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What Taxes and How Much?

This fourth article in this series points up the importance of taxes in planning the distribution or transfer of farm and other property. Of interest here are estate, inheritance and gift taxes, and how they apply.

by John F. Timmons and John C. O'Byrne

TAXES HAVE a role of major importance in planning the distribution and transfer of farm and other property—especially in periods of high tax rates and property valuations. A knowledge of the federal and state taxes that may apply can help in making plans to minimize these taxes in carrying out a desired plan of property management and distribution.

Death Taxes . . .

There are two types of taxes levied upon property passing at death. These are the federal *estate tax* and the state *inheritance tax*. In some cases, property transferred during life also is taxable at death—if the transferor of the property “kept some strings on it.” In theory, death taxes are levied on the right to transfer or receive property at death of the owner. But, in a practical sense, it's the property itself that's taxed.

The *federal estate tax* is levied on the estate of a decedent, without reference to the persons who

are to receive the property. As with income tax, estate tax rates are graduated. The percentage rate of tax increases as the amount of property increases. The federal government levies an estate tax.

The *Iowa inheritance tax* is levied on the amount of property that passes to particular beneficiaries. These rates also are graduated. The amount of property that can go to a particular beneficiary free of tax and the rate of tax on the excess vary—according to the degree of family relationship between decedent and beneficiary. The inheritance tax on property left to a widow, for example, is much less than the tax on the same amount left to a cousin. The state government levies an inheritance tax in Iowa.

Federal Estate Tax . . .

The federal estate tax is levied on the value of the property owned by the decedent at his death—and on other property transferred during his life over which he retained some interest or control. The total value of these is the *gross estate*. From this, certain deductions and an exemption are taken to compute the *taxable estate*. Graduated rates are applied to the value of the taxable estate to determine the amount of tax due.

Gross Estate: The gross estate is determined under the provisions of the Internal Revenue Code, sections 2031 through 2044. It includes:

—all property which the decedent owned at his death (except real property outside of the United States);

—insurance on the life of the decedent payable to his estate;

—insurance on the life of the decedent payable to beneficiaries other than his estate if the decedent had any rights of ownership in the policy;

—the full value of property owned in joint tenancy with the right of survivorship (less any portion that did not originate directly or indirectly with the decedent);

—property given away within 3 years before death if the gifts were made in contemplation of death;

—property given away during life, if the decedent retained some interest or control or power over the property (for example: where a gift had strings on it or where the intended recipient could not get possession and enjoyment of the property before the decedent's death and the decedent retained certain reversionary rights);

—property given away by the decedent in which he kept a life estate for himself (a “reserved life estate”);

—property over which the decedent had a power of appointment which he could have exercised in favor of himself, his creditors or his estate;

—the value of payments to be received by a surviving beneficiary under an annuity contract if the decedent also was entitled to payments under the con-

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tract (a "joint life and survivor annuity"); some or all of the payments to a survivor from a qualified employees' trust or annuity plan may be exempt.

Deductions: To determine what the decedent left "free and clear" and to provide for the passing of some property to a spouse and charities free of tax, certain deductions are subtracted from the gross estate. This determines the amount of the taxable estate on which the tax falls. The deductions allowed by sections 2053 through 2056 of the Internal Revenue Code are:

—debts, funeral expenses, costs of administering the estate and losses from fire, storm, other casualty or theft during settlement of the estate;

—the amount of money or property left to charitable, religious and educational organizations (the "charitable deduction");

—the amount of money or property passing to a surviving spouse, though this deduction cannot be more than 50 percent of the adjusted gross estate (gross estate less the deductions in the first item above) even though more than that actually goes to the spouse. This is the "marital deduction" which permits a person to leave roughly half of his estate to his spouse free of tax.

Exemption: An exemption of \$60,000 is allowed by Section 2052 of the Internal Revenue Code to all estates. This means that the first \$60,000, after all deductions are subtracted, passes free of tax.

Taxable Estate: The amount left over after all deductions and the exemption have been subtracted from the gross estate is the taxable estate. The graduated estate tax rates are applied against this to determine the amount of federal estate tax (see table 1).

Credits Against Tax: In many estates, the tax as computed above will be reduced by certain credits or offsets. If a gift tax was paid on a lifetime transfer of property which also is included in the gross estate at death, a credit is allowed against the estate tax. If two or more people die within short periods, a credit is allowed in subsequent estates to prevent the estate tax from striking with full force each time. Two other credits permit offset against the federal estate tax of some or all of the taxes paid to a state or foreign government.

Thus, the over-all pattern of computation of the federal estate tax is (1) Gross Estate reduced by (2) Deductions and (3) the \$60,000 Exemption equals (4) the Taxable Estate. Tax on the taxable estate is determined as shown in table 1, and the tax so determined is then reduced by any credits allowed.

Iowa Inheritance Tax . . .

The State of Iowa imposes an inheritance tax on the property received by each beneficiary. Prop-

erty subject to the state inheritance tax is similar to that subject to the federal estate tax, but the rates, exemptions allowed and methods of taxing are somewhat different.

The state inheritance tax as set out in Chapter 450 of the Code of Iowa reaches:

—all property passing by will or intestacy (except property permanently located outside of the state);

—insurance payable to the decedent's estate (but not insurance payable to a named beneficiary);

—property given away before death if the transfer was made in contemplation of death;

—property given away before death if the transferor reserved a life estate for himself or if the use and enjoyment of the property could not be obtained by the recipient until the transferor died;

—property over which the decedent exercised a power of appointment;

—property held in joint tenancy to the extent that the property really originated with or was purchased by the decedent.

Certain deductions and exemptions are allowed in determining the net amount of the estate subject to tax. Deductions are allowed for (a) debts due at death, (b) certain taxes owed by the decedent and the estate, (c) funeral expenses, (d) temporary allowance for a widow and young children while the estate is being settled, (e) costs and fees of administering the estate and (f) property on which an inheritance tax had been paid within 2 years

TABLE 1. Computation of Federal Estate Tax.

Taxable estate		Tax on amount in col. 1 (3)	Rate of tax on excess over amount in col. 1 (4)
Amounting to (1)	But not exceeding (2)		
\$ —	\$5,000	\$ —	3%
\$5,000	\$10,000	\$150	7%
\$10,000	\$20,000	\$500	11%
\$20,000	\$30,000	\$1,600	14%
\$30,000	\$40,000	\$3,000	18%
\$40,000	\$50,000	\$4,800	22%
\$50,000	\$60,000	\$7,000	25%
\$60,000	\$100,000	\$9,500	28%
\$100,000	\$250,000	\$20,700	30%
\$250,000	\$500,000	\$65,700	32%
\$500,000	\$750,000	\$145,700	35%
\$750,000	\$1,000,000	\$233,200	37%
\$1,000,000	\$1,250,000	\$325,700	39%
\$1,250,000	\$1,500,000	\$423,200	42%
\$1,500,000	\$2,000,000	\$528,200	45%
\$2,000,000	\$2,500,000	\$753,200	49%
\$2,500,000	\$3,000,000	\$998,200	53%
\$3,000,000	\$3,500,000	\$1,263,200	56%
\$3,500,000	\$4,000,000	\$1,543,200	59%
\$4,000,000	\$5,000,000	\$1,838,200	63%
\$5,000,000	\$6,000,000	\$2,468,200	67%
\$6,000,000	\$7,000,000	\$3,138,200	70%
\$7,000,000	\$8,000,000	\$3,838,200	73%
\$8,000,000	\$10,000,000	\$4,568,200	76%
\$10,000,000	\$ —	\$6,088,200	77%

TABLE 2. Iowa Inheritance Tax Rates.

Amount above exemption	Tax rate for each bracket
Class 1, spouse, child, parent or lineal descendant:	
\$ — to \$ 10,000	1%
\$ 10,000 to \$ 25,000	2%
\$ 25,000 to \$ 50,000	3%
\$ 50,000 to \$ 100,000	4%
\$ 100,000 to \$ 150,000	5%
\$ 150,000 to \$ 200,000	6%
\$ 200,000 to \$ 300,000	7%
\$ 300,000 to \$ —	8%
Class 2, brother, sister, child's spouse or stepchild:	
\$ — to \$ 25,000	5%
\$ 25,000 to \$ 50,000	6%
\$ 50,000 to \$ 100,000	7%
\$ 100,000 to \$ 200,000	8%
\$ 200,000 to \$ 300,000	9%
\$ 300,000 to \$ —	10%
Class 3, all persons not in class 1 or 2:	
\$ — to \$ 100,000	10%
\$ 100,000 to \$ 200,000	12%
\$ 200,000 to \$ —	15%

prior to the death of the decedent. This determines the net amount of property available for distribution to beneficiaries on which the computation of the tax chargeable to each beneficiary is based.

Not all property passing at death is taxed. No tax is imposed if the estate doesn't exceed \$1,000. Property passing to certain religious, charitable and educational organizations or for public purposes isn't taxed.

Property left to relatives is taxed. But the rate of tax and the amounts that may be left tax-free depend on the degree of relationship to the decedent. Exemptions are granted to certain relatives, permitting some property to pass to them free of tax. The tax then falls on any property received over and above the amount of the exemption.

The first \$40,000 of property passing to a surviving spouse is exempt from the Iowa inheritance tax. The same is true of the first \$15,000 passing to each child (natural or adopted), the first \$10,000 passing to a parent and the first \$5,000 passing to a grandchild or other lineal descendant. Tax rates on property left to persons in this group range from 1 percent on the first \$10,000 above the exempt amount to 8 percent on amounts over \$300,000 in excess of the applicable exemption.

No exemption is allowed for property passing to brothers, sisters, sons-in-law, daughters-in-law or stepchildren of the decedent. For these persons, the tax rate ranges from 5 to 10 percent, depending on the amount of property received. Amounts left to all other persons are taxed at rates from 10 to 15 percent (see table 2).

Federal Gift Tax . . .

The federal gift tax is levied on transfers by gift made during life. Complete and outright lifetime gifts are taxed in the year made and aren't subject to the estate tax at the death of the giver. Sometimes a transfer may be a gift for gift-tax purposes and still be taxable at death because the donor retained certain powers or control over the property. In such

cases, however, the gift tax paid is credited against the amount of estate tax due to prevent a double tax.

Gift tax rates, as shown in table 3, are about three-fourths of the estate tax rates. The computations and exemptions differ so much, however, that the gift tax on a transfer during life often will be considerably less than the estate tax on a transfer of the same amount of property at death.

The gift tax law allows an annual exclusion from taxable gifts of \$3,000 for each person to whom a gift is made. In addition, each taxpayer-giver is granted a specific exemption of \$30,000 which he can use at any time. Thus, \$3,000 in gifts can be made to each beneficiary in each year without tax. Additionally, \$30,000 in gifts (over and above \$3,000 per recipient per year) may be made free of tax during the taxpayer's lifetime.

Gifts made by married couples—split gifts:

If a married person makes a gift to someone other than his or her spouse, the gift may be treated as given half by the donor and half by the spouse. This may be done even though only one of them owned the money or property given. It means that parents who have made no previous gifts could make gifts up to \$60,000 free of tax by using the \$30,000 exemption. Also, \$6,000 each year to each beneficiary would be free of gift tax because each spouse is entitled to a \$3,000 exclusion for each beneficiary each year.

Gifts made to spouse—marital deduction: The gift tax marital deduction is similar to the estate tax marital deduction. It simply means that half of the gift from one spouse to the other is tax free. The \$30,000 exemption and the annual \$3,000 exclusion can still be applied to offset the half of the gift to the spouse which is subject to tax.

Gifts are taxed according to graduated rates. The more gifts that a person has made in past years, the higher will be the tax rates on gifts made in the current year. The gift tax is collected annually. So, to figure the tax for any year, it is necessary to know the amount of gifts made in prior years. Gifts of the current year are added to all gifts made in previous years (since 1932) to determine the rate of tax for the current year's gifts which are considered to be "on top of the pile." The method of computation is this:

(a) A tax is figured on all taxable gifts made from 1932 to the *end* of the current year.

(b) A tax is figured on all taxable gifts made from 1932 to the *beginning* of the current year.

(c) The *difference* is the tax due on the taxable gifts made *during* the current year.

Taxable gifts means the aggregate of the gifts made in each year—less (a) the exclusions allowed each year for each recipient, (b) the amount of any gift made to a charitable, religious or educational organization, (c) half of any gift made to a spouse after April 2, 1948, and (d) the lifetime exemption of \$30,000.

TABLE 3. Federal Gift Tax Rates.

Taxable gifts		Tax on amount in col. A	Tax on excess over amount in col. A
Amounting to (A)	But not exceeding (B)		
\$ —	\$ 5,000	\$ —	2¼%
\$ 5,000	\$ 10,000	\$ 112.50	5¼%
\$ 10,000	\$ 20,000	\$ 375	8¼%
\$ 20,000	\$ 30,000	\$ 1,200	10½%
\$ 30,000	\$ 40,000	\$ 2,250	13½%
\$ 40,000	\$ 50,000	\$ 3,600	16½%
\$ 50,000	\$ 60,000	\$ 5,250	18¾%
\$ 60,000	\$ 70,000	\$ 7,125	21%
\$ 70,000	\$ 100,000	\$ 9,225	21%
\$ 100,000	\$ 200,000	\$ 15,525	22½%
\$ 200,000	\$ 250,000	\$ 38,025	22½%
\$ 250,000	\$ 400,000	\$ 49,275	24%
\$ 400,000	\$ 500,000	\$ 85,275	24%
\$ 500,000	\$ 750,000	\$ 109,275	26¼%