Community Development

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Basic Estate Planning Fact Sheet Series

Tax Basis if Property Is Transferred

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In previous fact sheets we discussed savings possible from some very simple estate planning tactics. We are now ready to discuss some of the details of estate planning.

Property can be transferred to others in four ways: exchanged (traded), sold, inherited, or gifted. Each has certain advantages and disadvantages, and different tax consequences. One method may be appropriate in one situation and another may be more appropriate in other circumstances.

Sales

Selling property seems clean and simple; and at first glance, appears to be the best way to transfer a farm operation or family business to heirs who will take over the business. It allows for a clean and immediate transfer of assets and liquidity. The child gets control and the parents get the liquidity for their retirement or to dole out to the other non-business children. However, income tax is often due when appreciated property is sold, even to an heir.

Gain in the value of property is called capital gain. In the past, every dollar of capital gain was taxed at the same rate as ordinary income. However, retroactive to May 7, 1997, the highest marginal non-corporate tax rates for income derived from capital gains on the sale of assets is reduced. In general, capital gains that were taxed at 28% are now taxed at only 15% and gains that were taxed at 15% are now taxed at 0%. To qualify for the reduced rate, the assets sold must have been owned for 12 months. However, increases in the rate may occur in the future.

The new law does not reduce the tax rate for collectibles such as coins, stamps, antiques and artwork, which will continue to be taxed at a maximum of up to 28%. In addition, the lower rate will not apply to some unrecaptured gain on depreciated property.

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If thirty years ago Dad bought a farm or other property for $100,000 and sold it to a Son for $300,000 today, the capital gain will be $200,000. Dad will have a significant income tax bill if gains are taxed at 15%. The additional federal income tax bill due to the capital gains may be $30,000 ($200,000 X 15%). Some Ohio income tax will also be due. Many choose not to sell farms to family members due to this tax.

Lowering the price of property when sold to children or charging a significantly lower interest rate appears at first to be another viable strategy. However, sale or interest charges significantly below market are considered by the government as gifts. Also, the government may impute interest income to you if reasonable interest is not charged. Therefore, if this is done, income tax forms may need to be revised, reflecting the dollar difference between market price of sale and what was charged, as a gift. In addition, gift tax forms may need to be filed. Also, lowering the sales price gives the buyer a lower basis. The consequences of lower basis will be discussed later.

Inheritance

Inheritance may have advantages in transferring appreciated property. The reason inheritance is often preferable to both selling and gifting is capital gain and income tax treatment. However, with inheritance there are still costs. Estate settlement costs were discussed in the last fact sheet. If Son inherited the $300,000 farm, instead of buying it from Dad as in the previous example, for smaller estates estate settlement costs for the farm would be about half that of a 15% capital gain rate with $200,000 of capital gain, and due to stepped up basis capital gain liability is avoided or reduced.

Giving

Unlike sales and inheritance, gifts do not incur transfer tax at the time of giving unless the gift is over gift exclusion amounts established by the federal government.

Each person has an annual giving exclusion to each recipient of $13,000 per person, per year in 2009. This annual exclusion has been indexed for inflation since 1998, but is rounded down to the lowest $1,000 increment. So, at the present rate of inflation do not expect an increase for several years.

However, there is also a lifetime exclusion, also called the unified credit, that excludes federal gift and/or inheritance taxes. The following chart indicates the increases of the unified credit for federal estate tax purposes.

Year of Death	Exclusion
2004–2005	$1,500,000
2006–2008	$2,000,000
2009	$3,500,000
2010	Unlimited
2011	$1,000,000

Although the estate tax exclusion increases over the next several years, the gift tax exclusion remains fixed at $1,000,000. This exclusion is not indexed to keep pace with inflation. This once in a lifetime exclusion (unified credit) may be allocated at different times to offset gift taxes, but gifts over the $13,000 per person per year annual exclusion use up the exclusion amount so it is no longer available to offset inheritance taxes. This exclusion is called a unified credit, as it can be used to offset either gift taxes or inheritance taxes, or a combination.

Giving in general postpones transfer costs. First, a gifted asset carries with it the basis of the original owner. That means the initial value from which to calculate gain goes back to when the asset was purchased or inherited. If an asset has been given to generation after generation, when the asset is sold, the seller will pay taxes on the gain that occurred during all the previous generations. Second, gifts over the annual $13,000 per person per year exclusion, use up the lifetime exclusion (unified credit) that the

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federal government allows. If one uses up the lifetime exclusion from federal gift and/or estate taxes by giving, then it is no longer available to offset federal estate taxes. However, if an asset appreciates after it is given, the gifting strategy can actually transfer assets of more value than could be transferred by the unified credit at death.

Examples

Let's look at several examples to demonstrate costs associated with each option. In situation one, Dad bought his farm from Grandfather for $100,000. In situation two, Howard inherited a farm, and in situation three, a similar farm was gifted to Edward. All farms were worth $100,000 when they were purchased, inherited, or gifted to Dad, Howard, or Edward respectively. All farms were purchased some years ago by their fathers, for $30,000. Assume property improvements equaled depreciation. Dad, Howard and Edward have just now sold their farms, each for $300,000, and are concerned about their income tax bill.

Sale Example

In situation one where Dad bought the farm, Grandfather paid more income tax the year(s) he sold the farm to Dad. His purchase price was $30,000 so that was his base value (basis) to figure appreciation or gain. His sale price was $100,000 so his gain was the difference between the base value or basis ($30,000) and the sale price ($100,000), or $70,000. The gain of $70,000 likely increased Grandfather's income tax even if he spread this gain over multiple years by an installment sale.

Today, gain of $70,000 would increase most people's federal tax bill by $10,500 ($70,000 X 15%). There would also be increases in Ohio income taxes. However, the taxes Grandfather paid allowed Son to have a basis of $100,000.

Inheritance Example

In situation two, Howard's farm was willed to him by his grandfather, so it passed through the estate settlement process. Estate settlement costs for the $100,000 farm might have been approximately $1,000, assuming various factors. The settlement costs would be much higher if the estate were large enough to be subject to federal estate tax. The base value Howard uses for gain calculation (basis) was "stepped up" to the appraised value of the farm ($100,000) when Howard inherited the farm. In this example, Howard paid the transfer costs, which were estate settlement costs when the estate was settled. In the previous "sale" example, Grandfather paid the transfer costs prior to death, which were increased income taxes due to the gain from the sale to Dad.

In the previous example, Dad purchased the farm for $100,000, so that is his base value or basis for gain calculation. In this example, the value of the farm when Howard inherited it was also $100,000, so that is also Howard's basis. Dad's and Howard's gain is the difference between $100,000 and the sale price ($300,000), or $200,000. Assuming no installment sale, Dad and Howard have to include this $200,000 in their income tax calculation the year of the sale.

As indicated previously, capital gains of $200,000 will increase the federal income tax bill for most by $30,000 ($200,000 X 15%). In addition, the Ohio income tax bill will increase by approximately $13,000 because of the gain.

Gift Example

Recall that in situation three, the farm was gifted to Edward. Under the current tax law, gain is figured differently for Edward than for the other two. Unlike the other situations, the base value used for gain calculation was *not* increased or stepped up when the farm was gifted to Edward. Gifted property keeps the base value (basis) of the donor. So Edward's basis for his farm is $30,000, the value when his father purchased the farm, even though the property's current value is much higher. The gain for Edward is $300,000 minus $30,000, or $270,000. The gain

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for Edward is $70,000 greater than that of Dad or Howard. This increased gain will result in Edward having to pay even more dollars to the government than Dad or Howard. If Edward sells, the additional $70,000 of gain "postponed" to Edward will increase his federal tax bill by $10,500 ($70,000 X 15%) if Edward is in a higher tax bracket, not to mention the increased Ohio income tax liability.

In comparing the situations, Edward, who was gifted his farm, realized gain that occurred while both he and his father owned the farm. In essence, recognition of gain was postponed until the sale of the farm triggered tax liability. Thus, the gain was "lumped" so Edward realized more taxable gain, but neither Edward's father nor Grandfather had to pay additional income tax or inheritance expenses when the farm was gifted.

In summary, in the sale example, Grandfather sold the farm to Dad, Grandfather paid transfer costs because he realized a $70,000 gain that triggered income tax liability. This cost was paid by Grandfather and not passed on to Dad or Son. In the inheritance example, Howard's father paid no transfer costs, but Howard paid estate settlement costs. In the gift example, transfer costs for $70,000 were "postponed" to Edward, who paid the income taxes on the $70,000 gain in addition to the $200,000 gain that occurred while he owned the farm. This example simplifies some of the tax issues; however, it is important to note that the overall cost is lower in the inheritance situation if the estate will not be subject to federal estate taxes. Since taxes are deferred until sale with a gift, the gift strategy could minimize taxes and transfer costs if income is low enough that the gain in value is taxed at 5% or zero if sold in 2008 or 2009. Likewise, if one is in the lowest tax brackets and can sell appreciated property without capital gain liability, now may be the time to transfer property by sale. Check with your accountant to see if this may be your best transfer option.

Change of Assumptions

Let's change our assumptions. Instead of selling their farms, Howard, Dad, and Edward each willed their farms to an heir. The heir then immediately sold the farms. Assume again that all the farms were appraised at $300,000 when the estate was settled, and that all the farms sold for $300,000. How much gain for the heir? The answer is none. In all three estates the basis of the farms was stepped up to the appraised value of $300,000. The sale price is $300,000, so there is no tax liability for the heirs.

Sale and inheritance of appreciated property does not "pile up" gain and the resulting tax liability, as does making a gift of the property. However, if appreciated property is gifted to "pile

Transfer Cost if Son Sells (Chart does not include Ohio income taxes)

	Grandfather	Father	Son	Total
Sale	Income Tax $3,500–$10,500	None	Income Tax $10,000–$30,000	$13,500–$40,500
Inheritance	None	Inheritance Cost $1,000	Income Tax $10,000–$30,000	$11,000–$31,000
Gift	None	None	Income Tax $13,500–$40,500	$13,500–$40,500

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up" gain but then inherited by the seller to step up basis, transfer costs through generations can be minimized. Thus, giving with an inheritance before sale, at least on paper, can result in the least expensive total transfer costs. Also, with low income and current low capital gains tax rates, there may be a window to transfer now by sale.

Summary of Transfer Methods

If the estate is less than $3,500,000 and/or one pays more than 15% federal income tax, inheritance is often but not always less expensive than sale when transferring highly appreciated assets. A general rule is to sell high basis property but let low basis property transfer at death (be inherited).

When contemplating the best method to transfer assets to heirs, a professional estate planning team should be involved. Gifting, sale, exchange, or inheritance, or a combination may be best for you. Also, the least expensive method may not be the best method. The younger generation may need the assets or business to manage as they see fit, or the farm to improve and call their own long before they can inherit them. They may consider the advantages of earlier ownership to outweigh the higher cost of purchase. Advantages and disadvantages of each method of transfer for each generation need to be fully investigated and communicated before the final decision is made.

Special Use Valuation and Qualified Family-Owned Business

Certain "tax breaks" are available for farm and other businesses that are intended to make it easier for the business to continue operation when such property passes through the estate settlement process. The first, special use valuation is generally only for farm businesses and allows for the farm property to be valued as a farm rather than its "highest and best" use. The advantage of this valuation is that it lowers significantly the value placed on property, thus the size of the estate and the amount of estate settlement costs. In 2009, the estate may reduce the value of real estate by up to $1,000,000, and this number is indexed for inflation annually. However, if the property will be sold by the heirs before it passes through another estate to step up basis to the "highest and best" use valuation, the lower "farm use" basis may result in higher income tax liability at a later date due to more capital gain. Ohio also permits a special use valuation election that gives a maximum $500,000

Transfer Cost if Inherited by Son's Heirs

	Grandfather	**Father**	**Son**	**Son's Heirs**	**Total**
Sale	Income Tax none–$10,500	None	None	Inheritance Cost $1,000	$1,000–$11,500
Inheritance	None	Inheritance Cost $1,000	None	Inheritance Cost $1,000	$2,000
Gift	None	None	None	Inheritance Cost $1,000	$1,000

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reduction in value, and the Ohio election does not reduce basis.

A more recent deduction is available for qualified family-owned businesses; however, until at least 2011, it will not be available. Prior to 2004 and again in 2011, the qualified family-owned business deduction and the special use valuation with proper division of ownership and planning may allow a couple to pass a farm business worth approximately $4.6 million (as much as 1.3 million per person utilizing the qualified family-owned business deduction times two people in a couple equals $2.6 million, increased to approximately $4.6 million by utilizing special use valuation). Unlike the special use valuation, the qualified family-owned business benefit is a deduction, which does not result in a lower basis and thus possibly higher income tax liability due to more calculated gain if sold, as does the special use valuation benefit. Even without the Qualified Family-Owned Business exclusion in 2009 a couple may be able to protect over $9 million of assets from federal tax if planning is done to use the $3.5 million federal estate tax exclusion plus $1 million farm property value reduction for each spouse.

The above deduction and special use valuation come with restrictions. In brief, to use either, a family must meet tests of owning a specified portion of the business and must meet tests of material participation. Also, for both benefits there are penalties in the event that the family does not continue to own and operate the business for a specified time following estate settlement. The tests and penalties are different for the deduction and both the federal and state special use valuation.

Kinds of Property

In some cases, different kinds of property may be handled differently when estates are settled. Real property is land and improvements to the land. Real property cannot be moved, so that fixtures built into a home or building are also considered real property. Perennial farm crops are considered improvements to the farm land, so are real property, but annual crops are personal property. Personal property is then separated into two classes: tangible and intangible. Tangible property has a use as it is. It doesn't have to be redeemed or exchanged. Your car is tangible, because you can drive it without going through an intermediary. However, items that represent value rather than having inherent value are intangible. Examples of intangible personal property are cash, checks, life insurance, stock, bonds, and bank accounts. These items have value only because they can be "cashed in" sometime in the future, and only then can be consumed. We make this designation between real and personal property because they are treated differently when settling an estate.

Ways of Owning Property

The way names are put on property deeds and bank accounts is very important. It may be desirable to divide jointly owned property at estate settlement time; however, much joint property is held with right of survivorship so that when one owner dies, the property automatically goes to the surviving owner. This can present problems if one wished for the property to go to someone other than the co-owner when the first owner dies or if your will indicates otherwise. A discussion of methods of property ownership follows.

Fee Simple vs Life Estate

Fee simple is the method of ownership most familiar to us. Fee simple means that a person has all rights of ownership during one's lifetime, and the right to will it to anyone they wish (except for spousal rights). With this property there are no inherent instructions in the deed as to who should receive the property upon the owner's death.

Life estate means that a person (the life tenant) has the right to use and benefit from the property only during his or her lifetime. The life tenant has no right to will the property to who they choose.

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In fact, the person to receive the property upon the death of the life tenant was determined when the life estate was created. An example of wording for life estate is "John Doe for life, Ruth Doe as remainderman."

The gift of property directly to children with the parents retaining a life estate is unlikely to reduce estate taxes, but may save other estate settlement costs. Tax problems with this strategy differ with the method in which the remainder interest is transferred to the children. If the remainder interest is sold to the children, capital gain occurs and there may be an income tax liability. Many parents would like to gift the remainder interest to children but retain the life interest. However, this is generally not recommended. If the remainder interest is gifted to the children and the life interest is retained, the total value of the property is considered to be in the donor's estate for tax purposes. In addition, a gift tax return will need to be filed reporting the entire value of the property, not just the value of the remainder interest. The remainder interest does not qualify for annual exclusion treatment.

A more appropriate and more common use of the life estate is for one parent (spouse) to will property to the children with a life estate granted to the other parent (spouse). Here the stepped up basis of inheritance occurs. Instead of the property passing through two estates (as is the case if it goes from one spouse to the second spouse and then to children), this property only goes through one estate settlement, reducing settlement costs. However, a trust may be more desirable than a life estate because it allows for more flexibility.

Co-Ownership of Real Property

Note that we mentioned before that property can be separated into real (land, buildings, etc.) and personal property. We will first deal with ways of holding real property.

Tenancy in Common

Tenancy in Common is the form of co-ownership of real property analogous to fee simple for single ownership. Each tenant owns an undivided share (not necessarily an equal share) and has the right to dispose of his or her share without the consent of the other (except for dower rights). An example of wording for property held in joint tenancy is "John Doe and Mary Doe."

Each undivided share is generally administered by Probate Court (or another instrument such as a trust), because as with fee simple, there are no inherent instructions in the deed to indicate who should receive the property upon the owner's death. This form of joint property ownership has an advantage in that either spouse can transfer property upon their death directly to the intended beneficiaries or through a trust. As shown in the last fact sheet, this can result in estate settlement cost savings, especially where the combined estates of both spouses have a value larger than $3,500,000. If the property passes through a trust on its way to the children or other heirs, the surviving spouse can receive the income from (and even some of the principal in the case of hardship) from the property.

Joint Tenancy with Right of Survivorship (JTRS)

Joint tenancy or joint tenure (JTRS) is a way of jointly holding property in such a way that 1) it is held in equal shares 2) the property automatically passes to the survivor at the death of the first owner. An example of wording in JTRS is "John Doe and Mary Doe for their joint lives, remainder to the survivor of them."

The important feature of JTRS is that if one owner dies, the survivor automatically becomes the sole owner of the entire property. This transfer is not subject to probate administration and implementation of the will. JTRS avoids the property going through the probate process and averts costs directly associated with probate, for

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the JTRS property, but tax forms still need to be filed for JTRS property, and there are still some attorney fees associated with JTRS property transfers.

It may not be a good idea for a couple with a combined estate over $3,500,000 ($338,334 for Ohio planning purposes) to hold the majority of their property in JTRS. It also may not be a good idea for unwed parties to hold property in JTRS. JTRS property is treated differently, depending if the parties are married or not. Property held as JTRS between unwed parties is generally problematic.

If not married, a taxable gift may occur when the title is established. If not married, all of the JTRS property is assumed to be that of the first to die. Therefore, if JTRS is in the names of a mother and daughter, upon the mother's death all of the value of the property will be included in the mother's estate unless the daughter can prove that she contributed to the value of the property. All of the property (except that portion where contribution can be documented) is treated as if completely owned by the first to die and incurs estate settlement costs charged against all the JTRS property, even though it automatically passes to the daughter.

With married couples, generally only one-half of JTRS property is included in the estate of the first to die. It appears at first that all is well and good, at least the JTRS is not charged estate settlement costs on all the property as would be the case if not married. However, an estate planning strategy demonstrated in the last fact sheet was to have some of the property of the first to die go (indirectly or directly) to the children. Remember, assets going directly to children (heirs) get charged estate settlement costs only once, in only the first spouse's estate. With property held as JTRS by a couple, this strategy is not possible, as all JTRS automatically goes to the surviving spouse. This is true even if the will says otherwise. Again, the need for planning and/or separating a couple's estate is more important for couples with estates valued at $3,500,000 or more ($338,334 for Ohio planning purposes). Therefore, a large portion of property held as JTRS may be problematic for those with estates over these amounts.

For those with estates less than these amounts who wish for the joint property to pass directly to the surviving spouse, having that property held as JTRS property may be appropriate.

Tenancy by the Entirety

You can no longer create tenancy by the entirety deeds in Ohio. Deeds now in existence are still valid. A tenancy by the entirety deed could have been created only between a husband and wife and is similar to a JTRS deed in that they both carry the right of survivorship. They differ in that in JTRS each spouse can direct his or her lifetime interest as they please (except for dower rights and the survivorship rights at death), but with tenancy by the entirety neither the husband nor wife can break the arrangement unless both join in a deed to convey away what they both own. Since both tenancy by the entirety and JTRS carry the automatic right of survivorship, both can remove the flexibility of splitting estates as is possible with tenancy in common. As mentioned with JTRS, tenancy by the entirety deeds may be problematic if created without proper planning for those with estates over $3,500,000.

Co-Ownership of Personal Property

Personal property may be co-owned as can real property. Bank accounts that are co-owned are generally set up in joint tenancy with right of survivorship (JTRS) unless tenants-in-common ownership is specifically requested. The wording on your account should be checked carefully to determine the method of joint ownership. As with real property, the half of JTRS personal

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property that is co-owned with a spouse is included in the taxable estate of the first to die. Also as with real property, when JTRS bank accounts are owned with someone other than a spouse, the entire account balance is presumed to be owned by the first to die for estate purposes. If otherwise, the surviving heir needs to prove "contribution."

For this reason, JTRS bank accounts held by a parent and child do not reduce estate taxes and are generally not recommended. The *entire* account is considered to be in the taxable estate of the first to die. The entire account will automatically go to the survivor. The other heirs will not be treated equally if JTRS property goes to one child and the rest of the probate property is divided equally. Take an example where Mom's will says all property will be divided equally between Mary and Joe, the two children. However, a large portion of Mom's estate is held as JTRS property between Mom and Joe. All the JTRS property will go directly to Joe, and will not be directed by the will. The only property divided equally will be the property that was not JTRS. If Mom had actually desired for her property to be divided equally, those wishes could not be carried out by the executor of her estate.

A more desirable arrangement is to give one child a durable power of attorney to transact affairs and have accounts in the name of parent(s). Then, accounts can be divided among children by other methods before or after death.

In JTRS accounts, while living, each party has a right to all of the account. Upon the death of one of the parties, accounts up to $25,000 can be withdrawn by the survivor without obtaining a tax release, but a tax release is needed if the accounts at that financial institution total more than $25,000. If the only surviving account holder is the surviving spouse, the spouse should not need to obtain a release regardless of the value of the account. A tax release can generally be obtained in one business day from the county auditor.

Stocks and bonds are also commonly held in JTRS but may also be held as tenants in common. The wording should be checked carefully to determine the type of joint ownership. If personal property is held as tenants in common, the appropriate share is included in the decedent's estate. This share may be willed to the surviving spouse or to other heirs. Most bank accounts are held in JTRS but about half of stocks and bonds are held in JTRS and about half are held as tenants in common.

As with real property, the advantage of joint tenancy without survivorship is the flexibility to split the asset value and pass the decedent's share directly to children or other heirs (or through a trust) rather than outright to the spouse. However, the advantage of JTRS ownership may be simplicity. If a couple is sure all property rights should transfer to the survivor, JTRS is the appropriate method of ownership.

These fact sheets should in no manner be considered as a replacement for consulting with estate planning professionals, nor should the general principles in these fact sheets be applied to specific situations without consulting with an attorney.

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Your Response
Fact Sheet 3

1. What type of tax is likely to increase when appreciated property is sold?

   ______ Ohio estate tax

   ______ Federal estate tax

   ______ Ohio and federal income tax

2. Following are three examples in which income tax may be due because of gain on a farm that was sold. In all the below situations a farm was initially purchased by Grandfather for $30,000. The farm was sold by Grandson for $300,000. The farm was appraised at $100,000 when the farm was transferred to son, and the appraisal was $300,000 when the farm was transferred to Grandson. Indicate below the amount of gain for each situation:

   A. If Grandfather sold the farm to Son for $100,000 and the Son sold the farm to the Grandson for $300,000, what was the gain assigned to each?

   Gain assigned to Grandfather ______________________

   Gain assigned to Son ______________________

   Gain assigned to Grandson ______________________

   Total of all gain: Grandfather, Son, and Grandson ______________________

   B. If Grandfather gifted the farm to Son, and Son gifted the farm to Grandson, then Grandson sold the farm for $300,000:

   Gain assigned to Grandson ______________________

   C. If the farm was inherited from Grandfather by Son, and inherited from Son by Grandson:

   Gain assigned to Grandson ______________________

   D. In which of the above two scenarios was the combined gain liability of Grandfather, Son, and Grandson the same and the largest?

   ______________________ and ______________________

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3. Circle below the form of joint property ownership that allows the most flexibility in estate planning.

   TENANCY IN COMMON

   JOINT TENANCY WITH RIGHT OF SURVIVORSHIP (JTRS)

4. Circle below the form of joint property ownership in which the property automatically goes directly to the survivor.

   TENANCY IN COMMON

   JOINT TENANCY WITH RIGHT OF SURVIVORSHIP (JTRS)

5. What is one disadvantage of bank and checking accounts being owned as Joint Tenants with Right of Survivorship (JTRS) between a parent and a child?

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Answers

Fact Sheet 3

1. What type of tax is likely to increase when appreciated property is sold?

   _____ Ohio estate tax

   _____ Federal estate tax

   __✓__ Ohio and federal income tax

   The answer is increased income tax due to gain. Taxable gain does not occur until appreciated property is sold. Then, if the original value (basis) is less than the net selling price, capital gain occurs. Capital gain increases taxable income.

2. Following are three examples in which income tax may be due because of gain on a farm that was sold. In all the below situations a farm was initially purchased by Grandfather for $30,000. The farm was sold by Grandson for $300,000. The farm was appraised at $100,000 when the farm was transferred to son, and the appraisal was $300,000 when the farm was transferred to Grandson. Indicate below the amount of gain for each situation:

   A. If Grandfather sold the farm to Son for $100,000 and the Son sold the farm to the Grandson for $300,000, what was the gain assigned to each?

   Gain assigned to Grandfather **$70,000**

Grandfather purchased the farm for $30,000 and the basis was stepped up to $100,000. The difference is $70,000. This assumes no undepreciated improvements were made by Grandfather.

   Gain assigned to Son **$200,000**

Son purchased the farm for $100,000 and sold it for $300,000. The difference is $200,000. Again, if the farm was improved, but the improvements were not depreciable, these would increase basis, thus reduce capital gain.

   Gain assigned to Grandson **- 0 -**

Grandson inherited the farm and sold the farm for $300,000. Therefore, there is no capital gain or loss.

   Total of all gain: Grandfather, Son, and Grandson **$270,000**

In "A," Grandfather's gain was $70,000, Son's was $200,000, and Grandson's was zero. This results in a total gain of $270,000.

   B. If Grandfather gifted the farm to Son, and Son gifted the farm to Grandson, then Grandson sold the farm for $300,000:

   Gain assigned to Grandson **$270,000**

Because they were gifts, Grandfather's basis is "passed on" to Son and Son's basis is "passed on" to Grandson. Therefore, Grandson's basis is only $30,000. Grandson sold the farm for $300,000 therefore Grandson's gain is $300,000 minus $30,000 or $270,000.

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C. If the farm was inherited from Grandfather by Son, and inherited from Son by Grandson:

Gain assigned to Grandson **- 0 -**

The farm was appraised at $100,000 when inherited by Son and $300,000 when inherited by Grandson. When property is inherited, the base value (basis) is raised to the appraised value. Therefore, Grandson's basis was $300,000 and he sold the farm for $300,000. Therefore, Grandson has no gain.

D. In which of the above two scenarios was the combined gain liability of Grandfather, Son, and Grandson the same and the largest?

A and **B**

The total gain in situation "C" was lower because of stepped up basis. However, to get stepped up basis, inheritance costs were incurred. In "A" the total gain was $270,000, even though it was shared by Son and Grandson. In "B," Grandson is assigned the entire gain of $270,000, because Son and Grandfather were assigned no gain.

3. Circle below the form of joint property ownership that allows the most flexibility in estate planning.

(TENANCY IN COMMON) — circled   JOINT TENANCY WITH RIGHT OF SURVIVORSHIP (JTRS)

With Tenancy in Common each of the spouses' share of the property may go to the surviving spouse or may be directed to the children (through a trust or will). Thus the answer is Tenancy in Common. Under JTRS, jointly held property automatically goes to the survivor, even if the will says otherwise.

4. Circle below the form of joint property ownership in which the property automatically goes directly to the survivor.

TENANCY IN COMMON   (JOINT TENANCY WITH RIGHT OF SURVIVORSHIP (JTRS)) — circled

In Joint Tenancy with Right of Survivorship the property automatically becomes solely that of the survivor; upon the death of one of the owners. This occurs even if the will indicates otherwise and regardless of the wishes of the survivors. This may necessitate property passing from one spouse to the surviving spouse, possibly resulting in higher total estate settlement costs.

5. What is one disadvantage of bank and checking accounts being owned as Joint Tenants with Right of Survivorship (JTRS) between a parent and a child?

Bank and checking accounts owned as Joint Tenants with Right of Survivorship (JTRS) between parent and child are treated as if owned solely by the deceased parent for estate tax calculations. However, they become solely the property of the surviving child. This type of ownership doesn't reduce estate taxes, but may cause the child named on the JTRS account to receive a larger portion of the estate than other children not named in the JTRS accounts. Having only one heir named in JTRS accounts, even if the executor is on JTRS accounts, may cause unequal distribution of assets. This can be the case even if the deceased desired equal distribution and designated such in the will.

If the money in the account was contributed by the child, and that can be proven, then those assets will not be included in estate tax calculations. However, the burden of proof is on the child.

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