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# ESTATE PLANNING FOR THE MAN WITH A BUSINESS

BERTRAM W. TREMAYNE, JR.†

## *The Problem in General*

One of the most challenging situations in the estate planning field is presented by an individual who owns all or a substantial part of a business, be it a corporation, partnership, or sole proprietorship. The problem is how to transfer the business interest to the objects of the owner's bounty with as little reduction in capital and loss of income as possible. Under our present tax structure, without careful estate planning, or perhaps even with it, the death of a founder or chief executive of a closely held business is apt to destroy or greatly reduce its value. While this is especially true of professional or other personal service enterprises, it is also true of businesses such as manufacturing concerns, where capital is a major factor and where, accordingly, it might be expected that the value of the business would be capable of being transferred over to the heirs of the deceased owner. The heavy bite of death taxes, federal and state, and the other "costs of dying" represent a major threat to a family fortune founded on a closely held business.

With perhaps most, and often substantially all, of the family fortune tied up in the land, buildings, machinery and other assets of the business, how shall the need for cash to pay costs of dying be satisfied? Many business men have taken one look at the difficulties and have liquidated, or sold out to or merged with their larger competitors on the best basis possible in advance of their deaths, in this manner assuring themselves that their families would at least have something solid to rely upon.

Proper estate planning for an individual with a business should undertake to determine, realistically and conservatively, whether an effort shall be made to retain the business interest in the chain of inheritance or whether plans shall be made for its disposition. Retention of the business interest means keeping it in the family, or with other

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1. A Missouri estate of \$500,000, with debts and costs of administration of \$40,000, taking full advantage of the marital deduction, will incur a federal estate tax of \$39,780 and a Missouri inheritance tax of at least \$1,920. If the marital deduction is not available, as where the owner of the business is a widower, the taxes on an estate of the same size would be \$104,980 and \$8,720 respectively. A \$1,000,000 estate, with debts and costs of administration of \$65,000, would incur a federal estate tax of \$107,140 and a Missouri inheritance tax of at least \$8,960, assuming the full marital deduction, and \$249,890 and \$29,560 respectively, without the marital deduction. INT. REV. CODE OF 1954, § 2001 (Rate of Tax) and § 2011 (Credit for State Death Taxes); MO. REV. STAT. § 145.070 (1949).

objects of the owner's bounty, as long as it is profitable or otherwise desirable to do so. Disposition of the business interest means its sale, liquidation, or merger before the death of the owner, or as soon as possible thereafter, recognizing that in certain instances this may take considerable time.

The factors which influence or even dictate the decision whether to retain or to dispose of a business interest will normally be a mixture of family and finance. First, is it desirable to retain the business? Are there sons, sons-in-law, or others for which it should be retained and preserved? Do the profit record and future prospects portend continued prosperity? Is the share owned a minority interest likely to be at the mercy of an unreliable majority? All things considered, are the advantages to be gained sufficient to justify the difficulties and risks involved in retention of the business interest? Second, must it be retained? Must it be retained because it cannot be disposed of at a reasonable price? Must it be retained because the family needs the larger income which it can be expected to produce, in comparison with that which would be available through other investment of the proceeds of disposition? Finally, is it possible to retain the business? Is it the kind of business which necessarily dies with the owner? Are competent managers available? Will sufficient capital or credit be available after the death of the owner? Can the costs of dying be paid without disposing of the business?

These are difficult questions and later events may dictate a change in policy, but it is well to arrive at a decision as early as practicable, for steps can be taken implementing an early decision which may be impossible at a later date.

### *Retention of the Business Interest*

Assuming that the decision is to retain the business interest and that the owner has children or others whom he wants to own and manage the business upon his death, a program of annual gifts could be availed of, which, over a period of years, might transfer, tax free, or in any event at the relatively lower gift tax rates, a substantial part of the value of the business.<sup>2</sup> Because shares of stock are more readily transferred than a sole proprietorship or an interest in a partnership,

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2. Generally speaking, gift tax rates are two-thirds the estate tax rates. INT. REV. CODE of 1954, § 2502. Also, lower brackets are available where the gift tax applies to part of an estate and the estate tax to the rest. Since 1948, a donor, with his spouse's consent that the gift be considered as one-half her gift, can give each year to as many persons as he chooses \$6,000 without it being counted a gift. INT. REV. CODE of 1954, § 2513. Without such consent, the exclusion is \$3,000. These exclusions are not available if the gift is of a future interest. INT. REV. CODE of 1954, § 2503(b). In addition each donor has a life-time exemption of \$30,000 which becomes, in effect, \$60,000 with such consent of the spouse. INT. REV. CODE of 1954, § 2521. Taxable gifts to a spouse can be reduced by one-half if they qualify for the marital deduction. INT. REV. CODE of 1954, § 2523(a).

it might be advisable to incorporate a business which is presently being operated on either a proprietorship or partnership basis. This may be done without incurring a federal income tax, provided that the applicable requirements of the Internal Revenue Code of 1954 are met.<sup>3</sup> Should incorporation be deemed inadvisable, it may be that the partnership form of doing business is practical. In this case a sole proprietorship can be transformed into a family partnership. Even though this may involve antecedent gifts to the children or other members of the family of the erstwhile sole proprietor, this is not necessarily an obstacle. Formerly, the fact that various members of the family had acquired the interests which they contributed to the partnership by an antecedent gift from the person who had been the sole proprietor cast considerable doubt as to the good faith of the parties involved in the arrangement. Congress, however, has attempted to remedy this situation in order to permit the formation of a family partnership in good faith even though some of the capital contributed by a partner had been the subject of a gift to him by another person, also a member of the partnership.<sup>4</sup> Although a long term program of inter vivos gifts may not solve all of the problems of retention, it will at least reduce the size of the problem by reducing the size of the owner's estate and the consequent tax liability. If gift tax returns are required and are audited as they sometimes will be, some precedents, helpful or otherwise, with respect to the value of the business will be established. Often, too, such gifts will result in an over-all income tax reduction to the family as a unit by spreading income among additional taxpayers with their own exemptions and deductions, causing such income to be taxed in lower tax brackets.

There will be many occasions where inter vivos gifts are not feasible or where such a program will provide only a partial solution. For example, where an owner's control of an enterprise is dependent upon continued control of a few shares of stock, he would be well advised not to part with any of it, even to a trusted member of his family whose untimely death with an ill-conceived will might place control with others. In many instances, the business interest will be too valuable and the program of gifts will have been commenced too late to accomplish more than a partial transfer of the business interest.

In the typical case, the question often asked is where will the money come from with which to pay the cost of dying. Fortunate and rare

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3. INT. REV. CODE of 1954, § 351.

4. The difficulties raised by *Commissioner v. Culbertson*, 337 U.S. 733 (1949); *Lusthaus v. Commissioner*, 327 U.S. 293 (1946); and *Commissioner v. Tower*, 327 U.S. 280 (1946) were sought to be remedied by the Revenue Act of 1951, § 340, 65 STAT. 511 (1951) (amending INT. REV. CODE of 1939, § 191 and § 3797(a)), now known as INT. REV. CODE of 1954, § 704(e).

is the owner of a business who has been able to remove from it sufficient funds, after taxes, so that his estate contains liquid assets enough to meet such obligations. So far as time is available and circumstances permit, the owner should begin to provide liquidity in his estate. Income splitting between husband and wife,<sup>5</sup> as afforded by the income tax law of 1948,<sup>6</sup> has facilitated the withdrawal of more money from a business at less tax cost. The new dividend exclusion and credit provisions of the Revenue Code of 1954 will also be of some help,<sup>7</sup> but more often than not, the cash, bonds, stocks, etc., will fall short of meeting the obligations of the estate.

If the owner is still insurable, and not so old as to make the premium rates on life insurance prohibitive, he might be well advised to take out additional insurance on his life or, at least, to rearrange the beneficiary and ownership provisions of existing insurance. The proceeds of insurance which are made payable to the assured's estate are certain to be available to the executor for the payment of the costs of dying. The advantage of such certainty, however, may be more than offset by the disadvantage that such insurance proceeds are exposed to the decedent's debts and to state inheritance taxes in most states.<sup>8</sup> In Missouri for example, payment to the estate will also increase the executor's commissions and probably the attorney's fees.<sup>9</sup>

On the other hand, if the insurance is made payable to an individual beneficiary, such as the owner's wife, with the expectation that she will make the proceeds available for the use of the estate by a loan to it or by the purchase from the estate of non-liquid assets, the proceeds will escape state inheritance tax,<sup>10</sup> will not be exposed to debts of the assured, and will not increase the costs of administration. However, there is always the danger that the wife may not be willing to make the proceeds available to the estate, or that her creditors may seize them, or that she may suffer an untimely death. If trustees of an *inter vivos* insurance trust are named as beneficiaries of the insurance and if the trustees are empowered to purchase assets from the estate or make loans to it, the advantages of an individual beneficiary are obtained plus greater assurance that the proceeds will actually be available for the cash needs of the estate.

The Revenue Code of 1954, by eliminating the "payment of premium" test in determining whether or not a decedent's insurance is

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5. INT. REV. CODE of 1954, § 2(a).

6. Revenue Act of 1948, § 301, 62 STAT. 114 (1948).

7. INT. REV. CODE of 1954, § 34 and § 116.

8. See, e.g., MO. REV. STAT. § 145.020-3(3) (1949).

9. In Missouri, an executor is allowed a commission of 5% on personal property and on money arising from the sale of real estate. MO. REV. STAT. § 465.100 (1949). Although not statutory, the fee for the executor's attorney will also bear a relation to the size of the estate.

10. See note 8 *supra*.

includible in his estate for federal estate tax purposes,<sup>11</sup> has furnished a new reason for not naming the estate of the assured as beneficiary. If a person who owns insurance on his life is willing to divest himself of the incidents of ownership in such policies and give them to another or to an inter vivos trust, he may continue to pay the premiums on such policies and yet the proceeds will not be taxed in his estate for federal estate tax purposes.<sup>12</sup> Such transfer of the ownership of insurance would constitute a gift, as would the payment of subsequent premiums, which would be taxable or not depending on the value of the policy, the amounts of the premiums, the annual exclusions, and the unused amount of the lifetime exemption.<sup>13</sup>

Often, however, there is insufficient insurance in existence or obtainable to meet the cash needs of the estate notwithstanding the arrangement of its ownership and beneficiaries. In such instances, where a corporate interest is involved, it might be possible to arrange for a redemption by the corporation from the estate of enough of its stock to pay the death taxes and certain other obligations of the estate. Before the Revenue Act of 1950 such a partial redemption of stock was typically treated as a dividend to the extent of earned surplus and taxed as ordinary income. That act,<sup>14</sup> however, added section 115(g)(3) to the Code of 1939, and the gain, if any, realized as a result of such partial redemption, where the requirements of that section were met, was taxed as a capital gain. Section 115(g)(3) was amended by the Revenue Act of 1951<sup>15</sup> in an effort to make it possible for more estates to qualify, and when this amendment did not fully accomplish the purpose intended, the provision was further liberalized by the Internal Revenue Code of 1954.<sup>16</sup> Now, before an estate can take advantage of these provisions, the stock in the corporation held by the estate must constitute more than thirty-five per cent of the value of the gross estate or more than fifty per cent of the value of the taxable estate. Where stock of more than one corporation is owned by the estate, such stock may be added together in determining whether or not the thirty-five per cent or the fifty per cent requirements are met, provided the estate owns more than seventy-five per cent of the stock

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11. INT. REV. CODE of 1954, § 2042.

12. Because a reversionary interest of 5% or more of the value of the policy immediately before the death of the assured is defined as a taxable reversionary interest (INT. REV. CODE of 1954, § 2042), the "fine print" of insurance policies should be studied carefully to make certain there are not unexpected reverter provisions in them. See also, Mannheimer, Wheeler, and Friedman, *5% Reversionary Interest in Proceeds of Life Insurance*, 5 MONTHLY DIGEST OF TAX ARTICLES 20 (1954) (condensed from the ESTATE PLANNER'S LETTER, Sept. 9 and Sept. 23, 1954) on whether inheritance of an insurance policy, previously assigned over, constitutes a reversionary interest.

13. See note 2 *supra*.

14. Revenue Act of 1950, § 209, 64 STAT. 932 (1950).

15. Section 320, 65 STAT. 498 (1951).

16. Section 303.

of each such corporation. Enough stock may be redeemed to pay the estate, inheritance, legacy and succession taxes, including interest, imposed by reason of the deceased's death and also the amount of funeral and administration expenses.

Those who would use this device must be wary of permitting stock of a majority interest to be redeemed to an extent that what remains no longer represents control. Where a corporation has been organized, or can be reorganized, with non-voting preferred stock, the preferred stock can be redeemed to raise cash without affecting control. For this device to be available, the corporation would need to have both a surplus and cash on hand from which to redeem the stock.<sup>17</sup> If it is anticipated that such redemption of stock may be needed and if the existence of cash and a surplus when needed is particularly doubtful, the corporation might consider the use of "key-man" insurance on the life of the owner of the business interest. Unless the estate alone, or with allies who can be relied on to vote with it, will have control of the corporation after the death of the owner, consideration, perhaps, should be given to a lifetime agreement whereby the corporation agrees to purchase stock from the estate on demand of the executor up to the amount of the taxes and funeral and administration expenses.

If the problem of raising funds to pay death costs can be solved, there are other devices available to facilitate retention of the business interest. Where the business is a partnership or a sole proprietorship, its incorporation should be considered. The probate administration of an estate containing a sole proprietorship or a partnership interest, and the transfer of such assets to the persons designated in the will, is more complex than where stock in an incorporated business is involved. This is not to say that incorporation should automatically follow. The frequently less favorable tax treatment of corporations and the inevitable increase in "paper work" may entirely justify a more complex probate administration.

The operation of a sole proprietorship must cease on the death of the owner and liquidation must follow, unless there is an express provision in the will authorizing the continued operation of the business or a specific order of the probate court to that effect (and preferably both).<sup>18</sup> Even with such authority to continue the business, the executor runs some risk in continuing its operation. In some states, it has been held that an order of the probate court authorizing the executor to continue the business is beyond its jurisdiction and hence is no protection to the executor.<sup>19</sup> In any event, the executor is personally liable

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17. See, e.g., MO. REV. STAT. § 351.200 and § 351.390 (1949).

18. See, e.g., *In re Mills' Estate*, 349 Mo. 611, 162 S.W.2d 807 (1942); *Metzger v. Metzger*, 153 S.W.2d 118 (Mo. App. 1941), transferred from 145 S.W.2d 380 (Mo. 1940).

19. 33 C.J.S., EXECUTORS AND ADMINISTRATORS §§ 193 to 197 (1942).

on contracts which he executes, absent an agreement by the other party to look only to the estate for satisfaction of obligations arising from such a contract,<sup>20</sup> and his right to indemnification by the estate will be ineffectual if the estate is insolvent. If continued operation of a sole proprietorship is so authorized, the will should also state what assets are to be considered assets of the business, what liabilities are to be paid by the business, and whether assets from the general estate may be added to the business.

A partnership interest is even more difficult to transfer to one's heirs. The death of a partner ordinarily dissolves a partnership.<sup>21</sup> The partnership does not terminate immediately upon a partner's death, however, but continues until the surviving partners wind up the partnership affairs in respect to the interest of the members of the partnership, and complete transactions entered into, but not consummated prior to the partner's death.<sup>22</sup> The surviving partner or, upon his failure to act, the executor or administrator of the deceased partner, is required to administer the partnership assets.<sup>23</sup> Such administration contemplates a transfer of the value of the deceased partner's interest in the partnership to his legatees or heirs. In its simplest and perhaps most frequent application, this results in either a complete liquidation of the business of the partnership and a division of the proceeds among the surviving partners and the estate of the deceased, or a purchase by the surviving partners of the deceased partner's interest in the partnership. In either event the deceased partner's heirs or legatees no longer have an interest in a going business. Although often difficult to accomplish, other arrangements are possible which retain the estate's interest in the business of the partnership. Although the dissolved partnership will terminate when its affairs are wound up, the *business* of the dissolved partnership may continue in the form of a new partnership or a sole proprietorship.<sup>24</sup> There would seem to be no reason, as a matter of law, why the executor of the estate of the deceased partner could not become a member of the new partnership if the old partnership agreement so provides and if the will of the deceased partner so authorizes. Unless the executor were to become a limited partner, however, the entire estate would be exposed to liability for debts incurred by the new partnership.<sup>25</sup> So far as the general assets of the estate are concerned, the general creditors of the estate of a deceased partner are given priority as against

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20. McClatchey, *Liability of Fiduciaries in Operating Business Enterprises*, 90 TRUSTS & ESTATES 528 (1951).

21. MO. REV. STAT. § 358.310 (1949); UNIFORM PARTNERSHIP ACT § 31 (1949).

22. MO. REV. STAT. § 358.300 (1949); UNIFORM PARTNERSHIP ACT § 30 (1949).

23. See, e.g., MO. REV. STAT. § 461.650 (1949).

24. 40 AM. JUR., PARTNERSHIP § 197 (1942).

25. See MO. REV. STAT. § 358.360 (1949); UNIFORM PARTNERSHIP ACT § 36 (1949).



creditors of the dissolved partnership, but this would not be so as against creditors of the new partnership after the executor becomes a general partner.<sup>26</sup> For this reason, a probate court might raise some objection to an executor becoming a general partner, especially if there is any question about the solvency of the estate. A partnership agreement might also provide that when administration of the deceased partner's estate is closed, the person to whom the partnership interest is bequeathed would become a partner. The legatee might object to this, however, and even the partners might be unwilling to agree to such a plan, except with respect to an heir specifically designated in the partnership agreement, and even then, perhaps, only where necessary to avoid liquidation of the partnership business. However, such an arrangement might be the only way of avoiding liquidation of the partnership if the capital of a profitable partnership is substantial and the partner likely to die first has a large interest in the business, and if the probable surviving partners are not likely to be able to buy out the deceased partner's interest.

Where the business interest is already incorporated, these problems do not exist, but even then, it might be appropriate to reorganize the capital structure by the creation of preferred stock in order to facilitate a division of the value of the corporation among the various objects of the owner's bounty.<sup>27</sup> For example, cumulative preferred stock with voting rights only on default in dividends might be bequeathed to a married daughter, with the voting common stock going to a son who is active in the business.

If the business interest is to go in trust under a will, it is even more necessary that the interest be incorporated. It is doubtful whether many corporate trustees would be willing to operate an unincorporated business interest in trust.<sup>28</sup>

The kind of will which is drawn, and the provisions which it contains, can help or hinder the retention of a business interest. Where the availability of cash to meet death costs is a problem and where the owner has a wife who may survive him, consideration should be given to taking full advantage of the marital deduction under the federal estate tax law<sup>29</sup> in order to hold the estate tax to a minimum, thus reducing the need for cash to meet the decedent's obligations.

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26. MO. REV. STAT. § 358.360 (1949); UNIFORM PARTNERSHIP ACT § 36 (1949).

27. Such a reorganization can be accomplished without tax consequences if brought within the provisions of § 305 of the Internal Revenue Code of 1954. Foonsaner, *Stockholder Estate Problems*, 92 TRUSTS & ESTATES 908 (1953); Kumler, *Corporate Stockholder Relationships Under the New Code*, 5 MONTHLY DIGEST OF TAX ARTICLES 11 (1954) (condensed from the Committee Report of the Tax Section of the American Bar Association).

28. Some differences of opinion apparently exist on this point among trust officers. See panel discussion at the American Bankers Association Mid-Winter Trust Conference of Feb. 8, 1953, *Handling Businesses in Trust*, 93 TRUSTS & ESTATES 105, 110 (1954).

29. INT. REV. CODE OF 1954, § 2056.

In the case of a sole proprietorship, as was indicated earlier, the will should authorize the executor to retain and to operate the business, should delineate the assets, should probably authorize incorporation of the business and should state whether or not assets from the general estate may be put in the new corporation. Where it seems at all likely to be needed, the executor should be authorized to change the nature of the business. He should be authorized to employ managers and, where appropriate, the executor should also be authorized to act as manager of the business and be compensated over and above his executor's commissions. Where the sole proprietorship is bequeathed to certain persons and the residue of the estate to others, it is usually appropriate to specify in the will that obligations of the business as of the date of death, as well as those incurred during administration, shall be paid out of the business assets.

Where the business interest is a share of a partnership, it will ordinarily be sufficient in the will to direct the executor to carry out the provisions of the partnership agreement, which, in turn, should detail the respective rights and liabilities of the deceased partner's estate and those of the surviving partners.

Where the business interest consists of shares of a corporation, the executor usually needs no specific authority to retain the stock and, absent special circumstances, such as a need to raise cash, an executor will not be permitted to dispose of it.<sup>30</sup>

Before the will is drawn, a decision must be made as to whether the business interest is or is not to be placed in trust. There are a number of reasons why the business interest will sometimes be placed in trust. If the estate plan does not use the business interest as a part of the marital deduction, it can be placed in a non-qualifying trust for the life of the widow or in a trust for the life of one or more beneficiaries other than the widow and, under present law, no federal estate tax need be incurred on the business interest when it passes out of trust to the remainderman.<sup>31</sup> Thus, successive estate taxes may be avoided. A trust might also be useful as a sort of "caretaker" of the business until a member of the family achieves sufficient maturity and experience to take over its management. A trust will also enable the retention of a centralized control of the business through stock ownership by the trustees while, at the same time, affording a division of the earnings of the business among a large number of beneficiaries who might not be able to work together in harmony as stockholders. For these, and perhaps other reasons, it will sometimes be desirable for the business interest to be placed in trust.<sup>32</sup>

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30. Mo. REV. STAT. §§ 463.010 to 463.130 (1949).

31. See, e.g., INT. REV. CODE OF 1954, § 2031 and § 2033, *Helvering v. Rhodes Estate*, 117 F.2d 509 (8th Cir. 1941).

32. Pfeleiderer, *When the Fiduciary Takes Over*, 93 TRUSTS & ESTATES 107

If there is to be a trust, some of the will provisions discussed above with respect to an executor are equally applicable to trustees. For example, the trustees might be authorized to incorporate an unincorporated business. They too should be specifically authorized to employ managers. The will should also authorize additional compensation for the additional burdens of supervising the operation of the business.<sup>33</sup> This is best worked out in advance with the prospective trustee, although an acceptable method is to refer specifically, by date or other means of identification, to a printed schedule of fees if one has been published by the chosen trustee. Specific authority should be included in the will, when a need for it might conceivably arise, which would authorize a trustee to also serve and be compensated as a director, officer or manager of the business and to pass on his own compensation as such. Where a bank is named as trustee, specific authority should be granted in the will to permit its loan department to continue or to make loans to the business.

Of course, the trustees will be specifically authorized to retain the business interests, but to the power of retention should be added the power of disposition. Rarely, if ever, should retention of the business interest be *directed*; it should only be *authorized*. The will should specifically waive the requirements of state law pertaining to investments in "legals," diversification and productivity. A waiver as to productivity, however, might disqualify the business interest for the marital deduction if a power of appointment trust is employed.<sup>34</sup>

Where executors and trustees are expected to undertake the continued operation of a business, which usually involves more than ordinary hazards, the matter of a broad exculpatory or exoneration clause should be carefully considered. Probably a non-professional executor or trustee should be exonerated from liability for loss occasioned by the continued operation of a business except where the loss was brought about by willful misconduct or fraud on the part of the executor or trustee. Whether or not professional executors or trustees should be similarly exonerated, when called upon to operate a business, is more debatable. Some professional trustees have taken the position that they want no exoneration from any liabilities for loss for which they would be liable under general principles of law.<sup>35</sup> On the other hand, it might be that an otherwise unwilling professional executor or trustee would accept appointment and operate a business if given

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(1954); Pope, *When Trustee Goes in Business with His Human Relations*, 91 TRUSTS & ESTATES 8 (1952).

33. Johnson, *Extra Compensation*, 93 TRUSTS & ESTATES 109 (1954).

34. U.S. Treas. Reg. 105, § 81.47a(c) (1951). "Legals" are investments authorized by statute.

35. See panel discussion at the American Bankers Association Mid-Winter Trust Conference of Feb. 8, 1953, *Handling Businesses in Trust*, 93 TRUSTS & ESTATES 110 (1954).

exoneration for everything except willful misconduct, fraud or gross negligence.

Special care should be taken to extend to successor executors and trustees the powers given to those originally named. The will should carefully avoid too much "management from the grave," which, for example, would seek to direct the employment of specified persons or to govern like details.

### *Disposition of the Business Interest*

Let us now assume that, for one reason or another, retention of the business interest is either not desirable or is not feasible. What planning should be considered in order to facilitate its disposition in a way which achieves maximum realization of the value of the business?

Perhaps the first question to be considered is whether disposition shall be before or after the death of the owner. Disposition before death will not be practicable until the owner is psychologically and financially ready to retire. Many businessmen are never willing to step from the saddle into the rocking chair. Others, although willing, may be unable to exchange the usually greater financial rewards of a successful business for the more conservative income of other investments. Yet, there is a likelihood that a better price will be obtained if the owner personally makes disposition of his business interest, instead of the executor who is less familiar with it and who is under pressure to close out the administration of the estate. Disposition before death, however, would incur a tax, usually at capital gains rates, on the profit, if any, from the disposition,<sup>36</sup> whereas after death, probably no gain would result because of the new cost basis acquired upon the owner's death.<sup>37</sup>

What kind of disposition should be sought—liquidation, merger or sale? There may be no choice in the matter. Generally speaking, liquidation can be expected to produce the poorest results. The going concern value or good will is lost, the assets are sold at a discount and accounts receivable become harder to collect. Disposition by sale as a going concern is more likely to realize the full value of good will and other assets. Mergers have been used in many instances, in lieu of liquidation or sale, whereby the stock of a smaller closely held corporation is exchanged for the stock of a larger corporation. If properly arranged, there will be no tax at the time of the merger, but such tax as there may be will be deferred until the stock acquired in the exchange is sold.<sup>38</sup> The listed stock of the larger corporation is more

36. INT. REV. CODE OF 1954, §§ 1201 to 1241 (Capital Gains and Losses).

37. INT. REV. CODE OF 1954 § 1014.

38. INT. REV. CODE OF 1954, §§ 351 to 368 (Corporate Organizations and Reorganizations). Provisions in the original House bill which would have virtually eliminated the tax-free character of such mergers were omitted from the Code as enacted. H.R. 8300, 83d Cong., 2d Sess. § 359 (1954).

readily marketable and its value is more readily determinable, which fact may avoid a contest over inflated values which the Commissioner of Internal Revenue has been known to claim where no readily determinable market value can be easily shown.

A device by which an owner of a business interest can obtain, to some degree at least, the advantages of a sale before death, while enjoying during his lifetime the advantages of continued ownership, is the buy and sell agreement.<sup>39</sup> Such an agreement is frequently employed between partners, between shareholders or between shareholders and their corporation. Basically and in its simplest form, partner or stockholder *A* and partner or stockholder *B* agree that the survivor of them will purchase, and that the estate of the first to die will sell, the partnership interest or the stock of the first to die at a price to be determined in the manner set forth in the agreement. The fact that insurance is very often necessary in order to "guarantee" the performance of such an agreement, has caused this arrangement to be promoted extensively by insurance men. Undoubtedly, buy and sell agreements are often helpful in the disposition of an owner's business interest, with a resultant benefit to his estate and heirs. Too often, however, such agreements have been entered into without an adequate realization by the parties and their advisors of the consequences of their actions or of the problems involved.

Buy and sell agreements often assume a certain succession of deaths; usually that the older owner with a larger interest will predecease the younger owner with a smaller interest who will then acquire the deceased's interest in the business. When, however, the younger man dies first, as sometimes happens, the older man will have to invest even more of his assets in the business, instead of having his estate "bailed out" as was intended. Where the parties to the contract have approximately the same life expectancies, the one who fortuitously dies first will have his interest purchased by the survivor. The question then arises as to who will "bail out" the estate of the survivor, which by then will consist of not just part of the business but perhaps all of it. It may be that the survivor should not invest still more of his assets in the business venture, but under the agreement he will have to do so and may even have to put himself into "hock." Conceivably also, the erstwhile friendly business associates may have a falling out before the death of either of them, in which event the buy and sell agreement is one more knot to untie.

Frequently, in buy and sell agreements, the deceased business associate has actually furnished the money with which his own business

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39. See HIRST, *BUSINESS LIFE INSURANCE AND OTHER TOPICS* (1949); Neuhoff, *Book Review*, 15 *MO. L. REV.* 320 (1950). For a comprehensive series of articles on buy and sell agreements, see Ray and Hammonds, *Tax Aspects of Business Purchase Agreements*, 89 *TRUSTS & ESTATES* 368, 448, 523 (1950).

interest is purchased by the survivor. This will occur, for example, where the larger owner permits the compensation of the smaller owner to be increased above what would otherwise be paid to him in order that the latter may be enabled to build up a fund, by savings or by purchasing insurance on the life of the larger owner, with which to acquire his stock on death.

One should caution the client to guard against an expectation of getting "something for nothing." Persons contemplating the execution of a buy and sell agreement should not lose sight of the fact that insurance premiums are established actuarially, so that, based on all the insurance in effect, the total premiums paid, plus earnings thereon, will exceed the proceeds of insurance paid out by the insurance company. This "something for nothing" will only be realized if one of the parties to the agreement dies before his expectancy. Perhaps each party to the agreement optimistically expects to be the survivor and to benefit by the windfall which would thus occur. Where such a windfall does occur it goes not to the estate of the deceased business associate, which may be in dire need of a "break," but rather to the survivor who uses the insurance proceeds to acquire his former associate's interest in the business. If instead of having entered into a buy and sell agreement, funded by insurance, the deceased business associate had purchased insurance on his own life, the deceased's heirs would have received the windfall occasioned by his death before expectancy and would still possess the business interest which could then be marketed for whatever it would bring. So long as it would bring more than the surrender value of the insurance on the life of the survivor, which under the usual buy and sell agreements would then be owned by the deceased's estate, the heirs of the deceased owner would have been better off had he bought insurance on his own life.<sup>40</sup>

Undoubtedly some buy and sell agreements are motivated by a desire on the part of the principal owner to retain the association of

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40. A corporation worth \$100,000 has two equal stockholders, *A* and *B*, each 45 years old, and insurable. If *A* and *B* enter into a buy and sell agreement and each insures the life of the other for \$50,000 (ordinary—non-participating) and *A* dies within one year of the issuance of the policies, *A*'s family will net \$48,479 (\$50,000 received from *B* for *A*'s stock minus \$1,521, the first year's premium). (The policy on *B*'s life, which the estate now owns, has no surrender value as yet since the policy has been in effect for less than one year). If *A* had not made a buy and sell agreement and had insured his own life, his family would have \$48,479 plus one-half the stock of the company or its market value. If *A* lives for ten years and then dies with a buy and sell agreement, his family nets \$45,390 (\$50,000 less premiums paid of \$15,210, plus surrender value of policy on *B*'s life \$10,600). *B* will net \$84,790 (\$100,000 value of business, less premiums paid on policy on *A*'s life). Had *A* insured his own life instead, his family would net \$34,790 (\$50,000 less premiums of \$15,210) plus whatever one-half of the business would bring. If *A* lives twenty years and then dies, with a buy and sell agreement, his family nets \$42,130 (\$50,000 less premiums paid of \$30,420 plus surrender value of \$22,550). *B* nets \$69,580 (\$100,000 less premiums of \$30,420). If *A* had insured his own life instead, his family would net \$19,580 (\$50,000 less premiums of \$30,420) plus the value of the business.

a valued partner, key employee or stockholder officer by giving him a present expectancy of a future benefit in the form of a larger interest in the business. Other such agreements are undoubtedly occasioned by a desire to confer a benefit on a business associate while at the same time assuring the estate of the deceased owner of a prompt conversion of his business interest into cash even though at a minimum figure. Still others might be motivated by the fact that where the principal owner is in a much higher income tax bracket than the prospective surviving associate, more money will remain after taxes if that which is available is paid to the associate. This larger sum will purchase more insurance on the life of the principal than the principal could have purchased had he received the money. This might permit a more generous formula to be used in setting the price on the business interest of the principal and, in the long run, might result in a larger net payment to the estate of the deceased principal.

The difficulties with respect to buy and sell agreements are not necessarily fatal in every case, and there will be many occasions where businessmen will desire to enter into such agreements, even when they are made acquainted with the problems. In such instances, it is important that the best method be chosen.

Basically, there are two kinds of buy and sell agreements and each has its advantages and disadvantages. One kind, the so-called "indirect" method,<sup>41</sup> or "entity" plan,<sup>42</sup> contemplates the purchase by the corporation or the partnership of the business interest of the stockholders or partners, as the case may be. The stockholders or partners, on behalf of their estates, agree to sell. More often than not the partnership or the corporation purchases life insurance on the lives of the stockholders or partners who are parties to the agreement. The other approach is the "direct" or "cross-purchase" method, whereby two or more of the partners or stockholders agree with each other to purchase their respective stock or partnership interests on death. Ordinarily this is funded by insurance, with each stockholder or partner taking out life insurance on the lives of the other stockholders or partners who are parties to the agreement.

As a matter of procedure and administration, the entity method is less complex than the cross-purchase plan. One major convenience of the entity method is that there are fewer insurance policies to purchase. The corporation or the partnership will only be obliged to purchase one policy of insurance on the life of each stockholder or partner whose interest is to be retired. Under the cross-purchase plan, each stockholder or partner who is a party to the agreement will have

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41. HIRST, *op. cit.* *supra* note 39.

42. Redeker, *Business Insurance Agreements*, 93 TRUSTS & ESTATES 386 (1954).

to take out a policy of insurance on the life of each of the other stockholders or partners who are parties to the agreement. Where, for example, four parties are involved, a total of twelve policies of insurance will have to be written under the cross-purchase plan, whereas under the entity method only four policies would have been required. As the number of parties involved in such an agreement increases, the arrangement becomes more and more burdensome. For this reason it is easier under the entity method to add or subtract parties to the agreement, or to increase or decrease the insurance on their lives as their interests in the business change.

Before the enactment of the Revenue Code of 1954, cross-purchase plans involving three or more parties and funded by insurance were handicapped by the assignment for value rule.<sup>43</sup> For example, if *A*, *B* and *C* were equal partners in a partnership worth \$150,000 and each had insured the lives of the other two for \$25,000, when *A* died, *B* and *C* each collected \$25,000 of insurance proceeds and used it to purchase, equally between them, *A*'s interest. After that *B* and *C* each owned a \$75,000 interest in the partnership, but had only \$25,000 of insurance on the other's life with which to acquire his \$75,000 interest. If *B* purchased from *A*'s estate the insurance policy on *C*'s life, on *C*'s death *B* would be taxable on the difference between the insurance proceeds and what he had paid for the policy plus premiums he had paid after acquiring it. The same result followed if *C* purchased the policy on *B*'s life. Consequently, the usual practice was for *A*'s estate to either cash in its policies on the lives of *B* and *C* or to sell the policy on *B*'s life to *B* and the policy on *C*'s life to *C*. If *B* and *C* each acquired the policy on his own life, there would be no tax on the proceeds of the policies as each died, but the proceeds would not be useful in carrying out the buy and sell agreement. The Revenue Code of 1954<sup>44</sup> introduced an exception to the general assignment for value rule which will permit *B* and *C*, partners of *A*, each to purchase from *A*'s estate the policy of insurance on the life of the other without tax consequences. This exception would not appear to cover the situation if *A*, *B* and *C* were stockholders in a corporation and *B* and *C* each purchased from *A*'s estate the policy of insurance on the life of the other. Here, the assignment for value difficulty still exists. The entity plan, however, suffers from no such handicap.

The entity plan enjoys another practical advantage over the cross-purchase plan in that the corporation or partnership pays the pre-

43. INT. REV. CODE of 1939, § 22(b) (2) (A).

44. INT. REV. CODE of 1954, § 101(a) (2) (B). Even if for a value consideration, the proceeds will be exempt

. . . if such transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.



miums on the insurance. This often makes it more attractive to the individuals involved. In the case of a partnership, the attraction is more psychological than real because no tax saving results. The premiums are not deductible and the partners are taxed on all of the net earnings of the partnership, whether distributed or not.<sup>45</sup> In the case of a corporation, however, tax savings are sometimes possible under the entity plan. Under the cross-purchase plan, however, if dividends are paid to the stockholders so that they can pay the premiums for the insurance on the lives of the other stockholders, such funds will first have been taxed to the corporation and again to the recipient of the dividend. The 1954 dividend exclusion and credit provisions will only serve to soften a little the impact of such "double taxation."<sup>46</sup> Under the entity plan, only the corporation tax will have been paid on such funds. If, however, the stockholders can receive the premium money in the form of increased compensation, the corporation will have an expense deduction and only the individual income tax on the recipient will apply. In such instance, whether a tax saving results from the use of the entity plan depends upon the respective tax brackets of the stockholders and the corporation.

As against these apparent advantages of the entity plan are some rather substantial practical and legal disadvantages. Under the cross-purchase plan it is clear that the purchasers, whether stockholders or partners, obtain a "stepped-up" cost basis for their interests in the business, thereby reducing or eliminating their capital gains upon a subsequent sale of their interests. Under the entity plan, however, stockholders do not get an increase in their cost basis.<sup>47</sup>

Entity plans also present an inherent dilemma. If the insurance proceeds collected on the death of the insured stockholder or partner are counted in computing the value of the deceased's interest in the business there will be insufficient insurance proceeds with which to acquire that interest.<sup>48</sup> To illustrate, *A* and *B* each own one-half of a corporation which has a value of \$100,000. The corporation insures the life of each for \$50,000. *A* and *B*, through their corporation, in effect have each paid one-half of the premiums. On *A*'s death the corporation collects \$50,000 and then has a value of \$150,000. *A*'s

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45. INT. REV. CODE of 1954, § 702.

46. INT. REV. CODE of 1954, § 34 and § 116.

47. Query, whether the surviving partners, under the entity plan, would get a stepped-up cost basis. Would § 705 of the Internal Revenue Code of 1954, which gives an increased basis to a partner in the amount of his distributive share of the partnership tax exempt income, operate to increase the partner's basis to the extent of his share of the net gain on the proceeds of an insurance policy? See also Redeker, *supra* note 42, written before the enactment of the 1954 Code, where the author plausibly argues that partners under the entity plan should get a stepped-up basis.

48. HIRST, *op. cit. supra* note 39; Haddad, *Disposition of Business Interests*, 1949 U. ILL. L.F. 115.

estate's interest is then really worth \$75,000. But the corporation has only \$50,000 of insurance proceeds with which to purchase such interest. Because of this, some plans ignore the insurance proceeds in computing the value of the deceased's interest, which, it is submitted, may well be grossly unfair to the estate of the first to die. If the insurance proceeds are to be sufficient to cover the purchase price of the deceased's interest, fairly computed, the company would need to insure the life of each stockholder for \$100,000. Then on the death of *A* the value of the corporation would have been \$200,000 and the value of *A*'s one-half interest would have been \$100,000, the amount of the insurance proceeds available. This dilemma is avoided under the cross-purchase plan.

Another difficulty with the entity plan, where a corporation is involved, is presented by the usual requirement that a corporation may purchase its stock only from surplus.<sup>49</sup> It is impossible to know now whether a corporation, perhaps years hence on the death of a stockholder, will have a surplus, even if the agreement is funded by insurance and the proceeds are collected.<sup>50</sup>

Another danger, once thought to be implicit in the entity plan, was the possibility that both the value of the business interest and of the insurance on the life of the deceased owner would be included in his estate for estate tax purposes. Clearly the deceased's interest in the partnership or his stock in a corporation is includible in his gross estate.<sup>51</sup> Proceeds of insurance on the deceased's life, collected by the partnership or by the corporation, were said to be included in his gross estate by reason of his relationship to the partnership or to the corporation under the "alter ego" and "indirect payment of premiums" theories.<sup>52</sup> The Commissioner of Internal Revenue attempted this in a series of cases but was uniformly unsuccessful.<sup>53</sup> The Revenue Code of 1954, by dropping the payment of premiums test, has made this danger even more remote.<sup>54</sup>

Another difficulty with the entity plan, where a corporation is involved, is that it presents the problem whether the purchase by the corporation of the deceased stockholder's shares will be considered a con-

49. See, e.g., Mo. REV. STAT. § 351.390 (1949).

50. A New York case ruled invalid an entity plan buy and sell agreement between a corporation and its stockholder because under New York law a corporation could only purchase its own stock out of surplus and it could not be determined in advance whether there would be a surplus. *Topken, Loring & Schwartz, Inc. v. Schwartz*, 249 N.Y. 206, 163 N.E. 735 (1928).

51. INT. REV. CODE of 1939, § 811(a), now INT. REV. CODE of 1954, § 2033.

52. INT. REV. CODE of 1939, § 811(g)(2) and U.S. Treas. Reg. 105, § 81.27 (1943), stating in part, "... a decedent similarly pays the premiums if payment is made by a corporation which is his alter ego."

53. G. C. Ealy, 10 CCH T.C. MEM. DEC. 431 (1951); Ray E. Tompkins, 13 T.C. 1054 (1949); John T. H. Mitchell, 37 B.T.A. 1 (1938); M. W. Dobrzensky, 34 B.T.A. 305 (1936); Boston Safe Deposit & Trust Co., 30 B.T.A. 679 (1936).

54. INT. REV. CODE of 1954, § 2042.

structive dividend. Under the 1939 Code and Regulations<sup>55</sup> it appeared reasonably certain that the purchase of *all* of such stockholder's shares would not be considered a dividend, especially if he retained no interest in the corporation through trusts, other corporations or members of his immediate family. On the other hand, it appeared rather clear that a purchase by the corporation of part of the deceased's stock would be taxed as a dividend to the extent of surplus, except to the extent that such partial purchase could be made to qualify for capital gains treatment under Section 115(g)(3) of the 1939 Code.<sup>56</sup> The Revenue Code of 1954, however, provides generally that redemption by a corporation of its stock results in capital gains treatment and not in a dividend, unless the redemption is "essentially equivalent to a dividend."<sup>57</sup> The Code then defines certain redemptions which will not be considered essentially equivalent to a dividend, including the purchase of all of a stockholder's shares in the company. In such an event there is no dividend unless the transaction runs afoul of the constructive ownership of stock rules, which are less stringent where the stockholder's interest is fully redeemed.<sup>58</sup> If there is anything less than a complete purchase of the stockholder's interest, the provisions of the new Code must be carefully complied with to avoid a constructive dividend. Even with a complete redemption, one must watch out for circumstances which would bring into play the constructive ownership rules.

Much has been written to the effect that where a corporation is involved and the entity theory employed, the agreement by the corporation to purchase its own stock and to purchase life insurance on the lives of its stockholders to fund the agreement invites "Section 102 trouble" (accumulated earnings tax) under the Internal Revenue Code of 1939, or as it is known under the Revenue Code of 1954, "Section 531 trouble." The theory has been that the agreement is some indication that the corporation had no need for the money for ordinary corporate purposes. Dictum in the *Emeloid* case,<sup>59</sup> which said that buy and sell agreements serve a bona fide corporate purpose of promoting harmony in the business, did much to relieve the concern about the possible application of that section. Now, the exclusions from and the procedural limitations on the application of the accumulated earnings tax, introduced by the Revenue Code of 1954,<sup>60</sup> will afford further protection to corporate buy and sell agreements on the entity plan.

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55. INT. REV. CODE of 1939, § 115(g)(1); U.S. Treas. Reg. 118, § 39.115(g)(1) (1953).

56. Tax free redemption of stock to pay death taxes.

57. INT. REV. CODE of 1954, § 302(b)(1).

58. INT. REV. CODE of 1954, § 302(a)(b)(c) and § 318.

59. *Emeloid Co. v. Commissioner*, 189 F.2d 230 (3d Cir. 1951), reversing 14 T.C. 1295 (1950).

60. INT. REV. CODE of 1954, § 532 and § 537.

As has been stated, one of the principal dangers to the owner of a business interest is that the Internal Revenue Service will seek to place a value on the interest, based on the earnings of the business during years when the owner was in charge, which may be far in excess of its real market value, especially after the death of the owner, who is often the founder and guiding spirit of the enterprise.<sup>61</sup> The price for the business interest set by a carefully drawn buy and sell agreement may be determinative of the federal estate tax valuation and will at least be persuasive.<sup>62</sup> The agreement should provide a method of arriving at the price to be paid for the business interest which is fair, and the price should bear an arguable relationship to market value as determined by the application of more or less objective and acceptable methods. Where the agreement is between members of a family, particular pains must be taken towards this end if it is to have any influence on estate tax values because family transactions and agreements are viewed with suspicion when dealing with questions of taxation. The agreement must prohibit any party from selling his interest during his lifetime, at least without offering it to the other parties at a price determined in the agreement.<sup>63</sup> It is best if there is a binding agreement on all parties and their estates to buy or to sell, as the case may be, but at least the survivors must have a binding option to buy from the deceased's estate at the price determined according to the agreement.

It has been suggested that an owner of a business with a "trusteed" pension or profit sharing plan might work out an agreement with the trustees whereby the trust would purchase his interest on his death.<sup>64</sup> It is suggested that such an agreement might destroy the qualified character, and thus the tax exemption, of the trust. The danger is that

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61. An often used formula in computing the value of stock in a close corporation is one which takes the average earnings for the last five years, minus 8% of the average tangible assets, multiplied by 6.66. Computation in this way attributes to a close corporation, disorganized and weakened by the death of its executive, a per share value greatly in excess of the listed per share value of a "blue chip" corporation having the same earnings per share ratio. Casey, *Business Insurance*, 89 TRUSTS & ESTATES 818 (1950).

62. *Helvering v. Salvage*, 297 U.S. 106 (1936); *Lomb v. Sugden*, 82 F.2d 166 (2d Cir. 1936); *Wilson v. Bowers*, 57 F.2d 682 (2d Cir. 1932); *May v. McGowan*, 97 F. Supp. 326 (W.D.N.Y. 1950); *Lionel Weil*, 22 T.C. No. 158 (Sept. 27, 1954) (not binding where no lifetime restrictions on sale); *Robert R. Gannon*, 21 T.C. No. 121 (March 31, 1954) (earnings from beginning of year to date of death were added); *George M. Trammell*, 18 T.C. 662 (1952); *Albert L. Salt*, 17 T.C. 13 (1951); *Clare Giannini Hoffman*, 2 T.C. 1160 (1943), *aff'd sub nom. Giannini v. Commissioner*, 148 F.2d 285 (9th Cir. 1945), *cert. denied*, 326 U.S. 730 (1945); see also *Mannheimer, Wheeler and Friedman*, *supra* note 12.

63. A provision in an agreement that a sale will not be made to an outsider without first giving the parties an opportunity to match the offer will not establish estate tax valuation. *Worcester County Trust Co. v. Commissioner*, 134 F.2d 578, 582 (1st Cir. 1943).

64. *Foosaner, Stockholder Estate Problems*, 92 TRUSTS & ESTATES 908, 910 (1953); *Zeigen, The Business Continuation Agreement*, 8 J. AM. SOC. C.L.U. 29 (1953).

the agreement might be considered a plan to bail out the owner of the business and aid his estate and family, rather than to benefit the employees under the pension or profit sharing plan.<sup>65</sup>

Under the 1939 Code, it was often uncertain whether payments from a continuing partnership to the estate of a deceased partner were to be treated as a return of capital, with the appreciation in value, if any, taxable as a capital gain or as ordinary income. Frequently, the result appeared to turn on the specific language selected.<sup>66</sup> The Revenue Code of 1954 makes capital gain rates applicable to the extent that payments are for "the interest of such partner in partnership property . . ." but goes on to provide that such interest shall not include amounts paid for "unrealized receivables" nor for "good will," "except to the extent that the partnership agreement provides for a payment with respect to good will."<sup>67</sup> Amounts paid other than for an interest in the partnership will be taxed as ordinary income to the estate of the deceased partner and will be excluded from the taxable income of the surviving partner. On the other hand, payments for an interest in the partnership property are not allowable as a deduction to the surviving partner. Whether it is advisable to provide in the partnership agreement for a payment for "good will," thus converting it into an interest in partnership property, will depend on the respective tax brackets and life expectancies of the partners involved and whether tax advantages are to be given to the estate of the deceased partner or to the surviving partners.

As in cases involving the retention of a business interest, a carefully drawn will is important where the estate plan contemplates a disposition of the business interest. If a sale has been arranged before death, which is to be carried out after death, as with a buy and sell agreement, the will should expressly instruct the executor to carry out the terms of the sale. Absent a prearranged sale, or other very special circumstances, the will should not ordinarily direct the sale or liquidation of the business interest. To do so would almost certainly depress the market, impair employee morale and injure customer and supplier relationships. Instead, the executor should be authorized, in his discretion, to dispose of the business, and even such authorization is best grouped in a "general powers" clause with a further authorization to retain the business if he deems that to be the proper course. So that he will know what is expected of him, the executor usually should be made aware, before death, of the owner's decision as to retention or

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65. INT. REV. CODE of 1954, §§ 401(a)(2), 501(a), 503(a)(1), and 503(c) (especially subsections (4) and (6)); Haddad, *Disposition of Business Interests*, 1949 U. ILL. L.F. 115, 117.

66. See, e.g., *Bull v. United States*, 295 U.S. 247 (1935); *Raymond S. Wilkins*, 7 T.C. 519 (1946), *aff'd* 161 F.2d 830 (1st Cir. 1947); *Charles F. Coates*, 7 T.C. 125 (1946); *Bavier C. Miller*, 38 B.T.A. 487 (1938).

67. INT. REV. CODE of 1954, § 736(b)(1) and § 736(b)(2)(B).

disposition of the business interest and the reasons for such a decision. If it is not practicable for the executor to know the owner's decision prior to death, a business confidant, family lawyer, elder son, business-minded widow or someone else, should be made fully aware of the decision and the reasons for it, so as to be in a position to advise the executor. Non-testamentary "letters of instruction" over the signature of an owner have been employed, but it is difficult to express adequately in a letter or memorandum all of the factors and conditions which have led to the decision, the absence of which might dictate an opposite conclusion. There is danger, too, that a letter of instruction, once written, will be allowed to continue unrevoked, although the decision has been reversed because of a change in circumstances. There is no substitute for frequent discussions between the owner and his associates or the prospective executor as to the current situation so that the decision is always "fresh."

Where a partnership or sole proprietorship is involved, even where disposition of the business is contemplated, the will should specifically authorize the continued operation of the business in order that the sale or liquidation can proceed in an orderly manner without an immediate cessation of operations. The owner may sometimes wish to give certain persons, such as relatives or key employees, the first opportunity to purchase his business interest. Such persons should either be named or the group should be carefully defined, and such matters as price, terms of purchase, deferred payment, security for deferred payment, time within which the election to purchase must be made, and the manner in which the estate is to be notified of the election, should be carefully spelled out.

Rarely, if ever, should a will provide that in the event of sale, the executor must obtain a specified price or close the sale within a designated period of time or secure the consent of third parties to the terms of the sale.

Timely, thoughtful and realistic estate planning is likely to be more essential and profitable to the man with a business than to others. Such planning will present many difficulties to the attorney. Yet, often his chief difficulty will be to persuade his client to take time from his business to ponder the fact that all men are mortal.