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ESTATE PLANNING

A Review of "An Estate Planner's Handbook" by Mayo Adams Shattuck and "Estate Planning and Estate Tax Saving" by Edward N. Polisher

Ralph R. Neuhoff*

If Congress calls the tune, taxpayers can hardly be blamed for dancing to it. The impact of inheritance and gift taxes upon the estates of even the moderately wealthy is so great that the best intentioned citizen can hardly fail to keep one eye, and preferably two, cocked on the tax features—so-called—of his estate plan. Any other procedure may result in the most distressing consequences including possible partial or complete frustration of his most cherished wishes. Indeed, a substantial portion of the estate may conceivably be lost by failure to shape the will in the pattern necessitated by the law.

It is idle to speculate whether the tax laws caused estate planning, or whether estate planning caused the present features of the estate tax law. They grew up together. Many clauses in the estate and gift tax provisions of the Internal Revenue Code are the direct result of "estate plans" by ambitious, if over-zealous, taxpayers. Likewise, many clauses in wills are the direct consequence of and response to, particular provisions of the estate tax law. And, in the process of growing up, the science, or art, of estate planning has become exceedingly complex.

As an assistance to the estate planner, be he attorney, trust officer, life underwriter, or accountant, we have the two works under review in this article. Mr. Shattuck's work[1] is a single, compact volume, well manufac-

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1. An Estate Planner's Handbook, by Mayo Adams Shattuck. Boston: Little, Brown & Co., 1948. Pp. xxxii, 575, with index, table of cases and table of authors. $6.50.

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tured, documented with many footnotes which are placed at the bottom of the page in the usual fashion. Citations to decided cases are italicized in the customary way. It also contains, in an appendix, articles by other authors.[2]

As might be expected, the effect of including these other articles is somewhat diffuse. The reader might have been better served if Mr. Shattuck had secured permission to merge this material into his own text with appropriate acknowledgments.

There is another appendix to Mr. Shattuck's work: the chapter on the Revenue Act of 1948. This chapter, having been written shortly after the Act was passed, and after the rest of the book had been written, is based largely upon the committee reports and Mr. Shattuck's own interpretation of the law and cannot be considered significant in view of the vast outpouring of comment on the Revenue Act of 1948 which has since been printed.

Mr. Polisher's work[3] is in two volumes—much more bulky in execution, with larger type, wider margins and thicker paper. There are no footnotes, citations being given at appropriate points in the text itself in the same size type as the text, which is somewhat disconcerting, especially where the citation of authorities happens to be lengthy. Furthermore, the names of decided cases are not italicized or distinguished from the text in any manner whatever. The result is that it is not possible for a person familiar with the authorities to pick up the author's treatment of various well known cases merely by scanning the page; he must consult the table of cases.

Mr. Polisher does not include the works of other authors in his book, but he does include in an appendix a digest of the inheritance tax law of each state and territory. This adds very considerably to the bulk of the book and, while undoubtedly handy as long as the book is new, will rapidly become obsolete. There is a table of cases cited, a very good index and an analytical table of contents, but no table of authors cited, largely for the reason that Mr. Polisher apparently has the policy of not citing other authors. There is a tendency in some parts of the work to use the digest form of treatment rather than an analytical form. This puts the burden on the reader of organizing the material and of knowing its relative value.

2. Kenneth W. Bergen, Henry Cassorte Smith, Richard F. Barrett, W. Barton Leach, Gilbert T. Stephenson and A. James Casner.

3. ESTATE PLANNING AND ESTATE TAX SAVING, second edition, by EDWARD N. POLISHER. Philadelphia: George T. Bisel, 1948. Pp. viii, 923 (2 vols). $20.00.

Mr. Polisher also has his treatment of the Revenue Act of 1948 in a separate chapter, which, however, is quite complete.[4]

I. What Is Estate Planning?

Basically, estate planning is the conscious selection of means whereby the property or wealth of a person can be passed to his family or other persons of his choice. This rather simple objective becomes highly complex in execution, in many cases largely because of tax considerations.

Therefore, in practice, the problem becomes one of selecting the most desirable (or rather least undesirable) compromise between what the testator really wants and what he can get under the tax laws and still have as much as possible remaining.[5]

II. The Ingredients or Tools

As vehicles for the passing of benefits to the chosen recipients, the estate planner has a wide selection of available means. He may make conveyances or transfers during his lifetime, with or without incorporating a trust in the instrument; he may make the transfer by will, again with or without one or more trusts; he may allow the intestate laws to operate in default of a will; he may purchase life insurance, which is available in a variety of forms, and the settlement on maturity of the insurance may be by lump sum payments, various forms of installment payments, or payments to a trustee of an active trust, with features similar to those found in a will.

Mr. Polisher has an extended treatment of estate planning in general in his first chapter. His classification is as follows:[6]

1. Gifts and transfers of property
2. The creation of trusts
3. The release of interests retained or owned by the client in property previously transferred
4. The use of restricted powers of appointment and, in some instances, even the creation of general powers of appointment
5. The purchase of new life insurance on the client's life or the assignment of existing insurance, and changes in the beneficiary provisions

4. Unfortunately it was written too early to include the amendments to § 812(e) made by Public Law 869, 80th Congress, second session, adopted July 1, 1948.
5. Polisher expresses this thought in other terms at p. 22.
6. Polisher, p. 22.

6. The reshuffling, refinancing, or reorganization of business interests, to assure their continuity of existence and management after client's death
7. The execution of stock or partnership-interest purchase agreements to aid in the liquidation of business interests and to avoid unnecessary losses in values incident to forced sales
8. The client's last will and testament through which most of the dispositive provisions of the estate plan will be accomplished.

In this connection we are warned that there will be continued change, not only in the circumstances and relationship of the objects of the testator's bounty, but also in the law and decisions;[7] wherefore, frequent checking and revision are desirable.

III. Who Should Be Interested in Estate Planning?

Anyone who has either property or life insurance should be interested in some aspect of estate planning. In general, however, the tax aspect will be a relatively minor consideration in estates of less than $75,000.00. On the other hand, an estate of $250,000.00 or more requires definite attention to the tax features.

IV. Who Should Do the Job?

Mr. Shattuck states[8] that estate planning is a team job. The members of the team are said to be ordinarily the person whose property and family are in question, his legal adviser, his banking or investment adviser (meaning the corporate fiduciary), his insurance adviser, and oftentimes his accounting adviser. This many cooks ought to spoil any broth. Mr. Shattuck goes on to remark that many an estate plan appears to have been warped to suit the private interests of one set of advisers or another.[9] It would seem much better for the duty of drawing the estate plan to be placed squarely on the lawyer. If he needs advice on the technical features he should freely call upon the other advisers.

V. General Principles

Mr. Polisher states[10] that the primary objective of every sound estate plan is "to make certain that the benefits to be derived therefrom will be

7. *Id.* at 23.
8. Shattuck, Foreword, p. xxi.
9. *Ibid.*
10. Polisher, p. 3.

enjoyed by the estate owner during his lifetime, and, upon his death, his estate will pass to his beneficiaries under a program designed to promote their welfare." He says that the tax saving features are secondary considerations. However, despite the secondary role ostensibly assigned to tax saving, the reader will find that most of the book is devoted to the tax features of estate planning.

Mr. Shattuck's work, on the other hand, considers not only the tax features, but also the non-tax features of estate planning, such as draftsmanship of wills and trusts, powers and duties of trustees, investments, "the prudent man rule," conflict of laws, the rule against perpetuities, and other subjects which have nothing whatever to do with taxes.

One of the general principles of estate planning, according to Mr. Polisher, is to pay attention to the operation of the federal income and gift tax law "so that the exactions of these laws will be reduced to their lawful minima and the benefits to the family unit thus correspondingly increased."[11] In order to achieve this end he recommends that the ownership of the property be divided among the various members of the family group in such a manner "that each member of the unit receiving the income shall report it in his own right."[12] He recognizes that in making this division the owner of the property will desire to retain what control he can, and he states that a thin line of demarcation often separates success from failure where efforts are made by the donor or settlor to retain a measure of control over the property while the income is intended to be made available to other members of the family.

Another general principle of estate planning is that a flexible trust may sometimes be substituted for outright testamentary bequests, so that one may at least prevent imposition of successive estate taxes as the economic benefits pass from one set of beneficiaries to another.[13]

Mr. Shattuck also suggests, that, while the danger of the inclusion of certain *inter vivos* transfers in the estate as having been made "in contemplation of death" is a real one, *yet it is usually worthwhile to run the risk,* since, as he says, there is little penalty if the ruling should go against the estate.[14]

11. *Ibid.*
12. *Ibid.*
13. Mr. Shattuck suggests this at p. 23.
14. SHATTUCK, p. 23.

While not stressed by the authors under review, it should perhaps be noted here that under the Revenue Act of 1948, creating the "marital deduction," "contemplation of death" may lose some of its sting. A gift to charity during life in contemplation of death may henceforth be better taxwise than one not in contemplation of death if it results in a larger marital deduction.[15]

VI. Tax Saving Techniques

A. *Gifts as tax savers*

Mr. Polisher points out the desirability of reducing the estate by gifts.[16] He mentions the annual exclusion of $3,000.00 to any number of persons in any one year,[17] as well as the specific exemption of $30,000.00. He further points out that the amount of the property which is the subject of the gift will come off the top bracket of the estate tax, while for gift tax purposes it will be computed at rates which begin low. Moreover, the gift tax rates are only 75% of the federal estate tax rates applicable to the same bracket, and, finally, the payment of the gift tax *depletes the estate,* thereby saving additional estate taxes.

In the other direction, the estate owner loses the income on the amount paid as a gift tax,[18] but this is not net loss because the income, if received, would have been subject to income tax and the net amount of the income remaining after taxes, if on hand at the date of death, will be subject to estate taxes.

A further complication is introduced where, as is usually the case, the annual income from the assets which are the subject of the gift would be subject to a different rate of income taxation in the hands of the donor than it would bear in the hands of the donee.[19] This calculation involves an assumption as to the expectancy of life of the donor as well as compound interest on income.

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15. See Surrey, *Federal Taxation of the Family—The Revenue Act of 1948,* 61 Harv. L. Rev. 1098, 1152 (1948). According to this author this Carollian picture is not limited to charitable gifts. In some cases, he states, an *inter vivos* gift to children, despite the gift tax credit calculation, will reduce the estate tax if the gift can be included in the gross estate and thereby increase the available marital deduction.
16. Polisher, p. 486.
17. This is not applicable to a gift of a future interest.
18. Mr. Polisher does not mention this feature at this point, but from his treatment the reader will, of course, be aware of it.
19. Polisher, p. 490.

B. *Powers of appointment*

Powers of appointment still offer some tax saving possibilities, even after the amendments contained in the Revenue Act of 1942.[20] This subject is neatly dealt with by Mr. Shattuck in a section[21] in which he discusses the amendments which were made in 1942 and particularly points out those powers of appointment which are still tax free. There is no doubt that a very considerable latitude has still been allowed to testators or trustors whereby they may, in effect, "skip" one generation, so far as the federal estate tax is concerned, and yet accomplish their reasonable desires. *No estate planner can afford to ignore the possibilities of powers of appointment as tax saving instrumentalities.*

C. *Others*

Mr. Polisher has a chapter entitled "Tax Saving Mechanisms."[22] Here he gathers together numerous schemes whereby those so inclined can cut down more or less their income, gift or estate taxes by manipulations or, shall we say, "intelligent choices." For example, since a trust is a new taxpayer, it is entitled to elect its accounting period and thereby determine the time when its first and subsequent income tax returns shall be filed. Mr. Polisher says[23] that a "short period first return" often results in a substantial tax saving. Also, since a decedent's estate is a new taxpayer, it may do the same thing.[24] At this point Mr. Polisher amplifies as follows: "Where substantial amounts of income are received or expected to be received by the estate during the first twelve months after death, it is to the tax advantage of the estate to divide the income between two reporting periods by closing the first fiscal year of the estate before the end of twelve full months. In this manner, lower income surtax rates can be made applicable."

Another suggested mechanism is the election by the surviving spouse not to take under the decedent's will or a renunciation by a beneficiary of the share of the estate distributable under the will."[25] It is possible under the existing law to decide whether certain deductions shall be taken *under the income tax* or the *estate tax.* They cannot be taken under both taxes, but the option exists.[26] Among these are "non-business non-trade expenses

20. INT. REV. CODE § 811 (f) as amended by Revenue Act of 1942.
21. SHATTUCK, § 40, p. 268.
22. POLISHER, Chapter XXI, p. 486.
23. *Id.* at 497.
24. *Id.* at 513.
25. *Id.* at 511.
26. *Id.* at 514.

which include expenses incurred for the production of income or for preservation and management of property held for production of income."

Mr. Polisher suggests that, under certain circumstances also, it may be possible to obtain a state court decree concerning property rights.[27] In this connection, he says that notice of litigation should be given to the Collector of Internal Revenue of the district in which the estate is being administered so that he may not later be heard to complain that the proceedings were uncontested and arranged by the parties involved to reduce the applicable federal estate taxes. The ever present question of whether an executor should accept his commissions is also referred to,[28] because if accepted they will be subject to income tax, and if not accepted they do not operate to reduce the estate tax.

VII. Life Insurance

Both authors recognize the value of life insurance in providing liquidity.[29] Mr. Shattuck warns against the use of life insurance by a man of wealth for any purpose other than protection.[30] This may have a strange sound to taxpayers who are solicited in season and out of season to buy life insurance on the theory that in some mysterious manner it will save them a lot of taxes.

Funded life insurance trusts, that is, life insurance trusts which contain assets the income from which will be used to pay the premiums, are referred to by both authors.[31] Both authors mention[32] the requirement of the law that income of a funded life insurance trust, which is or may be used to pay premiums on policies upon the life of the grantor, may be required to be included in the taxable income of the grantor. But nowhere in either work is the reader sufficiently warned that there is a serious danger that the creation of such a trust will *ipso facto* be considered to have been in contemplation of death, with the result that the securities transferred to such a trust must to the extent needed for the purpose of payment of premiums be included in the transferor's gross estate.[33] Both authors cite the *Garrett* case referred to in the last footnote without stressing its importance.

27. *Id.* at 510.
28. *Ibid.*
29. Polisher, p. 520; Shattuck, p. 20.
30. Shattuck, p. 22.
31. Polisher, p. 201; Shattuck, p. 47.
32. Int. Rev. Code § 167(a) (3); Polisher, p. 201.
33. See Proceedings of New York University Sixth Annual Institute on Federal Taxation, p. 44, and Estate of Paul Garrett, 8 T.C. 942 (1947).

The "contemplation of death" danger seems to apply also to *unfunded* life insurance trusts which provide that the trustee shall either lend money to the grantor's estate for the payment of debts or estate taxes or shall purchase assets of the estate at their fair market value. The proceedings of the New York University *Sixth Annual Institute on Federal Taxation* contain an article which points out the serious danger that even unfunded trusts so providing will also be considered in contemplation of death.[34]

VIII. Business Insurance

Both of the authors whose works are under review deal at length with insurance carried for the purpose of furnishing funds for the retirement of a decedent's interest in the business, either in whole or in part.[35] Both authors describe the elements of the arrangements customarily used. Mr. Shattuck says that the business insurance "is disappointing in practice," but he does not indicate very precisely why this is so. On the contrary, he suggests that the difficulty is due to complexity of form. Mr. Polisher merely details the plans and recounts the court decisions and some of the tax problems involved.

There is no doubt that if the amounts involved are small, so that the income tax on the additional dividends needed is not too great, and if the insurance is applied for early enough so that the premiums are not too high, business insurance may be a very good solution of the problem involved when there are several associates and one of them dies. However, these plans must be drawn with great care and with much imagination as to future changes. This reviewer has found that the following points should be watched.

1. The burden must not be too large. Frequently one of the associates is elderly and the premium on the insurance necessary to buy out his interest may be quite heavy.

2. In addition, it will usually be found that the company must finance the payment of the premiums by additional dividends paid to the stockholders. These will necessarily be subject to federal income tax at the rates applicable to income in excess of the regular income of the stockholders. If these rates are as high as 50%, it will be seen that there is a substantial disadvantage involved in declaring dividends to finance insurance, as com-

34. Article by Abraham S. Guterman reprinted from Columbia Law Review, at p. 31 of the Proceedings.
35. Polisher, p. 214; Shattuck, p. 58.

pared with leaving the money legitimately in the business where it would not be subject to a 50% income tax rate. Moreover, the plan once adopted cannot be easily changed, and the income tax rate may increase at some time before the plan is consummated, either due to higher tax rates being enacted or because the income of the stockholder increases, as it is generally hoped that it will.

3. The plans generally do not visualize how they will "bail out" the second person to die. They provide that the insurance is to be used to buy the stock of the *first decedent.* This means that the survivor is the owner of that stock if we have but two associates. It might happen that the survivor would live only a short time—possibly only a year longer—and then his widow would not have a cash estate but would have the stock of the company on her hands.

4. The plan usually presupposes that the relationship between the various business associates will continue until one of them dies. They are not very flexible if one of them wants to sell out prior to his death. Suppose they disagree?

5. Some plans do not preserve a clear distinction between assets of the corporation and assets of the stockholders. For example, they permit the corporation to pay the premiums on the insurance and yet utilize it in order to present the surviving stockholder with the stock of the first to die, which is a concealed dividend. This plan is frequently met with because on first inspection it seems to have such great advantages.

6. Sometimes the plan is altered so that the company will carry the insurance on the various stockholders, but if this is done the amount of increment in value which occurs when the first stockholder dies is ignored in arriving at the book value of the stock, and yet this increment belongs ratably to all of the stockholders and it should not be ignored. On the other hand, if it is not ignored, it in turn calls for more insurance which has more increment, so that the insurance increases in geometric proportion.

7. Where there is one wealthy stockholder and one who is not very wealthy, it is frequently impossible for the small man to buy out the large one, because he simply cannot afford it. This often results in a concealed gift to the small man.

8. In order to permit the small man to do what he can, frequently he is encouraged to contract to buy the large man's stock on time payments, disregarding the fact that he is really entering into a margin transaction which may wipe him out completely if things should go bad.

9. The best solution in many cases is to recognize that the stock of a closely held corporation is not of very great permanent value and to build up an independent insurance estate for the family of the stockholder. This has an important tax advantage because it results ordinarily in the stock of the corporation being valued for federal estate tax purposes at a much lower figure. The insurance buy-out plans have the definite disadvantage that they furnish a ready market for the stock and therefore inevitably result in a high valuation of the stock for federal estate tax purposes. The stock could hardly be valued at less than it is going to be sold for promptly after the death.

IX. Key Man Insurance

Insurance payable to a corporation upon the death of an officer or important employee is called "key man" insurance.[36] If the stock of the key man is to be purchased at book value, the proceeds of the life insurance should be excluded in computing that value, according to Mr. Polisher.[37] The logic of this might be debated, since it will have been corporate funds which made the purchase of the insurance, and any advantage redounding to the company through the fortunate purchase, if it proves to be such, ought to be the property of all of the stockholders ratably. If it be said that the insurance is merely compensation for the loss of the key man, still he can hardly be blamed for having died inopportunely, and the loss to the company should not be entirely borne by his estate through a diminution in the value of the decedent's stock as against the value of the remaining stock.

Serious question exists whether the payment of premiums on a key man is a proper disposition of funds under Section 102 of the Internal Revenue Code, which penalizes improper accumulation of surplus. Mr. Polisher is of the opinion that it is a proper disposition when ordinary types of insurance are used, as distinguished from heavily weighted premium policies, but this may be questioned by some.[38]

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36. Polisher, p. 531; Shattuck, p. 65.
37. Polisher, p. 532.
38. *Id.* at 534. See for example the discussion of the analagous question of purchase of a retiring officer's stock by George R. Blodgett in the Proceedings of the New York University's Sixth Annual Institute on Federal Taxation at p. 45, citing Gus Blass Co., 9 T.C. 15 (1947). Mr. Blodgett flatly says that if some or all of the executives covered by the stock purchase or retirement plan are stockholders it would seem to be by its very nature an accumulation to prevent the imposition of surtax on the stockholders.

Mr. Polisher points out that repurchase of shares of the corporation, necessarily out of surplus, may be a taxable dividend to the decedent's estate.[39]

X. The Living Trust

Mr. Shattuck points out that it is possible to avoid probate costs, delay and inconvenience by an *inter vivos* trust which has no tax consequences because it is revocable.[40] There are other advantages. The trustor has a chance to see his trust in actual operation and has the benefit of the fiduciary's advisory management service, even while he lives. In addition, if there are flaws in the plan, they can be corrected—something not possible with a testamentary trust, since it will not go into operation until after the testator has died. Still another advantage is the saving in cost due to the fact that the charge for legal assistance in drawing the trust instrument and transferring the securities to the trustee is likely to be considerably less than the charge made by the attorneys on the probate of the estate. This is for the reason that it is relatively a simple matter to transfer securities from a living person to the trustee of an *inter vivos* trust, as compared with the task of transferring the same securities from the name of a decedent to the name of a trustee under a will, and possibly also because fees for drawing an *inter vivos* trust will be fixed by agreement.

The avoidance of publicity in by-passing the probate court may itself be deemed a sufficient advantage to cause the estate planner to adopt this method. In the war years there was another advantage. A business man may be departing on a dangerous mission to foreign parts, and if he should appoint an attorney in fact, the uncertainty as to whether the principal is still alive puts the attorney in fact in a vulnerable position. Exculpatory clauses excusing the attorney in fact for actions taken in good faith after the death of the principal, but without actual knowledge of his death, are in use but were of uncertain efficacy.

Another merit of the living trust, which may be very important in a particular case, exists where there is a possibility of a will contest. Any disposition by will is subject to proceedings in the probate court appealable thereafter to a court of general jurisdiction, such as the circuit court, in most states, all of which would take place *after the death of the testator* in case the will is contested. Here the burden would be on the proponents of the will to establish the will in solemn form, and in most, if not all, of the

39. Polisher, p. 535.
40. Shattuck, p. 66.

states a jury would be the trier of fact and might substitute its judgment of the proper disposition of the estate for the one desired by the testator.

On the other hand, the attack on a *trust* accomplishing the same purpose would have to be *in equity* with *no jury*. The judge would be the trier of fact, and the burden would be on the moving parties who were seeking to set aside the trust conveyance, a considerably more difficult position. Moreover, the trust conveyance might have been in effect for some time, and any attack on it would appear to be "stale." Furthermore, the fact that the trustor himself had not seen fit to upset the trust after it went into effect and the trustee took possession, might be quite potent proof that the trust was satisfactory to the trustor, which is in marked contrast with the situation in case of a will contest.

As the author points out, *inter vivos* transactions are rarely upset because of lack of "sound mind" or by "undue influence," which are the factors decisive of a will contest. Other advantages are that, in some jurisdictions at least, future creditors would have no standing to attack an *inter vivos* transfer, and that the place of administration may be controlled by the grantor of an *inter vivos* trust, whereas the state of his domicile at death would necessarily be the place of administration of his estate, and therefore the state having primary jurisdiction over the trust created in his estate.

XI. Irrevocable Trusts

While irrevocable trusts have some of the advantages above mentioned for revocable trusts, Mr. Shattuck feels that they are much less attractive.[41] He says that they frequently fail to obtain tax advantages which are expected of them and often miscarry woefully as regards their original donative intent. He says it is clear also that, being irrevocable, they may result in undue and irremediable impoverishment of the donor. Practitioners who have experience in this field will heartily second the author's sentiments in this regard.

Conclusion

The attentive reader will have gathered from the foregoing, among other things, that estate planning is an art which will challenge the best efforts of competent lawyers or other advisers of the estate owner, that in many instances the problem is exceedingly complex and yet so important in practical results as to justify a very considerable amount of effort and time being

41. *Id.* at 77.

expended upon it. It will appear also that due to the peculiar tax laws, it is highly essential in all but the smallest estates to pay very particular attention to, first, the estate tax and, second, the gift and income tax.

The two works under review in this article are quite unlike, and yet each is pre-eminent in its special sphere. They are very well written, quite accurate, quite explicit, comprehensive, and exceedingly useful. The acquisition of both of them would involve very little duplication and together they would form a solid basis for any estate planner's library.

As to the elements of estate planning, they can best be gained by a perusal of the books themselves. However, in general, it may be reiterated that the purpose of the estate owner is three-fold. In the first place, he desires to arrange his affairs so that he has whatever advantages and protection he desires from his own estate during his life. In the second place, he desires to utilize his wealth and property for the protection of those beneficiaries who are dear to him, and, of course, for the benefit of such charities as he may select. And in the third place, all of the foregoing objects are to be accomplished with a full understanding of the provisions of the various federal and state taxes involved so that, to the extent desired, and without undue sacrifice of the basic plans, the taxes payable to state and federal governments will be reduced.