Vanderbilt Law Review

Volume 2
Issue 2 *Issue 2 - A Symposium on Estate Planning*

Article 7

2-1-1949

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Recommended Citation
Alec Brock Stevenson, Some Aspects of Estate Planning in Tennessee, 2 *Vanderbilt Law Review* 265 (1949)
Available at: https://scholarship.law.vanderbilt.edu/vlr/vol2/iss2/7

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SOME ASPECTS OF ESTATE PLANNING IN TENNESSEE

ALEC BROCK STEVENSON *

Not many years ago a large New York bank circulated privately a booklet with the provocative title "The Passing of the Simple Will." The choice of the title and the text itself underlined the complexities which surround the owner of property and his advisers when they jointly attempt to plan the disposition of a modern estate for modern needs. The now almost legendary owner of Blackacre could, indeed, write a simple will, quite effective and satisfactory as a plan for the disposition and use of the family property. One need scarcely recite the changes which have taken place in more recent times: the special characteristics of the relatively newer types of property interests, such as insurance, and the specific legal conditions and prohibitions which encircle them have received expert attention elsewhere in this symposium. The estate planner, be he owner or professional consultant, has become a tightrope walker precariously balanced between what is possible and what is desirable. That which is desirable from the family standpoint, and may also be legally proper, all too often runs afoul of federal or state tax law, or both.

This paper has limited objectives. They are (1) to examine a typical family situation in need of estate planning, proposing one out of many possible practical solutions, and (2) to assemble and discuss with reference to the proposed plan a modest selection of Tennessee statutes and cases illustrating some of the considerations peculiar to Tennessee which the estate planner in this state must take into account if his plan is to be workable. Thus these pages do not purport to be a complete treatise on estate planning and death taxes in Tennessee, certainly not a digest of the Tennessee law of wills and trusts, and least of all a course of instruction for Tennessee draftsmen of wills and trust agreements. All these matters are considered, of course, but, so far as possible, in the way and in the sense that they may be expected to appear as practical considerations affecting wills and trusts in day to day experience, whether in the administration, planning or drafting phases. To save time, familiarity with federal income, estate and gift taxes is assumed.

For two reasons the hypothetical estate is to be considered as that of a widow. First, in recent decades there has been a shift of wealth in the United States which has placed more of it in the hands of women than ever before,

* Vice-President and Trust Officer and Director, The American National Bank of Nashville; author, SHARES IN MUTUAL INVESTMENT FUNDS (1946); INVESTMENT COMPANY SHARES (1947).

though perhaps estate planners and women themselves have not given the matter enough thought. Second, the widow has no marital deduction problems, the introduction of which within the space limitations of this article would complicate matters without adding very much to the value of the discussion. The attempt is to build upon a factual analysis of a family situation an effective and economical plan for the preservation, use and transmission of the family property. This means, of course, careful attention to tax problems, but certainly not an excessive emphasis upon *immediate* tax savings.

An Estate Plan for the Jones Family

Mr. Jones died in 1946. His widow, now 65, inherited and has just now gained possession of the fairly substantial estate of her husband. She has also inherited a set of problems to solve and decisions to make, though these, to be sure, were not mentioned in Mr. Jones' will. But a separate letter of advice did contain the suggestion that if Mrs. Jones felt the need of talking to someone about the management and ultimate disposition of the family property, she could be sure of a sympathetic hearing and some practical advice if she would go to Mr. Jones' old personal friend, one of the trust officers at the bank.

In the conference with the trust officer, the widow Jones is understandably at sea to know just where to begin to talk about her problems. The main thing is that she realizes her chances of surviving her husband for an extremely long period of years are none too good, and somehow, she has never gotten around to making a will. Her husband's estate has been added to her own, and the total seems much too large to leave to the mercies of intestate distribution. Besides she has just recently seen the effect upon her husband's estate of the voracious estate and inheritance taxes. Perhaps, she thinks, there are practical ways to meet her problems.

This commonsense approach indicates the necessity for surveying Mrs. Jones' assets. After considerable conversation and some leading questions Mrs. Jones' assets look something like this (excluding personal effects and other tangible personal property and modest bank balances):

Received from her husband by deed, will or inheritance:

Marketable securities, by will	$40,000.00	
Insurance proceeds	50,000.00	
Home—Mr. Jones' share as tenant by the entirety, plus her own interest received from him during his lifetime	30,000.00	
Total from husband		$120,000.00

From Mrs. Jones' father:	
General power of appointment, exercisable by will or deed over corpus of trust created by his will for her benefit; trust situs in Alabama	$ 50,000.00
From her own savings, gifts received, etc. all marketable securities	45,000.00
Widow Jones' Gross Investment Assets, as of today	$215,000.00

With this gross figure in mind, a quick census of the family discloses the following facts.

Mrs. Jones has two sons, both happily married, the first son 40 years of age and the second 38. Robert, the oldest, has a son and a daughter, aged 10 and 12 respectively; William and his wife have only one child, a son aged 9. Mrs. Jones' sons are both in business and enjoying moderate success, or perhaps very good success, considering the major depression and major war which have occupied a good part of the years since they were born. At any rate, Bob is earning about $10,000 a year and Bill $8,000. Each carries $20,000 of life insurance, and each has received $50,000 outright by the will of his father. Neither of the boys' wives has any estate of her own. It develops, also, that the widow Jones has no close relatives; her children and grandchildren are her only concern.

Asked at this point how she would like to leave her own property, Mrs. Jones says, "Why, leave it share and share alike to my boys. What would people think if I did anything else?"

Before answering, Mrs. Jones' adviser suggests a tax computation to determine how much effectively disposable estate she would have, after death taxes and expenses, if she were to pass away now. The adviser's pencilled figures look about like this:

		Taxable Estate	Disposable Estate
GROSS ASSETS		$215,000	$215,000
Less administration expenses, debts, accrued taxes, etc.	$15,000		15,000
Specific federal estate tax exemption	60,000	75,000	
Net taxable estate		$140,000	$200,000
Estimated federal estate tax		32,700	32,700
Total effectively disposable estate			$167,300

At this point, if this may be taken as a fairly typical conference, the obvious thing to do is to carry on the computation on the assumption that Mrs. Jones dies and leaves this net $167,300 to her sons in equal shares.

Tax Erosion Begins

Since both sons are in about the same financial condition, let us look at Robert's inheritance of $83,650. But Bob already has $50,000 which he received from his father, and his estate will also include the proceeds of $20,000 life insurance, plus, to round out our figures, $11,350 of miscellaneous assets, represented by equity in his home, bank accounts and perhaps a few stocks and bonds. If Mrs. Jones passes away at this time, Bob will be faced with the necessity of planning his own $165,000 estate, the aggregate of the foregoing items. Allowing $60,000 federal estate tax exemption, and a conservative $5,000 for administration expenses, debts, etc., he is left with an estate of $100,000 net, on which the federal tax alone is $20,700. Thus, Robert's estate of $165,000, gross, works out to $139,300 available for his wife and children after $25,700 taxes and expenses have been paid. 15% shrinkage is encountered.

Now, if Robert does not get his mother's bequest, what is the result? His gross estate will be $81,350, taxes *and* administration expenses about $4,863, and the net available will be $76,487. Deducting this from the $139,300 of the previous example, Mrs. Jones can be told that if she leaves Robert outright a net $83,650, and he then dies, his family will only get $62,813 of it. So that, actually, her bequest will suffer almost a 26% shrinkage by reason of passing through her son's estate, since it is subjected to additional taxes and administration expenses in the process. If the same thing happens in William's case, then $41,674 (twice the difference between $83,650 and $62,813) will *not* be available for Mrs. Jones' daughters-in-law and grandchildren.

Mrs. Jones' adviser suggests here that two trusts in her will can be arranged so as to save the damaging second set of taxes and administration expenses. But, though she responds readily to the idea of saving expenses and taxes, Mrs. Jones has two objections. First, she dislikes "tying things up," and especially having to set out so far in advance the detailed provisions for distribution of income and principal to her grandchildren. She doesn't know what their characters or needs may be, nor, certainly, how many of them there will be to share her bounty. And, second, she saw enough of business hazards during her husband's lifetime to make her desperately anxious to have the principal of her estate reasonably available for her sons' use, whether the grandchildren get anything or not.

Saving the Second Death Tax

Nevertheless, if some way can be found to meet these objections, there is a worthwhile saving to be had in taxes alone by the use of the trusts. Robert's federal estate tax on an estate including his present estate plus $83,650 received outright from his mother would be $20,700, as against $1,363 on his estate if he were, for example, only the income beneficiary of a trust composed of the *same $83,650 inheritance.* So there is a saving to the family in estate taxes alone of twice the difference between $20,700 and $1,363, or $38,674.

Such a situation, and it is rather a common one, calls for flexible trust provisions, among the more important of which would seem to be (1) a special power of appointment to both Robert and William exercisable by will only, as to the corpus of the trusts, and, (2) authority in the trustee (and in the trustee *only*) to pay over principal to Robert and William in its uncontrolled discretion, to enable them to maintain the standard of family living to which they have been accustomed, and, as well, authority to pay over principal in cases of emergency. These suggestions meet the widow's objections and are checked as approved, subject of course, to the opinion of Mrs. Jones' attorney, whom she will certainly wish to consult.

Meanwhile, aside from the legal questions, it is fairly clear that from the practical standpoint the rough outline of the estate plan provides certain definite advantages for Mrs. Jones and her family. First, by reason of the estate tax savings it preserves a larger portion of Mrs. Jones' estate for the benefit of *all* her family than would otherwise be the case. Second, the recommended special power of appointment (restricted to such classes of persons as will render the appointment tax-free so far as federal taxes are concerned) will give Mrs. Jones' sons the power to say in their own last wills how any remainders in their mother's testamentary trusts are to be distributed. They may thus take account as often as need be during their own lives of such special or changed circumstances or needs as might affect their wives and children. The widow Jones' will, of course, should include a saving provision, designating family beneficiaries to take in default of appointment by Robert and William. Third, the very liberally expressed power of encroachment granted the trustee has several advantages. To begin with, it makes funds available to Mrs. Jones' sons if, in the unbiased judgment of an independent party, they are really needed. Second, the funds paid over are principal, and not income, and hence tax-free. And finally, sums so paid over do not have to be restricted as to their use solely to the benefit of Mrs. Jones' sons, but may be used for the benefit of their families as well.

To complete the picture, it is agreed that the trustee is to have discretion

as to income from the widow's testamentary trusts, either to accumulate it or to pay it out from time to time for the benefit of her grandchildren, and *not* for her sons who are sufficiently protected by the encroachment provisions. Thus, all of those in whom Mrs. Jones has the greatest interest will be taken care of for the duration of the trusts.

Some Income Tax Benefits

There are other incidental gains which the conference brings out, resulting from the use of the two family trusts rather than outright bequests by Mrs. Jones. So long as the bequests are made in trust, and each grandchild has a separate taxable share, both income and capital gains realized upon the trust investments will be taxed to the minor beneficiaries or the trusts, as the case may be, rather than to Mrs. Jones' sons, as would have been the case had they received their inheritances outright. More tax-splitting is possible than appears at first sight. In a year in which there are capital gains in the trusts there may be as many as eight taxpayers. That is, the taxes could be paid like this: (1) and (2) by the trustee on capital gains taken in the trusts for Robert's two children, (3) likewise by the trustee in the trust for William's child, (4), (5) and (6) by the three grandchildren on *income* from the trusts, and finally, (7) and (8) in joint returns by Robert and wife, and by William and wife. As is the case with estate tax, there are likely to be worthwhile income tax savings also in a carefully planned trust structure.

If Robert and William received Mrs. Jones' estate outright, or if they received trust income from her testamentary trusts, the situation would work out as follows. The sons now enjoy earned incomes of $10,000 and $8,000, respectively, plus say 4% on their $50,000 inheritances from their father, or gross incomes of $12,000 and $10,000. Assuming, in Robert's case, that his wife has no separate income, and the joint return deductions are $1,000, his gross income of $12,000 is taxed on the joint return at $1,575 or 13.1%. William, with only one child, would pay on $10,000 gross a tax of $1,283 or 12.8%. If each son had the trust income added to his own (or received the trust corpus outright and invested it), assuming each $83,650 trust produced 4% net, then Robert to get $3,346 additional income would pay $760 additional tax; that is, the effective rate on the increase would be 22.8%. William, to get the same amount of additional income, would pay $735 additional tax or 22%. Roughly speaking, therefore, every dollar of income paid through the trusts but not given to Mrs. Jones' sons is worth $1.20 to their families.

Making Insurance Proceeds Tax-Free

Meanwhile, Mrs. Jones introduces a new thought. She would like to make it possible for both of her sons to increase the amount of life insurance they are carrying. Neither of them feels able to pay for any more policies. This suggests the use of gifts during Mrs. Jones' lifetime, but this part of the discussion is postponed while an examination is made of what may be done about insurance in Mrs. Jones' will.

Assuming that Robert would like to have at least $30,000 additional life insurance, on which the premium would be substantial at age forty, how can it best be bought? It can be acquired for him through the trust under his mother's will provided the trustee is given power to acquire the insurance as a trust asset.[1] Further, it will cost less this way than if the trust income were paid to him for the purpose of paying premiums, or than if he received his mother's legacy outright and invested it.

If Mrs. Jones can afford to make gifts by way of paying her sons' life insurance premiums during her lifetime, that is, to be sure, quite all right. But even so, there is the problem of whether her sons could carry the policies after her death. Mrs. Jones can either buy the insurance now, and instruct her testamentary trustee to pay the premiums after her death, or merely authorize the trustee after her death to purchase the insurance and pay for it out of trust income. $1,000 per year paid outright to Robert and William as income would, in their present tax brackets, cost them around $228 and $193 additional tax, respectively, or an aggregate of $421. On the other hand, if the trustee were authorized to invest income in premiums on insurance on the lives of the two sons, with death proceeds payable to their families, two important consequences would accrue.

First, the trustee, and not the sons, would pay income tax on the income so used. The trustee would only be taxed on income not distributed nor distributable; that is, only on the income used to buy life insurance, so long as remainder of trust income were currently distributed to or used for Mrs. Jones' grandchildren. Hence, with the regular trustee's income exemption of $100, only $900 of the insurance premium money would be taxed in the minimum bracket, at 16.60%. Actual annual cost of the $2,000 insurance premiums for both sons would be $2,298 against $2,421 if the sons bought the insurance with trust income paid them outright. The yearly saving would pay somewhere around 1/5 or more of the trustee's annual compensation.

More important, however, upon the death of the sons their families would receive the insurance proceeds *free from estate and inheritance taxes,* since

1. There is a Tennessee statute under which fiduciaries may with the approval of a court of competent jurisdiction invest in insurance, but it is thought by some Tennessee attorneys to be unsatisfactory in some respects. TENN. CODE ANN. § 9596.6 (Williams 1934).

the sons would have had no taxable connection whatever with the policies.[2] Further, the proceeds of the policies would go far to replace such amounts as might have been paid out of trust principal under the encroachment provisions; or, the proceeds might be considered to offset nearly twice over Mrs. Jones' estate tax of $32,700. At the present ages of Robert and William, 40 and 38, a total of $63,572 ordinary life could be bought for $2,000 per annum. Finally, using the assumed 4% rate on the trust assets, each trust, after paying $1,000 annual insurance premiums, would still have about $2,000 net annual income left for the grandchildren, to be used for their education, maintenance, etc., until they reached majority.

The grandchildren, of course, are taxable on whatever trust incomes they receive. Robert's two children will have possible gross incomes of $1,000 each and be taxable on $400 (after the $600 exemption) at 16.60% for a total tax of $66.40 each, and their father will lose the benefit of their $1,200 exemptions, which will cost him $474 additional tax, or a total of $596. But this cost compares with $702 additional tax if he had to take the same $2,000 into his own tax return, even though he would retain the benefit of the $1,200 exemptions under those circumstances. The tax benefit is not excessively large but might easily become so if Robert continues to prosper.

Tax Reduction by Making Gifts

There is still one further matter for tax-saving consideration. Can Mrs. Jones afford to make gifts during her lifetime and will they be of real benefit to the family, if made? Of her present $215,000 of assets, the home returns no cash income. The remaining $185,000 at 4% produces $7,400 per year, on which Mrs. Jones' income tax (using her exemptions at age 65 of $1,200, and the $500 standard deduction) is $1,128, leaving a net of $6,272. She has seven logical donees, the sons, daughters-in-law and the three grandchildren. Seven gifts of $3,000 each plus a $30,000 gift against her unused lifetime exemption would be $51,000, the maximum she could dispose of free of federal tax in 1948. But this would mean a gross income loss to her of $2,040 a year and a net annual loss of $1,565. Besides, the Tennessee gift tax[3] (which now comes to mind) would take a substantial cut if all seven donees were included in such a gift, since the total *annual* exemption is just $10,000 for gifts to a Class A donee *or donees as a class,* and only $5,000 for those to a Class B donee or donees as a class. The sons and grandchildren (Class A) would get $36,424, and Mrs. Jones would be taxed $285 on the gift. The balance of $14,575 of the gift (Class B) would cost Mrs. Jones $478, and the aggregate would be $763. It seems more desirable to reduce any gift made at this time to an

2. Werthan v. McCabe, 164 Tenn. 611, 51 S. W. 2d 840 (1932).
3. Tenn. Code Ann. §§ 1328.1-1328.21 (Williams 1934). Rates are the same as for the inheritance tax but exemptions differ.

amount which will escape Tennessee gift tax, and which, at the same time, will not too seriously lower Mrs. Jones' annual income.

A gift of $51,000 would reduce Mrs. Jones' net income of $6,272 to $4,707. One would scarcely wish to suggest so large a reduction in income at one stroke, bearing in mind that the widow's children are well established in life, and that she herself might outlive her expectancy. But Mrs. Jones is still thinking about her federal estate taxes, so it remains to examine the effect of a $51,000 gift on this impost. After such a gift her net taxable estate is reduced from $140,000 to $89,000, and the federal tax on it from $32,700 to $16,720, a saving of $15,980. If retained in the trusts under Mrs. Jones' will this sum would produce about $320 per year for each trust, a benefit which is outweighed by the effects of the gift on Mrs. Jones' standard of living. The trust officer therefore suggests that Mrs. Jones limit her gifts to such annual amounts as over a period of 10 or 15 years would aggregate about $50,000. This would permit annual gifts in the range of some $3,500 to $5,000, avoiding by a wide margin any question of either federal or Tennessee gift taxes, and would noticeably reduce her own federal estate tax in proportion to the number of years she might be able to continue the program.

Ordinarily the trust officer would suggest that Mrs. Jones make a list of all her invested assets, with their different federal tax bases dependent on manner of acquisition, in order to select for gifts those which would have the greatest attraction for the donees from the standpoint of possible capital gains tax. And he would caution her, too, to be alert for opportunities to register capital losses for her own account, thereafter making cash gifts of the proceeds. However, Mrs. Jones' Alabama trust introduces a new set of questions. Since *Curry v. McCanless* [4] it has been imprudent (certainly in Tennessee) to possess a power of appointment over a trust with a situs in another state, if, that is, you are careless enough to die without having done your best to protect your estate against the imposition of death taxes by both the state of domicile and the state where the trust is located. In the case just cited a Tennessee resident by last will exercised a power of appointment over the corpus of an Alabama trust, and both states were permitted to tax the corpus as part of decedent's estate.

Mrs. Jones' unlimited power of appointment may be exercised by will or deed. She might, of course, effect a tax-free [5] release of the power, but she does not like the distribution provisions which her father wrote into the will to take effect if she did not exercise or only partially exercised the power. Besides, whatever part of the trust she dies without having appointed will cer-

4. 307 U. S. 357, 59 Sup. Ct. 900, 83 L. Ed. 1339 (1939). For the decision below, by the Tennessee Supreme Court, see Nashville Trust Co. v. Stokes, 174 Tenn. 1, 118 S. W. 2d 228 (1938).

5. Tax free, that is, so far as federal taxes are concerned. But no one seems to know exactly what constitutes an effective release so far as Tennessee law is concerned.

tainly be taxed in her estate by the Federal Government, Tennessee and Alabama.[6] One solution would be, first, that she should so far as possible make her gifts to her family by way of amounts of corpus withdrawn from time to time from the Alabama trust and, second, that her will should appoint whatever may be left in the trust to her testamentary trustees. She might be able in this way to dispose of enough of the Alabama trust before death to make a substantial reduction in her federal estate tax and, perhaps, to avoid altogether any tax levy by Alabama. However, this procedure is open to obvious objections. It would seem more sensible to close out the Alabama trust at one blow, leaving no loose ends at all, and giving Mrs. Jones immediate and close control of all her assets. She could then, with a larger fund, make more advantageous arrangements for investment management during her lifetime, whether on an agency or revocable trust basis.

Final decision is to make gifts both direct and by way of purchasing insurance on the lives of Robert and William, naming their wives as primary and their children as secondary beneficiaries. At the boys' present ages gross premium rates for ordinary life per $1,000 are $32.55 and $30.44, respectively, so Mrs. Jones can, within her proposed annual $5,000 of gifts, easily carry $30,000 life insurance for each of her sons, and have $3,000 a year left over for outright gifts.

Mrs. Jones' Plan Summarized

Mrs. Jones' estate plan can now be summarized. As this is a hypothetical case, we can assume there were no competing trust institutions, and our trust officer's bank will be named executor and trustee. The residuary trusts are for the benefit of the boys and their families, with due provisions for the daughters-in-law, so often forgotten by testators and testatrixes alike. The trustee is to use trust income to continue to pay the premiums on the life insurance policies Mrs. Jones has just bought, and may accumulate the balance of income, or pay it out to or apply it for the benefit of the grandchildren. And the trustee will have ample authority to use principal by way of payments to Robert and William if its prudent judgment so dictates. Finally, the two boys will have special powers of appointment, so limited as to be exercisable free of federal tax, which they may exercise by will so as to direct ultimate disposition of the corpus of the two trusts.

So much for the will. Meanwhile, Mrs. Jones has committed herself to a plan of annual family gifts, so that the scheme as a whole, with ordinary good fortune, assures substantial estate tax savings, that her family will have the

6. And if her partial exercise of the power was in contemplation of death as understood by the Tennessee statute, maybe all of the Alabama trust would still be taxed by Tennessee at Mrs. Jones' death. TENN. CODE ANN. §§ 1260(c), 1260(h) (Williams 1934).

use of her estate on as favorable a tax basis as can be devised, and that, as a result of the insurance arrangements, a goodly amount of productive value otherwise unavoidably lost by tax erosion will eventually be replaced in the family's hands.

PUTTING THE JONES PLAN INTO EFFECT—CERTAIN LEGAL CONSIDERATIONS

At this point matters are ready for Mrs. Jones' attorney. Actually, to be sure, no one meeting would likely have covered so much ground, and the probabilities are that the trust officer has long since, with Mrs. Jones' permission, passed along factual memos to her attorney, and has asked his opinion as to the suggestions so far made. In ordinary course there will follow several meetings in the attorney's office, in which Mrs. Jones and the trust officer will participate, before the will is finally signed.

In the actual drafting of Mrs. Jones' will, aside from federal tax law and those aspects of trust law which are more or less common to all states, there will be a host of legal and tax considerations which her attorney must take into account, many of them peculiar to Tennessee. No really comprehensive treatment is possible here, but there will be outlined some of the areas (principally having to do with practical trust and estate administration) in which experience shows that difficulties have been encountered, and these as a result either of inadequate language or because the area of trouble was entirely ignored.

Provisions of a will having to do with execution and appointments are generally regarded as routine matters by attorneys drafting such instruments, but can nevertheless occasionally cause trouble. However, the Model Execution of Wills Act was enacted in Tennessee in 1941 and spells out execution provisions in detail.[7]

Co-fiduciary Troubles

As to the appointment of the executor and the trustee two types of difficulties arise in actual administration. The first usually arises when co-executors and co-trustees are appointed and the will does not define the respective duties and powers of each. Thus, when, as is often the case, the trust institution is one of the fiduciaries, and unanimous action is required as is true under Tennessee law,[8] there are likely to be occasions when the co-fiduciary cannot be consulted, and even, perhaps, when one co-fiduciary may become liable for the act or omission of the other.[9] Such difficulties can only be obviated by language carefully dividing and defining duties and

7. Tenn. Pub. Acts 1941, c. 125; TENN. CODE ANN. §§ 8098.1-8098.9 (Williams 1934).
8. PRITCHARD, WILLS AND EXECUTORS § 510 (2d ed., Sizer, 1928).
9. Deaderick v. Cantrell, 18 Tenn. 263 (1837).

powers. The second difficulty arises from the fact that, at least until quite recently, the functions of executor and of trustee were not only held to be quite distinct but also not to be concurrent in any sense. Thus, it was generally held that the functions of the trustee could not commence until the trust property was delivered to him,[10] usually after completion of the administration of the estate,[11] thus effectively preventing the trustee (even though he was the same person as the executor) from investing for the benefit of the beneficiaries of, for example, a residuary trust under will. The doctrine was gradually modified after several exceptions were made in favor of pecuniary legacies for support and maintenance,[12] and it has finally become established, apparently, that income from a residuary trust under will becomes effective from the date of the testator's death.[13] Nevertheless, many attorneys still prefer to give to the executor and trustee concurrent and coextensive powers in both capacities.

Tennessee is one of about eight states which by statute always require bond of a bank or trust company acting as executor or administrator, just as in the case of an individual, unless the will provides otherwise.[14] Although the rates for banks and trust companies making bond in Tennessee are lower by one-third than those charged individuals, the annual cost for a bank is substantial and particularly burdensome in a small estate.

Administration—Payment of Debts, Distribution, etc.

There are a number of provisions affecting the administration of the estate before any trust really comes into operation. While Tennessee laws allow a testator to dispose of his property in practically any way he chooses,[15] the personal representative nevertheless has a duty to pay all lawful debts and charges before making distribution to legatees, distributees, etc.[16] And the assets of the estate are charged with the burden of paying costs of administration and debts of the decedent, except for such part as may be

10. Nashville & American Trust Co. v. Baxter, 171 Tenn. 494, 105 S. W. 2d 108 (1937); Fidelity Trust Co. v. Service Laundry Co., 160 Tenn. 57, 22 S. W. 2d 6 (1929).
11. Cole v. Edwards, 62 S. W. 641 (Tenn. Ch. App. 1900).
12. Ensley v. Ensley, 105 Tenn. 107, 58 S. W. 288 (1900); Harrison v. Henderson, 54 Tenn. 315 (1872); Morgan v. Pope, 47 Tenn. 541 (1870); Darden v. Orgain, 45 Tenn. 212 (1867).
13. American National Bank v. Embry, 181 Tenn. 392, 181 S. W. 2d 356 (1944).
14. TENN. CODE ANN. § 8169 (Williams 1934). But an interested person may successfully require bond to be made if he can show the executor is wasting or likely to waste the estate. TENN. CODE ANN. § 8174 (Williams 1934). For this citation, as well as for a number of others given in this article and for substantial parts of discussion of certain details of estate administration, the author is indebted to G. Frank Cole, Jr., Vice President and Trust Officer of The American National Bank of Nashville, and also for permission to use and paraphrase such material from his "The Drafting of Wills and Trust Agreements in Tennessee," submitted in 1947 in partial fulfillment of the requirements of The Graduate School of Banking, conducted by the American Bankers Association at Rutgers University.
15. Smith v. Harrison, 49 Tenn. 230 (1871).
16. PRITCHARD, WILLS AND EXECUTORS § 742 (2d ed., Sizer, 1928).

specially exempt by law.[17] Nevertheless, it takes a petition in court to subject real property to the payment of debts of a decedent, even though his personal property has been exhausted in the process of paying them.[18] Furthermore, the law specifies an order in which claims and demands against the estate of a decedent shall have priority,[19] and, after that, if the estate is insufficient after payment of debts and charges to take care of all gifts provided for in the will, there is a specific order to be followed as between legatees, devisees, heirs and next of kin.[20] All of this, however, the testator may alter by express words or manifest intent, and his draftsman ought to be particularly careful in expressing such intent if it exists.[21]

Tennessee law does not favor the payment of distributive shares under the statute in kind, rather than in cash.[22] An early case indicates this attitude, and suggests that when a will does not contain trusts testators who do not wish to see their assets reduced to cash during the administration had best make provision for discretionary distribution in kind by the personal representative.[23]

Powers of Sale—Executor and Trustee

In view of the foregoing, express powers, including especially powers of sale, when bestowed upon the executor and trustee by the testator, are of real value in Tennessee. Furthermore, where the powers are extended to include the power to sell real estate, as well as other property, and to sell at private as well as at public sale, there is a large gain in maneuverability and economy.

The personal representative's power of sale is more firmly established than that of the trustee, and he may sell decedent's personal property at public sale on ten days' notice and, though responsible for the value of the property, will not be responsible for failure of property to bring its value if the directions of the statute are followed.[24] There are many circumstances under which public sales are not desirable, and ordinarily draftsmen will wish to provide the power to sell at private sale. As to the trustee's power nothing is more frustrating than to have to apply to a court of equity [25] in order either

17. TENN. CODE ANN. § 8197 (Williams 1934); Agee v. Saunders, 127 Tenn. 680, 157 S. W. 64 (1913).
18. Tenn. Pub. Acts 1939, c. 175, § 8; TENN. CODE ANN. § 8196.8 (Williams 1934).
19. Tenn. Pub. Acts 1939, c. 175, § 4; TENN. CODE ANN. § 8196.4 (Williams 1934).
20. PRITCHARD, WILLS AND EXECUTORS § 471 (2d ed., Sizer, 1928).
21. Overton v. Lea, 108 Tenn. 505, 68 S. W. 250 (1902); Morrow v. Morrow, 2 Tenn. Ch. 549 (1875).
22. PRITCHARD, WILLS AND EXECUTORS § 760 (2d ed., Sizer, 1928).
23. Wright's Distributees v. Wright, 8 Tenn. 43 (1827).
24. TENN. CODE ANN. § 8191 (Williams 1934); Johnson v. Kay, 27 Tenn. 142 (1847); PRITCHARD, WILLS AND EXECUTORS § 702 (2d ed., Sizer, 1928).
25. Weakley v. Barrow, 137 Tenn. 224, 192 S. W. 927 (1916); Greenlaw v. Greenlaw. 84 Tenn. 435 (1886).

to determine that a general power of sale may be implied from the trust language, or that changed circumstances will warrant approval of a given sale,[26] or whether the purpose [27] for which the property is to be sold is expressly authorized by the trust instrument.

Miscellaneous Powers

There appears to be no law in Tennessee with respect to the rather important group of trustee's powers centering around participation in consolidations, mergers, dissolutions, liquidations, reorganizations, etc., with respect to the trust property. Likewise, there seems to be nothing assuring the trustee that, if he could so participate, he might accept and retain securities so issued. Undoubtedly this sort of provision has become more or less routine in well prepared trust instruments, but the Tennessee practitioner ought not to overlook that its omission may easily cause administrative difficulties and even loss.

Although many states have statutes permitting fiduciaries to carry trust securities in the name of a nominee without showing the name of the trust, Tennessee has never passed such a statute. Here, again, convenience and saving in both time and money suggest the use of nominee provisions in all trust instruments where it is contemplated that the trustee will invest in stocks and bonds.

Another gap in Tennessee law exists with reference to the authority of the trustee, without express provision in the trust instrument, to lease real estate for a time extending beyond the term of the trust. With respect to leases on farm and residential property, which ordinarily are leased from year to year, the difficulty is not great. However, business property leases present another picture, and the trustee who is restricted to a year-to-year or month-to-month lease on business property, by reason of a careless omission in the trust instrument, is bound to have to make arrangements damaging to his income beneficiaries.

In Tennessee, as elsewhere, the power of a trustee to mortgage, pledge or otherwise encumber the trust property ordinarily depends upon the terms of his instrument.[28] Some cases, however, are on record indicating an implied power to raise money by mortgage when necessary for the purpose of the trust.[29] And it has been held that a personal representative borrowing money for the benefit of the estate without authority is entitled to credit if the money is properly applied.[30] But these are poor substitutes for language authorizing

26. Griffith v. Nashville, C. & St. L. Ry., 147 Tenn. 224, 246 S. W. 532 (1922).
27. Simmons v. Kincaid, 37 Tenn. 450 (1858).
28. East Tennessee Iron Mfg. Co. v. Gaskell, 70 Tenn. 742 (1879).
29. Harding v. St. Louis Life Ins. Co., 2 Tenn. Ch. 465 (1875).
30. Allen and Hill v. Shanks, 90 Tenn. 359, 16 S. W. 715 (1891). *Contra*: Cowan v. Hamilton National Bank, 177 Tenn. 94, 146 S. W. 2d 359 (1941).

the trustee to borrow for the benefit of the trust estate, such power being frequently of use in connection with tax settlements and the protection of good but non-liquid assets.

Payments to Minors—Encroachments

A minor matter, but one of substantial practical importance from the standpoint of smooth administration, concerns payment to or for the benefit of minors or others under legal incapacity. In the absence of specific authorizing language in the will or trust agreement, it is thought that Tennessee law would prohibit payment in such cases except to the legally appointed guardians for such persons. The growing concern for the welfare of those nearest and dearest to the testator would in itself be reason enough for putting carefully drafted encroachment provisions in a Tennessee trust, aside from cases on the subject. Encroachment for a particular purpose is construed literally,[31] and particular attention has been paid to the problems of encroachment upon the corpus of a minor's estate, especially where the rights of others are affected.[32]

Continuing Testator's Business

While the widow Jones had no business or partnership interests to protect in her will, there is scarcely an area of estate administration in which one finds more difficulty than that embracing the operation, liquidation and conversion of going businesses and partnerships. If it is desired in Tennessee to authorize the executor or trustee to continue to operate the testator's business beyond the reasonable period allowed for disposal, it had best be done expressly,[33] and the power should be conferred not only on the executor but also upon the trustee, since forced sales of assets of this type are usually unfortunate. Further, it usually will be necessary, if the trustee is to continue an interest in the testator's business that he be given authority to continue it not only with the funds which were in the business at the time of the testator's death, but also with additional funds if necessary.[34] In this connection the borrowing power again becomes important. While there are no cases in Tennessee on the subject, the modern will and trust having to do with business interests usually carries a clause empowering the trustee, where expedient or prudent, to terminate a partnership or proprietorship and incorporate it.

31. Green v. Cleveland Bank & Trust Co., 6 Tenn. App. 685 (W. D. 1928).
32. Stewart v. Hamilton, 151 Tenn. 396, 270 S. W. 79 (1924); Bennett v. Nashville Trust Co., 127 Tenn. 126, 153 S. W. 840 (1912).
33. Wrenne v. American National Bank, 183 Tenn. 247, 191 S. W. 2d 547 (1945); Morrow v. Morrow, 2 Tenn. Ch. 549 (1875).
34. Morrow v. Morrow, 2 Tenn. Ch. 549 (1875); Brown v. Aydlett, 12 Tenn. App. 568 (W. D. 1930).

Tennessee law is noticeably deficient, also, in cases controlling the allocation or apportionment by the trustee of receipts and expenses as between principal and income, immediate and ultimate beneficiaries. The cases in other states and the Uniform Principal and Income Act are warning enough that a great deal of expense and bother can be avoided by clear provisions on these matters.

Investment Provisions

The investment provisions of a Tennessee trust need, under present conditions, a considerable amount of care in draftsmanship. Giving expression to the growing interest of testators of means in forms of investment not authorized by the Tennessee statute requires specific language. Tennessee is one of the "legal" states, although two characteristics of the Tennessee trust investment statute[35] must be noted. First, the permitted trust investments are governed by a legal standard, and not by a legal list issued by an agent or agency of the state government. Certain classes of securities are described in detail, and the tests set up which must be met before an individual security will come within the permitted class. Generally speaking, investments permitted by the statute include bonds of the United States Government and its instrumentalities; bonds of foreign governments and their political subdivisions; state, city and county bonds of the United States; first mortgages; certain railroad, telephone and gas and electric bonds. The only stocks permitted are shares in savings and loan associations insured under a certain act of Congress.

The second characteristic of the Tennessee statute is that it is permissive and not mandatory.[36] The cases so holding are said by some to afford considerable comfort to those who believe that, the statute being permissive only, the real trust investment rule in Tennessee is the Prudent Man Rule. Others are of the opinion that so long as the trust investment statute stays on the books it is obvious that the trustee complying with the statute (failing other authority in his trust instrument) is bound to be in a better position than one who goes outside the statute. Most draftsmen in Tennessee appear to prefer to refer specifically to the Prudent Man Rule if the testator or trustor wishes a liberal investment policy, or to use other language indicating clearly the trustee's authority to go outside of the classes of securities set out in the statute. It would seem to go without saying that it would be safer to include in an investment clause of generally liberal authority explanatory language illustrating but not limiting the trustee's authority, and specifically granting

35. TENN. CODE ANN. §§ 9596.1-9596.11 (Williams 1934).

36. Steinberg v. Cox, 24 Tenn. App. 340, 144 S. W. 2d 12 (W. D. 1939); Falls v. Carruthers, 20 Tenn. App. 681, 103 S. W. 2d 605 (W. D. 1936); Gibson County v. Fourth & First Nat. Bank, 20 Tenn. App. 168, 96 S. W. 2d 184 (M. D. 1936).

power to invest in common stocks, real estate, common trust funds, investment companies and other forms of proved investments, etc., wherever, as is almost always the case, the testator or trustor is a person of sufficient wealth to have become familiar with these highly useful forms of investment.

A kindred question is that concerning the continuation or retention of so-called "original" investments; that is, those coming into the hands of the executor or trustee from the decedent himself. The executor, of course, is allowed a reasonable time within which to sell investments coming into his hands as assets of the estate,[37] and even if they are not proper investments, the same is true of the trustee. As a matter of statute law, so far as the trustee is concerned nothing specific on the question appeared until 1945 in Tennessee when a public act [38] was passed, allowing a fiduciary to make application to chancery court or to any other court of concurrent jurisdiction "for permission to retain and hold in unchanged form any security or investment originally forming a part of the estate."

While the power thus granted is useful, it would be even better if the will or trust agreement contained the power to retain originals in the first place. All the more importance should attach to a provision empowering the executor and trustee, if such should be a bank or trust institution, to retain its own stock if in fact the testator or trustor desired this to be done. Obviously, the hazard to the institution in so doing without express authority is substantial.

While it is more properly an administrative matter, mention should be made here of the fact that there is no Tennessee law on the subject of the handling of premiums and discounts on trust investments. It is believed that most Tennessee trust institutions amortize premiums (but not discounts) unless otherwise instructed in the will or trust agreement, and that this is in accord with practice in most of the states in which no law or statute exists. Nevertheless, many testators and trustors are not even aware of what amortization is, though when it is called to their attention the majority of them will wish to have written in a provision excusing the trustee from amortizing premiums, but giving him authority to amortize them when and if in his judgment it is prudent so to do.

The treatment of stock dividends where securities are held in trust in Tennessee is governed, so far as can be determined, by one reported case.[39] This appears to commit Tennessee to following the Pennsylvania Rule, under which stock dividends and special or extraordinary dividends as well are distributable to the life beneficiary to the extent that the earnings out of

37. Pearson v. Gillenwaters, 99 Tenn. 446, 42 S. W. 9 (1897).
38. Tenn. Pub. Acts 1945, c. 53; TENN. CODE ANN. §§ 9596.9-9596.11 (Williams 1934).
39. Pritchitt v. Nashville Trust Co., 96 Tenn. 472, 36 S. W. 1064 (1896).

which the dividends were declared and paid were accumulated during the life of the trust. It is submitted here that slavish devotion either to the Massachusetts or to the Pennsylvania Rule may result in substantial inequities. The tendency in today's wills and trust agreements in Tennessee is to give the trustee a rather wide authority to determine the allocation or apportionment of stock and extraordinary dividends, but to suggest to him that, in general, stock dividends taxable for federal income tax purposes be distributed as income, and the others retained as corpus.

Tax Provisions

As to taxes, it has been usual in Tennessee to insert in a will a clause directing the executor to pay estate, inheritance and succession taxes out of the "general estate before distribution and not to apportion same among the several beneficiaries." This type of provision has been held to result in a charge of the taxes to undevised realty and personalty.[40] As a rule, this is proper, but the fact suggests that extreme caution be used to avoid the possibility that the residuary estate (usually that part devoted to those closest to the testator) may be so depleted by the payment of taxes on outright devises and bequests not a part thereof that real damage will be done.

The Tennessee statute places the liability for the payment of the inheritance tax on the personal representative regardless of the ultimate beneficial interest,[41] but the tax is a tax upon the privilege of receiving an estate or interest,[42] while the federal estate tax is imposed upon the privilege of giving or transmitting property at death. In short, the Tennessee inheritance tax, although it is payable by the personal representative, is the obligation of the recipient and may be recovered by the personal representative from such recipient as beneficiary.

As to the federal estate tax, it is there provided that, unless otherwise directed by the will, it is to be prorated equitably among beneficiaries and persons interested in the estate. Accordingly, both the inheritance tax and the federal estate tax are in practice payable by the personal representative who has no choice except to prorate them unless otherwise directed.

Spendthrift Trusts

Tennessee is one of the states in which the law with respect to spendthrift trusts and restraints on alienation in general is relatively liberal. It is true, though, that the law does not go so far as to make possible the adoption

40. Nashville Trust Co. v. Grimes, 179 Tenn. 567, 167 S. W. 2d 994 (1943).
41. Tenn. Code Ann. § 1292 (Williams 1934).
42. Hutchison v. Montgomery, 172 Tenn. 375, 112 S. W. 2d 827 (1938); State *ex rel.* McCabe v. Clayton, 162 Tenn. 368, 38 S. W. 2d 551 (1931); English v. Crenshaw, 120 Tenn. 531, 110 S. W. 210 (1908).

of Shattuck's suggestion that a revocable trust in which the grantor reserves an interest for himself may afford a shelter either against his creditors or those of his beneficiaries when he shall die.[43]

The cases in general hold that it is not against public policy to create spendthrift trusts for the protection of improvident or unfortunate beneficiaries, that actual language "excluding the rights of creditors" is not necessary,[44] that a trust for "support and maintenance" of a beneficiary where the trust is active is not subject to levy of execution.[45]

In *White v. O'Bryan* [46] it is stated that a trust sufficient to withstand the attack of a creditor under a bill in the chancery court must contain these elements: (1) it must be created by some person other than the beneficiary; (2) it must be an active trust; (3) it must be declared by will duly recorded, or deed duly registered. It is further stated that a chancery decree creating a trust is not sufficient, since it does not comply with the third requirement.[47]

The Tennessee Constitution prohibits perpetuities.[48] However, the law permits transfers which "must pass in interest, if at all, within a life or lives in being and twenty-one years and a fraction thereafter for the term of gestation in cases of posthumous births." [49] Nor is the rule "offended if an estate begins within the limits of the rule regardless of the time at which such an estate may end." [50]

The question of accumulations is closely allied with that of perpetuities, but in Tennessee accumulations are permitted. "The rule is that a trustee may pay over the income to the cestui que trust as the same is received unless the instrument creating the trust especially directs the accumulation of the income." [51]

The Tennessee Inheritance Tax

In order to avoid slowing the narrative, no account was taken of the Tennessee inheritance and estate taxes in calculating tax effect on the widow

43. Menken Co. v. Brinkley, 94 Tenn. 721, 31 S. W. 92 (1895); Rose v. Third Nat. Bank, 27 Tenn. App. 553, 183 S. W. 2d 1 (M. D. 1944).
44. Mayberry v. Redmond, 169 Tenn. 190, 83 S. W. 2d 897 (1935).
45. Henson v. Wright, 88 Tenn. 501, 12 S. W. 1035 (1890); Jourolmon v. Massengill, 86 Tenn. 81, 5 S. W. 719 (1887).
46. 148 Tenn. 18, 251 S. W. 785 (1922).
47. For a thorough discussion of Tennessee law as to spendthrift trusts and other trust law, see Malone, *Distinctive Features of the Tennessee Law of Trusts*, 16 TENN. L. REV. 33 (1939). For further cases on the subject, see Shelton v. King, 229 U. S. 90, 33 Sup. Ct. 686, 57 L. Ed. 1086 (1913); Stier v. Nashville Trust Co., 158 Fed. 601 (C. C. A. 6th 1908); Keeling v. Keeling, 185 Tenn. 134, 203 S. W. 2d 601 (1947); Porter v. Lee, 88 Tenn. 782, 14 S. W. 218 (1890); Turley v. Massengill, 75 Tenn. 353 (1881); Mills v. Mills, 40 Tenn. 706 (1859); State v. Nashville Trust Co., 28 Tenn. App. 388, 190 S. W. 785 (M. D. 1944); Davis v. Mitchell, 27 Tenn. App. 182, 178 S. W. 2d 889 (W. D. 1943); Patton v. Winters, 20 Tenn. App. 600, 101 S. W. 2d 708 (M. D. 1936).
48. TENN. CONST. Art. I, § 22 (1870).
49. Yarbrough v. Yarbrough, 151 Tenn. 221, 231, 269 S. W. 36, 39 (1924); Eager v. McCoy, 143 Tenn. 693, 702, 228 S. W. 709, 711 (1920).
50. Eager v. McCoy, 143 Tenn. 693, 703, 228 S. W. 709, 711 (1920).
51. Godsey v. Lenderson, 9 Tenn. App. 580, 585 (W. D. 1929).

Jones' estate. The Tennessee estate tax[52] is, as is the case in many other states, primarily designed to absorb the federal estate tax credit. The inheritance tax itself,[53] while the rates are not excessive, does play some part in estate planning.

The rates of tax are shown in the statute as follows:

Class A

1% on amounts from $10,000.00 to $25,000.00
1½% on the next $25,000.00 or part thereof
3% on the next $50,000.00 or part thereof
4% on the next $200,000.00 or part thereof
5% on the next $200,000.00 or part thereof
7% on the excess over $500,000.00 or part thereof.

Class B

5% on amounts from $1,000.00 to $50,000.00
7% on the next $50,000.00 or part thereof
9% on the next $50,000.00 or part thereof
10% on the next $50,000.00 or part thereof
12% on the next $50,000.00 or part thereof
15% on the excess over $250,000.00 or part thereof

We calculated Mrs. Jones' federal estate tax at $32,700 on a gross estate of $215,000. For Tennessee inheritance tax purposes her taxable estate is $190,000; that is, $215,000 less the administration expenses, debts, etc., of $15,000 and less the $10,000 specific exemption allowed her by the state statute. On this $190,000 her gross Tennessee inheritance tax is $5,625. Upon computing 80% credit for the State of Tennessee tax against the basic federal estate tax under (Federal) Section 810, a credit of $1,200 is obtained. In Mrs. Jones' case the Tennessee tax is not inconsiderable, but still so much smaller than the federal tax that there would be no sense in changing provisions satisfactory for federal tax purposes in order to save on the Tennessee tax. Actually, except to leave substantial gifts to charity, etc., there is little Mrs. Jones can do to lessen the Tennessee tax burden. It is clear from the rate table, though, that Tennessee residents are given a strong incentive to transmit their estates to Class A beneficiaries.

Since the major differences between the Tennessee inheritance tax and the federal estate tax are treated elsewhere in this issue[54] no further attempt

52. TENN. CODE ANN. §§ 1296-1315 (Williams 1934).
53. *Id.* §§ 1259-95.
54. Note, *Tennessee Death Taxes,* 2 VAND. L. REV. 294 (1949).

will be made here to consider the characteristics of the Tennessee tax or to deal with any of the legal problems created by it.

CONCLUSION

These pages have but briefly outlined some of the areas of the Tennessee law of estate and gift taxation, and of the Tennessee law of wills and trusts in which estate planners are most often likely to find themselves when the time comes to reduce to system the unplanned family property aggregate. It is, of course, the prerogative of the family lawyer to draft from memoranda of facts and personal desires an instrument which, as he will certainly take into account all of the legal matters here discussed and many more besides, is the final valid and effective embodiment of a sound estate plan. No layman would wish to be thought to be instructing lawyers about estate planning. But in the recent development of the art the lawyer more and more finds himself working with a team which includes at least three lay members—the tax consultant, the trust officer and the life underwriter. They can teach the lawyer no law. But to the extent that he is willing to inform them as he works with them, he is less likely to be asked to do the legally impossible, and therefore more apt to have presented to him the outline of a plan that is both legally proper and practically workable.