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A Planner's Primer

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I. Introduction

Anyone undertaking an assignment to write within a few pages under this comprehensive title must limit his coverage. This general article on a subject as intangible as estate planning omits entirely or gives short treatment to many considerations which may be of great importance to the conscientious planning of relatively complicated estate situations.[1] Emphasis will be placed on the tax aspects of estate planning, particularly federal taxes, but consideration will be given to other aspects which may be of equal or even greater importance. This deliberate emphasis is certainly not intended to add to the misleading impression, too frequently held, that the purpose of estate planning is merely to devise schemes to save taxes.

It should be borne in mind that the estate being planned is the family economic fortune in its present form as well as the property which will pass at the owner's death. They may be quite dissimilar.[2] It is the living estate owner who is to be helped with his planning through action to be taken by him currently.[3] About the only planning done after death is the upsetting of prior planning or lack of planning.[4] The owner of an estate should not sacrifice his own security and that of his family as it is now constituted by an excessive regard for members who may survive him. He may turn out to be the one surviving them. Many plans have produced adverse consequences beeause death refused to follow in the planned sequence. This does not mean that estate planning should disregard all possibilities for betterment merely because the unexpected might happen. Reasonable probabilities should be acted upon, but all possible consequences must be carefully considered.

The case to delight the estate planner is the one of the extremely wealthy client whose own security, and that of his living family, can be made "fool proof" by the use of only a portion of assets. As to the balance, the planner

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1. To name a few: reorganization of corporate and other holdings, key-man insurance, family controlled enterprises, purchase and sale agreements, options, installment sales, deferred compensation, voting trusts, annuities, special ventures to place "growth" assets in young hands, etc.
2. The conversion of insurance cash values to death benefits is one example.
3. Although the estate owner will often be spoken of in the masculine gender, this is done merely for economy in expression—since the estates of women, particularly if they are the surviving stakeholders of the family fortune, require at least as much attention as those of men.
4. Taking against the will promises to become a more popular diversion now that we have the "marital deduction."

can then apply all his tools. The writer has been privileged to work frequently on large fortunes where there is more "elbow-room" for the taking of bold steps with a minimum of risk than would be found in smaller estates. However, the fact of great wealth alone does not make for this happy circumstance. The wealth is often concentrated in a manner that makes it most susceptible to sudden shock from which it may never recover. The wealthy family having all of its fortune in a family controlled business is usually in this position—although it may not be recognized while the business is profitable. If the profits should disappear, even temporarily, at some particularly difficult time in the future the present capital wealth may be found to have been quite illusory.

It is not very often that a planner has the chance to use all his tools and reserve talents in any one case. Above all else, he should not strain to use what is not needed. Programs for estate planning and their presentation are frequently criticized as being too complicated. Estate planning, like other planning, should carefully avoid this error. The use-of-a-sledge-hammer-to-drive-a-tack technique serves no useful purpose in this field. The real cleverness of the planner lies in dealing with the problem at hand as intelligently and clearly as possible. This does not mean that he should give less than he can offer to a particular case. If he has several sound suggestions, one will often be dependent on the adoption or rejection of another or several others. He must prepare for this and not hold stubbornly to one line of approach because he did not or will not think of others.

It is unfortunate that estate planning is often regarded as important to only the very wealthy. While an estate of less value than the amount of the federal estate tax exemption does not have much need for the estate-tax part of planning, it does need the best advice on safeguarding the assets and passing them on by a well-considered and workable will. Not only does it need a technically good will, but it needs a will setting up a made-to-order testamentary plan to protect the particular family concerned, by the best use of whatever property there is in the estate. It needs the best-considered advice on all problems concerning the family insurance—including the special tax problems.[5] The owner can often be given help on his current position as a property holder and income earner which will help to maintain and increase his estate. To the small estate each dollar carries a heavier responsibility than it does to a large estate.

Many remarks appearing herein on the Revenue Act of 1948 are entirely unsupported by authority at this time. They present only the writer's own opinion on something still without official interpretation and tested experience.[6]

5. See Bowe, *Life Insurance, The Forbidden Fruit,* 2 Vand. L. Rev. 212 (1949).
6. Since the above was written, the proposed estate and gift tax regulations were

II. Some Elementary Principles Used in Estate Planning

The elementary principles applicable to a typical case are relatively clear. Many of them have been with us for a long time. It is surprising that men of means are so infrequently acquainted with them. This brief review of a few of the principles is included in the belief that the planner should make his client familiar with some fundamentals in order that he will better understand recommendations made to him. Applying the principles and making them work within a framework of special facts is the planner's task.

Estate vs. Gift Taxes

A transfer of property at death is usually the most expensive manner (taxwise) of distributing a man's possessions. Present federal gift tax rates, after exemptions, are three-quarters of the estate tax rates, also after exemptions.[7] By making a gift, however, the taxpayer may save more than one-quarter of the estate taxes on the amount given away because of the double use of exemptions and lower tax brackets. Furthermore, the amount of the gift tax is not included as a part of the taxable estate, whereas it would be if the gift were not made. There is some possibility in the future that the gift and estate tax laws will be integrated into one "transfer tax." If this comes about, the opportunity to save estate taxes by making lifetime gifts after the law is changed will probably be removed.

Gifts in Contemplation of Death[8]

This subject is mentioned here merely because of the belief that any discussion of gifts in relation to estate taxes requires the precautionary remark that property given away will not escape estate tax if the gift was made "in contemplation of death." It can be demonstrated, however, that some savings result from taxable gifts even though the property is subjected to estate tax because the gift was made in contemplation of death. This comes about because the gift tax (which is not subject to gift or estate tax) is normally allowed as a credit against the estate tax. In this connection it is interesting to note that the estate tax itself is subject to estate tax.[9]

The Treasury Department has lost many cases in the courts on its claim

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published on Nov. 6. Although a preliminary study of the proposed regulations does not disclose a conflict between them and general remarks on the subject herein, such remarks should still be regarded as lacking the authority which only time and litigation can provide.

7. The new "marital deduction" can be made to apply to both estate and gift taxes.

8. See in general, Polisher, *Transfers in Contemplation of Death,* 2 VAND. L. REV. 195 (1949).

9. Some states allow the federal tax as a deduction in calculating the property subject to their local inheritance taxes.

that particular transfers were made in contemplation of death, but even in the cases where the courts have decided in favor of the taxpayer the estates have been subjected to substantial expense and delay in preparing for and defending against the Treasury's position. It is quite likely that forthcoming new legislation will deal with this problem with particular emphasis to be given to a simplification in the administration of the rule, and a forecasting of the results. The proposed Revenue Revision Bill [10] attempts to do this by providing that a gift made more than three years before death will not be held to have been made in contemplation of death. On gifts made within three years of death, according to the proposed revision, there would be a rebuttable presumption in favor of contemplation of death. Also, as mentioned before, there is some possibility of a single transfer tax.[11]

Federal Income Tax Savings Through Gifts

In most cases the making of substantial gifts within the family actually increases the family's spendable income after taxes even during the donor's lifetime. When the donor owns more income-producing assets than the donee owns, this result is caused by the progressive rates of income tax. However, the new privilege given to husbands and wives—permitting them to calculate their income taxes as though all income belonged to each of them in equal shares—has removed the "income tax incentive" for gifts between husbands and wives.

Long-Continued Trusts to Save Estate Taxes

Over the long term, it is more costly in taxes and administration expenses to provide outright legacies [12] than to place the legacies in trust to continue as long as possible. This is because outright legacies fall into each legatee's estate and are again subject to taxation and administration costs.[13] If the legatee seeks to avoid this result by making gifts, he will suffer either the gift tax or the dissipation of exemptions and exclusions which he might use for other gifts.

The use of trusts for gifts made during lifetime also results in similar savings at the death of the donees, whereas outright gifts are made expensive to the ones who eventually receive from the donees.

10. H. R. 6712, passed by the House June 19, 1948, but not taken up by the Senate.

11. This would remove the troublesome concept of gifts in contemplation of death together with the opportunity to reduce estate taxes by gifts made after such legislation.

12. Other than of the marital deduction portion allowed to a surviving spouse by the Revenue Act of 1948.

13. Except in the case of the "prior-taxed property" deduction. This deduction no longer applies to property received from a spouse—whether or not it qualified for the marital deduction on the prior transfer.

The New Marital Deduction

The new and revolutionary marital deduction provisions contained in the Revenue Act of 1948 give estate planners a new implement with which to work. This discussion of general principles cannot deal with it at great length and does not consider the special rules pertaining to residents of community-property states. It also omits discussion of the income-tax features of the Act.

Estate planners are presently working under a severe handicap in the absence of regulations, decisions and tested experience applicable to the new legislation. Nevertheless, they are guilty of negligence if they do not give due consideration currently to the marital deduction on the excuse they are awaiting final decisions concerning it. (That will be a long period of waiting.) This is particularly true with respect to wills, since the new opportunities apply to all married persons who die after December 31, 1947. Death or the loss of opportunity to make or re-make a will may occur long before all uncertainties are settled. It is difficult to subscribe to the "do-nothing-now" attitude of some attorneys, trust officers and other planners in this regard.

Generally speaking, as to gift taxes, either spouse can make a completed gift to the other and have only one-half of the gift subject to gift tax. For this purpose, the other one-half can be treated as already the property of the spouse-donee. Therefore, although a donor's annual tax-free exclusion as to each donee is only $3,000, as much as $6,000 can be given each year from one spouse to the other free of tax whether or not the present lifetime specific exemption of $30,000 belonging to each of them has been exhausted. The Act also has the effect of permitting tax-free gifts up to a total of $60,000 between husbands and wives, over and above the annual exclusions, for gifts made after April 2, 1948, if the donor has not exhausted any part of his $30,000 specific lifetime exemption by prior gifts.

In addition, if both spouses agree, either one may make a gift to a third person and have the tax computed as though the gift were made one-half by each spouse. This, too, doubles the use of the annual exclusions and the specific lifetime exemptions (if still available).[14] Besides these benefits, the cost of making gifts is reduced by the double use of the lower beginning tax brackets of each of the two taxpayers.

As to estate taxes, the new law has introduced the concept of the "adjusted gross estate"[15] and permits a married person to leave up to one-half of that amount to the surviving spouse free of estate tax. Application of

14. This double use heretofore was possible in only those situations where each spouse could and did contribute one-half of the property from his or her own separate funds.

15. The gross estate under INT. REV. CODE § 811, less the deductions allowed by § 812(b)—debts, administration expenses, etc.

the concept in estate planning can become very complicated, particularly if there are items included in the decedent's taxable estate which may pass or have passed "outside" of the assets controlled by his or her will. This feature of the new law may be used to save substantial federal estate taxes in the estate of the spouse first dying. It is not always economical to use it, however, since the tax burden is partially shifted to the estate of the surviving spouse, who may then die with a larger taxable estate in higher tax brackets. Each situation requires specialized and individual consideration.

The law does not set up the "marital deduction" for the taxpayer or his estate automatically. It depends on his own gift and will planning. Generally speaking, in order that property qualify for the marital deduction it must be made to go to a spouse either outright or by a trust which provides that the spouse must receive all net income therefrom at least annually for life and have the unrestricted right to dispose of all of the corpus either during lifetime or at death. Thus, the property remaining at the death of the receiving spouse is subjected to tax in his or her estate. Therefore, in arranging for estate distributions it is often desirable to split the estate into at least two funds and leave the amount in excess of the marital exemption in a trust so organized that it will not be taxed in the receiving spouse's estate at death.[16] If this is not done there is double taxation since the amount in excess of the allowable deduction will be taxed to both spouses.

One further general feature of the marital deduction provision requires careful consideration in the drafting of wills which seek to obtain the maximum deduction and no more. If death taxes, federal or state, are to be charged or allocated against the property going to a surviving spouse, the deduction is reduced by the taxes charged against the spouse's share (unless the amount received by the spouse continues to be the maximum allowable amount even after the payment of taxes). Therefore the will should provide an adequate clause to take this into account.[17] The difficulties of making tax computations will themselves be an important consideration where the tax depends on the deduction and the deduction depends on the tax. Ordinarily it will be found desirable to have the will direct that no part of any death taxes is to be allocated against the marital deduction portion going to a spouse.

16. To have it free of tax in the second estate, a trust is required which does not give the spouse unrestricted control over corpus—the type of trust referred to in the preceding sub-division.

17. It is anticipated that the problem of the allocation of taxes where the will is silent will become increasingly complicated following the Revenue Act of 1948. Should a spouse be made to pay any portion of the federal tax if the portion going to her is tax-free? The allocation statutes and practices of the various states may call for new interpretations. What is the situation if a widow elects to take against the will, which provides for the payment of taxes from the residue—when her election has reduced the taxes and has also accelerated the enjoyment of others to the part she does not take?

Insurance and Other Means to Provide Liquid Funds

One of the greatest problems confronting estate owners is that of providing liquid funds at the right time to pay cash obligations resulting from death. These are new obligations which did not exist before. All taxes must be paid in cash and within a comparatively short time after death. Expenses of administration generally require cash also. Debts usually require cash and, although they may not be new obligations, the necessity for settling them may be accelerated by death.

The owner of property does not concern himself greatly with levies on capital during his lifetime. His executors and his family must concern themselves with them immediately following his death. The levies are severe. An estate of only medium large size may have to raise and pay out cash funds amounting to one-third or more of its entire capital funds. The enforced rapid liquidation of assets for this purpose can often add to the estate "shrinkage" brought about by the demands of estate taxes and expenses. Therefore, the estate planner has two very important tasks in this regard: (1) he hopes to reduce the shrinkage, and (2) he must plan steps for his client to take toward providing funds to pay the taxes and expenses which remain. By doing this he helps greatly to attain the primary objective of providing maximum benefits for the decedent's family.

To prepare for the problem discussed here, anything done to assure the presence of readily obtainable cash funds at death is of the greatest importance. A diversification of the client's investment holdings to obtain greater safety and marketability, and to provide a proper amount of "fixed assets," is often one of the answers. Another may be found in some program designed to make his own business interests more adaptable to meeting the problem. Ordinary savings and a conservation of funds as a liquid reserve are always good, but it is frequently difficult of accomplishment out of income after taxes.

Apart from the benefit of insurance as an additional asset, there is usually a sound need for some insurance to meet this problem of cash requirements. More than other types of investment it gives the double assurance that the cash will be on hand at the right time and in the anticipated amount regardless of the time when death occurs. Though insurance purchased by the decedent on his own life can no longer be utilized for tax savings to the extent it was once used,[18] it still has a most important place in over-all estate planning. It is at least as important to a small estate as it is to a very large one—and generally even more important. Insurance programs can still be planned for more than ordinary effectiveness in many situations even under present tax laws.

18. See Bowe, *Life Insurance, The Forbidden Fruit*, 2 VAND. L. REV. 212 (1949).

III. All or Nothing

The planning of an estate can not be done properly in small unrelated segments. Most individuals possessed of fairly substantial means have found advisors and salesmen only too willing to do that for them, each in his own field of special interest. Everything affecting the estate must be taken into consideration in forming the plan.[19] It is just as essential that the planner have a complete understanding of the family situation with respect to each individual comprising the unit. Most important is the comprehensive appreciation of the client's own objectives. The client may need help to pull his objectives out of his own mind into some orderly pattern, but this step can be of immeasurable value to all concerned. Securing this information and material is a big job, requiring the full confidence and cooperation of the client and the other advisors who are to cooperate in the project.[20]

The usually dull work of research, tabulation and analysis is the hard and time-consuming part of the task. Days are often spent in analyzing a few insurance policies and legal documents to visualize properly the whole pattern from which a start is to be made. A digest of what things are or what they purport to express is not enough. Research into the consequences to follow from present facts requires hard work and realization of what is important in the facts, each in relation to all others. In a rare case this might be the entire job of estate planning. There may be nothing else to do, but no one can properly say the estate is in perfect condition for the situation at hand if anything has been held back or overlooked. In a case where there are no improvements required, the conscientious planner who reports to that effect does not have much to show for his work, but the client who employed him has been excellently served. The planner's report showing him just how he stands, which he may never have otherwise known in any comprehensive sense, can be invaluable now and for his guidance in the future.

There are not many cases which will be found to end at the point where analysis and research stop. It is then that the planner appears to swing into action for the first time. Whatever he does from that time forward will depend for quality largely on his being able to make recommendations based on all the facts and circumstances having anything to do with the case.

IV. Inter-Vivos Gifts

Whether or not a client can and should make irrevocable gifts during his lifetime is one of the factors to be considered at the beginning of a case. This is largely because benefits from gifts may commence immediately. All three

19. This includes all investment and other general assets, business interests, trusts, future expectancies, insurance, joint tenancies, gifts, real estate, liabilities, income positions, wills, etc.

20. See Shattuck, *Foreword*, 2 Vand. L. Rev. 167, 170 (1949).

federal taxes—gift, income and estate—are involved with any large irrevocable gifts by which the donor divests himself of all interest in the gift property. Some states also assess all three taxes, but this article concerns itself principally with federal taxes. However, the local gift tax may be more troublesome than the federal tax in some states.[21]

Gift Taxes and Gifts in General

The federal gift tax is generally not particularly severe until the amount of gifts becomes quite large. However, it has cumulative quality, and is imposed at progressive rates, with the taxable gifts in one year placed on top of taxable gifts which were made in prior years. Frequently the gift tax is more troublesome than expensive if the gifts are modest in amount and made in property difficult to value for tax purposes. Sometimes the making of a large gift is found to be difficult because the donor does not have liquid funds for the cash payment of the tax. Normally, however, the gift tax is only a temporary capital loss since it is usually more than regained through a reduction in estate taxes at a later date by the removal of the gift property and tax from the assets taxed at death.

So far as gift taxes are concerned, there is a $3,000 "exclusion" from tax for gifts (other than of a future interest) made to each donee each year; there is also a specific lifetime exemption of $30,000 allowed to every donor over and above the annual exclusion to each donee.[22] The gift tax exemption (and exclusions) and low beginning tax rates are of absolutely no value unless gifts are made. The opportunity to use them dies with each taxpayer and they do not apply against the estate tax. Therefore, there seems to be some use for the gift device in practically all estates which are large enough to have a tax problem.

This article will not attempt to deal with the problem of whether or not a particular type of gift is treated as complete or incomplete consistently for all three taxes. Here we are speaking of the entirely completed gift—which is subject to gift tax (except for exclusions and exemptions), which relieves the donor from tax on income from the gift property and which removes the property from the donor's taxable estate at death. It is the planner's job to have the gifts made so as to operate as indicated above with respect to in-

21. For example, in Wisconsin a gift tax must be paid on any gift of over $1,000 made in one year to any one donee after the small lifetime exemptions have been exhausted. As a result, Wisconsin donors and donees are required to file returns and pay taxes in many instances where federal returns are not necessary. In Tennessee the exemptions are more liberal ($5,000 or $10,000 depending on the class of donees), but the exemption is allowed to the class and not to each recipient. The federal annual exclusion is allowed to each recipient. The rates and systems vary between the states which impose gift taxes. The federal tax cost will usually reach a point which exceeds state gift taxes, however, if large gifts are continued over a period of years.

22. These amounts can become $6,000 and $60,000 respectively for married donors as mentioned in the general discussion on the Revenue Act of 1948.

come and estate taxes if that is a part of the program he has in mind. His best way of doing it is to keep away from "fringe" schemes too close to a contentious line.

Reduction of Income Taxes by Gifts

Obviously, if a man in the high income tax brackets transfers income-producing property to someone in the family who is in lower tax brackets, and the tax burden is shifted to the donee thereafter, the family as a unit will have more annual income after taxes than it had before the transfer.[23] If there are several donees, the benefits will generally be greater than if there is only one donee. In a large case, savings of this nature are very great and it is well to start them as soon as possible to obtain the maximum number of annual benefits.

In many instances it is almost impossible for a taxpayer in high brackets to increase his family's income by providing additional income-earning capital funds out of accumulated savings from income after taxes. If he does increase the income by making gifts, he may be providing the benefits for which additional capital funds are usually sought. For example, suppose a man in the 70% income-tax bracket finds he ean increase the over-all family income $3,000 a year after taxes by making gifts. He has done the same in income for the family as if he had added $250,000 in capital funds invested at 4%.

Naturally the use of irrevocable gifts cannot be recommended in all cases to accomplish results which compensate adequately for the disadvantages and risks involved in a particular situation. In some cases there may not exist even the proper donees for the purpose. Yet there are many situations admirably suited to this device. A wealthy man having married children and many grandchildren can often use it to great advantage and obtain pleasure and satisfaction from his action as well.

Some cases almost cry out for large gifts. Consider the case of a widow who has been left a substantial fortune by her husband. She owns some of it outright and some of it is in trust from which she receives income. She supports her 68-year-old brother and his wife out of her top income, which is taxed at almost 70%. She has gross income of $70,000, gives $37,000 to the government and $7,000 to her brother, leaving her with $26,000. Instead of doing this, suppose she makes a gift [24] of $200,000 from which $8,000 will be earned and paid to the brother and his wife. She has not used her gift tax exemption by prior gifts, so she pays about $30,000 in gift tax. Her loss of income at 4% on $230,000 is $9,200 to reduce her gross income to $60,800.

23. Except in the case of transfers between husbands and wives who file joint returns.

24. Trusts would usually be used for this purpose, with the remainder to go to the donor's immediate family.

From $60,800 she pays about $30,200 in taxes to leave $30,600 for her own use. The brother and his wife are assured of being at least as well off as before, and the widow has $4,600 more net income every year for her own use.

Reduction of Estate Taxes and Expenses by Gifts

When a completed gift is made which removes property from the donor's taxable estate, it offers great opportunities for savings. The gift value and the gift tax come off the top of the estate-tax brackets, while the gift tax itself starts at the bottom brackets after exhausting the exemptions. To the extent that exemptions are used, capital transfers entirely free of gift or estate taxes have been accomplished. Illustrations of savings which can be realized are easily made in any given case, but they are not of much use as a general proposition since the results vary so much between estates of different size and also according to the size of the gift in relation to the property at death. For illustration, consider the case stated in the preceding paragraph of the widow who gave away $200,000. Assume her assets subject to estate tax before the gift were worth $600,000.[25]

Gross estate before gift			$600,000	
Administration expenses		$ 30,000		
Estate taxes		149,000		
Estate shrinkage				$179,000
Gift	$200,000			
Gift tax	30,000		230,000	
Gross estate after gift			$370,000	
Administration expenses		$ 18,000		
Estate taxes		79,000		
Estate shrinkage				97,000
Reduction in shrinkage and cash requirements				$82,000
Less gift tax paid				30,000
Net Saving				$52,000

We see that the payment of gift tax, in a sense the prepayment of estate tax, relieves her executors from a part of the liquidation problem, since they will now have to pay out $82,000 less in cash than if the gift has not been made. This of itself may be nearly as important as the absolute saving of $52,000.

The marital deduction now applicable to both federal gift and estate

25. Perhaps the balance of her fortune is in a trust left by her husband which will not be a part of her taxable estate.

taxes requires consideration again in the matter of gift-making by a married person. If the prospective donor would, whether he makes gifts or not, leave his surviving spouse the full maximum marital deduction under his will, it must be remembered that a gift removing taxable property from his estate also reduces the amount which can go tax-free within the deduction at his death if his spouse survives him. For example, in the preceding illustration the maximum marital deduction for estate tax before the gift would be $285,000 (½ of $600,000—$30,000). After the gift the maximum deduction would be only $176,000 (½ of $370,000—$18,000). On the other hand, all that the spouse receives within the marital deduction is taxed at the spouse's death, whereas a gift to the spouse [26] or to someone else can be kept out of the donee's estate by the use of trusts. Also, a spouse might be more free to make gifts if the other spouse uses the marital deduction by will. This requires arriving at a "nice balance" in each particular case.

Entirely apart from taxes, removing a part of a person's property from the expense, delay and publicity of estate administration can be very beneficial. Estate administration often causes the family property to be held more or less in suspense during an extended period for the settlement of all liabilities, including the final determination of taxes. In addition, there occurs an interruption in the continuity of management of the family business.

V. THE USE OF TRUSTS

Trusts can be used as the receptacle for gifts during lifetime and also for gifts under wills. A gift during lifetime may shift income and estate taxes away from the donor whether he makes an outright gift or a gift in trust. Obviously a bequest under a will, whether in trust or outright, can not do that for the testator.[27] However, whether a gift is in trust or outright (under a will or living-trust agreement), can vitally affect the taxes of the respective legatee or donee.

Unless the donee or legatee dissipates the property received outright, he cannot normally rid himself of it without the payment of gift or estate taxes (or the cutting into his exemptions). Furthermore, he alone is usually saddled with the taxes on income therefrom even if he uses the income for another person or gives the income to him. Placing the capital amount in trust, with the donee or legatee to receive all income therefrom for life, can relieve the beneficiary's estate from taxes on it at death if he can not control the principal fund. When death occurs, the capital can then go according to the terms of the will or trust agreement (or be continued further in trust for successive tax savings if the instrument so provides). The life tenant himself

26. Which is made so as *not* to qualify for the gift tax marital deduction.
27. Except in the case of an exempt or deductible legacy which escapes estate tax.

can even be given the right to designate how it will pass. If these plans are set up properly, there can be an elimination of needless successive losses in estate taxes and expenses.

The modern flexible trust frequently provides for discretionary distributions of principal in whole or in part before the specified final termination of the trust. Suppose the outright distributee might be expected to make gifts to his children or grandchildren—say for the purchase of a home or the starting of a business. He would run up against the gift tax. On the other hand, the trust agreement or will placing the property in trust may provide that distributions be made to the primary beneficiary or to other persons. If the discretion to do this is given properly and placed in the right hands, no gift (or estate) tax would be involved in the distributions whether they be made to the beneficiary, to his children or to other persons.

Again speaking of a flexible trust, discretionary power can be given over the distribution or accumulation of income.[28] The income does not have to go and be taxed in its entirety to one person. Suppose the trustee, not a beneficiary, under a father's will or living gift is authorized to distribute income to and among the adult son or his children, or accumulate it for minors, in such way as he believes will be most beneficial to the family group. If the son had been given the capital fund outright, he would be taxed on its income himself regardless of the fact that he might give all or part of the income to someone else. He might also pay gift tax. But under the trust arrangement, each recipient would pay his own income tax on whatever is distributed to him and the trust itself would constitute an additional tax entity for any income accumulated in the trust. And there would be no gifts to tax. There seem to be many situations of this kind where possible tax benefits so fortunately coincide with desirable planning irrespective of taxes.

There are, of course, many special circumstances which call for the use of special types of trust arrangements. Accumulation trusts can produce quite remarkable results in building up additional assets more economically than the donor himself could accumulate. Their use is more limited in some states than in other states. The donor of an inter-vivos accumulation trust may even have his own estate assisted in its liquidation problem by the use of the additional assets which have been built up in the trust. This may be done by authorizing the trustees to purchase assets from the donor's estate, and cash is thereby provided without the necessity for making forced public sales which remove the decedent's assets from the family control.

Funded insurance trusts can provide a remarkably fine combination to get the most out of both insurance and trusts. If a father establishes a trust with the income therefrom to be used for the purchase of insurance on his

28. Accumulation is limited in its use in many jurisdictions, but it is almost universally permitted for minors.

son's life, he can do a great deal which the son could not do for himself. The purchase of insurance by the son might be too expensive for him on two scores. The son would have to pay premiums out of income which had first been cut into for income taxes at high rates—to buy insurance worth only 65¢ on the dollar at his death if his estate is in the 35% estate tax bracket.

The many tax reasons for using trusts instead of outright distributions for gifts either during lifetime or by will call for little additional comment. It may be well, however, to add that greater tax safety is usually provided if discretionary powers over the distribution of principal or income are not lodged in a beneficiary who may exercise them for his own benefit. This may make it necessary to designate more disinterested trustees (if the trustees are the ones to exercise the discretionary powers) to the exclusion of family individuals. Sometimes, therefore, there is even good *tax* reason to appoint at least one corporate trustee which can have no personal interest in the way principal or income is distributed. [29]

One objection to a disinterested trustee which often comes up when "discretionary" trusts are recommended is that a non-family member may not have the personal "touch" to decide things according to the family's best interest. This may be true, but such trustee's "disinterestedness" is not all bad. The lot of an interested trustee who must make decisions wherein his own and other family members' interests are involved may not be a happy one. On one hand he may be justly or unjustly accused of favoring himself. On the other hand he may not treat himself fairly because of a fear of hurting others or of having them think he has hurt them. Family harmony can be greatly endangered in this situation. The interested individual may often welcome someone else to lean on. Of course, one of the most important things a man has to do in life is to decide upon and designate executors and trustees for the family in whom he has the greatest confidence, whether they be individuals, corporations or a combination of both, and he must anticipate that they may have to take his own place for a long time ahead.

Many persons seem to be of the belief that it is usually unwise to set up any type of trust other than one which is revocable—that irrevocable trusts are products of the devil. They seem to shudder at the thought of "irrevocable" and "trusts" getting together even when they would not think much about the irrevocability of an outright gift. This is hard to understand in many cases, particularly if it is remembered that great flexibility can be provided in modern trust agreements. However, it does follow that irrevocable trusts, like other irrevocable gifts, should not be used except in those situations which are found to be ready for them after due consideration of all factors. It sometimes works

29. It is possible, of course, to have an interested family co-trustee and to provide that he is to have no voice in making decisions which concern his own interest as an individual.

well to establish a revocable trust and then make it irrevocable at a later date. There are cases where a revocable trust can be made much more effective by changing it to an irrevocable trust at a time when it can be done with more safety than when the trust was originally established. Changes which have come about in the family's financial position may be the reason for this in many situations.

The tax benefits resulting from the use of trusts as discussed heretofore do not follow from trusts which may be revoked by the grantor. It is more accurate to say that tax advantages do not accrue to the grantor with respect to his income taxes or to the grantor's estate in relieving it of estate taxes. If the trust is set up to continue and does continue after the grantor's death when it becomes irrevocable, thereafter the beneficiaries and remaindermen can reap advantages of the character previously indicated.

It is unnecessary to give much space to the general usefulness of either revocable or irrevocable trusts as a device of convenience for the administration and investment of property and for the collection and distribution of the income. The placing of legal title over different assets of almost any category into one active and easily located set of hands can give the grantor a peace of mind and freedom for retirement or travel which he could not afford if he continued to be the one who must take all action and make all decisions.

The revocable-trust arrangement gives the advantages [30] of agency agreements without a great many of the disadvantages and limitations [31] of the agency relationship.

One of the most useful general purposes a revocable trust can perform is that of taking the place of the grantor's estate at death, with respect to the trust assets. The grantor can direct the terms for the trust after his death as he can for his executors and trustees under his will. The assets in the trust will not be subjected to the delay and interruption encountered by estate assets during the probate of the will and the administration of the estate. They will not be subjected to all the usual expenses of estate administration.[32]

There are also many special problems which can often be met by the use of revocable trusts. One of them is the problem of unified control which may be desirable both during the lifetime and after the death of grantors. This situation may exist when several different family groups together own stock which constitutes control of an enterprise managed by one or more individuals

30. The services of an agent are obtained and the grantor can at all times control the trustee and terminate the trust.

31. An agency is automatically revoked at the principal's death. It is often necessary to hold everything in suspense if the principal can not be proved to be living. This has been a particularly difficult complication in time of war. A trustee can carry on even if death has in fact occurred if the instrument so provides.

32. Whether or not the trust will have to bear a portion of death taxes will depend on the directions contained in the will and trust agreement, and, if it is not to bear them, whether sufficient assets are left in the estate to pay the taxes.

within the several groups. These management individuals may be named as the original trustees of all the several trusts of stock established by the participating stockholders. When a grantor dies, his trust can continue without a dilution of control which might otherwise result from distributions among many legatees, some of whom may be minors. Of course trustees will also die, but an arrangement must be worked out for the succession of trustees as well as for the succession of managers. This may be thought to be a very loose arrangement during the grantors' lifetimes if they have the right to revoke. Perhaps it is, but in practice it will often be found to provide a "formality" which makes it hold together. And generally the concern over control is not so much during lifetime as after death. In lieu of this arrangement, "statutory" voting trusts are sometimes used, but they frequently have a time limit placed on them by law which defeats the long-term planning beyond death which may be the principal objective.

One last word on the use of trusts. The marital-deduction feature of the Revenue Act of 1948 has not outmoded the use of trusts for property given to a surviving spouse. If the situation is such that a surviving wife (or husband) would be better served by placing property in trust than by giving it to her outright, the trust should still be used. However, there will be a new tendency to discard the trust device in some instances just because it may not be of any additional assistance in saving estate taxes as to the "marital deduction portion" of an estate or gift. This may turn out to be an unfortunate result of the marital deduction. It should be remembered that the use of the marital deduction does not require that the spouse be given the right to take or dissipate principal during lifetime. It is enough if the right is given to dispose of it by will. To avoid giving a surviving wife lifetime control over principal, in many cases for her own protection and the protection of the children,[33] the trust can be of use both actually and psychologically in guarding the assets, whereas outright transfers would not have such protection.

VI. USE OF THE MARITAL DEDUCTION

Whether or not the marital-deduction feature of the federal estate and gift tax laws should be used in a particular case requires the consideration of many things. Though this applies primarily to the use of the deduction in passing property at death, much the same consideration should be given if there is to be a gift between husbands and wives during life; and, of course, the opportunity to treat gifts to third persons as if made jointly by husbands and wives is a new tool to be used whenever the situation is right for it.

Many estates will qualify for part or all of the deduction if the owners die with a spouse surviving and make no changes in their present testamentary

33. Sometimes particularly if she should re-marry.

plans. A married person who dies without a will, or with a will which leaves all or part of the estate outright to the surviving spouse, will automatically provide the deduction wholly or partly for his or her estate. The federal tax on at least the portion qualifying for the deduction will be shifted from the estate of the one first dying to the estate of the survivor.[34] This may or may not be advisable.

There are other present testamentary plans which will require change to obtain application of the marital deduction as to any part of the estate. Other plans will need changing to make the deduction apply as to the correct portion of the estate. A great many present wills have been carefully planned heretofore to avoid leaving capital subject to the control of the surviving spouse solely to avoid double estate taxation—at the death of both husband and wife. All present plans, or the absence of plans, need to be re-examined in the case of married persons whose estates, jointly or severally, are in excess of the $60,000 federal estate tax exemption. What was planned before is probably not good taxwise now, since the tax tools for estate planning have undergone a major revision with the enactment of the Revenue Act of 1948.

There will be many cases where the marital deduction should be used even though its use increases total taxes following the death of both spouses. The reduction of estate shrinkage at the death of the spouse first dying will give the survivor the use of that much more property for his or her surviving lifetime. This may be much more important than some small saving for the benefit of persons less dependent on the decedent than his or her own surviving spouse. It also reduces the shock on family funds brought about by the sudden demand for a great amount of cash tax money all at one time.

On the other hand, there may be many reasons why the marital deduction should not be utilized despite the fact that its use would produce large tax savings. This is certainly true when it can be used only at the sacrifice of other well considered programs which take precedence over the saving of taxes. Little comment is required on the fact that many situations are not best served by placing complete control over family capital in the hands of a widow who may be unprepared to exercise it. To make an extreme illustration, consider the case of two brothers and a sister who each own one-third of a going family business inherited from their father. The sons run the business and it constitutes by far the greater part of all their estates. Suppose one son has several children and he has recently married a second time. His second wife is a divorcee or widow who has children of her previous marriage and she is an "easy mark" when her children go to her for money. It might be a serious mistake for this husband to leave a will giving his wife at least half of his interest in the company in such manner that she can dispose of it freely either

34. Unless given away, used up or lost.

during lifetime or at death. On the other hand, the sister may have a family situation wherein giving her husband (also an officer of the company) control over the capital of her estate is a good thing for her to do.

If the problem is one calling for minimum taxes after both deaths without concern over the manner of leaving property for the spouse, the solution is largely one of arithmetic applied to both their estates. Even the arithmetic, however, may not answer the question of whether or not a reduced tax at the first death is more important than the total tax effect following both deaths.

The problem of drafting wills properly to adopt the marital deduction feature for an estate is a troublesome one. If the objective is to supply the surviving spouse with the maximum allowable deduction, and no more, it is normally best to split the estate into separate parts to permit the non-marital portion to pass free of tax at the survivor's death. The portion constituting the marital deduction which goes to or for the spouse should be freed from the payment of any portion of estate and inheritance taxes, federal and state. The tax clause takes on even new importance.

Providing for a spouse to receive "one-half of my estate" may be unsatisfactory except in a very simple case. The maximum allowable deduction is one-half of the adjusted gross taxable estate, and the spouse must receive it to make it qualify. To arrive at that exact sum it is necessary in many situations to await the testator's death and the assessment of death taxes. Giving a spouse one-half of the estate passing by will may result in her receiving more or less than the intended portion of the taxable estate. If this is done, she will receive less than the maximum deduction if insurance is a part of the taxable estate but payable to the children, for instance, without passing through the estate. If the insurance is payable to the wife outright, such insurance plus one-half of the probate estate would total more than half the adjusted gross taxable estate. One way to handle this problem is for the will to provide the fund in accordance with a calculation to be made by the executor, who is first to arrive at the figure of one-half the adjusted gross taxable estate, and then deduct therefrom any amounts going to the spouse "outside" the estate [35] which also qualify for the deduction. As a further refinement, the will might request the executors to advise the spouse of her rights of disclaimer [36] as to any part or all of this bequest. This will permit proper ad-

35. Or by other bequests in the will.

36. Section 812(e) (4) specifically refers to disclaimers. It is believed that a disclaimer, if made promptly with the spouse taking no interest or benefit in the property disclaimed even for a moment, would not constitute a taxable gift—but the estate tax would then apply in the decedent's estate. Normally it might be better for the wife to take the bequest and then make a taxable gift. The request in the will, as indicated, might help to bring the possibilities to the attention of the spouse. The problem arising on disclaimers by persons other than spouses are dealt with in Note, *Will Renunciation of a Bequest or Failure to Claim a Statutory Share Constitute a Taxable Gift?* 2 VAND. L. REV. 287 (1949).

justment of her assets to those of the decedent to obtain the maximum overall benefits.

The "formula method" of the preceding paragraph is not always desirable. Giving the spouse a stated amount will often be better procedure if predictability is more important than providing for the exact maximum deduction. However, if the spouse is to receive income from all or the greater part of the estate, the advantage of exact apportionment might as well be obtained if the case calls for it.

State Inheritance and Estate Taxes and the Marital Deduction

The states have not as yet followed the Federal Government in providing the marital deduction in their estate and inheritance tax statutes. The effect of the federal deduction has considerable impact on the taxes of some states and not very much on the taxes of other states. For example, the New York estate tax [37] will be about the same whether a decedent's death takes place before or after the Revenue Act of 1948 and whether or not the marital deduction is allowed in assessing the federal tax. In the states having a relatively low "inheritance tax" plus an "additional estate tax" to absorb the full amount of the "80% credit," a reduction in federal taxes from the use of the marital deduction may also result in reducing state taxes at death.

Pennsylvania has an inheritance tax plus the "80% credit absorbing additional estate tax," but the inheritance tax is at a rate of only 2% which does not advance at progressive rates for bequests to the family class of receivers. On large estates the federal tax is the controlling figure [38] when the inheritance tax is less than the 80% credit. Tennessee, like many other states having an inheritance tax at progressive rates upward plus the "additional estate tax," will probably fall somewhere between the New York and Pennsylvania situations, depending largely on the size of the estate and the way in which it is left by the decedent.

There are some states where we might expect to see state taxes increased as a result of the federal marital deduction. This is where the state allows the federal tax as a deduction in calculating the local inheritance tax.[39] Some

37. New York does not have an "inheritance tax." Its "estate tax" normally exceeds the "80% federal credit" and a reduction in federal taxes by the marital deduction will not ordinarily reduce the state tax on a large estate. To illustrate by large figures, on a $10,000,000 estate the full marital deduction reduces the federal tax about 59%. With the New York tax remaining unchanged, the combined taxes are reduced only 46½% at the death of the first spouse to die.

38. When the estate is large, the inheritance tax on twice the amount at which the federal tax (after the marital deduction) is calculated will still be less than the 80% credit. Thus the state tax is reduced almost as if Pennsylvania had adopted the marital deduction.

39. Tennessee, New York and Pennsylvania are among the states which do not permit this deduction. Illinois, Wisconsin and quite a large number of other states do allow it before arriving at the amount subject to inheritance taxes.

other states[40] gear their death taxes directly and solely to the federal "80% credit." It would appear, therefore, that their tax systems automatically fall in line with the marital deduction.

It may be, of course, that the states will pass new legislation to take account of this situation. On one hand they may wish to stop a reduction in revenue, and on the other hand they may wish to adopt the principle of the marital deduction.

The problem of state taxes comes in for consideration in all cases where decision is to be made on the use of the marital-deduction device. By leaving property to qualify for the deduction, the situation is set up in which such property will be subject to death taxes, both state[41] and federal, when the survivor dies. Since no deduction is allowed for state taxes when the first spouse dies, there will often be double state taxes[42] which act as an offset to the reduced federal taxes.

VII. Wills and Trust Agreements

It is not within the scope of this paper to write extensively on the subject of the drafting of wills and trust agreements. The estate planner is concerned with having his client's programs correctly formulated, but it is not always necessary for the one doing the planning to be the draftsman. A great many law offices have this work done by men who make a specialty of drafting. If this procedure is followed, it will work well only if there is a full understanding between the planner and the draftsman.

Some mention of the problems of providing appropriate wills and trusts has been made heretofore. However, each situation calls for its own treatment. Nothing more is added here except a brief listing of some frequently encountered misfortunes in the details of drafting, as follows:

(1) The absence of tax clauses or the inclusion of general clauses not properly suited to the taxable estate as a whole.

(2) Lack of adequate attention given to the handling of residence and tangible personal property.

(3) Thoughtless designation of fiduciaries—the naming of too many to act concurrently and then without suitable provision for successors.

(4) Too general and lengthy clauses of administration and investment detail[43] while the more essential planning clauses are skipped over lightly.

(5) Lack of understanding of the effect of the inclusion or omission of certain clauses on the practical administration of the estate and trusts.

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40. Such as Florida, Georgia and Arkansas.
41. Not in all cases.
42. This might be avoided by the use of trusts if the marital deduction is not used.
43. Often taken from office forms without regard to the special treatment required in a particular case.

(6) The leaving of matters open to the cost and delay of later interpretation.

(7) A lack of appreciation of the opportunities and benefits obtainable from flexibility in long continuing trusts.[44]

(8) An apparent failure to keep "up to date" with regard to new opportunities and dangers and how to deal with them.

A technically "beautiful" will or trust agreement can be more than worthless if it does not "fit the wearer." It is well to be conscious of the fact always that it is wasteful and dangerous to think up a lot of good plans which do not quite work because they are not put into legal documents exactly as they should be written.

If the estate planner is a "specialist" called in to work with the client's general attorney, the two should work together closely and the latter, or his office, may be the one to prepare the legal documents. All wills and trust agreements must be prepared by an attorney, of course, and it is inexcusable in most states for anyone who is not an attorney [45] to draw any legal documents whatsoever for a client regardless of his qualifications as an estate planner in all other respects.

VIII. Conclusion

Good planning of any worth-while program is necessary and it is a source of satisfaction to everyone concerned in it. It normally seeks to cope with inevitable obstacles and to remove the ones which are not inevitable or necessary. The necessity for taxation generally can not be removed. A great amount of energy, with some talent, is burned up in what we call estate planning. It sometimes seems that the big part estate taxation plays in estate planning is an element which has been made "unnecessarily necessary."

It might be interesting if someone made a comprehensive study to determine if the present system of very high estate taxation is sound, purely as a machine for the production of government revenue. We rely most heavily on income taxes.[46] It would seem that levies on capital in the form of estate taxes must cut into income and capital-gains tax sources to some extent. The splitting up of large income-earning private capital [47] must do something of that nature.

Irrespective of whether or not this capital levy is sound as a revenue producer for public purposes or as a means of re-distributing private capital funds,

44. Such as discretionary distributions, powers of appointment, broad administration and investment authority, etc.
45. Including anyone—whether or not an attorney—who is acting on behalf of a corporation or non-attorney partnership or association.
46. This is shown by figures of the Bureau of the Census Report on "Government Revenue in 1947."
47. And the change in cost basis at death.

it may he that assessing the levy by the present estate tax system is not the best way to exact it. It certainly hits at the family concerned in the worst manner and at the most unfortunate time when the one dying has been the breadwinner and director of the family economy.

Why should the occurrence of death be the event which makes the capital levy operative? Why should the capital of a family of short-lived persons be hit sooner and oftener over a period of time than the capital of longer-living individuals? Why, even, should the fact that someone happens to die at a time of deflated values rather than at a time of inflated values make such a difference? There does not seem to be much orderliness in the device.

A change to a system of mandatory capital levies assessed periodically during life would probably not be popular or easy. But perhaps it would be popular and fairly easy to go part of the way and permit the anticipation and pre-payment of the eventual assessment according to an orderly program undertaken while the family "director" is still living. At present he can do this to some extent by making gifts and paying a gift tax. Would it not remove a great many of our present complications with respect to individual taxes if he could make the pre-payment without making the gift or without resorting to other plans dictated by the necessity for softening the great economic shock at death?

If it were made possible for a property owner to make the pre-payment of estate tax without having the amount set aside itself subject to tax (as is the case with the gift tax) we might find funds for this purpose taking a place high up in the family budget—perhaps somewhere near insurance premiums and other savings. It could conceivably increase tax revenues if some of the pressure is taken off—pressure which leads people to reduce estate taxes by plans which often reduce other taxes as well.