Succession Planning Terms and Definitions

Alternate valuation date - A date exactly six months following the decedent's date of death that the personal representative may choose to revalue, for estate tax purposes, all assets held by the estate.

Ancillary probate - Term for probate if decedent had real property in another state.

Annual exclusion - The inflation-indexed annual amount of $13,000 that can be given to any individual or any number of individuals gift-tax-free. A husband and wife together can give $26,000 to each person.

Annuity - A contract in which a given sum of money is paid on a periodic basis to a beneficiary for life or other specified time.

Appraised value or appraisal - A valuation or estimation of value of property by disinterested people of suitable qualifications. This process of ascertaining a value of an asset (or liability) involves expert opinion according to a specific methodology.

Assets - All types of property that can be made available for the payment of debts.

Attorney - Another name for a lawyer.

Basis - As used in accounting related to tax purposes, basis describes the value of an asset for the purpose of determining the gain or loss on its sale or transfer; or in determining the value of the assets in the hands of a donee (recipient) of a gift.

Beneficiary - A person named in a will to receive certain property of the testator. Also, a person who receives income or assets from a trust. A person who benefits from the existence and operations of a trust.

Business plan - a written document that defines a business's product concept, potential customers and necessary financial resources needed to achieve the objectives of the business.

Buy/sell agreements - Formal agreements that spell out terms of ownership transfers in case of death, divorce, disability, dissolution. They include information on valuation, discounts and any restrictions on asset transfers.

Codicil - A supplement, amendment or addition to a will executed with all the formalities of the will itself. It may explain, modify, add to, subtract from, qualify, alter or revoke provisions in a will.

Corporation -

> **C-corporation -** A corporation that is a legal entity and is taxed separately from its owners (shareholders). It has corporation tax schedules and rates.
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> **S-corporation -** A corporation that passes through profit (or net losses) to shareholders. The business profits are taxed at individual tax rates on each shareholder's Form 1040. The pass-through (sometimes called flow-through) nature of the income means that the corporation's profits are only taxed once: at the shareholder level. The IRS explains it this way: "On their tax returns, the S corporation's shareholders include their share of the corporation's separately stated items of income, deduction, loss, and credit, and their share of non-separately stated income or loss." S-corporations avoid the "double taxation" of dividends associated with regular C-corporations.

Chattel - An article of personal property (personal and movable). Machinery is an example.

Closely held business - A business organization in which the ownership is held by a limited number of people, often the same family, rather than owned by the public at large.

Common disaster clause - A statement in a will telling how property is to be distributed if would-be devisees die from the same accident.

Competency - A person generally is competent to make a will if the testator understands the following:

1. The general nature and extent of his/her property
2. The testator's relationship to the people named in the will
3. What a will is
4. The transaction of simple business affairs

Conservator - A person appointed by the court to protect and manage the interests of the estate (property and business matters) of an incompetent person. An individual may designate a conservator within a power of attorney document.

Contingency plan - Provisions in a comprehensive succession plan that mitigate the financial devastation caused by untimely death, disability and/or deteriorating health.

Corpus of a trust - Term used to designate the body of assets (property) placed in a trust. The trust holds title to all property included in the corpus.

Death taxes - Taxes due by reason of death of an individual. These may include federal, state and local estate and/or inheritance taxes.

Decedent - The person who has died.

Deed - A legal instrument used to transfer title to real property in the eyes of the law. Specific types of deeds may include the following:

Correction deed - A document used to correct an error in a previously recorded deed.

Deed restrictions - Provisions placed in deeds to control how future owners may or may not use the property.

Executor's deed - A deed used to convey the real property of a deceased person.

Deed in escrow - Papers prepared to transfer real estate to another owner and given to a third party for delivery at a later date or when the specified conditions are met. No transfer occurs until delivery is made.

Gift deed - A deed executed and delivered without consideration (a deed that states "love and affection" as the consideration).

Guardian's deed - Used to convey property of a minor or legally incompetent person.

Quitclaim deed - A legal instrument used to convey whatever title the grantor has. It contains no covenants, warranties nor implication of the grantor's ownership.

General warranty deed - An assurance or guarantee that something is true as stated, making it the highest quality title. A deed that usually contains the covenants of seizing, quiet enjoyment, encumbrances, further assurance and warranty forever.

Special warranty deed - The grantor warrants title only against defects occurring during the grantor's ownership but not before that time.

Donee - One who receives a gift.

Donor - One who makes a gift.

Entity - A stand-alone business unit usually referred to as a sole proprietorship, partnership, LLC or corporation.

Equal vs. equitable or "fair" distribution - In farm transition or estate planning, an "equal" distribution means that property is divided in equal percentages among heirs. In an equitable or fair distribution, property may be divided based upon the contributions and needs of the heirs; the monetary values of the shares may be different.

Escheat - Assignment of property to the state because no verifiable legal owner exists. Typically, where no heir to property exists.

Estate - Everything of value (all property) that a person owns while living or at the time of death.

Estate settlement - Also referred to as the probate process. This is the process of settling the affairs of a deceased person. Some terminology related to estate settlement or probate may include the following:

> **Administrator -** A person appointed by a court to carry out the instructions found in a will. Depending on the state, this may be referred to as the executor or personal representative.
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> **Bequest (legacy) -** Personal property received under a will.
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> **Curtesy -** The legal right of a widower to a portion of his deceased wife's real property.
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> **Devise -** A transfer of real property by means of a will.
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> **Dower -** The legal right of a widow to a portion of her deceased husband's real property for support of herself and children. This may be referred to as the elective share of a surviving spouse.
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> **Executor -** A person named in a will to carry out its instructions; if male, the person is called an executor, and if female, the person is called an executrix. Depending on the state, this may be referred to as the administrator or personal representative.
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> **Heirs -** Those designated by law to receive the property of the deceased when the deceased had no will.
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> **Personal representative -** A person appointed by a court to carry out the instructions found in a will. Depending on the state, this may be referred to as the executor or administrator.
>
> **Probate court -** A court of law with the authority to verify the legality of a will and carry out its instructions.

Estate tax - Taxes assessed by the local, state or federal government upon a decedent's right to transfer property.

Fair market value - The market price for an asset as agreed to by a willing buyer and a willing seller.

Family limited partnership - A family organization with one or more general partners who manage the organization and assume debts and obligations, and one or more limited partners who are liable only to the extent of their investments.

Fiduciary - Includes personal representative, guardian, conservator and trustee.

Formal probate proceedings - Those conducted before a judge with notice to interested people for probate of a will or appointment of a personal representative.

Gift - A voluntary transfer of property for which nothing of value is received in return. If the Internal Revenue Service is to recognize a transfer as a gift, the donor(s) must unconditionally transfer all title and control of the property to the recipient(s) at the time the gift is given. A partial gift may be given. For example: a sale at less than fair market value.

Gifting - An estate planning tool used to implement an estate plan by making gifts to intended successors of assets owned by the person/people making the gifts. A gift is only possible while the donor is alive.

Grantor - The person placing property in a trust.

Gross estate - For federal estate tax purposes, the total value of all property real or personal, tangible or intangible - that a decedent had owned or had control over at the time of death.

Guardian - A person legally empowered and charged with the duty of taking care of another who, because of age, intellect or health, is incapable of managing his or her own affairs.

> A guardian manages the person.
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> A conservator manages the property of a minor or incapacitated person.
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> A person can be appointed a guardian and conservator.

Heir - A person entitled by law to inherit part or all of the estate of an ancestor who died without leaving a valid will.

Holographic will - A will in which the signature and material provisions are in the handwriting of the testator and which does not need to be witnessed.

Incidents of ownership - Rights applying to ownership interest in an insurance policy. These include the right to change a beneficiary, borrow on a policy and change premium modes.

Income statement - A document that lists all expenses, income and changes in inventory for a business during a specific period of time.

Inherit - To receive property from a deceased person.

Inheritance tax - A state or county tax levied on a person who inherits. The rate of taxation depends on the size of the inheritance and the relationship between the person who inherits and the deceased. Inheritance tax laws vary state by state. Some states have no inheritance tax and some states have county inheritance taxes. North Dakota does not have an inheritance tax. In contrast to inheritance tax, an estate tax is levied on the estate before passing to heirs or beneficiaries.

Intergenerational succession - Succession in property ownership in which the property is transferred from one generation to another, usually from members of an older generation to members of a younger. In business succession planning, it includes the transfer of management responsibilities and profit opportunities.

Intestate - A term used when a person dies without leaving a valid will.

Intangible property - Property that only represents real value, such as bonds, stock certificates, promissory notes, certificates of deposit, bank accounts, contracts and leases. In contrast, tangible property can be seen. It includes land machinery and goods.

Lateral succession - Succession in property ownership in which the property is transferred between members of the same generation.

Letters of administration - Document issued by the probate court giving the administrator authority to administer the estate.

Letters testamentary - Document issued by the probate court giving the executor authority to administer the estate under the provisions of the decedent's will.

Liabilities - Financial amounts owed by a person, family or business. Everything owed to others.

Life estate - A transfer of ownership from an owner to a second party with a reservation of some rights, such as life use of the residence. The property does not go through probate but usually still is taxable in the estate of the deceased owner.

> **Life tenant -** Holds an estate for the period of his or her lifetime or that of another specified person.
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> **Remainder interest -** A future interest in property held by a remainder person usually following a life estate or term interest.
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> **Remainder person -** Is entitled to hold a remainder interest; also known as a remainder man.

Life insurance - A contract between an owner of a policy and the insurance company stating that, for a consideration (premium), the company will pay a given sum (face value of policy) to a named beneficiary in the case of a death of the named insured. Different degrees of savings also may be a part of the policy. The policies provide liquidity at death to pay obligations of the decedent. They also work well as a business planning tool and for the funding of buy/sell agreements.

Limited liability company - A limited liability company (LLC) is a business structure allowed by state statute. LLCs are popular because, similar to a corporation, owners have limited personal liability for the debts and actions of the LLC.

Limited partnership - An entity having one or more general partners and one or more limited partners. A written agreement must exist under state law. The entity is distinct from its partners. The written partnership agreement governs relations among the partners and between the partners and the partnership.

Lineal descendant - One who is, by blood relationship, in the direct line of descent from an ancestor. The term often includes legally adopted children.

Living will - Also known as an advance care or advance medical directive; sets forth an individual's personal wishes with respect to medical care. A living will is best defined as a written declaration that informs medical personnel of a person's desire not to have life-sustaining procedures used if the individual is diagnosed as terminally ill and cannot participate in a decision-making process regarding treatment, and use of life-sustaining procedures would merely prolong the dying process.

Long-term care (LTC) insurance - Insurance coverage that may provide payments for nursing-home care, home-health care, and personal or adult day care for individuals; it's usually for those with a chronic or disabling condition that needs constant supervision.

Marital deduction - The unlimited exemption for the transfer of assets to a surviving spouse under the federal estate and gift tax legislation.

Medical directive or patient advocate - This is a tool to advise medical care givers of a person's intent, wishes and desires in the event a medical catastrophe occurs. The medical directive may spell out specific wishes but also includes an appointed fiduciary to make necessary medical decisions. The document should include proper medical release information to allow access to medical records for an informed decision. "Living will" and "durable power of attorney for health care" are other terms that have been used.

Mentee - An inexperienced, new or aspiring agripreneur who is seeking the advice, counsel or guidance of a senior or experienced farm/agribusiness owner.

Mentor - A senior or experienced farm/agribusiness owner who advises, counsels or guides an inexperienced, new or aspiring agripreneur in the aspects of business growth and development.

Operating agreement - A set of standard operating procedures and management policies specifically designed to maintain the operational integrity of a farm or agribusiness. It may include a decision-making process, income/expense management, dispute resolution, ownership transfer and other terms and conditions of business ownership/management.

Partnership - A general partnership is an association of two or more people to carry on as co-owners of a business for profit. Although partnership agreements may be written, if two or more individuals do nothing more than verbally agree to conduct business as owners, a general partnership is formed.

Pay on death (POD) - Designation is the naming of a beneficiary to receive an account balance on a party's death.

Personal property - Assets whose ownership arises out of physical possession of the property or as the result of a document showing ownership. Examples include livestock, machinery, stored grain, bank deposits, stocks and bonds, checking and savings accounts, automobiles, and other transportation and recreation vehicles.

Personal representative - A person named in a will or appointed by the district court to administer the estate of a decedent. Formerly referred to as executor, administrator.

Power of attorney (POA) - A written document in which one person gives another the power to conduct certain acts on his or her behalf. May or may not need to be notarized, depending on the state.

> **Durable power of attorney -** Allows the power of attorney to survive any disability the principal could suffer.
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> **Health care POA -** grants powers related to health-care decisions.

Pretermitted child - One who may, under certain circumstances, become an heir by birth or adoption subsequent to the date of execution of a testator's will.

Private annuity - A means of transferring property from one owner to another by "selling" it for an unsecured promise to pay the original owner an income for life. The sale price is based on fair market value at the time of sale.

Probate - A court procedure for settling the personal and business affairs of a decedent by formally proving the validity of a will and establishing the legal transfer of property to beneficiaries, or appointing an administrator and supervising the legal transfer of property to heirs if no valid will exists. Probate varies state by state.

Property ownership - Below are definitions of various ways of owning property:

Fee simple - Ownership by one person who can buy, sell, give or mortgage as he or she sees fit. When the owner is married, real estate is subject to a spouse's dower rights and, therefore, any transactions require the spouse's signature. At death, the fee simple property becomes part of the probate estate. The IRS considers 100 percent of fee simple property value as part of the "gross estate" subject to estate taxes.

Joint tenancy with rights of survivorship (JTRS) - A conveyance or devise to two or more people as joint tenants or as joint tenants with rights of survivorship creates a form of ownership with survivorship-ownership by two or more individuals in which all owners must agree to any transactions involving sale, gift or use of borrowing purposes. At death, the surviving joint tenants take title to the property without probate proceedings. The IRS considers 100 percent of JTRS property value as part of the "gross estate" subject to estate taxes unless valid evidence is provided showing different percent ownership.

Partition - The judicial separation of the respective interests in property of joint owners or tenants in common so each may take possession, enjoy and control his or her share of the property.

Partnership (federal) - A general partnership is an association of two or more people to carry on as co-owners of a business for profit. If two or more individuals do nothing more than verbally agree to conduct business as owners, a general partnership is formed. Creation of the agreement establishes rights and duties between the partners and regulates their conduct as they transact business.

Tenancy in common (TIC) - A conveyance or devise to two or more people who are not husband and wife creates a tenancy in common (no rights of survivorship). The ownership is by two or more individuals who own an undivided share of interest of the whole property. At death, each tenant's share of ownership becomes part of the decedent's probate estate. The IRS considers "the percent of ownership" of TIC property value as part of the "gross estate" subject to estate taxes.

Tenancy by the entirety (TE) - A conveyance or devise to two people who are lawful husband and wife create a tenancy by the entirety unless a contrary intent is indicated in the deed, devise or ownership instrument. This type of ownership is ownership similar to joint tenancy with rights of survivorship, only available between a husband and wife. At death, the surviving spouse takes title to the property without probate proceedings. In accordance with IRS laws, TE ownership is considered to be owned 50 percent by each, husband and wife. Therefore, the surviving spouse receives a stepped-up tax basis to the "fair market value" for the 50 percent received from the deceased spouse's estate. The surviving spouse now has two basis in the property: 1) The original basis for the 50 percent owned before the death of the spouse and 2) the stepped-up basis in the 50 percent inherited from the estate of the deceased spouse.

Undivided interest - The interest or right in property owned by each joint tenant or tenant in common. Each tenant has equal right to use and enjoy the entire property. Unless an agreement to the contrary exists, each tenant is entitled to an income share proportional to his or her ownership interest. If the property is sold, the sale proceeds are shared among tenants in proportion to the ownership shares held by each tenant.

Property types - Below are definitions of various classifications of property:

Chattel - An article of personal property (personal and movable).

Personal property - A right or interest in things of a temporary or movable nature. Almost anything not classified as real property (real estate) is personal property.

Real property - Ownership rights in land and its improvements; for example, real estate, minerals, royalty interests, growing timber, land and buildings attached to the land.

Reverse mortgage - A contract/mortgage whereby a company makes payment to a homeowner based on the calculated value of a home. It allows the individual to reside there until death and takes title to the property upon issuing the loan as consideration and security for the loan. The loan is not required to be paid back in full in this type of arrangement, but the house is removed from the person's ownership and estate upon issuing the mortgage.

Right of election - The surviving spouse's right to a share of the augmented estate rather than accepting the amount provided by will or intestate succession statues. The percentage is based on the length of marriage.

Right of first refusal - The right to have the first opportunity to purchase a piece of property (usually real estate) when such becomes available or the right to meet any other offer on the subject property.

Sale - A transfer of property from one owner to another for a consideration at fair market value.

Sole ownership - Title to property in one name.

Sole proprietor - Form of business ownership whereby one person owns and controls the business, as compared with a partnership, LLC, limited partnership, C-corporation or S-corporation form of business.

Spouse - A person's wife or husband.

Sound mind - The testator possesses a sound mind for the purposes of making a will if he or she:

1. Understands the nature of the act of making a will or codicil to it
2. Knows the extent and character of the property subject to the will
3. Knows and understands the proposed disposition of that property
4. Knows the natural objects of his or her bounty

Succession - A term used to describe the transfers of asset ownership through inheritance, gifting, preferential sale or other means that fulfill the wishes of the person/people with present ownership of the assets.

Succession law - Law that governs the disposition of one's estate if no will exists.

Sweat equity - The increased financial value of a farm or other business (over and above money or tangible assets contributed) that was created by uncompensated mental and/or physical efforts.

Tangible property - Property that is capable of being perceived by the senses. Generally, tangible property is real estate, personal property or moveable property that has value of its own and is not merely a representation of real value. Land, machinery, buildings, business equipment, inventories, homes and furnishings are examples of tangible property. In contrast, intangible property is not visible; for example, patent rights.

Tax basis (federal) - The owner's cost of an asset for income and estate tax purposes as determined under the Internal Revenue code and IRS regulations.

Term life insurance - An insurance policy with a set duration limit on the coverage period.

Testator - One who writes or has written and signs a will.

Testamentary - Pertaining to a will.

Title - The right to or ownership of something. Terminology related to title may include:

> **Deed -** A written document that, when properly executed and delivered, conveys title to real property
>
> **Marketable title -** Title that is free from encumbrances and any reasonable doubt as to the owner. Title can be sold or mortgaged readily
>
> **Title by descent -** Laws that direct how a deceased's assets shall be divided to heirs when no will exists

Transfer on death (TOD) - Designation on securities that allows the naming of a beneficiary to receive them upon the death of a party.

Trust - Ownership and control of property by a third party (trustee) who manages the property and pays the income to a named beneficiary according to the instructions given by the person setting up the trust and who transfers property into it. Terminology related to trusts may include the following:

Fiduciary - A person in a position of trust, responsibility and confidence for another.

Trustee - A person or institution who holds property in trust for another.

Trustor - Maker of a trust.

Trust corpus - The subject matter of the trust. Definite and ascertainable property that is transferred to the trustee.

Generation-skipping trusts - Trusts that are used to provide income to a generation or two of heirs, with the property eventually passing to individuals two or three generations down the line.

Inter vivos trust (living trust) - A trust that takes effect during the life of its creator. However, the trust may continue after death.

Living trust - A trust established during the lifetime of the grantor.

Testamentary trust - A trust that is intended to come into existence at death. Its purpose is to provide for the management of property after death. They often are contained in an individual's will.

Revocable trust - A trust that is included as part of the taxable estate, can be revoked any time, is flexible and the most common form of advanced estate planning. The revocable trust can take on many different versions and may require special language to work through tax planning with a large taxable estate.

Irrevocable trust - A trust that is irrevocable and is not counted as part of the taxable estate. This trust should be used sparingly and only if the estate has significant tax problems. Once assets are put into the irrevocable trust, they cannot be removed, and the owner forever loses control, access and the benefit of the items placed in an irrevocable trust.

Life insurance trust - This is a special irrevocable trust that holds life insurance policies to exclude them from the gross estate. When a policy is not in the irrevocable trust and the decedent maintained control, it is counted as part of the gross estate.

Special-needs trust - This can be a revocable or irrevocable trust that is formed for a special-needs child, pet, business, real estate or other property that requires specific and special attention post-death.

Charitable remainder trust - A tax-exempt irrevocable trust designed to reduce the taxable income of individuals by first dispersing income to the beneficiaries of the trust for a specified period of time and then donating the remainder of the trust to the designated charity.

Undue influence - This term refers to a situation in which a person improperly or wrongfully persuades or takes over the mind of another person to make that person's will conform to that of another person. The dominion and control must be such that the free will of another is overcome and the influenced person is caused to do what he or she would not otherwise have done but for the dominion and control. The influence must have been so great that the testator lost the ability to exercise his/her own judgment and could not refuse to give in to the pressure being exerted.

Value - Terminology related to the value of property may include the following:

Fair market value (FMV) - The amount for which a piece of property (real or personal) would be sold in a voluntary transaction between a buyer and seller, neither of whom is under any obligation to buy or sell. A customary test of fair market value in real estate transactions is the price that a buyer is willing, but is not under any duty, to pay for a particular property to an owner who is willing, but not obligated, to sell.

Appraised value or appraisal - A valuation or estimation of value of property by disinterested people of suitable qualifications. This process of ascertaining a value of an asset (or liability) involves expert opinion according to a specific methodology.

Basis - As used in accounting related to tax purposes, basis describes the value of an asset for the purpose of determining the gain or loss on its sale or transfer; or in determining the value of the assets in the hands of a donee (recipient) of a gift.

Will - A legal document directing the disposal of one's property after death. Some terms related to wills include the following:

Codicil - A written supplement or amendment to modify an existing will.

Holographic will - One that is handwritten entirely and signed by the testator, and may not be witnessed.

Nuncupative will - A will made orally.

Intestate - To die without a will.

Intestate succession - Laws that direct how a deceased's assets shall be divided when the person dies intestate (without a will).

Testate - To die with a will.

Testator - A person who makes a will; the person is a testator if male and testatrix if female.

Witness - A person who observes the signing of a will and attests to the signature.