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Estate Planning Session

H. Brice Graves

W. Gibson Harris

Toy D. Savage Jr.

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Estate Planning Session
December 8, 1962, 2:30 P M.

PANELISTS:

- H. Brice Graves — Hunton, Williams, Gay, Powell and
Gibson, Richmond, Virginia
- W. Gibson Harris — Battle, Neal, Harris, Minor and
Williams, Richmond, Virginia
- Toy D. Savage, Jr. — Willcox, Cooke, Savage and
Lawrence, Nortfolk, Virginia
- Moderator: Joseph Curtis, Acting Dean, Marshall-Wythe
School of Law, College of William and Mary

MR. CURTIS:

In the event that you did not bring with you the printed sheets you received together with the announcement of this Conference, the sheets you have on the table in front of you are mimeographed copies for your use. (Reproduced on facing page). Using the circumstances set forth on this page as they may by way of illustration, the panel will consider the possibilities of reducing the tax costs in accomplishing the testator's objectives and also arranging the assets in the most appropriate form for the intended dispositions of them. First, I would like to comment briefly that if you should find that the nature of these assets or the values attributed to them do not quite square with your sense of logic, please do not blame the members of the panel as this was thrust upon them and they graciously accepted it for whatever it purports to be.

Each of the three members of the panel is a renowned author and lecturer in the field of tax law. On my far right, Mr. H. Brice Graves of the Richmond law firm of Hunton, Williams, Gay, Powell and Gibson. Mr. Graves was a member of the 1961 Virginia State Chamber's Tax Study Committee, and is a member of the American Law Institute. In the center is Mr. Toy D. Savage, Jr., a member of the Norfolk law firm of Willcox, Cooke, Savage and Lawrence. Mr. Savage is a member of the House of Delegates of the General Assembly of Virginia. Immediately on my right, Mr. W. Gibson Harris, of the Richmond law firm of Battle, Neal, Harris, Minor and Williams. Mr. Harris has served as Chairman of the Committee on Taxation of the Virginia State Bar, and is a member of the Section on Taxation of the American Bar Association. I will not further extoll these gentlemen's virtues and qualifications, many more of which you will find set forth in the announcement under Program Participants.

Before turning this matter over to the panel, it has been thought appropriate that some of the inadequacies and deficiencies in the present status quo of the estate be brought to your attention at this initial stage. I will try to do this as briefly as I can.

First and perhaps foremost in that respect is the great, heavy tax

burden that will be incurred by both H's estate and W's estate if H should suddenly die with his present will, and W should survive him by some ten years. All of the assets that you find listed on your sheet would be included in his gross estate at full values. Not only those assets which may pass through his executor, but as well as those assets which are jointly held with W, excepting such as it could be shown that W had paid something of her own in the acquisition of it, possibly so for \$10,000 of the \$80,000, item 8, by reason of its being stock dividends and if we assume that the dividends are attributable to earnings of the corporation after the acquisition of these stocks. The policy of insurance, item 10, would be included irrespective of any state exemptions that may apply, at least assuming that H owns these policies. And item 11, depending upon the date of creation of the power, would also be included in his gross estate.

TAX SITUATION UNDER PRESENT WILLS

H's ESTATE		W's ESTATE	Giving Her Only \$262,000
\$545,000	Gross Estate	\$480,000	\$262,000
7,500	Indebtedness		
15,000	Admin. Expenses	15,000	12,000
261,250	Marital Deduction		
60,000	Specific exemption	60,000	60,000
<hr/>		<hr/>	<hr/>
343,750	Total deductions	75,000	72,000
<hr/>		<hr/>	<hr/>
201,250	Net taxable estate	405,000	190,000
<hr/>		<hr/>	<hr/>
48,300	Fed. tax	107,500	45,300
11,700	State inheritance tax	7,500	3,000
<hr/>		<hr/>	<hr/>
60,000	Total taxes	115,000	48,300
<hr/>		<hr/>	<hr/>
TOTAL TAX BURDEN		175,000	

Therefore, we start out with a gross estate of \$545,000, (see above) that is, the \$540,000 listed on your sheet, plus the \$15,000 excess of the value of the item 3 residence over the equity of \$45,000, and minus the \$10,000 I just referred to of item 8, assuming that W's contribution could probably be shown.

The deductions against the estate include \$7500, which represents H's share of liability on the mortgage of \$15,000, assuming, of course, that he dies before the mortgage is paid off to any extent; and also pulling out of thin air, perhaps, an approximation of \$15,000 for administration expenses, which if anything is probably low for an estate of this size; the \$60,000 specific exemption that all estates are entitled to without qualification; and a marital deduction of \$261,250 because we have said that under his present will he is leaving all of his properties to his wife — and

that marital deduction is limited to one-half of what is called the adjusted gross estate, the gross estate of \$545,000 less the \$22,500 deduction for administration expenses and claims, and that divided by two would be the maximum marital deduction that this estate could receive, \$261,250. A total of deductions then of \$343,750, leaving a net taxable estate of \$201,250. I won't bother you with how the computation was made mathematically but the total federal tax on that is \$48,300, and the State inheritance tax some place in the vicinity of \$11,700, or a total tax liability on H's estate of \$60,000.

You may note that H's estate does get the benefit of the full marital deduction — and without inter-vivos gifts that is the best tax-wise that you can hope for there. In W's estate, however, there is the \$480,000 of this \$540,000 worth that she received from H less the \$60,000 taxes paid, and this is on the assumption that there is no fluctuation in the value of the properties that she receives from H over the time she holds them. If anything, as a matter of fact, it probably would be much more than what we have given her here. The \$480,000 gross, and we will assume the mortgage has been fully paid off by W's death approximately ten years later, less the administration expenses of somewhat the same amount of \$15,000, and now, of course, W gets no marital deduction. And if she had died ten years after H there will be no credit for her estate for the amount of properties received from H for property previously taxed credit. There would of course, be the \$60,000 specific exemption, and total deductions then of \$75,000, leaving a net estate of \$405,000. The federal tax thereon, and now you may see the difference between H's estate tax and W's estate tax would be about \$107,500, inheritance tax of about \$7500, and total taxes upon W's death of \$115,000. This in addition to the tax on H's estate of \$60,000 makes a total tax burden on both of these estates before the properties pass down to the children and grandchildren of \$175,000.

Now this tax burden can obviously be reduced if W did not have as much of an estate as she does have, that is, if she had not received all of H's property. Perhaps H might give her only so much as would qualify for the maximum marital deduction of \$261,250. That does not necessarily deny W the benefits of the balance of the property, as you will hear from the panelists later that W could well continue to enjoy the income from this balance of \$261,250, without the properties giving rise to that income having to be included in her gross estate. If W were given just \$261,250 and the balance set up whereby W might be able to enjoy the income from it if needed, this will reduce W's estate down to \$262,000. The administration expenses are also reduced somewhat by reason of the lesser estate, perhaps to \$12,000, and the specific exemption of \$60,000, giving total deductions of \$72,000, and now a net taxable estate of \$190,000. Total federal tax, \$45,300, State tax, \$3,000, total taxes \$48,300; this does not in any way change the tax liability on H's estate of \$60,000 so the total tax liability from H's and W's estate under these circumstances would be \$108,000. I do not pose this as the answer or solution to this problem, which, of course, the panel will go into, but as being just one obvious method of immediately reducing these taxes

by not giving W more than is necessary in order to give H the maximum marital deduction for his estate.

Before the panel engages in any joint discussion, each of the panel members in turn will discuss some of the considerations involved with respect to the different types of assets which are shown on your sheet. We will be hearing from each of the members of the panel frequently during the course of this session and I will therefore ask that you withhold applause until the session is ended. The first speaker will be Mr. Graves who will talk on the business assets and the considerations involved in dealing with them.

MR. GRAVES:

Ladies and gentlemen, before talking about the business assets, there are two preliminary comments I would like particularly to make. The first deals with the major objectives in any estate plan, and I will suggest these so that if you keep them in mind and apply them when you work out any estate plan, the plan is likely to be a satisfactory one. The major objectives as I see it are reasonable maximum of liquidity, reasonable maximum of flexibility and, in a proper case, maintenance of working capacity. The second area that we should examine before looking specifically at the business assets is the whole estate. We should make an estimate of the total liquid funds needed for tax and other purposes and try to determine where those funds will come from. In trying to anticipate what the panel's plan will be, I am assuming that the \$100,000 in item 11 will not be available because one way or another that will have been given away before the death of H. Looking at the other liquid assets we find that most of them are in the joint names of H and W. That might or might not be changed, but with that circumstance, it seems to me that we will have to look to the business interests to raise at least a part, if not the major part, of the necessary funds.

Now business no. 1 has a value of \$175,000, and presently is returning an income of \$25,000. That is a high rate of return. We know, of course, that a part of that return is due to the services of H and probably will not be that high after his death. Nevertheless, the return is so attractive that it seems to me that we would want to preserve that business interest. So this would leave business no. 2 as what we would hope to be a source of funds.

Before discussing how we would try to realize on the \$50,000 value of business no. 2, I will just comment in passing that H could not qualify with respect to business no. 2 under the Self-Employed Individual's Retirement Act of 1962 for the reason that he does not furnish personal services and therefore does not have any earned income from that business. We could assume, I suppose, that any figure here representing fair market value presupposes a ready market for the the interest, but as a practical matter a partnership interest of this kind has a very limited market for obvious reasons; it seems clear that the best market would be to sell the interest to the other partner. So we would suggest the possibility of a contract between H and the other partner for the purchase of that interest

on the death of H. There are a number of ways in which the contract could define the purchase price. One is to capitalize earnings over a period of past years; one disadvantage of this approach is that if we are in an inflationary period (and I think we still are) the value of a dollar of earnings in past years is more than that of the current year. Thus it would be well to express income of past years in terms of the current value of the dollar. We should note that book value of the assets would not be satisfactory, particularly since there is a good will element involved. Possibly the best way to determine price would be to have a contract that actually fixes the price, in this case, \$50,000, if we are careful to adjust the price at least annually and preferably every six months. In other words, in any contract to purchase a business interest at a fixed amount, the amount is likely to get out of date rather quickly, so that should be kept in mind and adjustments should be made at regular intervals.

Now, I think we may also assume that the partner in business no. 2 probably does not have \$50,000 of liquid capital available to make the purchase. His income from that business is the \$5,000 salary, and \$4,000 representing his half of the additional earnings. There are two possibilities here. One would be for the other partner to take out insurance on the life of H, if H is insurable; the second possibility would be to have the contract price payable in installments. The latter would not serve our purposes for two reasons. First, we want to look to this business interest to raise a substantial amount of cash; and secondly, again if we consider what I think is the probability of continued inflation, dollar obligations will become less valuable in the future. So much for business no. 2.

We return to a consideration of business no. 1, and we note that there is a little difference here from many family businesses in that there are no children in the picture who will want to be employed in this business. Thus my third objective stated in the beginning, that is the preservation of working capacity, is not of prime importance in this particular case but in many cases it is. From the standpoint of taxes, I think that we may conclude that there would really be no advantage in incorporating business no. 1. But there are so many other advantages that might result from incorporation that we should consider this very carefully. In the first place, if we incorporate the business, we could eliminate any corporate income tax, at least federal income tax, by making the election under sub-chapter S. And then H would be in exactly the same position tax-wise as he was before incorporation. Note here, however, that if any part of the stock of this corporation later is held by a trust under the will of H that would eliminate the sub-chapter S election.

Incorporation would lead to a number of fringe benefits such as the possibility of a pension or profit-sharing plan, group life insurance, medical, health and accident insurance. Again, I would like to emphasize the small value to H as a sole proprietor under the 1962 Self-Employed Individual's Retirement Act. H is earning \$25,000 a year out of his proprietorship, but the maximum contributions under the Self-Employed Individual's Retirement Act is based on earned income, and if capital is a material income producing factor, as it is here, earned income is 30% of total income.

That means that H has for that purpose \$7,500 of earned income, and in a plan that included him he could contribute \$750 a year, that is, 10% of which only \$375 would be deductible. So you see this new Act is not too important to proprietors in businesses where capital is a material income producing factor.

In this case we don't have a serious problem of maintaining control, but again in many other cases maintaining control of a family business is of great importance and we might just consider briefly some means of attaining that objective. One way would be to form a corporation for holding business no. 1 and have it capitalized largely in preferred stock, non-voting stock which would leave a relatively small value for the common stock. The common stock would represent control and therefore H could make gifts of the common stock at a relatively low gift tax value. I will just mention in passing again that in an incorporation of business no. 1, for preferred and common stock, the preferred stock would not be section 306 stock. Another advantage of incorporating business no. 1 is that the incorporation could grant to key employees restricted stock options that would tend to retain them in the business. It would give them an interest in the business and after the death of H it would be very important for his beneficiaries to have capable people in the picture running the business.

Again we have retirement possibilities in the case of a corporation that are not present in the case of a proprietorship. For example, the corporation could enter into an employment agreement with H to the effect that after his retirement he would be paid, say, \$10,000, a year for life with ten annual payments guaranteed. If he dies before receiving the guaranteed payments, his beneficiaries would be entitled to receive them. There are other possibilities of deferred compensation, and an interesting one to me is a contract under which the corporation agrees to purchase for its own account a stated dollar amount of, say mutual shares each year during which H works for the corporation. At his retirement or death, the corporation would agree to start paying out shares of stock to H or to his beneficiaries over the same number of months that purchases were made during employment. Finally, I will just mention that if we have a corporation, the corporation might make a voluntary death benefit payment to the widow of H in the amount of \$5,000 which would not be taxable as income to the widow, would be deductible to the corporation, and would not be includible in the gross estate of H.

One other possibility of maintaining control is to work through charities. Now you all know of the case of Henry Ford — he left to charity a very large equity, but a non-voting equity, in the Ford Motor Company in order to reduce his taxable estate to manageable proportions. Another possibility on a smaller scale would be to have the corporation issue preferred stock and have H borrow to the limit on the preferred stock, make a gift to charity of the money with an agreement that at the death of H the charity would purchase the preferred stock.

It often happens that a small business has an opportunity to be merged with a large business in return for a listed stock. That certainly is desirable from a standpoint of liquidity; it is not as flexible as having complete control of a small corporation and I suggest again that if working

capacity is important in the picture that might be determinative against such a merger in favor of retaining complete control and complete flexibility.

MR. CURTIS:

We thought it advisable to take up the estate as a whole before entering into joint discussion, and Mr. Savage will now discuss the joint interests, Items 3 through 9.

MR. SAVAGE:

I have been assigned the task of discussing the handling of the assets owned by the husband in this case jointly with his wife, with the right of survivorship.

It is the conclusion of the large majority of the persons who have carefully considered the matter that the joint ownership of property is undesirable in most situations where death taxes are an important factor. It would not seem to serve any valid purpose here to review the many considerations which have gone into the conclusion that has been reached. Joint ownership does have certain advantages which may outweigh the disadvantages in the small estate where death taxes do not constitute a serious problem. In addition, the family residence may constitute a valid exception to the general rule.

Most lawyers have had numerous experiences in which the conversation runs something like this.

Client: I think it's about time we got around to drawing my will.

Lawyer: What have you got in mind for your will?

Client: Well, my wife is a fine lady, but she is a little bit flighty and can't even keep her own bank balance straight. I think anything for her would have to go into a trust.

Lawyer: (Makes a note.)

Client: I have one son in the business with me and I would like to see to it that he gets control of that. My other boy, well, I'm having a time with him. I may have to tie up everything he has in a spendthrift trust. My daughter is married to a ne'er-do-well and I think perhaps you had better pass everything for her over to the grandchildren.

Lawyer: That is fine, sir, but what do you think you have in the way of value among your assets at this time?

Client: Well, I don't know exactly, but this morning I estimated that it must be somewhere between \$450,000 and \$500,000.

Lawyer: Well, now let's see how that is broken down? Do you own the house in which you live?

Client: Yes, I do.

Lawyer: Well, how do you have the title to that?

Client: Well, that is in my name, jointly with my wife.

Lawyer: What about the securities that you own?

Client: I think they are held jointly with my wife too.

Lawyer: The stock in your company?

Client: Well, recently we had a little recapitalization in the company and I just took the stock, like everything else, jointly with my wife.

It turns out that everything the client owns is owned jointly with his wife, with right of survivorship. This constitutes the height of frustration for the estate planner. The question becomes what can be done about it at this stage of the game.

So far as I am aware, there are no categorical answers to this most practical and common problem. The rules of the tax law are very straightforward, but their application to the individual situation is often quite difficult.

The general rule is that a gift is made when a joint ownership is created. When title to property is taken jointly, with the right of survivorship, there is a taxable event. If a husband purchases stock and takes title to it jointly with his wife, he has made a gift then and there. This is well recognized. To the contrary, the termination of such a joint tenancy does not constitute a taxable event so long as each person takes his share of the property at that time.

There are one large and two small exceptions to the general rule. Since 1954, the taking of title to real estate jointly by husband and wife does not constitute a taxable event unless the taxpayers so elect by filing a gift tax return before the time for filing has passed. If such election is not made to treat the transaction as a taxable gift at that time, there is no tax when the tenancy is terminated so long as each co-tenant receives that proportion of the consideration which he furnished. In the example we have for Item 9, the husband provided all of the funds for the purchase of the real estate. If this property were purchased subsequent to January 1, 1954, there will be no tax if the tenancy is terminated if the wife received none of the proceeds or interest in the property. This constitutes the basic exception to the general rule.

There are two other minor exceptions. One of them is a bank account. There is no gift when you make a deposit to a bank account in joint names. When the husband makes a deposit to a joint account with his wife, the gift occurs only when the wife makes a withdrawal of money from the account for which she does not have to account to her husband.

The second minor exception relates to U. S. Savings Bonds. There is no gift upon the purchase of bonds in joint names. The gift occurs if a person who did not contribute to the purchase price takes down part of the money.

The rules of law of the estate tax are as clear as those under the gift tax. The entire value of jointly held property is included in the gross estate of the first dying co-tenant unless the Executor can prove that the survivor furnished all or part of the consideration. Since 1954, to the extent that jointly owned property is included in the decedent's gross estate, the survivor will obtain a new cost basis for the property. I am sure that all of you must know the practical difficulties of trying to pin down just what contribution was made by the surviving co-tenant.

With the background of these basic rules of tax law, we turn back to the practical problem presented by our client, who owns everything jointly with his wife, with the right of survivorship. He can't set up a trust fund for his spendthrift son or his flighty wife. He can't make provision for the hardworking son in the business with him. What are we going to do? The first thing that must be done is to examine the facts which led up to the taking of each of the assets in joint names with his wife. It is interesting to note that title to personal property vests according to the law of the state in which you acquire the property. If you buy a car in Massachusetts and take title to it there, how that property is held is determined by the law of Massachusetts. Although it is not clear under Virginia law, it may well be that the title to securities is dependent upon the law of the state of the broker's office in which title to the securities was delivered to the joint tenants. The laws of the states vary as to the effect of taking title jointly. In many states, you cannot have a tenancy by the entirety in personal property. In other states, the husband is entitled to all of the income in the tenants by the entirety situation. As a result of this, it may be quite important to determine just what the legal situation is in considering jointly owned property.

Another important step is to document the exact amount of contributions which have been made by each of the co-tenants. This can be much more easily done when both the husband and the wife are present. An affidavit by them in this regard will be of some help. Frequently, however, the lawyer or accountant will find that the situation has become so confused that it is impossible to really separate the contributions of the co-tenants accurately. Where there are joint bank accounts and the reinvestment of interest and dividends, this is often the case.

There is another line of approach which should be explored quite carefully. It is the question of whether or not any gift was really made when the title to property was taken in joint names, with the right of survivorship. Two recent Virginia cases have held that the question of whether a stock, which is registered in the names of husband and wife, as joint tenants, with the right of survivorship, and not as tenants in common, is actually held that way is a question of intent. It is a question of the husband's intent, if he were the person making the purchase. A great many of the people with whom I have discussed such a matter had no real intent to make a present gift to their wife when they took stock in the joint names. It was taken in this manner simply because the broker with whom they were dealing put it that way — frequently, without even asking their instructions. A careful inquiry will frequently reveal that persons who have property registered jointly, with the right of survivorship, never really intended to make any gift. Under Virginia law, such registration does not, in that case, constitute a gift and results in some form of trust for the benefit of the husband, if he were the one providing the purchase price, and the husband would be entitled to demand that the property be re-registered in his own name.

After the necessary investigation has been made, a number of alternative courses present themselves. One of these is to leave matters just as they are found. I suggest that, in a great majority of the cases, that is

exactly what happens. The client realizes that he has registered his assets jointly with his wife, that he has not filed any gift tax returns and that he can't figure out how much he contributed to the purchase and how much his wife contributed. As a matter of human nature, he just never returns to the lawyer's office and things drift along as they were. I am sure this is the experience which many lawyers have had and, when it happens, it is a delicate situation. It seems to me that it would be to the client's best interest to impress upon him more strongly the dangers lurking in the existing situation and the difficulties which his survivors are going to have in straightening out the situation. It is in order to impress upon him the fact that he cannot set up the contemplated trust for his spendthrift son to keep him from procrastinating and end up in doing nothing. He might be advised that his wife will end up with all of his estate, with no strings attached, and that she might squander it all. In the alternative, there will be a substantial additional death tax to pay if she survives him. With these things in mind, the client might be more willing to face up to the current problems and to consider one of the other alternatives open to him.

One of the alternatives is to divide the property in the proportions to which each of the parties is entitled to it. There is no gift tax if that course is followed. The gift was made when the title was taken in joint names. In a great many cases, with a \$6,000 annual exclusion, there was no taxable gift at that time. If such gifts did exist, late returns can be filed for the years in which they were made. I do not know of any instance in which such late gift tax returns have been filed that the Revenue Service has insisted on any penalty for the late filing. I believe that they are glad to have the taxpayers come in and file and very little is said about the returns. After the client has "gotten right with the world," the joint tenancies can be terminated and the property divided between the cotenants, with no tax difficulty, and the client's property is put more nearly in shape for the purpose of carrying out his testamentary intent.

If the attorney is convinced that his client never really intended to make any gift in the first place, he would do well to document, so far as practical, the facts which surround the taking of the title in joint names. The client is entitled to have the property transferred back into the sole name of the person who furnished all of the consideration. When this is done, the earlier transactions are simply reversed to carry out the client's original intention and there should be no taxable transactions. This should not be done, however, except when the situation is reasonably clear.

Another alternative is to transfer the jointly owned property to a third party and terminate the tenancy in that way. This can be done by making a transfer to a trust reserving a life interest in the joint tenants, but as tenants in common, which provides a separate one-half interest in the husband and wife, with a remainder over on the death of the husband or wife to their children or other beneficiaries. In this situation, on the death of the husband, only one-half of the property would be taxed in his estate rather than all of it.

There are other alternatives which can be pursued in particular cases.

For instance, in one case at least, the taxpayer obtained the desired result by placing a mortgage on the property, with both husband and wife as makers of the note. The court held that the liability of the wife on the mortgage constituted a contribution. As a result, only a part of the value of the property was included in the husband's gross estate.

With these general principles in mind, let us attempt to make some plans for the specific example that we have presented to us today. The first item of jointly owned property is the family residence listed as #3, having a value of \$60,000, but subject to a mortgage with an outstanding balance of \$15,000, on which the husband has made all of the payments. Let us assume that the house was purchased in 1952 and that no gift tax return was filed in connection with the transaction. To the extent that the down payment on the house exceeded \$6,000, a gift tax return should have been filed at the time of its purchase, because the 1954 amendment to the law was not then effective. In view of the fact that the mortgage payments were less than \$6,000 per annum, it would not be necessary for subsequent annual gift tax returns to be filed unless other substantial gifts were made by the husband to the wife. A 1952 gift tax return could now be filed and, by use of a small amount of the lifetime exemption, no federal gift tax would be payable, and thereafter, a proportional undivided interest could be conveyed to each the husband and wife, without gift tax consequences. It would also be feasible to convey the entire interest in the residence to the wife and avoid the payment of any gift tax by the use of another part of the lifetime exemption.

In this instance, however, it seems desirable for the surviving widow to receive the family residence outright in any event. It would seem a shame to use any substantial part of the lifetime exemption in connection with this asset and, for this reason, it is suggested that the title to the jointly owned family residence be left as it is, without change.

The next item of jointly owned property is the checking account. As was earlier pointed out, there is no gift when money is deposited to a joint checking account. Ideally, it would be best to terminate the joint account and make a new account just in the husband's name if he is the one who has contributed all of the money to the account. That can be done without any tax problem. It frequently happens, however, that a husband and wife have become so accustomed to handling their affairs through a joint bank account that it would be disagreeable for them to change it. Therefore, and in view of the amount in the account, there is no real practical harm in leaving it as it is.

#6, the savings account, was built up with contributions from both the husband and the wife derived from their dividends and interest on jointly held securities. Even though it would be difficult to trace the exact amount of each person's contributions, as a practical matter, the account could be split up by being divided equally between them, without attack by the Revenue Service, and this course is suggested for the savings account. If you leave the account in joint names and the husband should be the first to die, it might be then quite difficult to carry the burden of proving the amount contributed by the wife because of the occasional with-

drawals. In that event, it is entirely possible that the full amount thereof would end up being included in the husband's gross estate.

The next item of jointly held property is set forth in #8, which consists of \$80,000 worth of jointly owned securities. About \$20,000 of these is attributable to stock dividends which have been received over the years. This item presents the greatest difficulty in dealing with the jointly owned property. It is reasonably obvious that the joint tenancy should be terminated.

It is in the situation of the securities that we have here that the investigation earlier suggested should be carried out. If a gift were really intended by the husband at the time that he purchased the securities, and I would assume that it was, a careful list of the dates, times and amount of purchases should be made. A gift tax return should be filed for any year in which the wife's share of securities purchased exceeded the maximum annual gift tax exclusion. In this case, the annual purchases would have to exceed \$12,000, if made subsequent to 1948, before any gift tax return would have been required. In view of the aggregate amount of securities involved, that is not probable.

After this has been done, the securities should be divided between the husband and wife in the proportions of their present interest therein, which can be computed from mortality tables provided by the Internal Revenue Service. For the purpose of this discussion, we will assume that their interests are equal and that each would receive \$40,000 of these securities.

If this were not done, it is probable that at least \$70,000 of these securities would be includable in the husband's gross estate if he should predecease his wife. This would amount to the entire value of them, except for the \$10,000 of stock dividends which would be considered as having been contributed by the wife.

The last item of jointly held property is the investment real estate, having a value of \$20,000. Here we will assume that the property was purchased subsequent to 1954 and that the husband did not elect to have the purchase taxed as a gift. In reviewing this item with the panel, it has been decided that it would best fit into the estate plan to have it transferred to an *inter vivos* trust. In this situation, however, care must be taken because of the joint ownership. It is important that the property be first transferred, of record, back to the husband. In this case, there would be no gift tax because he would receive from the property the same proportion which he contributed to it, that is, in this case, 100%. On the other hand, if the tenancy were terminated by conveying the property directly to a third person, such as the Trustee of the *inter vivos* trust, there would be a transaction which would have gift tax consequences.

In each estate, the handling of jointly owned property will depend upon its relationship to the other assets of the estate and upon the desires and purposes of the testator. It is difficult to lay down a general rule. Although jointly owned property is difficult to deal with at any time, it is certainly more difficult after death than it is before death. Estate planning is as important in this field as in any other.

MR. CURTIS:

Mr. Harris will speak on the insurance and appointive property, items 10 and 11.

MR. HARRIS:

Good afternoon, ladies and gentlemen. Toy's story about the client coming into his office reminds me of one of the first estate planning seminars of this kind that I ever had the pleasure of participating in. At the end of it, we had developed a schedule such as Mr. Curtis has already given today at the beginning, showing total taxes of \$175,000 as the client's affairs are presently arranged, and then by comparison taxes of \$108,000 under a carefully worked out estate plan. That was fine. But then a young attorney raised the question whether it was all right in this type of work to arrange ahead of time with the client to charge him a percentage of the savings of future tax. I did not undertake to answer that!

Gentlemen, we are to look at items 10 and 11, and since 10 offers more flexibility for planning than 11, let us turn first to 11, which concerns a power of appointment, coupled with a life estate over a trust corpus worth \$100,000, with the property passing on the husband's death to his issue if he does not exercise the power of appointment. The Federal tax consequences of this arrangement, as we all know, really depend on whether the power is of the type referred to as a pre-existing power. A pre-existing power is one created by a deed which took effect prior to October 22, 1942, or by the will of a testator who dies before that date, or by a will which was merely executed before that date if the testator subsequently died before July 1, 1949. One just has to remember those exact dates. If a power of appointment is pre-existing under this definition, it is not at all subject to the Federal estate tax unless it is exercised.

In this connection, however, one should beware of exercising a power of appointment inadvertently. §64-67 of the Virginia Code provides: "A devise or bequest shall extend to any real or personal estate, as the case may be, in which the testator has power to appoint as he may think proper and to which it would apply if the estate were his own property, and shall operate as an execution of such power unless a contrary intention shall appear by the will." Accordingly, the language customarily used in the residuary clause of a will would effectively exercise this power. Moreover, since the corpus of this illustrative estate before us is personal property, a specific bequest of "all my personal property" would also exercise the power, unless contrary provisions were then made in the will. Whenever there is a pre-existing power which the testator does not wish to exercise, I recommend that he expressly state in the will that nothing in it is intended or shall operate as an exercise of that power.

A very different rule applies in the case of all general powers (i. e., the post-October 21, 1942 powers). They are subject to Federal estate tax if they are in existence and exercisable at the time of the testator's death, whether he actually exercises them or not. Moreover, the inter vivos release or exercise of a post-1942 power is subject to the Federal gift tax. One exception to the latter rule, however, is that renunciation

within a reasonable time after one learns that he has the power of appointment does not entail a gift tax, nor will the property subject to appointment be included in one's taxable estate if by effective instrument he renounced the power of appointment within a reasonable time after learning that it had been given to him. If one seeks to make a gift of the property subject to appointment, however, as distinguished from a bona fide renunciation, then, of course, the usual contemplation of death rule applies. In the present case, where the client has a life estate as well as a power of appointment, he must give up the life estate as well as a power of appointment if the property is not to be included in his taxable estate under the retained life interest rule. Thus, for tax purposes, if the power of appointment is a post-1942 power, then the person having the power should look upon it as if he actually owned the securities and the underlying assets outright. Under Virginia law, powers of appointment are also taxable by the State, and Virginia law does not recognize the same distinctions as the Federal. Thus, the exercise or relinquishment of a power of appointment is taxable by Virginia whether the power is pre-1942 or subsequent to that. See §58-157 and 58-164 of the Virginia Code. One helpful feature of the Virginia law, however, is that property passing under a power of appointment falls into an entirely separate bracket for the purposes of tax computation, and is not included with other property given directly to the appointee.

As I have already mentioned, the release of a general power of appointment constitutes a gift under the Federal law; although there is no clear and specific authority for doing so, the Virginia Department of Taxation treats the release of a power the same way as the Federal law treats it.

To summarize item 10, if the power is pre-1942, and if the client is satisfied for the property subject to appointment to go to those persons who would receive it in the absence of an exercise of the power (in this case, his issue), then it is best to leave the power alone and to make sure that it is not exercised. If the client does not wish the taker-in-default of appointment to receive the property, then he must exercise the power at his death or by way of gift previous to his death. Either of these approaches will be subject to Federal tax. Since the upper Federal estate tax bracket for either of these estates is around 32%, if the client does not wish his issue to receive \$100,000, then his appointee will receive only about \$68,000 to \$70,000, after allowance for Federal estate tax. The choice, then, is the client's. Of course, in the instant case, where the property would go in default of appointment to the natural objects of the client's bounty, he probably would be satisfied with the non-exercise of the power. If so, adequate precaution should be taken that the residuary clause of his will does not inadvertently exercise this power.

If, on the other hand, the power is post-1942, then it is an adaptable source of funds for estate planning and should be viewed just the same as \$100,000 of liquid securities. In this connection, it may be useful to note that Virginia law permits one to create a trust and then exercise this power in favor of the trust, which allows more flexibility in estate planning than the outright exercise in favor of a named person.

The insurance problem, presented in item 10, is a typical situation. The client has three insurance policies; two little ones, one payable to each of his two children, and a larger one payable to his wife. Not having completely satisfied himself that his wife has the financial ability to manage investments which he has, this client has elected an option for payment of the insurance proceeds to the wife in guaranteed installments, and if she dies before all those installments are paid, the remaining guaranteed payments will go to his son and daughter. Now, what are the tax consequences of this arrangement?

As Mr. Curtis pointed out initially, if this client should die tomorrow then all three of the policies would be taxable in his estate because he owns them. Furthermore, there would be no marital deduction for any one of them. Obviously, there would be no marital deduction for the two policies payable to the children, and there is no marital deduction for the third policy because someone other than the wife (i.e. the son and daughter) would receive part of the proceeds if the wife should subsequently die before all of the guaranteed installments were paid. This possibility that the wife or her estate might not receive the entire benefit from the policy precludes a marital deduction for the policy.

Under Virginia law all three of these policies would be exempt from inheritance tax because they are all payable to named beneficiaries and not to the estate. This result rests not upon any precise language of the Virginia statutes but upon a long standing policy of the Virginia Department of Taxation which I am sure we can all rely on, certainly until there is any public pronouncement to the contrary. I should also point out that since these policies are payable to named beneficiaries, the proceeds will not be subject to probate expenses, such as executor's or trustee's commissions; the money will be paid directly by the insurance companies to the named beneficiaries.

Now what changes in insurance policies might we make to benefit this client's estate plan? Obviously, if the large policy is going to be paid to his wife, it is desirable to have the proceeds pass to her in such a way as to qualify for the marital deduction. The simplest way of obtaining the marital deduction for this policy is to have the insurance company pay \$25,000 to the wife outright, in one lump sum. If she does then survive her husband, the proceeds payable at his death will qualify for the marital deduction. However, one should be quite careful to ascertain that the insurance policy (or any form for the specification of a beneficiary) does not *condition* her right to receive the proceeds upon the filing by her of any forms for proof of claim. The good insurance companies of my acquaintance have now drafted their policy forms and beneficiary forms to avoid this problem. They do require that the beneficiary or executor or someone else supply certain forms for proof of claim, but that is not a condition precedent to the beneficiary's right to get the money.

Insurance can also qualify for the marital deduction even though the wife does not receive a lump sum settlement, if she does have a general power of appointment over the proceeds. Whenever an option other than outright cash settlement is to be used, one must comply with the five conditions stated in Regulations §20.2056(b)-6(a) if the insurance is to

qualify for the marital deduction. The most important requirement is that the wife must have a general power of appointment exercisable in all events to appoint everything either to herself or to her estate.

It is also possible to put into insurance policies or beneficiary forms a presumption of survivorship of the type we are all familiar with in wills. Although not frequently done, this arrangement is accepted by most insurance companies and will be effective. Thus, the insurance policy might provide that in the case of death of both husband and wife in a common disaster, the wife would be presumed to survive for purposes of settlement under the policy. Then the marital deduction would be available for proceeds paid to her estate.

Another important consideration with regard to life insurance is the payment of death taxes on those policies or parts of policies which do not come within the marital deduction. As a general rule, the beneficiary of the policy must pay the tax unless there is an express direction in the will to the contrary. Ordinarily, when one leaves a \$5,000 policy to his son, he wants the son to get \$5,000 and not \$5,000 less a pro rata portion of the estate taxes. Therefore, it is generally desirable to have in the will some language directing the executor to pay all such taxes, for example: "I direct my executor to pay all taxes, state, federal and others, that may be assessed by reason of my death, whether on assets passing under this will or otherwise, including but not limited to the proceeds of life insurance payable to named beneficiaries."

The life insurance policy is, in my opinion, a prime candidate for inter-vivos gift. In order to get the policy out of one's taxable estate, all the incidents of ownership must be transferred, and in addition the donor should be quite sure that the policy is not still pledged as collateral for one of his bank loans. There may, however, be a policy loan on the transferred policy. The distinction is that on a policy loan one is not personally liable and does not have to sign a note, but merely sends the policy itself in to the company. But if one borrows from a bank and puts the policy up as collateral, then he signs a note in the regular manner and is personally liable. If inter-vivos gift is effectively to remove the policy from the estate, then the policy must be released from any collateral assignment to which it was subjected by the donor.

For gift tax purposes an insurance policy (on which further premiums are payable) is valued by adding the "interpolated terminal reserve" to the amount of accumulated dividends and prepaid premiums, and subtracting the amount of any policy loan. For practical purposes, the interpolated terminal reserve is approximately the same as the cash surrender value. Thus, for example, on a \$25,000 life insurance policy with cash value of \$10,000 and with no policy loan, accumulated dividends or prepaid premiums, the value of the gift is only \$10,000, even though the gift effectively removes \$25,000 from the estate. If the donor were to obtain a policy loan of \$10,000 on the policy and then give it away, for tax purposes the gift would have no value at all.

If the above valuation formula for gifts of life insurance does not approximate the full "actual value" of the policy, then the Treasury may insist on a different method of valuation. For example, if an insured has

an incurable disease which materially shortens his life expectancy, his policy will probably be valued at much more than its cash surrender value, since the cash surrender value in this instance does not reflect the real value of the policy.

Gifts of life insurance sometimes create difficulties under the rule regarding transfers in contemplation of death. This is because of the difficulty in showing a predominant life motive (as opposed to a death motive) for the gift of insurance, a gift which in most instances will not take effect in enjoyment until the death of the donor. Accordingly, it may be desirable for the donee of the policy to borrow on a policy loan any cash surrender value and thereby enjoy immediately at least part of the gift. Of course, the best way to prevent application of the rule regarding contemplation of death is to live three years after making the gift, and that has an unqualified recommendation.

If one has decided to reduce his taxable estate by inter-vivos gift of insurance policies, then to whom should the gift be made? One possibility is to give to the wife the insurance policy which is already payable to her. Although this can be better than leaving the policy in the estate, there are some disadvantages. Of course, half of the proceeds of the policy would go to the wife without estate taxes anyway, because of the marital deduction; so really, under this arrangement, one is giving away a policy and saving the tax on only half of it. Moreover, property given to the wife in this manner is not protected from taxation in her estate at the time of her death. A better arrangement might be to give the insurance policy to the children, thus avoiding a whole generation of estate taxes. Once a policy has been given to children, in subsequent years the donor may wish to give them cash, which they could, of course, use to pay premiums on the policy (or for other purposes, since the gift of cash would not be for a restricted purpose). And the annual gift tax exclusion may possibly cover or exceed the amount of annual insurance premium. (As with all outright gifts, there may be difficulties concerning contemplation of death at the time of gift.)

If life insurance policies are given inter-vivos to individuals, the estate may be hard pressed for liquidity. To make the insurance proceeds available for settlement of the estate and payment of death taxes, one may put the policies into a trust and provide that the trustee, upon collecting the proceeds, may purchase various assets from the executor. There must be a bona fide purchase transaction, however. If the trustee merely contributes money to the estate, then such amount is subject to the estate tax. Let us consider, then, some insurance trust arrangements.

A trust can be revocable or irrevocable, but one does not gain much, from a tax viewpoint, with a revocable trust because it does not change the income tax or estate tax consequences. Accordingly, we will talk about irrevocable trusts.

The trust may be either funded or unfunded. An unfunded trust is one that has the insurance policy in it but no other appreciable assets. Accordingly, someone other than the trustee must pay the premiums or someone must give the trust money for payment of those premiums from year to year. Suppose, however, that one places an in-

insurance policy in an unfunded trust and thereafter for many years pays the premiums up until the time of his death, and that payments for the last three years are found to have been in contemplation of death. What part of the trust would be included in the donor's taxable estate? There are several theories about this, and the government usually takes the one most advantageous to it. One theory is to tax merely the dollar amount of premium paid in the last three years; another approach is to figure the relative number of premiums paid in the last three years (as compared to the total number of premium payments) and tax that proportion of the insurance proceeds. A third approach is to tax the increment in cash values which occurred during the final three year period. But the government has an even worse theory, and has suggested that the entire policy proceeds should be subject to estate tax since the policy would have lapsed before maturity except for the premium payments in contemplation of death. In litigation, however, I do not believe this latter argument would succeed.

A funded insurance trust is one which includes not only the insurance policy, but also some securities or cash (which may be invested to produce income), thus providing the means for annual premium payments. Income from the trust will be sufficient to pay part or all of the premiums on the insurance policy. Although this arrangement removes the insurance proceeds from the taxable estate, still the income of the trust will be taxable to the settlor if used to pay the premiums for insurance on his life (even though the insurance is owned by the trust). But if the wife owned an insurance policy on her husband's life and had sufficient assets to fund an insurance trust, she could set up a trust of this type and have the income taxed to the trust itself (since, in this instance, the settlor and the insured would be different persons). But even if one cannot arrange income tax savings through a funded insurance trust, the estate tax benefits may still be sufficient grounds for establishing such a trust.

I would like to close by telling you about an unusual case which the government lost last summer but which shows the flexibility and the extreme positions which the government will sometimes take in this area. In *Goodnow v. United States*, 302 F.2d 516 (Ct. Cl. 1962), the husband created a revocable unfunded trust to hold insurance on his own life. The trustee was to collect the insurance proceeds, invest them, and pay income to the wife for her life. But in this case, the wife paid the annual insurance premiums. At the husband's death, the proceeds were, of course, taxed to his estate since the trust was revocable by him. Subsequently, at the wife's death, the government sought to tax this entire trust as a part of her estate, even though she had no power of appointment over it. The government's theory was that payment of premium by the wife after the trust was created (and up until the husband's death) together with her subsequent right to receive income from the trust (after the husband's death) for her life constituted a transfer with retained life estate. The Court of Claims, however, would not accept that viewpoint.

One final matter which the estate planner should cover is life insurance on the wife's life. We have seen that on a gross estate of \$262,000, in the present situation, her estate would incur death taxes of approxi-

mately \$48,000. Although in this instance insurance on her life is not needed for liquidity, such insurance might prevent diminution of her estate. Assuming that she is fifty-eight years old, and that the net average annual cost of insurance for a lady of her age is \$50 per thousand, a \$50,000 policy on her life would cost \$2,500 a year. The calculations which we have made today assume that the husband's estate will have a marital deduction, but of course, the marital deduction would be unavailable if his wife predeceased him and he did not remarry. Accordingly, if the wife dies first, insurance on her life would somewhat compensate for loss of the marital deduction to the husband's estate.

MR. CURTIS:

Following a five-minute break the dossier and proposals will be consolidated into one composite picture by the panel. If you have questions and would write them out, please, for the members of the panel, there may be some opportunity at the close of the session to answer them.

On the blackboard is part of the plan that they have developed with such comments by the panel members as they may wish to give in respect to these items. The plan is as follows:

PROPOSED DISPOSITIONS

- # 1 Incorporate, and stock in residue and pension contract to W.
- # 2 Executor to sell at H's death.
- # 3 to W by survivorship.
- # 4 to W outright by will.
- # 5 to W by survivorship.
- # 6 split inter vivos \$4000 to each.
- # 7 to W by will.
- # 8 split inter vivos \$40,000 to each.
- # 9 Convert solely to H and then in inter vivos trust.
- # 10 Give \$5000 policies to S and D and \$25,000 policy to trustee.
- # 11 Exercise to inter vivos trustee.

Residue under will to W as necessary and balance to trustee.

MR. GRAVES:

We have a plan (see above) that we think is reasonably satisfactory, but it is not necessarily the only plan that can be developed and in the final analysis I suppose the wishes of the parties involved are of paramount importance. In any event, I would like to start with the last item, item 11. It seems to us that the probability is that the husband doesn't need the income on that \$100,000 of securities over which he has the power of appointment. We might assume that the income on that item is about \$4,000 a year. He has income from the two businesses of \$29,000, and the husband and wife together have income on the \$80,000

that represents jointly held securities and the \$15,000 of securities held by the husband alone of about \$4,000, I think we can say. So I am assuming that \$33,000 is all the income the family needs. We suggest that H set up an inter vivos trust and exercise his power of appointment over the \$100,000 trust property into that new trust. The trust would have an independent trustee; the trustee would have the authority or power to accumulate income during the life of the husband. After the death of the husband, for reasons that I will come to later, because this will be a pour-over situation and the trust will be greatly enlarged after the death of the husband, the trust agreement would provide that the trustee should distribute to the wife an amount of, say \$15,000 a year from income, and then the trustee would have the power to sprinkle any remaining income among the wife and descendants. After the death of the wife, the trust would be divided into two shares, one for each child, and again the trust would contain a sprinkling provision because of the probability that neither the son nor the daughter would need all the income. They are both in situations of excellent increased earning potential. These would represent the general terms of the trust.

Then we come to the next to the last item of insurance, and we suggest that the \$5,000 policy that is payable to the son be given to him—assigned to the son with all the incidents of ownership. The \$5,000 policy payable to the daughter would be given to her, and the \$25,000 policy that is presently payable to the wife would be changed to be payable to the trust. Mr. Harris has already pointed out that if the trust pays the premiums from the income of the income-producing securities, the husband would be taxable on the income so applied, but we do have the advantage, of course, of accumulating the balance of the income at the lowest income tax rate. So if we can assume that the husband will live, say ten years, I think we might also assume that the corpus of the trust, in addition to the insurance, might grow to as much as \$130,000 from the original \$100,000 because of the accumulation.

Going again up the list from the bottom to item 9, that is unproductive property, so we would suggest that the \$20,000 of real estate should be contributed to the trust. But as we have seen before, it should not be deeded jointly by the husband and the wife to the trust. It should be deeded first to the husband who then would make the transfer to the trust.

Now item 8 — We may assume, I think, that under the present situation \$20,000 of the total of \$80,000 is the result of stock dividends. If those dividends represent income that has been earned on the securities after the time they were acquired, the wife has an interest of \$10,000 in those securities. To put it another way, the wife will be treated as having contributed \$10,000 of that \$20,000, so that if no change were made, \$70,000 of the \$80,000 of item 8 would be includible in the husband's estate. We would suggest that the \$80,000 be taken out of the joint tenancy and that \$40,000 be assigned each to the husband and wife. This would have the effect of decreasing by \$30,000 the amount includible in the estate of the husband for estate tax purposes.

Number 7 would be left as it is.

Number 6 is the joint savings account of \$8,000. We suggest that the savings account should be divided, \$4,000 apiece into separate accounts of the husband and of the wife. I, personally, with respect to no. 5, would like to see the joint checking account put in the name of the husband alone, but I have been persuaded by Mr. Savage that people get so used to joint checking accounts, and this is such a relatively small amount, that possibly we should leave that as it is.

Item no. 4, we think, should go to the wife under the will of the husband. No change with respect to this item need be made now.

Under number 3, the residence is jointly held with right of survivorship. We would not change that.

We have already indicated that business no. 2 will be sold under a contract with the partner.

Now, we come to business no. 1. I am here assuming that this business has been incorporated and I will add one other factor: we would have the corporation and the husband enter into an employment agreement under which the corporation would agree to pay retirement benefits to the husband at his retirement or death of \$10,000 a year for life with ten annual payments guaranteed. And we will further assume that, as is very often the case in a situation of this kind, the husband will not retire; he will continue to be on the payroll of the corporation until he dies. If that is so, we would have a contract calling for payment of \$10,000 a year for ten years to the beneficiary of the husband, who would be the wife, and we would also provide that if the wife did not live to receive all the ten annual payments, any additional payments to be made after her death would be payable to her estate. The reason for that is to qualify this contract for the marital deduction.

The contract, of course, would have a value and would be includible in the gross estate of the husband for federal estate tax purposes. By the same token, but not necessarily to exactly the same extent, the stock of the corporation — the value of the stock — would be reduced. So again I am assuming that this employment contract would not add any significant net value to the estate. We would assume that this is subject to more exact determination, but a contract calling for payments of \$10,000 a year for ten years without interest obviously is not worth \$100,000. The total amount would have to be discounted, and in order to determine the fair market value of the contract the general credit rating of the business would have to be taken into account. But for present purposes we assume that the value of that contract would be in the nature of \$75,000.

Now, if that is all done, the wife will receive the \$75,000 contract; she will receive the residence under the survivorship provisions; she will receive the home furnishings, automobile, boat and other tangible personal property with a value of \$10,000; and she would receive the checking account of \$2,000 by survivorship. That adds up to \$132,000. I don't know if this is shown on the chart or not, but because of the relatively large amount of property that already goes outright to the wife under our assumptions, we did not think it would be desirable to provide for a

marital trust under H's will. We would suggest, instead, that the will of H should provide that there would be distributed outright to the wife an amount which, together with these other particular items that she will receive, would qualify the estate for the maximum marital deduction. I might point out here that in such a formula provision in a will it is desirable to provide that if property is distributed in kind to satisfy the bequest, the property should be distributed at tax basis. The reason is that otherwise gain or loss to the estate would be recognized on the transfer of the property.

Finally, the will would have a residuary clause bequeathing and devising the remainder of the estate to the inter-vivos trust. In other words, we have a pour-over situation so that the will itself would not need to provide for a trust; the inter-vivos trust would serve for that purpose.

MR. SAVAGE:

Arriving at this, we in fact came to it jointly, and there were a lot of things that we considered and thought well of but not as well as we did the one that Brice has finally come up with. What we do with the business must depend largely upon the particular facts of the situation with which you are dealing. The foremost of those is the strength of the personnel in the business who will be there to run it after H's death. Normally, for a widow, a small manufacturing business of this kind is a substantial risk — there is a good deal at stake, leaving taxes out of this, for her to retain it. Opposed to that is a very high return. If she took this same amount of \$175,000, and reinvested it in nationally listed securities, she couldn't get anywhere near as much return as she is going to get by the plan that has been suggested. I think that is the kind of thing that has to be carefully considered before you do anything. Another way that Brice suggested earlier is that this might be accomplished by the use of preferred stock having an accumulated dividend which must be paid and you might even wait then to incorporate after death. And with personnel in the business to whom it will gradually be turned over, using a preferred stock as a pay-out to the widow over the years. I don't think there is any one answer that can be given that will cover many businesses. I think each is entirely different.

MR. GRAVES

I have one thing that I would like to add in connection with the inter-vivos trust. I didn't cover that completely; I stopped after the death of the wife. There would be two shares, one for each child, and the trustee would then have the discretion to distribute the income from each share to the son or the daughter, as the case may be, and their children in any proportions that the trustee would see fit, or it could be accumulated. Then the step I omitted was that we would give the son and the daughter a limited power of appointment at his or her death so that there would be no inclusion of the share in the estate of the son or the daughter, but

MR. HARRIS:

they would have the right to dispose of that property to anyone other than themselves, their estates, their creditors and creditors of their estates.

With reference to the split-up of this joint property, we have been saying that when you split it up the husband and the wife each takes his or her part — and up here in item 8, a split-inter-vivos \$40,000 to each. It is \$80,000 and that implies it goes fifty-fifty, which we just use for purposes of simplicity. Really, when you break it up, it doesn't go fifty-fifty unless husband and wife happen to be born on the same day. You divide it as determined by actuarial tables, which will take into consideration their respective life expectancies. We are talking about joint tenancies with right of survivorship, so obviously a lady 58 has more chance of surviving her husband 65 than the other way around. And that would be reflected in the percentage of the whole of the joint property that she is entitled to get. In other words, instead of her getting \$40,000 of that, she might get \$50,000 and he \$30,000 depending upon their actuarial lives.

MR. GRAVES:

Since a lady has a longer life expectancy even at the same age than a man, you have a compounding then.

MR. HARRIS:

I suggest that an attorney follow a good rule there in getting their accountant friends to make their computations for them.

MR. SAVAGE:

Here again I think we ought to point out we are talking about husband and wife. If you move this jointly owned property over to father and son, it is fifty-fifty. Exactly fifty-fifty because either one of them could sell his half— while husband and wife cannot by sole act sell it. So it is fifty-fifty with anybody except husband and wife.

MR. CURTIS:

I would like to point out that under this plan as now devised, the total taxes including gift taxes and death taxes on H's estate and W's estate or \$68,000. (see below) We started out with a tax of \$175,000 under the present will. We got it down first to \$108,000 and now it is \$68,000 and Mr. Graves just mentioned that there is a further tax savings here if S and D are only given the income rights and a special power of appointment, the property would not be included in their estates upon their death and so it passes all the way down to the grandchildren and there is a total liability of \$68,000.

TAX SITUATION UNDER PROPOSED SOLUTION

H's Estate		W's Estate
\$540,000	Before inter vivos gifts	—
210,000	Gifts and Gift Tax	—
<hr/>		
330,000	Gross Estate	209,000
<hr/>		<hr/>
10,000	Adm. Expense	10,000
5,000	Debt	—
157,500	Marital Deduction	—
60,000	Specific Exemption	60,000
<hr/>		<hr/>
232,500	Total Deductions	70,000
97,500	Net Estate	139,000
<hr/>		<hr/>
97,500	Net Estate	139,000
20,000	Federal Tax	31,000
4,500	State Tax	2,000
<hr/>		<hr/>
24,500	Total Death Tax	33,000
10,500	Gift Tax	—
<hr/>		<hr/>
35,000	Total Gift and Death Tax	33,000
<hr/>		<hr/>
	TOTAL TAX BURDEN	<u>\$68,000</u>

MR. HARRIS:

You will see from this that we do not say exactly what assets passing under the will are going to the wife. In other words, she is going to get that amount of assets which, plus everything else that she has gotten outside that qualify for the marital deduction, come up to the one-half of the adjusted gross estate. And you can specify in the will, if you wish, what assets will be used to the extent necessary to fund that bequest to her. In other words, after you say just the way I have said it, or any other form of equivalent language, then you can say, "the first thing to give her in satisfying that \$60,000 that she is supposed to get is the tangible personal property. The next thing is any cash. The next thing is this and this and this." I, myself, don't like to tie the hands of the executor on that because the way we are looking at it when we plan the estate and write the will may be very different from what it is at his death, and if a man has confidence enough to name the person or institution as his executor, my view is that person ought to be trusted to make the best use of that discretion. But you always do put in, and it is really necessary that you do so, a statement that no assets that do not qualify for the marital deduction under the law will be given to the wife, because unless you put

that in, if there are any assets that don't qualify, the marital deduction will be reduced by that amount even if in fact the executor doesn't give them to her — in other words, so long as he has the right to give them to her. So, you have to negative that.

MR. CURTIS:

We have a few minutes left; if there are any questions that you may have and wish to pose to the members of the panel, I am sure that they will be willing to answer them for you. I may have to repeat the questions unless you are sitting up front, as this is being taped.

QUESTION:

I would like to ask about this last \$10,500 tax at the bottom of the blackboard.

MR. CURTIS:

That is the gift tax paid on H's inter vivos gifts. That \$210,000 at top includes both the gifts of about \$200,000 and the gift tax of \$10,000.

QUESTION TO MR. HARRIS:

This is probably more for an insurance man than it is for an attorney, this gift to the wife of the insurance policy with an evaluation of \$10,000 at the time of the gift, if she dies ahead of the husband then its value is perhaps \$15,000. She leaves a will leaving everything to the husband. I suppose that is carried in to her estate at its cash value then and what do the insurance people do with the policy?

MR. HARRIS:

Well, what you do is advise against her will of that dispositive nature as soon as the husband authorizes you to draw his will under a set plan. You must tie the wife's assets into the plan and you certainly would not in that situation ever let her assets come back to him as you would be compounding the tax. He would then have everything that she has. If he wants to have the benefit of it, the most you should give him is a life interest, with the trustees having the right to invade for his benefit. But you don't ever let that get back into his taxable estate. Am I addressing myself to the situation that you are?

QUESTIONER:

No, that is not the question.

I am assuming that the wife does not have an estate of any consequence and the husband is intent to provide for her to a large extent from the cash part of the estate which she may not use in her lifetime, and which, if she predeceases him, will revert to him.

MR. HARRIS:

Right sir, so what I am saying is that she should not have that kind of will. It is the estate planner's and will drafter's job to point that out and draft her will in accordance with the overall plan for the family. That was a good point, I am glad you raised it.

QUESTION: MR. GRAVES,

I lost you a few minutes ago, Mr. Graves, when you said that the amount going to the wife qualifying for the marital deduction would be something over \$100,000, so there would be no point in establishing a marital trust. What was the amount that would go to her automatically other than the house in joint names and the joint accounts?

MR. GRAVES:

Well, as I went up the items, we got to item 5 and that is the joint checking account with the right of survivorship that we did not change so that's \$2,000; Item 4, we would provide in the will that the tangible personal property would go to the wife, that is the \$10,000; so with those and with the residence — those three add up to \$57,000; and with our evaluation of \$75,000 on this pension contract of \$10,000 for ten years, that would be a total of \$132,000. We need \$165,000, so that would be \$33,000 more that would be required to bring the wife's property up to the maximum marital deduction. Now we just thought that it wasn't worth while to create a trust with \$36,000 since the wife already would have this \$132,000 plus a substantial amount of other property — half of the \$80,000 or \$40,000, well, I guess that is all, but she would already have \$172,000 of her own so another \$33,000 wouldn't do any harm to give it to her outright.

QUESTION:

What cash is there going to be needed to pay the taxes and the expenses and how is it provided for under this plan?

MR. GRAVES:

We need \$20,000 to meet administration expenses for the two estates and a total of \$68,000 for taxes. Now we would do this of course in two bites we have assumed that the husband would survive, in which case his estate tax would be \$35,000 and administrator's expenses would be \$10,000 for a total of \$45,000. We have assumed that we would sell business No. 2 to get the \$50,000 of cash, so that would take care of all the cash requirements on the death of the husband. Now, the wife's estate would require \$34,000 for estate taxes plus \$10,000 or about \$45,000. She has outright the \$40,000 of securities from item 8, and she would have received from the husband's estate \$33,000 of what we would con-

sider as liquid securities. I would suppose that the \$33,000 balancing item to go to the wife would come out of the husband's \$40,000 of liquid securities — or possibly a part of the \$15,000. So, there would be plenty of liquidity in the wife's estate to take care of the \$45,000 cash requirement.

QUESTION :

In a rather less sophisticated situation than you outlined there with a trust involved, but merely where the wife is the irrevocable beneficiary of the life insurance policy on the husband — in that situation should the wife die first, then I take it that the cash surrender value of the policy would be includible in the wife's estate?

MR. HARRIS:

If she is owner, yes sir.

QUESTION :

Where the wife is the owner of the insurance policy on the husband's life, is it a good idea to have as beneficiaries the children or someone other than the husband?

MR. HARRIS:

Yes, indeed.

QUESTION :

Suppose that he dies, a widower, during a bad recession, and both the businesses are losing money, how are you going to raise the tax money then?

MR. GRAVES:

I have heard it suggested that you take a drink of squirrel whiskey and run up a tree.

MR. HARRIS:

We ought to have that switch asset clause we spoke of in the inter vivos trust. So in there we have the \$25,000 insurance and securities which now are valued at \$100,000, which even at bad times would probably certainly be sufficient. As we say with the switch asset clause, they could be made available to the executor for payment.

QUESTION :

In this situation would you make any distinction as to where you would put the burden of payment of taxes?

Would you require that they be paid prior to or after taking the marital deductions?

If I remember correctly the marital deduction share if you have your taxes paid out of a residual estate, you get a little more marital deduction.

MR. GRAVES:

Yes, we would always provide that the taxes should be paid out of the residuary estate and would not be charged to any extent on any property going to the wife or any other legacy.

It would make a difference of half of your taxes, wouldn't it?

Yes.

MR. CURTIS:

If there are no further questions, I would like to express the appreciation of the College to the participants for their very excellent and able presentation, and the appreciation of participants for your attention and your presence here and I sincerely hope that you feel that your time has been well spent. Thank you very much.