

Evaluating Your Estate Plan: Estate Planning Terms

These definitions or descriptions of certain legal terms are intended to be educational and not a substitute for legal advice. Please contact your own attorney for legal advice or if you have questions regarding any of these concepts and the impact they may have on your estate or business plans.

Business Entities

C-Corporation – Sometimes called a “C-Corp” or a regular corporation, this is a legal entity that is taxed separately from its owners (shareholders). It is called a C-Corp because it is based on Subchapter C of the Internal Revenue Code. A C-Corp can have an unlimited number of shareholders. As a legal entity, the C-Corp has its own income tax return and pays taxes. If the corporation is profitable, individual shareholders may receive dividends from the corporation, which are then reported on the shareholder’s individual tax return and are subject to taxation at individual tax rates. This is referred to as a double-taxation of corporate profits.

S-Corporation – Also called an “S-Corp,” this type of corporation is based on Subchapter S of the Internal Revenue Code. This type of corporation can have from 1 to 100 shareholders (owners). An S-Corp passes its net profits (or losses) through to the individual shareholders, who then report the income or loss on their own tax returns. In this way, the business profits are taxed at individual tax rates on each shareholder’s Form 1040. This 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.

Partnership – A general partnership is an association of two or more persons 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. Creation of the agreement establishes rights and duties between the partners and regulates their conduct as they transact business. Iowa Code section 486A governs state law on general partnerships.

Limited partnership – Iowa Code section 488 governs limited partnerships. There must be a written agreement for a limited partnership to exist, and the agreement governs relations among the partners and between the partners and the partnership. A limited partnership is an entity distinct from its partners. There must be both general partners and limited partners. A limited partnership achieves both limited liability and partnership principles. A limited partnership has the power to sue, be sued and defend in its own name and to maintain an action against a partner for harm caused to the limited partnership by a breach of the partnership agreement or violation of a duty to the partnership. Under Iowa law at Iowa Code chapter 486A, there is a **limited liability partnership (LLP)** which is a form of general partnership with a significant difference: In a general partnership, individual partners are liable for the partnership’s debts and obligations whereas the partners in a limited liability partnership are statutorily provided full-shield protection from partnership liabilities, debts and obligations.

Capacity or competency – A person is generally competent to make a will (often referred to as testamentary capacity) if the testator understands (1) the general nature and extent of his or her

property; (2) the testator's relationship to the people named in the will (as well as any person the testator disinherits (also called "the natural objects of his bounty"); (3) what a will is; and (4) the transaction of simple business affairs. *See also* competency in relation to a **conservatorship** or **guardianship**. Competency is also sometimes referred to as capacity. It should be remembered that competency or capacity to make a will is a fairly low threshold, and the fact that the next day the testator does not remember the signing of the will does not invalidate the will if there was capacity at the time of execution.

Conservator (Conservatorship) – A conservator is a person appointed by the court to make decisions about the property (or estate) of an incompetent person, also called a ward. A conservatorship deals with a person's financial or business decisions. For purposes of a conservatorship, Iowa law describes an incompetent person as a person who has "a decision making capacity which is so impaired that the person is unable to make, communicate, or carry out important decisions concerning the person's financial affairs." An individual may designate a conservator within a Power of Attorney document. *See also* **Guardian (Guardianship)**.

Deed – A written document that, when properly executed and delivered, conveys (transfers) title to real property. *See also* **Title**. Specific types of deeds or related terms 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 use the property.
- **Executor's deed** – A deed used to convey the real property of a deceased person.
- **Gift deed** – A deed executed and delivered without consideration. (i.e., 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 of title. A deed that usually contains the covenants of seizin, 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.

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. *See also* **Sweat equity**.

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**.
- **Beneficiary** – Person named in a will to receive a bequest.
- **Bequest (legacy)** – Personal property received under a will.
- **Curtesy** – The legal right of a widower to a portion of his deceased wife's real property.
- **Devise** – A transfer of real property by means of a will.
- **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.

- **Executor/Executrix** – A person named in a will to carry out its instructions. Depending on the state, this may be referred to as the **Administrator**.
- **Heirs** – Those designated by law to receive the property of a deceased when there is no will.
- **Probate court** – Court of law with authority to verify the legality of a will and carry out its instructions.

Gift – The voluntary transfer of property (including money) to another person completely free of payment or strings while both the giver and the recipient are still alive. A bequest is a gift made in a will.

Guardian (Guardianship) – A guardian is a person appointed by the court to make personal decisions for the ward. These would be non-financial decisions such as where the ward lives and what type of medical care the ward receives. For purposes of a guardianship, Iowa law describes an incompetent person as a person who has “a decision-making capacity which is so impaired that the person is unable to care for the person’s personal safety or to attend to or provide for necessities of the person such as food, shelter, clothing or medical care, without which physical injury or illness may occur.” An individual may designate a guardian within a **Power of Attorney** document. *See also Conservator (Conservatorship)*.

Life estate – The conveyance of an interest for the duration of someone’s life. Related terms include:

- **Life tenant** – Holds an estate for the period of his or her lifetime or that of another specified person.
- **Remainder interest** – A future interest in property held by a remainder person usually following a life estate or term interest.

- **Remainder person** – Is entitled to hold a remainder interest; also known as a remainder man.

Living will – Also known as an Advance Care or Advance Medical Directive; sets forth an individual’s personal wishes with respect to medical care. Iowa law provides that adults can direct, in advance, whether they want to be kept alive by artificial means in the event they become terminally ill and are incapable of taking part in decisions regarding their 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, personal or adult day care for individuals, usually with a chronic or disabling condition that needs constant supervision.

Power of attorney (POA) – A written authorization to another to act on one’s behalf or as one’s agent. The agent may also be referred to as an **Attorney-In-Fact**. The two main types of POAs are the **Durable or General POA**, which usually grants powers in regard to business-related purposes; and the **Health Care POA**, which grants powers related to health care decisions.

Property ownership – Following are definitions of various ways of owning property.

- **Fee simple** – Owner is entitled to the entire property with unconditional power to both use and transfer. This is the highest level of ownership.
- **Undivided interest** – Ownership by two or more persons that gives each the right to use the entire property.

- **Tenants in common** – The shared ownership of a single property among two or more persons. The interests need not be equal and no right of survivorship exists.
- **Joint tenancy** – A form of property co-ownership that features the right of survivorship.
- **Right of survivorship** – A feature of joint tenancy whereby the surviving tenant or joint tenants automatically acquires all the right, title, and interest of the deceased joint tenant.
- **Partition** – To divide co-owned property into distinct portions so that each co-owner may hold his or her proportionate share separately.

Property types – Below are definitions of various classifications of property.

- **Chattel** – An article of personal property (both 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.

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.

Sweat equity – The increased worth of a farm or other business (over and above money or tangible assets contributed), which was created by uncompensated mental and/or physical contributions of a participating individual.

Taxes – Taxes are funds paid by individuals to governmental entities to support government services or programs. Taxes are also paid by entities such as corporations. Taxes are generally enforced contributions based on local, state, or federal legislative action. Taxes may include the following:

- **Income taxes** – Income taxes are generally imposed by the state (State of Iowa, Department of Revenue) or federal (Internal Revenue Service) governments and are based upon the income of the taxpayer, less any applicable or allowable deductions.
- **Inheritance taxes** – Iowa Inheritance Tax is a tax paid to the State of Iowa and is based upon a person's (beneficiary or heir) right to receive money or property that was owned by another person (decedent) at the time of death and is passing from the decedent to the beneficiary or heir. Iowa Inheritance Tax is generally not due if all estate assets are held solely in joint tenancy with right of survivorship between husband and wife alone; or all estate assets are held solely in joint tenancy with right of survivorship, and not as tenants in common, solely between the decedent and individuals who are entirely exempt from Iowa Inheritance Tax; or all assets are passing by a will or a trust to beneficiaries who are a surviving spouse or parents, grandparents, great-grandparents, children (legally adopted children and biological), stepchildren, grandchildren, great-grandchildren, or other lineal ascendants or descendants.
- **Estate taxes** – Federal estate tax is a tax imposed on the transfer of a taxable estate of a deceased person (decedent). For deaths occurring through the end of 2014, up to \$5,340,000 can be passed from an individual upon death without incurring federal estate tax. The Tax Policy Center estimates that approximately 8,600 individuals dying in 2011 will leave estates large enough to require filing a federal estate tax return. (Total U.S. deaths in 2011 are approximately 2,628,000.) Estates with a gross value under \$5 million are not required to file a return in 2011. Further, after allowances for deductions and credits, an estimated 3,270 estates will owe tax. Less than 50 small farms and businesses will pay any estate tax in 2011. See www.taxpolicycenter.org.

- **Capital gains taxes** – Capital gains taxes are imposed by the federal government on the profit from the sale of capital assets when the asset is sold for more than the acquisition cost and there is a gain on the sale. These capital assets include items like stocks, bonds, precious metals, and real estate (property). These do not include inventory assets, which are items that are acquired for the purpose of resale (such as retail inventories or livestock). Capital gain income from assets held one year or less (sometimes called short-term capital gains) is taxed at ordinary income tax rates in effect for that tax year. Capital gain income from assets held longer than one year is generally taxed at a special long-term capital gains rate. The rate that applies depends on the ordinary income tax bracket of the taxpayer. For most taxpayers, net capital gain is taxed at rates no higher than 15 percent. Some or all net capital gain may be taxed at 0 percent if the taxpayer is in the 10 or 15 percent ordinary income tax brackets. Beginning in 2013, a new 20 percent rate on net capital gain applies to the extent that a taxpayer's taxable income exceeds the thresholds set for the new 39.6 percent ordinary tax rate. These income thresholds are \$400,000 for single and \$450,000 for married filing jointly or qualifying widow(er); \$425,000 for head of household, and \$225,000 for married filing separately. *Each person should consult with his or her tax professional regarding any plans based on capital gains tax considerations.*

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

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 who the owner is. Title can readily be sold or mortgaged.
 - **Title by descent** – Laws that direct how a deceased's assets shall be divided to heirs when there is no will.
- Title XIX (Title 19) or Medicaid** – Medicaid is a government program available only to certain low-income individuals and families who fit into an eligibility group that is recognized by federal and state law. Medicaid sends payments directly to health care providers. The program is state-administered and each state sets its own guidelines regarding eligibility and services.
- Trust** – Ownership held by a trustee for the benefit of another. 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 that holds property in trust for another.
 - **Trust corpus** – The subject matter of a 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.
 - **Irrevocable living trust** – The grantor cannot amend, revoke, or alter the trust. These trusts may save estate settlement costs and death taxes.
 - **Revocable living trust** – The grantor retains the power or right to amend, revoke, or alter the trust.
 - **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 are often contained in an individual's will.

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. There must be such domination and control so 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 such domination and control. The influence must have been so great that the testator lost the ability to exercise his or 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 persons 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 entirely handwritten and signed by the testator; it 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/Testatrix** – A person who makes a will.

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