** Where these concepts are applicable the facts may dictate the use of general or limited partnerships or Subchapter “S” corporations.

(b) **The availability of new corporate tax rates substantially less than individual income rates as a means of sheltering income required to service debt and provide for retention of working capital.**

(c) **The possible shift of taxable income among family members through transfers of general partnership interests, “units” in a limited partnership or shares of stock in a Subchapter “S” corporation.** Bear in mind, particularly, the need to plan for the farm widow—too often the forgotten character in the play. Also important is the test of “economic reality” in *Duarte v. Commissioner* where there was an attempt to allocate corporate earnings among family members notwithstanding complete dominion retained by the donor after gifts to minors. Remember that the provisions of I.R.S. § 704(e) relating to family partnerships focus on recognition of interests created by purchase or gift; the distributive share of a donee under the partnership agreement is includable in his gross income. This section also addresses the question of whether an interest purchased by one member of a family shall be treated as a gift from the seller and thus donated capital.

(d) **Double taxation of previously taxed but undistributed income of a Subchapter “S” corporation should the election be inadvertently lost.**

(e) **Possible selection of a fiscal year different from the taxable year of the principal owners and selection of a different method of accounting.** Often important is a shift from accrual to cash-basis if the operation involves the regular sale of I.R.C. § 1245 assets, such as breeding stock, but with the knowledge that *Rooney*,

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15. 1978 Revenue Act (R.A.) amending I.R.C. § 11 (and others) repealed existing normal tax and surtax, substituting the following:

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0 to $25,000</td>
<td>17</td>
</tr>
<tr>
<td>Over $25,000 to $50,000</td>
<td>20</td>
</tr>
<tr>
<td>Over $50,000 to $75,000</td>
<td>30</td>
</tr>
<tr>
<td>Over $75,000 to $100,000</td>
<td>40</td>
</tr>
<tr>
<td>Over $100,000</td>
<td>46</td>
</tr>
</tbody>
</table>

16. 44 T.C. 193 (1965). See also I.R.C. § 1375(c) relating to reallocation right of Commissioner among family group.


18. 305 F.2d 681 (9th Cir. 1963).
be used by the I.R.S. to reallocate income.

(f) Additional prospect of loss of Subchapter "S" election and resulting classification as a personal holding company in the year of incorporation. This may occur where there has been an attempt to defer income through selection of a different fiscal year when land has been under a mineral lease with no reservation of minerals to grantor-owner, and the corporation is to receive delay rentals.\(^9\)

(g) Unless a Subchapter "S" corporation is involved, prospective unreasonable accumulation of earnings and profits\(^20\) in a year of substantial income. This concern over the unreasonable accumulation of "E & P" for farm and ranch corporations has been most "academic" for many years; however, substantially higher prices for farm and ranch products may have returned to the scene in which case unreasonable accumulation will once again be a problem. This concern also brings into play I.R.S. contentions of unreasonable salary, accumulations intended to insulate the corporate business from expected contraction, funding of corporate-shareholder indemnity agreements, and prospective availability of I.R.C. § 303 redemptions to enable payment of estate and inheritance taxes and expenses of administration of deceased shareholders.\(^21\)

(h) Problems among owner-transferors arising from the differences in adjusted tax basis of contributed assets. If the entity is a Subchapter "S" corporation, shareholders share income (and loss) pro rata.\(^22\) In a partnership there is an opportunity to agree to an allocation of gain, loss and/or depreciation allowances attributable to the sale or other disposition of such property.\(^23\)

(i) Planning for the possibility that minor family members may become owners of interests in the business entity. A major consideration is the inability of a custodian of a minor to be a general or limited partner as contrasted with the ease of ownership of shares of stock under the Revised Montana Uniform Gifts to Minors Act.\(^24\)

(j) Recognition of the possibility of sale or other disposition of the farm even before the death of the principal owner. With the knowledge that "nothing is certain except death and taxes," this is an important consideration. The prospects of recapture of depreciation, investment credit and availability of the installment

19. I.R.C. § 1372(e)(5).
21. Id.
22. I.R.C. §§ 1372-78.
method of reporting gain on the sale of farm assets will be critical elements.

Of particular importance is I.R.C. § 453. Because of the substantial appreciation of assets, and the unusually long term embraced in contracts for deed in which the owner is financing the purchase of the real property, the opportunity to pay income tax in installments may be vital. If the corporate form has been employed, the intricacies of I.R.C. § 333 and § 337 must be anticipated to avoid a trap that could otherwise leave in shambles a carefully crafted plan. The distribution by the corporation to its shareholders of an installment obligation (following the adoption of a plan of liquidation) is a "disposition" of such obligation within the meaning of I.R.C. § 453(d) which will result in an immediate acceleration of all remaining income tax generated by the sale.

Furthermore, the possibility that the 1976 Tax Reform Act provision relating to "carryover basis" ultimately may become effective in one form or another also imposes on the planner the requirement of selecting the entity with the greatest flexibility. No longer is there any assurance of the availability of the "safe harbor" of "stepped-up" basis that has minimized the income tax aspect of corporate dissolutions following death of the principal shareholder. The attraction to clients of proposed tax-free exchanges under I.R.C. § 1031 requires attention to the pitfalls of such exchanges immediately following an I.R.C. § 333 liquidation. See discussion infra.

(k) The need to determine whether projected "cash flow" of the enterprise suggests that consideration be given to a form of entity that permits maximum utilization of "fringe benefits." Most frequently mentioned are group life insurance, medical-dental reimbursement, employer-employee profit and/or pension plans, and depreciation deductions on the farm residence. Few owners of agricultural businesses have felt that these incentives should dictate the choice of business form.

7. Ability of Entity Selected To Enable Debt Retirement and Support of Family Units

After confronting possible income tax consequences in the formation of the entity and before considering the refinements of gift and estate/inheritance tax motives, it is essential to step back from the painting and put the picture in perspective. Often the modus operandi suggested at this point has made it virtually impossible for there to be a natural, uninterrupted flow of cash (a) for application on either or both short- and long-term debt, and/or (b) for distribution to family members. It is lack of attention to this facet of "estate planning" for agriculture that often disturbs the client, his family and banker. Once again, the "team approach" absolutely dictates the necessity of a close working relationship with the accountant. If
FARMERS AND RANCHERS

a plan has been devised which contemplates separate entities—one to which the land may be transferred and one owning machinery and livestock—in response to gift and estate tax motives alone, it may be realistically impossible for there to be sufficient cash funneled to the land organization as rental to enable payment of principal and interest on the real estate mortgage. The fair rental value of the land to the operating concern may be far less than the aggregate of such payments plus depreciation on improvements and ad valorem taxes.25

The foregoing is not intended to be an exhaustive checklist of current operational factors involved in the selection of a business entity, but I hope that it will illustrate the obvious—estate and gift tax considerations must be dealt with as a part of a more extensive panorama.

III. ESTATE AND GIFT TAX CONSIDERATIONS

In a narrow and restricted sense “estate planning” for the agricultural client has dealt with the subject of death and an obsession with taxes that result in a confiscation of estate assets. Indeed, the phrases “estate planning” and “estate planner” are synonymous with “tax saving” and apparently carry with them such magnetism that many business and professional interests utilize the terms as an entree into the kitchens of farm and ranch families. But for the shock treatment administered by the truly well-intentioned life underwriter, or the confidential exchange of information with a potential client by a knowledgeable local banker, some of whom prescribe estate plans at will, few lawyers and accountants would have much chance to “do their thing” as a part of the team. Fortunately, more farm and ranch families are becoming aware of the dangers posed by opportunists who offer simplistic, but often appealing, “estate plans.”

A. DETERMINATION OF POTENTIAL SHRINKAGE FROM ESTATE AND INHERITANCE TAXES

Application of 1976 Tax Reform Act Provisions Relating to Unified Gift and Estate Tax Credit

The 1976 Tax Reform Act (T.R.A.) 26 eliminated the difference between gift and estate tax rates and brought with it an entirely new concept of gift and estate taxation. In lieu of the $30,000 lifetime

25. For discussion of planning with multiple entities see ALI-ABA, Tax Planning for Agriculture at 407-18.
exclusion, there has been substituted a tax credit which in 1977 was $30,000 and which will increase to $47,000 in 1981. Translated into estate values, this unified credit amounts to an estate exemption equivalent of $120,667 in 1977, increasing to $175,625 in 1981 and thereafter.

The new legislation eliminated consideration of gifts in contemplation of death insofar as the $3,000 annual exclusion is concerned. If a gift of $3,000 or less was made within three years of the donor's death, the gift will not fall within the contemplation of death rule requiring inclusion in the decedent's estate. A gift for which no return was required to be filed by the beneficiary is not includable. An exception is where the $3,000 exclusion is increased by spousal consent to enable a $6,000 gift which requires the filing of a gift tax return. In this situation, no portion of the gift is excluded. (See discussion infra).

The gross estate now consists of the following:

1. the fair market value of assets owned by the decedent at the time of death, plus
2. pre-1977 gifts made in contemplation of death and within three years of death (the full value without exclusions, deductions or splitting), plus
3. post-1976 gifts for which a gift tax return is required made by decedent within three years of death (full value without exclusions, deductions or splitting), plus
4. all post-1976 gifts of life insurance within three years of death, plus
5. federal gift tax paid by decedent or his estate on post-1976 gifts made within three years of his death by decedent, or by his spouse.27

From this resultant figure (the "gross estate") the debts and expenses are deducted to arrive at the "adjusted gross estate." Then deductions such as marital, orphans or charitable are taken to arrive at the "taxable estate."28

To the "taxable estate" is then added post-1976 adjusted taxable gifts (defined as gifts after gift splitting less decedent's $3,000 annual exclusions, and marital or charitable deductions). The result is the "tentative estate tax base." The tentative tax is then computed from which is deducted gift taxes payable on certain post-1976 gifts.29 Next the unified credit is applied,30 and from this is

deducted the credit for state death taxes,\(^{21}\) gift tax credit on pre-1977 gifts made in contemplation of death and within three years of death,\(^ {22}\) and finally a deduction or credit for prior transfers\(^ {23}\) and foreign death taxes,\(^ {24}\) if applicable. The result is the "net estate tax payable." Somewhat confusing? I guess!

The gift tax marital deduction has been amended substantially.\(^ {35}\) The first $100,000 of gifts is gift-tax free. Gifts in excess of $100,000 to and including $200,000 are fully taxable. One-half of all gifts in excess of $200,000 are taxable.

The estate tax marital deduction has been amended to provide for the deduction of one-half of the adjusted gross estate of $250,000, whichever is greater.\(^ {36}\)

Finally, the assurance of "stepped-up" basis attributable to property owned by a decedent dying before January 1, 1977, was "brought to its knees" by the substitution of "carryover" basis. The basis of inherited property is "carried over" from the decedent to the estate of beneficiaries for purposes of determining gain or loss on subsequent sales and exchanges.\(^ {37}\) The new provisions introduced the "fresh start" concept: property owned by a decedent on December 31, 1976, will have as its tax basis the lower of its fair market value on that date or its estate tax value. A special method is to be used for determining the value of property, other than publicly-traded securities, on December 31, 1976, which amounts to a proration of appreciation from date of acquisition to December 31, 1976. If the value of all of the decedent's property on December 31, 1976, exclusive of the first $10,000 of household goods and personal effects, was under $60,000, then the assigned basis is to be $60,000 prorated among the estate's assets according to their respective values.\(^ {38}\)

So vehement has been the opposition to "carryover" basis that Congress postponed the effective date of the provisions to apply only to decedents dying after December 31, 1979.\(^ {39}\) If no further action is taken, "carryover" basis will become the law effective January 1, 1980. While there is considerable speculation regarding its future, complete elimination will probably come to pass only in a legislative trade-off for something not much better, and perhaps worse, such

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35. I.R.C. § 2523.
37. I.R.C. §§ 1014, 1015, 1023, 1040.
38. Id.
as a provision for capital gains at death on appreciated property, or an "additional estate tax" on appreciation.\textsuperscript{40}

Notwithstanding the possible demise of "carryover" basis, drafting documents which deal with future events and which may escape amendment through client neglect or otherwise, requires attention to the implications of the section.

B. Minimization of Federal Estate Tax

1. Gifts

The day of substantial gifts as a means of prepaying federal estate tax at lower rates has ended. Under the 1976 T.R.A. taxable gifts, that is, gifts which require the application of the gift tax credit, seem warranted only if the gift is property likely to substantially appreciate. This is particularly applicable to the farm family where the major assets are likely to be real property which is increasing in value far beyond any immediate economic return to the owner.

It is most important to encourage use of the $3,000 annual exclusion. Beginning in 1977 transfers made by a decedent within three years of death are included in the decedent's gross estate without regard to whether they were in contemplation of death. The exception to this is the annual exclusion where no gift tax return is required to be filed. Note, however, that under the 1978 R.A., amending I.R.C. § 2035, this exception would not permit the exclusion of any portion of a $6,000 gift which has resulted from spousal consent, as in a $3000 gift from the donor and an additional $3,000 consented to by the spouse. Why? Because a gift tax return is required to be filed as evidence of the consent. Thus the entire $6,000 is added back into the decedent's estate if death occurs within three years.

To the extent possible, separate $3,000 gifts should come from each spouse recognizing, however, that this does not permit the convenient equalization of estates between husband and wife available prior to the 1978 R.A. amendment. Further, the foregoing provision relating to the annual exclusion exception where the spouse has consented to an additional exclusion, gives additional impetus to the use of the $100,000 marital deduction gift to the spouse. Not only is this step in the equalization of estates referred to above, but it also sets the stage for such spouse in turn to make the annual $3,000 gifts to children and avoids the adverse effect of the 1978

\textsuperscript{40} See Lubick and Gutman, Treasury's New Views on Carryover Basis, 118 TRUSTS AND ESTATES 10-16 (January, 1979); Conway, Carryover Basis—An Impossible Dream, 118 TRUSTS AND ESTATES 10-18 (March, 1979).
amendment. It is apparent that the wife should have sufficient
property in her name to fund her use of the new unified credit in
order to save subsequent federal estate tax on the appreciation of
such property.

Applying the knowledge of these changes in gift taxes to the
farm-ranch estate encourages the selection of a business entity
which enables the gift of nominal increments of value (that is,
$3,000 amounts) to permit annual giving. The faculty of giving
is critical. Accordingly, little imagination is necessary in seizing
upon either the limited partnership, with its "units of ownership"
or the dutiful, but often maligned, corporation as the planning vehi-
cle.

2. *Estate Tax Marital Deduction*

Little argument can be made with the observation that the
amendments to I.R.C. § 2056(c) by the 1976 T.R.A. will dramati-
cally benefit medium-sized estates. The effect is to produce no fed-
eral estate tax in estates no larger than $425,625 for married de-
cedents dying after 1980. This is the result of the new $250,000
marital deduction, to which is then added the estate tax exemption
equivalent of $175,625. Ownership in many family farms may be
divided so that the separate estates of the husband and wife readily
fall within the $400,000 range. Where this can be done the federal
estate tax impact upon the death of the first to die is zero.

It is also quite possible unintentionally to "overqualify" the
marital deduction share when the estate is less than $425,625.00.
Without proper attention to the drafting of marital deduction
clauses, far more value than necessary to produce no tax may be
channeled into the marital deduction portion. Remember that the
portion the spouse receives through the marital deduction will be-
come part of his or her estate and will be taxable. If more than is
necessary to produce maximum savings for the spouse dying first is
passed, there will be tax consequences which could have been
avoided. Wills which customarily have left to the spouse "an inter-
est in my [testator's] estate which will result in the maximum
marital deduction..." must be redrafted to avoid needlessly los-
ing a part of the estate tax exemption equivalent.

3. *Orphan's Deduction*

The availability of the orphan's deduction41 equal in amount to
$5,000 multiplied by the number of years the minor has to attain

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41. I.R.C. § 2057.
age twenty-one, whether left as an outright cash bequest or in trust, may or may not be an important consideration to the farm and ranch client. To younger couples who may meet with premature tragedy, and may have a number of young children, it could result in substantial savings. In the orchestration of the estate plan, make certain that the orphan's deduction is adequately considered and is discarded only after the client has full knowledge of its provisions. To neglect a discussion of this factor is a serious omission. It is difficult to understand, however, why a client would not want to have an orphan's deduction clause if, at the time of the execution of the will, there are any children under age twenty-one. Unless there are well-considered reasons for not doing so, it should be recommended.

4. Testamentary Dispositions Designed To Minimize Federal Estate Tax

The use of the marital deduction in conjunction with a "nonqualifying" residual trust continues to be one of the principal tools in the estate planning kit, even though the "generation-skipping" provisions of the 1976 T.R.A. may result in the imposition of federal estate tax upon the death of the life tenant who is the principal beneficiary of the nonqualifying trust. There is available a $250,000 deduction from the value of the interest passing to each of the ultimate remaindermen; however, substantial land values coupled with fewer children as remaindermen, the most common situation, may still result in distributive shares upon the termination of the nonqualifying trust in amounts far in excess of $250,000.

The first task is to determine the form of devise for the transmission to the spouse of the marital deduction share. There are essentially three alternatives. First is the outright devise; second, the use of the marital deduction trust; and third, the life estate with a power of appointment. The choice usually most acceptable to the surviving widow is the outright devise, but where the testator wishes to clothe the interest passing with some form of restraint against disposition, then options are limited to either the trust or life estate.

The life estate coupled with the power of appointment is easier for the parties to comprehend, and results in less administration and expense; nonetheless, the absence of flexibility leaves much to be desired. If, however, the assets comprising the estate consist primarily of real property, then with proper planning the life estate may not present a hindrance to the spouse. Provisions may be in-
cluded giving the life tenant the opportunity to sell and/or mortgage such interests with specific directions concerning the proceeds if the real property is disposed of.

If a farmer has selected the corporate form as a consequence of “current operational considerations,” and the corporation has elected Subchapter “S” treatment, then the use of the marital deduction trust will result in a termination of the election at a most inopportune time. The surviving widow often cannot justify a salary from a regular corporation sufficient to take care of living expenses, but her proportionate share of Subchapter “S” distributive income might well suffice. Other adverse income tax consequences may be involved in the termination, particularly if the corporation is the owner of assets such as I.R.C. § 1245 livestock. The sale of such assets will be subject to more favorable capital gain treatment in a Subchapter “S” corporation than in a regular corporation.

Where land is the principal asset and the entity has a continued history of loss, the availability of the marital deduction may be in doubt. If a marital deduction trust is involved, serious consideration must be given to granting to the surviving spouse the right to withdraw any marital deduction assets from the trust. Apparently no estate tax plan involving farm and ranch lands in a marital trust has been the subject of audit and disallowance. If such a case were to develop, particularly in any agriculturally oriented state, a rigorous contest with the I.R.S. could be expected. The position of the I.R.S. is based upon the requirement that the marital deduction be funded with “productive” property. 43

What has been said concerning the marital deduction trust and life estate is also applicable to the remaining nonqualifying share. The goal is to reduce the second tax on this portion of the decedent’s estate which will be payable at the death of the survivor. Again, the absence of flexibility with the life estate suggests use of the trust. Most wills for a decedent whose estate consists of over 50 percent of the stockholdings in a Subchapter “S” corporation will be structured to pass the marital deduction share outright, create a legal life estate without any power of appointment in the balance of the shares, and place the residue of the estate in a nonqualifying trust.

Although apparently not extensive, there has been an increased interest in the use of limited partnerships in farm and ranch estate planning to facilitate a transfer to a spouse of the marital share and the use of the residual trust. In these situations there may be a disposition of units in the limited partnership to the surviving spouse in either the marital deduction share or the nonqualifying

portion of the estate. The problems of corporate dissolution in the event of sale after death, termination of the Subchapter "S" election mentioned above, double taxation, and other related matters provide estate planners with incentive to give serious consideration to the limited partnership. Some have suggested that a limited partnership, to accomplish the objectives desired, requires considerable sophistication in the drafting of the document and therefore results in additional expense. Such an argument is entirely specious and unworthy of emphasis. If we are promiscuously prescribing the use of a farm and ranch corporation—be it regular or Subchapter "S"—because of an unwillingness to carefully consider the refinements of a well-drafted limited partnership agreement, then we do not deserve the confidence of our clients. There are, however, legitimate questions yet unanswered with respect to limited partnerships in family situations where one or more of the limited partners actually participates in the decision-making process. Does such participation by a limited partner convert the legal status of such limited partner to that of a general partner without further adverse consequences to the entity? Does the participation of more than one limited partner in the decision-making process not only convert such limited partners to the status of general partners, but also remove the cloak of limited liability to all other limited partners based on the argument that the limited partnership no longer is functioning as a limited partnership, and for all reasons shall be considered as a general partnership? If the I.R.S. is successful in this contention, have we lost the right to freely transfer units of limited partners because of its classification as a general partnership? (See Part 5(c) infra.)

5. Selection of Business Entity or Other Form of Ownership To Enable Effective Transmission of Estate

This section addresses selection of the form of business entity or method of ownership of property that will best enable an effective transmission of estate interest to survivors.

a. Creation or Retention of Joint Tenancies with Right of Survivorship between Husband and Wife in Real or Personal Property

Joint tenancies with right of survivorship have long been known as the "poor man's will." Indeed, more joint tenancies have been created by accident than on purpose, whether through contact with a real estate or investment broker, banker, accountant, or lawyer.

Prior to the 1976 T.R.A. and subsequent to December 31, 1954, the acquisition of real property in joint tenancy was not considered a gift by the spouse furnishing the consideration to the other unless an election was made to treat the acquisition as a gift. Such election was evidenced by the timely filing of a gift tax return. Prior to 1955 such acquisition was considered a gift and required filing a return. As a result of the 1954 amendment, unless there was an election to treat the acquisition of real property as a gift between husband and wife, no gift tax consequences resulted unless and until a termination of the joint tenancy occurred otherwise than by the death of a joint tenant. Thus a sale or other disposition of the joint tenancy property would terminate the joint interest. For instance, such sale evidenced by a promissory note in which the sellers are clearly identified as joint tenants would seem to be merely a continuation of the joint tenancy relationship, but in a different form of property, as in the conversion from a joint tenancy in real property which is the subject of the sale to a joint tenancy interest in the proceeds. However, the acceptance of a promissory note payable to the sellers by the buyer which represents the unpaid balance of the purchase price may be a form of termination that would trigger the gift.45

The 1976 T.R.A. established “qualified joint tenancies.”46 If a joint tenancy is determined to be “qualified,” then the prior presumption that the full value of the joint tenancy property belonged to the estate of the first joint tenant to die is no longer applicable. Instead only one-half is included. Again, there must be a determination whether the joint tenancy is qualified. To be qualified there must be a determination that the acquisition of the joint tenancy resulted in a gift. If the parties did not file a gift tax return, then no gift of an interest to a noncontributing spouse arose. The death of one of the joint tenants in such instance would again invoke the presumption that the full value of the property would be included in the decedent’s estate, subject, however, to the right of the survivor to prove contribution.

The 1978 R.A. amendment addressed only the technical aspects of the manner in which “qualified joint tenancies” were created and did not make that form of ownership more attractive as a means of transmission of interests to surviving heirs. The new law simply permits the spouse who has previously created a joint tenancy to elect to treat the acquisition as a gift without going through the mechanics of severing the old joint tenancy and recreating it. The donor-spouse must report a gift of the property on a gift tax return

46. I.R.C. §§ 2040(b) and 2515, as amended.
file for any quarter in 1977, 1978 or 1979 in which the spouse elects to treat the acquisition as a gift. The amount of the gift will be equal to the appreciation attributable to the gift portion of the consideration furnished by the donor-spouse at the time of the creation of the joint interest. 47

Lack of flexibility, again, is the "Achilles’ heel" of this form of ownership. Unless the farm-ranch family consists only of a husband and wife, without children, its usage should be severely curtailed. Where real property is the estate's primary asset, ownership in joint tenancy will not allow any major distribution to children, or fractional interest to a marital or nonqualifying trust. The result could be a substantial increase in total tax liability.

b. General Partnership

The general partnership form severely limits the ability to devise interests to surviving heirs. A decedent’s interest in a partnership cannot be the subject of a gift to heirs. The Uniform Partnership Act provides for the dissolution of a partnership occasioned by the death of a partner (for federal income tax purposes, the death of a partner owning more than 50 percent interest). 48 Thus the legal impediment to a testamentary disposition of a partnership interest prevents continuity; it is thus impossible to control those actively involved in the day-to-day management decisions. Mention has already been made of the attitudes of lending institutions related to continuity, but this problem deserves emphasis.

No two individuals can be compelled to continue to do business with each other. While the partnership agreement can purport to bind the surviving partner to the heirs and/or devisees of the deceased partner, anyone not wanting to continue the business relationship may simply give notice under the provisions of the law. 49 This will then set into motion the machinery for the dissolution of a partnership which requires the liquidation of assets, payment of debts, return of capital and distribution of the residue in accordance with the capital accounts or in the percentages provided in the partnership agreement. 50

In addition the partnership form does not lend itself to the presence of minors, and thus any attempt to plan for death or retirement prior to all members of a family becoming of age is thwarted. The provisions within the partnership agreement which allow the

47. Id., as further amended by 1978 R.A.
continuation of the partnership after the death of a partner by the purchase of the deceased partner’s interest may make the partnership more viable in certain situations. The problem remains, however, to meet the requirements imposed upon the survivors to pay the decedent’s estate monies necessary to liquidate his interest. The burden on the survivors, unless the obligation is funded with life insurance, can be extremely onerous. Within the agricultural community this problem is aggravated by the combination of minimum cash flow and substantial land values.

c. **Limited Partnership**

Comment has already been made concerning the increasing interest in the limited partnership as a viable business entity which will accommodate both current operational concerns as well as true gift and estate tax planning.51

In the early stages of the farm and ranch family’s life parents usually want to maintain management control while setting the stage for gifts to other members of the family for the express purpose of decreasing the donor’s estate. This is the ideal setting for the use of a limited partnership. The law permits the parents, as general partners, to own units as limited partners.52 It is these units of ownership that will be the subject of gift. The limited partnership can also provide that in the event of the death of the general partner there will be a substitution of management—presumably from among the survivors—which would be binding upon all parties.53 This is an effective way to accomplish the transition of control to a member of the family in the event of death without any business or legal interruption. Continuity has been accomplished.

If, however, one of the objectives of the parent is to provide incentive to a son to participate more actively in the day-to-day management decisions of the ranch, then gifts of units of limited partnership may not be appropriate unless the parties are willing to accept the son as a general partner. If a son has been made a limited partner through gifts, and then becomes an active participant in the operation, one of the primary characteristics of a limited partnership is destroyed insofar as the son is concerned. Even if the son continues to own only limited partnership interests, active participation may effectively render him a general partner.54 To what extent this situation will lead to the ultimate assessment of the entity

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51. See Section III(B)(4), supra.
53. MCA § 35-12-401 (1978) (formerly codified at R.C.M. 1947, §§ 63-810 and 63-901 (Supp. 1977)).
as a "general partnership" for income tax purposes has not yet been decided. If enough involvement of limited partners with management decisions occurs, then the limited partnership will undoubtedly be deemed general in nature. If so, it may lose the attributes of a limited partnership not only for the purposes of taxation and liability, but also in the area permitting the devolution of the limited partnership interests to devisees. 55

Some contend that limited partners who participate in the affairs of the partnership, while subjecting themselves to the liability of a general partner, will not disqualify the limited partnership from being treated as such for state law as well as tax purposes. An unequivocal answer is necessary, however, before we advocate wide spread use of the limited partnership in farm operations. 56

Finally, if there is an attempt to build into the agreement a large number of "corporate attributes" in addition to centralized management of the general partner and the continuity of interest, then the client should be aware that the entity may well be the subject of attack by the I.R.S. on the grounds that the organization is, in fact, "an association taxable as a corporation." 57 Therefore it is important to consider whether a regular corporation, not a Subchapter "S", would be so totally adverse to the interest of the client that the gamble of being treated as an "association" is justified.

In summary, the limited partnership, offers a fresh approach that may provide an alternative to incorporating even though it has previously been of limited use. The jury is still out. For an excellent discussion of special problems of limited partnerships, see ALI-ABA Tax Planning for Agriculture, mentioned at the outset of this article.

d. Corporation

There is little need to repeat the fundamentals of a corporation. Its popular acceptance by estate planners, particularly during the last ten years, is an outgrowth of recognition that it does possess many of the characteristics which satisfy both current operational objectives as well as gift and estate tax considerations.

The continuity of existence and freedom of transferability of interests are paramount in the eyes of the client in most farm and ranch situations if there is concern about family perpetuation. The

56. See Park Cities Corp. v. Byrd, 534 S.W.2d 668 (Tex. 1976) for discussion of problems presented by the clash of tax law and state law.
corporate form also provides the opportunity to retain effective management control while surrendering a large percentage of the donor's estate.

The facility of disposition of real property without the necessity for ancillary administration or probate of a deceased shareholder's estate has also been a factor which recommends adoption of the corporate form.

Of more recent interest to estate planners has been the opportunity to discount a decedent's ownership in a business rather than be required to report the interest on the basis of a fair market value net worth of assets (less liabilities) before apportionment among the several owners. Historically this fair market value net worth approach has been advocated by the I.R.S. notwithstanding the many-faceted explanation of factors involved in determining stock values set forth in Rev. Rul. 59-60. But the I.R.S. dies hard, and it was only after constant confrontation with taxpayers that inroads were made into the "land holding company" concept of the I.R.S. insofar as farm and ranch organizations were concerned. Such "net asset value" is but one of the many factors to be included in arriving at the value of stock in a closely held corporation. Other factors, such as stock restrictions, accrued deferred income tax liability, corporate earnings and dividends paid, must be taken into consideration. At this point, lack of marketability is injected into the scene in arriving at the prospect of discount. The cases have generally fallen into two categories—those dealing with lack of liquidating control (Montana: 66 2/3 percent), and those involving less than management or operating control (Montana: 50 percent plus, with the use of cumulative voting). The reduction of a shareholder's interest to less than that required for liquidating the company should enable a substantial discount of the stock value because of decreased marketability, notwithstanding a disposition to the members of a family group. In Rothgery v. United States,\(^{58}\) however, the Internal Revenue Service urged that the minority stock should not be permitted a discount where full control of the corporation was within the family group.

A discount should also be available even where the decedent dies owning more than 50 percent but less than 66 2/3 percent of the stock where there are genuine restrictions placed upon the stock which are operative both during the lifetime of shareholders as well as at time of death.\(^{59}\) The I.R.S., however, has insisted that if there

\(^{58}\) 201 Ct. Cl. 183, 475 F.2d 591 (1973).

is to be a discount for minority stock, then there should be a premium added for the majority stock interest because of the ability of the majority to control the corporation.60 Often cited in connection with the question of premiums is Estate of J. E. Salisbury,61 in which the court added a premium of 38 percent to the majority stock's par value because of the ability to control the corporation.

It is apparent that if there are restrictions contained within a corporation-shareholder agreement applicable to all parties, and if the stock ownership of the client is reduced to anything less than management control, that is, less than 50 percent, a substantial discount should be available for federal estate tax purposes.62 You should not surrender in your efforts to obtain a discount. Even if the decedent's stock ownership was greater than 50 percent but less than 66 2/3 percent, efforts to obtain a discount should be vigorous since there is authority, supra, establishing the right to control liquidation as a test for applicability of a discount in recognition of reduced marketability.63

Perhaps the most recent and important case dealing with the valuation of closely held stock is Estate of Ethel C. Dooley,64 in which the court discusses at considerable length the elements of value which ought to be involved in an appraisal of corporation assets. The result in the Dooley case may not have been nearly as favorable for the taxpayer had the I.R.S. employed as competent an appraiser as the taxpayer.65 From a reading of the pertinent cases, it is evident that a well-prepared appraisal is the key to a substantial discount. If the decedent died owning less than controlling interest, that is, less than 50 percent of the stock, there should be little doubt regarding the ability to discount. Where discounts of 30 percent to 40 percent are available, considering the prospect that your client may be in a 34 percent to 42 percent federal estate tax bracket, the expense incurred in having a qualified appraiser is minimal compared with the ultimate benefit.

These same considerations used in determining the fair market value of closely held stock may well be used in determining the value of "units" in a limited partnership. There is not yet enough authority to forecast whether all of the criteria will be applicable in

61. 34 T.C.M. 1441 (1975).
63. See text accompanying notes 58 and 59, supra for a discussion of the depressing effect of restrictions on stock. See also Estate of Cotchett, 33 T.C.M. 138 (1974).
64. 31 T.C.M. 814 (1972).
65. For a discussion of appraisals, see Spicer, 33 T.C.M. 45 (1974); Nail, 59 T.C. 187 (1973); Vinson, 22 T.C.M. 280 (1963); United Virginia Bank, 74-1 U.S.T.C. 12,972.

https://scholarship.law.umt.edu/mlr/vol40/iss2/1
the limited partnership situation, but the logic of the cases should apply in many instances. Certainly the rationale of a discount for lack of marketability should be applicable to units in a limited partnership.  

6. Additional Estate Valuation Concerns for the Farm and Ranch Family

a. Undivided Interests

Fractional interests in real property should enable a discount in arriving at fair market value for lack of marketability; however, where the undivided interests are all owned by a single family unit, this may limit the extent of the discount.

b. Special Use Valuation

The most recent tool that has been added to the estate planning kit is the potential for valuation of farm land and other real estate used in a trade or business under I.R.C. § 2032A. An entire article is warranted for a treatment of this subject. Essentially this section permits the personal representative to elect to value farm land (or real property used in a trade or business other than farming) on a basis of current use rather than a potential of “highest and best use,” subject to a limitation of $500,000 on reduction of the gross estate, if the following requirements are met:

(i) The decedent must be a U.S. citizen;
(ii) the value of the farm or closely held business (reduced by debts against assets) must be at least 50 percent of the decedent’s gross estate (reduced by certain debts and expenses);
(iii) at least 25 percent of the adjusted value of the gross estate must be “qualified” farm or closely held business real property;
(iv) real property must have been owned by the decedent or a member of the family and held for use as a farm or closely held business for at least five of the eight years prior to the decedent’s death; and
(v) there must have been a “material participation” in the operation of the business by the decedent or a member of the decedent’s family in five of the eight years immediately preceding the decedent’s death.

The special valuation formula available to the farmer-rancher

66. Angela Firioto, 33 T.C. 440 (1959) (indicating such considerations may even be applied to partnership interests where “arm’s-length” restrictive agreements are concerned involving bona fide business purposes).

referred to as the "farm method" requires capitalization of net average annual rents (defined as gross rental for comparable lands less local real estate taxes for such comparable lands) by the average annual effective interest rate for new Federal Land Bank loans. Present lending rate indicates a formula of approximately twelve times the net rent. The average annual effective interest rate is determined over the five years preceding the date of death. In this connection, the cost of stock required to be purchased in the Federal Land Bank by a borrower is to be considered in defining "effective" interest rate.68

In most situations within Montana there is an opportunity to arrive at rental for comparable land. While the statute, as enacted, suggested that a lack of "comparables" would eliminate the opportunity to use the formula, and would thus present special problems to lands that are customarily the subject of share-crop rental patterns, the proposed regulations69 seem to permit equating the value of the crop to rent. This opportunity would be particularly important in the southeastern United States where a long history of share-crop arrangements has rendered it difficult to determine a net average annual rental of land.

Since the enactment of I.R.C. § 2032A was at the behest of the family farmer-rancher in response to his plea that there should not be a confiscation of the ranch as the result of federal estate taxation, it was only natural that there be a provision for a recapture of federal estate taxes if the property was subsequently sold "out of the family." Accordingly, the section provides that if property is disposed of within fifteen years after death to nonfamily members, or ceases to be used for farming purposes, any portion of federal estate tax benefits obtained by the reduced valuation is recaptured. There is a transition procedure if property is disposed of after ten years but before fifteen years. A special lien is granted to the United States for all possible recapture taxes on real property until the expiration of fifteen years or death of the qualified heir. Regulations are being enacted to provide the opportunity to substitute other property in discharge of this lien.

The special problems presented by I.R.C. § 2032A include the need to have two separate valuations of land in an estate; if the alternate estate tax valuation date is used, then there is a need for three separate valuations.

If the "fresh start" rule, previously discussed, becomes a reality, then there will also be a requirement that property be valued

69. Id.
on December 31, 1976, reduced by the amount of any § 2032A election to arrive at its adjusted basis for future income tax purposes. This special use valuation may well produce a value which reduces depreciation deductions for future years. Its implication upon a lower marital deduction and the possible conflict with state law governing interests passing to surviving spouses will no doubt be the subject of litigation.70

Whether I.R.C. § 2032A will give to agriculture the relief needed remains to be seen. Considerable opposition has been voiced to this relief measure on the basis that it was “class legislation” not justified by the facts. In my opinion, Congress was warranted in meeting the outpouring of sentiment from the agricultural community regarding the confiscatory nature of estate taxes. Farm and ranch estates are experiencing a devastating tax impact. These situations arise upon the death of the survivor, where there has been no use of gifting as a means of reducing the parents’ interest in the ranch. The “material participation” test has been the subject of criticism, but if the philosophical basis of the statute is to permit the farm to be run by the family, then material participation and recapture seem logical.

For the practitioner, however, the decision whether to use § 2032A imposes a special responsibility. The provision is fraught with prospects for malpractice, in one form or another, principally because of the obligation to acquaint all interested parties with the consequences. Indeed, in many of the seminars being held throughout the country on the subject, it seems to be “in vogue” for the speaker to announce that he will have nothing to do with special use valuation. I believe, however, that not to use § 2032A in a farm and ranch estate may result in disastrous consequences; disgruntled heirs some years after closing the estate may realize that substantial taxes could have been saved through its use and may raise the question of why it was not adequately explored by counsel and family. Corporate fiduciaries are extremely nervous, fearing that the provision is akin to “Pandora’s Box.” In all fairness to those who voice objections to its use, there is much uncertainty concerning the construction of the language. Proposed regulations relating to closely-held corporations, partnerships and other such entities have not been drafted. The proposed regulations cited are expressly limited to individuals. At the time this article is being written some Montana I.R.S. auditors are asserting that § 2032A may not be used unless it is apparent that the real property has been impacted by recreational, urban or other similar pressures. If farming is its

70. Id.
“highest and best use,” it does not qualify for § 2032A treatment, in their opinion.

C. Availability of Life Insurance To Ease Transmission of Estate

Life insurance, in any substantial amounts, continues to be suspect by many farm and ranch families due primarily to the lack of sufficient cash flow to acquire the amounts needed, notwithstanding the many plans which accommodate a concept of “automatic premium loan—minimum deposit.” Nevertheless, the funding of cross-purchase agreements between or among partners and/or shareholders, the funding of entity-purchase agreements for partnerships and corporate redemption agreements of deceased shareholders’ interests all emphasize the need for liquidity without looking to the farm assets as a basis for obtaining the necessary funds.

Such agreements do not need to provide for all of the cash for the outright purchase of a decedent’s interest, but merely enough to constitute a substantial down payment. The unpaid balance can then be handled under an installment note or contract where the annual payments are geared to the projected financial ability of the survivors. In many instances it is neither necessary nor desirable to purchase father’s or mother’s interest in the ranch since it is their intention to devise it to family members in all events. What must be insured is the ability of the brother who is going to actively manage the corporation or partnership to liquidate the interests of others who no longer should be tied to the entity. Life insurance on the life of the principal owner can include a clause which designates the son as the beneficiary, but requires the use of the monies for application on an installment agreement between the son and others.

The problem with this arrangement is getting monies into the hands of the son to meet the annual payments if the method of transferring funds to the son is either a distributive share of partnership profits, a share in Subchapter “S” distributable income or salary. Until recent months, farm and ranch income in many instances has been insufficient to provide minimum living expense and, in addition, dollars for the payment of insurance premiums. While the case can certainly be argued for “term” insurance, usually it will be preferable to provide the cheapest form of permanent insurance which will result in the minimum amount of cash necessary at death where the goal is to allow interest passing to nonactive children to be acquired by those who are active in the farm operation.

Under the 1976 T.R.A. transfers made by a decedent within three years of death are included in his gross estate regardless of whether the gifts were actually made in contemplation of death.
exception to this requirement for inclusion was made for any gifts excludable under the $3,000 annual gift tax exclusion. The 1978 R.A. further amended § 2035 and limited the exception to those gifts for which no gift tax return was required to be filed, that is, gifts to a donee that do not exceed $3,000 in a calendar year. This exception "shall not apply to any transfer with respect to a life insurance policy." Thus, even though the policy is worth $3,000 or less, and even though the transfer is a present interest gift, or the donor is not required to file a gift tax return, there is still a transfer within three years of death "with respect to the policy," and the full amount of the proceeds will be includible in the decedent's estate.1

Premiums paid on life insurance more than three years prior to death are excludable; however, premiums paid within three years of a decedent's death may or may not be includable under the exception. There continues to be some ambiguity regarding third-party purchase of insurance with premium dollars gifted by the insured where no gift tax return is required to be filed—for example, annual premium payments of less than $3,000. The Senate Committee, in explaining the Code language, suggests that the decedent's estate should not be required to include either the proceeds of the insurance or premiums paid within the last three years of the decedent's life. On the other hand, under prior case law, proceeds will probably be includible since the value of the "deemed gift" made by the insured is essentially the death proceeds and not the premiums.2

When considering the use of life insurance to facilitate the transmission of estate properties, the "transfer for value" problem addressed in I.R.C. § 101(a)(2) must be avoided. It is also imperative that counsel be familiar with the legal aspects of "split-dollar" insurance which may be established through either the "endorsement system" or the "collateral assignment system." There are serious income, estate and gift tax consequences involved in utilization of this form of insurance too extensive for treatment here; however, there are several sources which can provide guidance.3

71. See Section III(A)(1), supra, for discussion. See I.R.C. § 2035, as amended.
IV. MISCELLANEOUS TAX AND NONTAX CONSIDERATIONS AFFECTING CHOICE OF OWNERSHIP ENTITY

A. Estate Tax Payment Provisions

1. Ten-Year Extension To Pay Estate Tax

The 1976 T.R.A. amended I.R.C. § 6161 by providing that the secretary “may for reasonable cause, extend the time for payment” of any federal estate tax for a reasonable period not in excess of ten years from the due date, rather than requiring a showing of “undue hardship.” The test can be satisfied by showing that the personal representative must be granted time in which to marshal assets of the estate and to convert them to cash.

2. Fifteen-Year Extension To Pay Estate Tax

Where the value of the farm exceeds 65 percent of the adjusted gross estate, a fifteen-year installment method is allowed. The first installment may be deferred for five years; the payment of 4 percent interest is required. Thereafter the tax is paid in equal annual installments over the next ten years. This special 4 percent interest rate is permitted on the estate tax attributable to the first $1,000,000 of farm or closely held property. Interest on estate tax in excess of $345,800 requires payment of the regular rate for deferred payments, which the I.R.S. is granted the authority to change from time to time. 74

The decedent must either own the entire farm or 20 percent of the capital interest in the partnership or corporation owning the farm, or no more than fifteen partners or shareholders may be involved. The 1978 Revenue Act further amends I.R.C. § 6166 by providing for the application of attribution rules in determining the number of partners or shareholders. 75

The 1978 R.A. likewise amends I.R.C. § 6324A and modifies the security requirements where extended payment of estate tax provisions are elected. Before amendment, bond in an amount equal to double the amount of the unpaid tax was required. An election also was available to have a lien attached to real property or other assets with useful lives during the period that deferred taxes were paid. The amendment requires property to be subject to a lien in an amount equal to the deferred tax liability plus the required interest amount payable over the first four years of the deferral period.

The personal representative and all parties with an interest in the property which is the subject of the lien are required to file an

74. I.R.C. §§ 6166, 6601, 6621.
75. I.R.C. § 6166, as amended.
agreement which consents to the creation of the lien. An agent may be designated to represent the beneficiaries of the estate and persons who consent to the lien in future transactions with the Internal Revenue Service.

It should be noted that under § 6324A(d)(3), the lien is junior to: (1) real property tax and special assessment liens; (2) mechanics' liens; and (3) real property construction or improvement financing agreements. In the instance of an improvement financing agreement, the security interest may come into existence either before or after the tax lien has been filed. Should the I.R.S. be authorized to accelerate the payment of the deferred tax as a result of any of the happenings which caused the acceleration, then the tax lien takes priority over subsequent mechanics' liens or real property construction or improvement financing agreements, but not real property tax or special assessment liens.

3. Ten-Year Extension To Pay Estate Tax

The old ten-year extension to pay estate tax is retained where the interest of the estate in a closely held business exceeds 35 percent of the value of the gross estate or 50 percent of the taxable estate. 76

4. Redemption of Corporate Stock To Pay Estate Tax

Under prior law there was a requirement that the decedent's stock be in excess of 35 percent of the gross estate or 50 percent of the taxable estate in order to redeem stock to pay estate taxes. The 1976 T.R.A. amending I.R.C. § 303 requires the value of the decedent's stock to exceed 50 percent of the adjusted gross estate. Stock that qualifies for capital gain treatment as the result of such redemption must be redeemed from the shareholder(s) whose interest in the estate is reduced by payment of death taxes and other estate shrinkage. No such requirement existed under pre-1976 T.R.A. law. The effect of the 1976 T.R.A. amendment is to severely limit the usefulness of I.R.C. § 303 redemptions. Substantial gifts of stock prior to the death of the decedent must be carefully considered if making the gifts would make it impossible to qualify for an I.R.C. § 303 redemption.

In summary, the amendments in the 1976 Tax Reform Act and 1978 Revenue Act provide considerable relief to the survivors in

76. I.R.C. § 6166A.
meeting federal estate tax payments. There is some ambiguity in the law regarding the effect which the estate tax lien will have on the persistent needs of the farm-ranch community to refinance existing long-term debt resulting from a buildup of annual operating expense. This problem is being seriously considered by Congress as a result of concerns voiced by the Federal Land Bank and other institutional lenders.

B. 1978 Revenue Act Amendment to I.R.C. § 2040 Relating to Spouse’s Services Included in Valuing Jointly Owned Farms and Closely Held Businesses

Prior to the 1978 amendment the value of a joint tenancy with right of survivorship was included in the joint tenant’s gross estate, except to the extent that the surviving joint tenant was able to prove consideration furnished by him or her. While there have been isolated instances in which the taxpayer was successful in urging that “services rendered” as a member of a farm-ranch team should satisfy the requirement of “contribution,” the Internal Revenue Service did not readily accept the argument.

The new law provides that where property is jointly owned by a husband and wife and is used in the farm or other business, the services of a spouse are taken into account as consideration furnished. The excludible amount (not to exceed 50 percent of the value of the eligible interest or $500,000) is determined by applying to the excess value of the joint interest over the amount attributable to the original consideration furnished, a percentage rate of 2 percent for each year the surviving joint tenant-spouse materially participated in running the farm or business. For such purpose, the amount attributable to the original consideration is the amount of that consideration plus assumed appreciation equal to 6 percent simple annual interest. The question of whether or not the spouse has provided services shall be determined by the use of the self-employment test, that is, “material participation” as in the case of I.R.C. § 1402(a).77

The amendment may soften the impact of death on estates where substantial joint property between husband and wife is involved. The section should be used only as a relief measure where

77. See Estate of Everett Otte, 31 T.C.M. 301 (1972) for discussion of contribution by surviving spouse. Query: Does the 1976 T.R.A. amendment to I.R.C. § 2040 now establish the criteria for proof of contribution or is the rationale of Otte still available to the taxpayer? It is this writer’s opinion that the amendment to § 2040 was not intended by Congress as a substitute for the facts of the Otte case. Accordingly, in an I.R.C. § 351 transfer to a corporation of jointly owned property in exchange for stock the Otte case should be authority for issuance of shares to the wife without adverse gift tax consequences.
adequate planning was not possible rather than as a justification for the retention of highly appreciated joint tenancy property.

C. 1978 Revenue Act Amendments Pertaining to Closely Held Corporations

1. Subchapter “S” Shareholders

I.R.C. § 1371 and § 1372(c), relating to the maximum number of shareholders in Subchapter “S” corporations, have been amended to permit an election in all cases where not more than fifteen shareholders in all cases are involved, and not only where some of the shareholders received their interest by inheritance. Husband and wife are to be counted as a single shareholder regardless of how their stock was owned, and the period of time for making elections has been expanded to include the entire preceding taxable year and extends over the first seventy-five days of the current year for which the election is effective. Grantor trusts are permitted to be shareholders if the grantor is either a U.S. citizen or resident. A post-death grantor trust is permitted to be a Subchapter “S” shareholder for a sixty-day period after the grantor’s death. The 1976 T.R.A. had previously amended the law requiring the consent of a new shareholder to be filed within thirty days after the receipt of stock. The amended provision now requires a new shareholder to affirmatively disavow the Subchapter “S” election and has effectively removed one of the tax traps fallen into by many—particularly upon the death of a shareholder.

2. I.R.C. § 1244 Stock Plans

Section 1244 of the Internal Revenue Code, pertaining to the stock of a small business corporation, was amended to permit an increase in the amount of stock issued by such corporation from $500,000 to $1,000,000 and eliminated the requirement that such stock be issued pursuant to a written plan. Section 1244 stock offers relief to an investor in a closely held corporation who suffers a loss. The relief provision permits such loss to be deducted against ordinary income. A written plan, however, should still be encouraged. The maximum amount that an individual may treat as ordinary loss (as contrasted to a capital loss if a plan was not adopted) has been increased from $25,000 to $50,000, or from $50,000 to $100,000 in the case of a joint return.

3. I.R.C. Amendment to Section 105 Regarding Medical Expense Reimbursement Plans

The foregoing section has been amended to expressly prohibit
discrimination in favor of employees who are shareholders, officers or highly compensated employees. Previously, the I.R.S. has not often challenged corporate plans where less privileged employees are obviously excluded.

D. Need for Consideration of Problems in Dissolution of Business Entity After Death of Principal Owners

One of the most important considerations in the selection of a farm-ranch business entity is analysis of income tax consequences which may arise in the event of a sale of the property following the death of the principal owners. It is difficult to conceive a method of doing business that will accommodate current operational concerns and accomplish gift and estate tax savings without presenting some problems if the venture terminates. There is an increasing number of family farms and ranches which have succumbed to current economic problems. These dispositions have not been triggered by an undue burden of federal estate tax, for that burden also affects other businesses. The outrageous appreciation of land, and the insatiable thirst of others to acquire it have proved to be a primary catalyst to the farm sale.

The discussion of estate planning for farmers and ranchers must incorporate the prospects of disposition through sale or exchange. Practitioners often have been guilty of myopic vision and the sins of the past may come back to haunt the lawyer and accountant. In partial defense, however, it may not be possible to devise a plan “for all times.” Nonetheless, problems which arise prior to and at the time of a prospective sale of assets and/or shares of stock of a farm and ranch corporation require critical attention.

Because of the problem of highly appreciated property, the installment method of sale⁷⁸ may be mandatory. The purchaser, however, is anxious to assign as high an adjusted tax basis as possible to depreciable assets. It may also be that not all assets will be the subject of purchase. Finally, there may be the prospect of some form of I.R.C. § 1031 tax-free exchange of real property as an inducement to the sale.

Many of the problems surrounding the sale or exchange of farm-ranch properties arise because of the corporate form. If the parties wish to use the installment method of reporting income tax, the provisions of either I.R.C. § 333 or § 337 will be applicable. These sections are referred to as the “one-month or thirty-day election” and the “twelve-month liquidation.” Were the owners able to negotiate a sale of their shares of stock, this readily lends itself to a down

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⁷⁸. I.R.C. § 453.
payment of less than 30 percent, with the balance payable over a period of years to ease the tax burden. The problem confronted by the buyer is two-fold. First is the matter of undisclosed liabilities arising from acts of the corporation and/or shareholders prior to the sale. One of the most common potential claims is for unpaid income taxes. Other claims may be the subject of insurance coverage and therefore would not present a serious controversy should they arise. The sales agreement, which requires the escrowing of shares of stock with an agent pending payment in full of the purchase price, can provide for indemnification to the buyers if any claim is proven which requires the payment of money or assumption of liability not previously considered.

Second is the more important consideration to the buyer—his need to allocate as much of the purchase price as is reasonable to those assets that can generate the noncash expense of depreciation. Indeed, the ability to do so is often a primary factor in determining the purchase price since such form of expense amounts to subsidizing, indirectly, the purchase of the property. Since the purchase is for shares of stock, there is no such right to make a new allocation of purchase price among the various assets to the benefit of the purchaser. This dilemma has given rise to assorted schemes using I.R.C. § 334(b)(2) and related Code provisions, the essence of which is felt will justify an immediate liquidation of the corporation by the purchaser, an allocation of the purchase price to the corporate assets received in liquidation and a substitution of a real estate mortgage and security interest in the real and personal property in favor of the sellers. There is not unanimity of opinion among attorneys and accountants whether this approach will leave the seller in a position of continuing to report gain on the installment basis if at the inception of the contract for sale the parties contemplated and agreed to the proposed dissolution of the corporation. Nonetheless the practice has become firmly established even though the I.R.S. may well advance the theories of "step transaction," "sham," and other phrases which point to the argument that what the parties actually did was to liquidate the corporation and sell the assets on an installment basis.

It is urged that the parties should approach this form of agreement with considerable care and attempt to avoid where possible any written provision giving to the buyer the right to so dissolve. Certainly the seller should be advised that the Service may contest his right to report the sale under I.R.C. § 453. Our concerns here have been with the seller and the adverse income tax consequences to him. These considerations are in addition to the problems of recapture of investment credit and accelerated depreciation, and the entire new area now serviced by the "tax benefit rule" used by
the Internal Revenue Service as a means of generating ordinary income from the disposition of any asset where expenses or deductions have been previously taken in the computation of taxable income.\textsuperscript{79} While the taxpayer won in \textit{Commissioner v. South Lake Farms, Inc.},\textsuperscript{80} the peculiar facts of this case no doubt warranted the Internal Revenue Service failing to acquiesce in its decision. Numerous other cases in support of the I.R.S. position are cited by Wheeler in his \textit{Tax Desk Book for Farming and Ranching}, mentioned at the outset of this article.

An installment sale of corporate assets will permit the deferral contemplated by I.R.C. § 453, but only if the corporation continues in existence. To avoid double taxation at the corporate and shareholder level, the parties will ordinarily have adopted a plan of liquidation under I.R.C. § 337 which requires complete liquidation and distribution within a twelve-month period following the adoption of the plan. Even though the specter of double taxation is eliminated through the use of the twelve-month plan of liquidation, the conveyance to the shareholders of undivided interests in the contracts for deed or other evidence of indebtedness is a “disposition” within the provisions of I.R.C. § 453(d); the result is an acceleration of all income tax attributable to the transaction.

As a consequence of the problems presented either through an installment sale of shares of stock followed by a dissolution of the corporation, or an I.R.C. § 337 liquidation coupled with a sale of assets, parties have looked to I.R.C. § 333 as an avenue of escape. This section requires ordinary income tax treatment by the shareholder of his ratable share of corporate accumulated earnings and profits and of earnings and profits which are determined as of the close of the month in which the transfer and liquidation occurs. In addition, either short-term or long-term capital gain is recognized on the remainder of any money or stock or securities distributed to the shareholder and acquired by the corporation after the year 1953.

The particular pitfall of a § 333 liquidation involves an accurate determination of accumulated “earnings and profits,” since a cash basis agricultural taxpayer is placed on an accrual basis for the purpose of computing earnings and profits. All items of income and expense are accrued to the date of transfer of property to the shareholders. The expenses for “zero basis” assets such as crops and raised cattle have been previously deducted; they may result in the addition to “E & P” in the year of liquidation.

The principal benefit of the use of I.R.C. § 333 in liquidating the farm corporation occurs in those situations where there has been

\textsuperscript{79} See Rev. Ruls. 77-67, 73-396, and 61-214 for discussion of “Tax Benefit Rule.”

\textsuperscript{80} 324 F.2d 837 (9th Cir. 1963).
no accumulated earnings and profits, cash and other stocks or securities due to the existence of the Subchapter "S" election from inception of the corporation to the date of sale. A § 333 liquidation is most attractive where land, cows and machinery are involved. Considerable caution is essential in two additional areas. The first is in the negotiation for the sale. The corporation and shareholders are not provided with a "safe harbor" as is the case in an I.R.C. § 337 liquidation, where the corporation can adopt the plan of liquidation and then engage in the sale of the assets without fear of double taxation to corporation and shareholders alike. Rather, the doctrines of Commissioner v. Court Holding Co.\textsuperscript{81} and cases cited suggest the need to follow carefully the guidelines for negotiations set forth in United States v. Cumberland Public Service Co.\textsuperscript{82} to avoid the "step transaction" theory alluded to above. The shareholder, and not the corporation, must negotiate the sale.

Second, caution is essential in the area of an I.R.C. § 1031 tax-free exchange. If the parties are contemplating the exchange of property upon receipt of the assets in liquidation, then it is highly unlikely that the sellers will be protected under I.R.C. § 1031. They have not acquired the property in the corporate liquidation with the intention of use in the trade or business or for investment.

Finally, I.R.C. § 333 demands that all assets of the corporation, of every nature and description whatsoever, be ferreted out and conveyed to the shareholders within the calendar month that the first act of distribution takes place. The penalty for having inadvertently left some item of real or personal property in the corporation is the disallowance of the beneficial tax treatment of property received; it will be treated as ordinary income to the extent of accumulated earnings and profits and of "E & P" determined as of the close of the month in which the transfer occurs. All property in the hands of the shareholders is considered as a distribution essentially equivalent to a dividend.

Notwithstanding the horrors of a § 333 liquidation and the prospect that the election is not revocable under Treas. Reg. § 1.333-2(b)(1) (1975), it may be a most useful tool in many farm and ranch corporations where there is need to assure the client that the installment method of reporting gain will be available. It is also fundamental that there is an absolute need to have a meeting of the minds with the accountant to determine the specific areas of responsibility in arriving at the adjusted earnings and profits picture of the corporation. The total basis of assets distributed in a § 333 liquidation is

\textsuperscript{81} 324 U.S. 331 (1945).
\textsuperscript{82} 338 U.S. 451 (1950).
the basis of the shareholder in his stock plus any gain recognized, less money received, and plus the unsecured liabilities assumed by the shareholder as prorated among the assets based on "fair market value." In addition, liabilities which are specific liens on property distributed are added to the basis of that property. Unquestionably, the problems discussed above, which are an outgrowth of the corporate form and a subsequent sale, will dictate a closer examination of the use of a limited partnership for farms and ranches in the years to come, unless either case law is developed or legislation enacted that either eliminates or minimizes the pitfalls. There is little doubt that the termination of a partnership and the distribution to the partners of interests in partnership assets followed by a sale of the assets is far less involved than the same steps taken by a corporation and shareholders.

E. Potpourri Considerations

1. Restrictive Buy-Sell Agreements

Throughout the foregoing discussion reference has been made to "buy-out" agreements for corporate stock or partnership interests which either restrict the transfer of stock in a corporation, give an option or impose an obligation to buy such stock or partnership interest to the corporation, remaining shareholders or partners in the event of death or retirement, and provide for a series of other contingencies. The usefulness, indeed the absolute need, for such agreements as an integral part of any "estate plan" is obvious. Too often have we seen insurance policies acquired on the lives of shareholders and partners with the intent to fund an obligation to purchase the interest of a deceased shareholder or partner and then discovered, much to the chagrin of all concerned, that the parties did not complete the execution of a formal agreement dictating the use of such monies.

The form and content of such agreements might well be the subject of a separate law review treatise, but certain essentials should be shared with the reader.

First is the requirement that the provisions be binding or operative during the lifetime of the parties as well as at death. Second is the need to employ a reasonable "arm's-length" approach, having some basis other than estate tax avoidance. The Internal Revenue Service will continue to attack those agreements whose sole purpose is to provide justification for reporting an inordinately low fair market value of a decedent's interest.

83. See note 62, supra.
Prior to the 1976 T.R.A., "stepped-up" basis of a decedent's interest avoided any adverse income tax consequences. Since there usually was no gain, a distribution of an installment note or contract obligation to devisees went unnoticed. However, the prospect of some form of "carryover basis" or "fresh start" may cause us to redraft such agreements. Not only is there the likelihood of a sale at a price in excess of the adjusted tax basis, but the distribution of the contract or note obligation from the estate to the devisees of the deceased shareholder or partner will be a "disposition" of an installment obligation resulting in an acceleration of tax payable by reason of the sale.84

The suggestion most readily offered is to avoid having the sale made by the personal representative of the estate. Such obligation to sell can be imposed upon the devisees of the deceased shareholder or partner after distribution to them of the decedent's stock or partnership interest.

2. Private Annuity Agreements

The use of a private annuity as a means of effecting a transfer of economic interest is often considered more out of deference to the highly sophisticated tax planner than from any sense of conviction that the device will work to the benefit of the parties.

The concept is simply this: a father-mother (or other owner of property) may convey the property to a son or third party in exchange for an unsecured promise to pay essentially amounts which the actuarial tables would dictate should be paid to the transferors were they to purchase a commercial annuity from a life insurance company.85 No security can be granted to the transferor-annuitant to assure that payments will be made, except life insurance on the life of the obligor, and too often the annual payments dictated by the appropriate tables are far in excess of the ability of the son or third party to pay. In addition, there are many adverse income tax consequences relating to the adjusted tax basis of the property in the hands of the son.

There may be appropriate opportunities to employ a private annuity. Its use is often suggested by those who intend more to impress the client with their expertise than by the practitioner who has given careful consideration to all available alternatives. The practitioner should proceed with caution and use the private annuity only after he has thoroughly digested every source of information which can be mustered on the subject, even though there is a temp-

84. I.R.C. § 453(d).
tation to eliminate from the client's estate the ranch in consideration for a mere promise to pay. It sounds simplistic, but its indiscriminate use will no doubt provide the basis for malpractice unless it can be shown that both the transferor as well as the transferee were thoroughly knowledgeable of all of the consequences at the time of its inception.

V. Conclusion

An attempt has been made to illustrate the need for each of us to look at problems of operation, transmission and after-death disposition of farm and ranch assets as a part of a total picture in suggesting to our client a "plan." Much has been left unsaid or inferred. Nevertheless, if the reader has persevered with the writer to this point, it will be apparent that "Estate Planning for Farmers and Ranchers" involves considerable patience and understanding and applied psychology, all of which should be "salt and peppered" with judgment and knowledge of the law. In short, what is needed is the wisdom of Solomon! Since this is not possible for most of us, we must be content with a maximum effort at exploring alternatives. To be avoided, however, are complex, intricate schemes designed solely to avoid tax, which are not capable of being understood by our clients and which result in hidden problems rising up to smote client and counselor alike at the most unsuspecting moment.