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W. Bruce Krag graduated from The Hill School, Pottstown, Pennsylvania in 1923, from Princeton University in 1927, and from the University of Michigan Law School in 1930.

From 1930 until 1938 he practiced law in Detroit with the firm of Miller, Canfield, Paddock & Stone and since then has been affiliated with the Trust Department of the National Bank of Detroit, where he serves as Assistant Vice President and Assistant Trust Officer.

This paper was the basis of a talk before the Detroit chapter ASWA. It exceeds the length of our usual fetaure article, but is so packed with interesting and useful information that we could not bring ourselves to cut it.

SOME ASPECTS OF PLANNING THE SMALL ESTATE

By W. BRUCE KRAG, L.L.B.

Many people think of estate planning as arranging for the disposition of one's property after death, whereas as a matter of fact, it includes what is perhaps an even more important phase, namely, the arrangements for the best use of current income and the accumulation and preservation of one's property during life. Thus, this field readily divides itself into two parts—first, a complete analysis of the individual's present situation with a mind to rearranging his affairs in such a way that he and his family may, during his lifetime, receive the greatest benefits from the use of the property and, secondly, a careful consideration of the provisions to be included in the person's will, for the use, preservation, and ultimate disposition of his property after his death.

The problems presented by estate planning are somewhat analagous to those presented to an architect when called upon to build a house. The architect must first determine the amount of money which is to be spent in the construction of the house and he must next determine the particular requirements and desires of the family who are to occupy it. His next job is to fulfill their wishes as nearly as possible by drawing plans which will economically provide them with the type of home desired. There are as many, if not more, different types of estate arrangements as there are different types of houses, and the job of the estate planner is to determine the total assets held, the general plan desired for the particular family, and the most economical method of carrying it out.

All estate planning, either for the period during life or after death, necessarily evolves upon the question of taxes. Certain paths lead into additional taxes, whereas other paths avoid or lessen them and it is only common sense to use the paths which lessen the taxes, providing they will lead you to approximately the same destination.

In order intelligently to assist a client in his estate planning problems, it is first essential to determine all factors connected with his or her present circumstances. These include such factors as:

1. A complete list of the assets and liabilities. You should also determine:
   - (a) The current market values of the assets.
   - (b) The cost base thereof.
   - (c) The form of ownership—whether individual or joint.
   - (d) The desires of the owner as to which should be protected or preserved, if possible.
2. A complete list of the life insurance. Who are the beneficiaries, how were the premiums paid, what are the present cash surrender values?
3. A complete report on the family with

the names and ages of each member. Has the wife property of her own; is the son a spendthrift; has the father confidence in his son-in-law? Are trusts necessary or should the property be left outright?

4. You should also know about the business or profession of the owner. Is it a partnership, sole proprietorship, or corporation? How can the owner's interest be purchased by others in the event of his death?
5. You should make an estimate of the amount of taxes and administration expenses that will probably be payable if the owner should die with his estate arranged as it is at present. This should be studied from the point of view of exposure to gift, income and Federal estate taxes.
6. Lastly, and probably most important of all, you should determine the particular wishes of the property owner as to how he wishes to leave his property or use it during his lifetime.

Ascertaining and compiling this information is quite a task but it is the base that must be laid before any intelligent or well-balanced program can be formulated.

Although each person's estate plan will probably differ from that of another, nevertheless there are certain vehicles which are generally used to bring about the results desired and they should always be kept in mind to determine whether or not they would be helpful in the particular situation under observation. It might be well at this point briefly to discuss certain of the more common vehicles which may be used in estate planning:

1. GIFTS

First, let us consider the use that can be made of gifts in estate planning. As you all probably know, the owner of property has the lifetime privilege of giving away $30,000.00 worth of property before incurring gift tax liability. In addition to this, he may give away $3,000.00 to as many different individuals during any one year as he may choose. In other words, if a man gives $5,000.00 to his wife, $3,000.00 of this gift comes under the $3,000.00 annual exclusion and the remaining $2,000.00 of the gift would be deducted from the $30,000.00 lifetime exemption, leaving him with a $28,000.00 exemption. As you also know, the first $60,000.00 of a person's net estate is exempt from Federal estate tax. We therefore have these two exemptions available to everyone—the $30,000.00 gift tax exemption (plus also the $3,000.00 annual exclusion) and the $60,000.00 Federal estate tax exemption. One of the constant endeavors in estate planning is to make sure that your client receives the full benefit of these two major exemptions offered by the Government.

Suppose a person seeks your advice and discloses that he has an estate consisting solely of $100,000.00 worth of liquid assets, all in his own name. His wife owns nothing. Upon his death, roughly speaking, $40,000.00 will be subject to Federal estate tax, which would produce a tax of $4,800.00. If he should give $40,000.00 of his holdings to his wife, there would be no Federal estate tax payable upon his death and the gift tax would amount to $217.50 assuming he had used none of his gift tax exemption. There would be the added resultant advantage that the income from the $40,000.00 of securities transferred to his wife would be taxable to her and thus his top income tax bracket would be decreased, and, in states which are not subject to community property, the income from the $40,000.00 would be in her relatively low tax bracket. It would seem that such a suggestion would materially improve this person's affairs during his lifetime, providing, of course, it was prudent for him to have made so large a gift.

One word of caution should be here injected in connection with gifts. The Government has a most pernicious habit of claiming, upon the death of the donor, that practically all gifts were made in contemplation of death, and if it is determined that such was the case, the property transferred would be subject to Federal estate tax in the donor's estate. To overcome such a claim by the Government, it must be shown that the donor was in good health at the time of making the gift and that it was made for some purpose associated with living, rather than with death, one of the best of which is to avoid future income taxes.

It is also possible for an individual over a period of time to build up a fairly sizable estate for his wife or children through full use each year of the annual $3,000.00 exclusion, by giving $3,000.00 in cash or property each year to such members of his family as he may choose. He will avoid encroaching upon his $30,000.00 lifetime exemption, will systematically increase their estates, and will lessen his own income tax burdens to some extent.

Thus the reshuffling of an individual's property through full use of the gift tax exemption, with its resultant advantages

from the point of view of both Federal estate tax and income tax, is an important factor in estate planning. The use of gifts is important even in cases which exceed the $30,000.00 gift tax exemption because the gift tax which must be paid on such gifts is only about three-quarters as much as the Federal estate tax, were the property involved to be taxed in the estate of the donor. Furthermore, it works out even more advantageously than that sounds because the property transferred is removed from the highest estate tax bracket and placed in the lowest gift tax brackets.

2. JOINTLY-OWNED PROPERTY

Let us next consider holding property in joint names as an aid to estate planning. This has become a very popular method of holding property and it has certain distinct advantages, particularly in a small estate. Placing property in the joint names of a husband and wife is usually prompted by a desire on the part of the husband to prove to his wife his wishes that she share equally with him in the property he owns. Upon the death of one of the owners, jointly-owned property passes and becomes immediately available to the survivor from the instant of death. Thus the delays incident to probate and administration of the deceased joint owners' estate are avoided. Also, probate costs are eliminated in so far as the assets so held are concerned and furthermore, jointly-owned property is not subject to Michigan inheritance tax. The income from joint property is taxable one-half to each of the joint owners.

On the other hand, there are certain disadvantages which result from holding property in this manner which become more serious the larger the estate. In the first place, in an estate which will be subject to Federal estate tax, jointly-owned property will be fully taxed in the estate of the husband upon his death, unless it can be proved conclusively that the wife contributed all or part of the original cost. If she survives her husband by five years or more, the property will be subject to a second Federal estate tax upon her death, provided, of course, her estate exceeds the estate tax exemption. When property is placed in the joint names of husband and wife,assuming it was purchased originally by the husband, a gift is made which may be subject to gift tax. Although property in joint names will not be subject to probate costs upon the death of the first joint owner, it will be subject to such costs upon the death of the survivor, and as a result, the probate costs on such property are merely deferred rather than eliminated. One point is sometimes overlooked—the fact that a will has no effect whatsoever on jointly-owned property. Such property passes to the survivor automatically regardless of the provisions of the will. People holding everything jointly have been known to execute wills, perhaps leaving a portion of the residue to their children, overlooking the fact that the will will have no effect upon their jointly-owned assets and as a result their children will receive nothing.

Another disadvantage in connection with jointly-owned property is that the cost base of the property in the hands of the survivor for income tax purposes is not the appraised value as of the date of death of the first joint owner, but it is the original cost price of the property. Thus an individual owning stock in his own company, which today may have a very substantial value but which was acquired at a very nominal cost when the company was originally founded, should hesitate before placing such low-cost stock in joint names of himself and wife. If he should die, his wife might find it necessary to sell some of this stock to advance money to his estate for taxes or sale might seem advisable for other reasons, and her cost base for income tax purposes would be the cost of this stock to her husband. Thus she might be faced with a prohibitive capital gain, whereas if the stock had been left to her through his estate, her cost base would have been the value of the stock which was accepted for Federal estate tax purposes in the husband's estate. This would be the value as of the date of death or as of one year from the date of death.

Today, when the papers are so full of reports of automobile, airplane and railroad wrecks, many husbands and wives worry about the results that would take place if they were both killed at the same time in an accident. They wonder what the effect of such a catastrophe would be on their jointly-owned and other property. In 1941, the Michigan Legislature passed what is known as the Uniform Simultaneous Death Act. This act provides that where the title to or devolution of property depends upon the priority of death and there is no sufficient evidence that the persons have died other than simultaneously, the property of each shall be disposed of as if he had survived. In other words, if the husband by his will leaves everything to his wife, if living, otherwise to his children, his estate will be administered as though he had survived his wife, and everything will go direct to the children. Likewise, if the wife's will

had left everything to the husband, if living, otherwise to the children, her will will be administered as though she had survived, and her estate will be distributed directly to the children. The act further provides that as to property held jointly, it shall be distributed one-half as if one had survived, and one-half as if the other had survived.

Another interesting provision found in this act is to the effect that if the insured and the beneficiary of an insurance policy die simultaneously, the proceeds of the policy shall be distributed as if the insured had survived the beneficiary. In other words, if the husband's insurance is payable to his wife, if living, otherwise to his children, the proceeds will be payable direct to the children, as if the husband who is the insured had survived his wife. If the wife were the only beneficiary named in the policy, the proceeds would be paid to the husband's estate on the theory that he, the insured, had survived the beneficiary.

3. Voluntary Revocable Trusts

Another vehicle which is sometimes useful in estate planning, and this is for the period during life, is the Voluntary Revocable Trust. Such a trust is established by an agreement entered into by the person creating the trust, know as the settlor, and the trustee, by the terms of which the property which constitutes the corpus of the trust is deposited with the trustee primarily for management. The trust agreement will direct the trustee as to its powers and duties, which can be as extensive or as limited as the settlor may desire, and will further designate the manner in which income or principal is to be distributed by the trustee and to whom. The trust agreement will further go on to provide as to what disposition should be made of the property in the event of the death of the settlor. It may provide that the property be distributed outright to certain named beneficiaries or may provide that the property be continued in trust for their benefit. This type of trust is designated a revocable trust because it may be altered, amended, or terminated at any time by the settlor. Although title to the property passes to the trustee, the settlor nevertheless retains complete control in that he may regain possession of the property during his lifetime by revoking the trust. For this reason it is not looked upon as a completed gift by the settlor and therefore affords no tax advantages to him. He will be called upon to pay the tax on the income of the trust and the assets held therein will be subject to Federal estate tax upon his death.

The principal advantages of a Voluntary Revocable Trust are that such an arrangement relieves the settlor from the burdens of managing the property and supervising the investments, providing he has conferred such authority upon the trustee, and such a trust agreement will, in so far as the assets in the trust are concerned, act as a will upon the death of the settlor. In other words, upon the death of the settlor, the trust agreement can no longer be changed —it becomes irrevocable—and the property wil be administered and eventually distributed by the trustee, in accordance with the terms of the trust agreement. The property will not be involved in the probate of the settlor's estate, even though it will be subject to taxes in the estate.

4. Voluntary Irrevocable Trusts

Going a step further, we come to Voluntary Irrevocable Trusts, which are similar to revocable trusts but with the important distinction that in creating such a trust, the settlor should retain no powers in connection with the assets. In other words, he cannot terminate such a trust, and under the recent trend of tax cases, he should retain absolutely no strings in connection with the administration or management of the property. If he retains no control whatsoever over the assets placed in trust, it follows that he has made a completed gift, that a gift tax will be payable when the trust is established but that the income of the trust will not be taxed to the settlor, providing of course, it is paid to someone other than himself and is not used to carry out any of his legal obligations; and that the property will not be subject to Federal estate tax upon his death unless it be established by the Government that the trust was created in contemplation of death.

The Voluntary Irrevocable Trust is a very useful arrangement in estate planning, particularly in larger estates, because if the trust agreement is properly drawn, it can be used to remove income from the settlor's high bracket and to distribute it to other members of the family, who will no doubt be in much lower income tax brackets. It also, if properly drawn and set up under the right circumstances, will remove this property from the settlor's Federal estate tax return, and although the transaction will be subject to a gift tax, this tax is materially less than the amount of the Federal estate tax.

5. Life Insurance

No consideration of a person's estate plans

can be complete without a very careful consideration of his life insurance. How much does he own, what are the modes of settlement, and what will be the cash requirements for taxes, fees, and administration expenses in settling his estate? An eye also should be kept on the question of whether or not he will have sufficient income for the period after his retirement from active work. If this seems questionable, the advisability of obtaining annuities should be considered. Furthermore, if your client's chief asset is an interest in a partnership or a close corporation, should insurance be procured on his life, payable to a trustee in order to produce funds with which to purchase his interest upon his death?

An estimate should be made of the probable taxes and other expenses of the estate which must be paid in cash, in order to determine whether sufficient liquid assets will be available to meet these payments. By liquid assets is meant cash, Government or other readily marketable bonds and life insurance proceeds. There should be ample insurance to supplement the other liquid assets to the extent that the taxes and costs of administering the estate may be settled without sacrificing the estate.

In addition to the payment outright of insurance proceeds, the use of standard option settlements must be considered. Generally, these modes of settlement include payment of income only to the beneficiary, or payment of fixed sums, including principal and interest for the life of the beneficiary, or for life and a fixed term of years certain. Settlement options serve an excellent purpose, particularly for widows with limited investment experience. They should comprise at least a part of any well-rounded program. These modes of settlement have one limitation, however, and that is inflexibility. It is not difficult to imagine a situation where because of illness or other emergency, a widow may desperately need additional funds quickly but yet the insurance company, having no discretion in the matter, would be unable to advance additional funds to her.

6. Life Insurance Trust

To overcome the inflexibility of the settlement options mentioned above, a Life Insurance Trust might be considered. Broadly speaking, a Life Insurance Trust is an arrangement created by the insured during his lifetime under which he enters into an agreement with the trustee named therein, deposits his policies with the trustee, and has them made payable upon his death to the trustee. Upon the death of the insured, it is the duty of the trustee to collect the proceeds of the policies. The trust agreement usually provides that the trustee shall invest the proceeds and pay the income to the wife for life, and upon her death to the children, until they reach majority, or until certain stipulated ages thereafter, when the principal shall be distributed to them. Flexibility is provided for by giving the Trustee broad discretionary powers to advance so much of the principal as may be necessary in its discretion to cover any emergency that may befall the wife or the children, or to maintain them in the manner in which they have been accustomed to live. Another important feature of the life insurance trust is that the trustee may be given power to lend money, with or without security, to the insured's estate to enable his executor to pay taxes and administration costs. Thus the insurance proceeds will be available for this purpose to whatever extent may ultimately seem advisable.

7. After-Death-Planning

So far, you will note that most of the arrangements discussed have had to do with the arrangement of one's property during lifetime with certain carry-overs which become effective upon death. I now wish to touch upon the will, which of course becomes "the Bible" for the disposition of one's property after death.

Probably the most common type of will is the one in which the husband, after providing for payment of his debts, and possibly leaving a few bequests to close relatives or friends, gives, devises and bequeaths the residue of his estate to his wife to become hers absolutely. The wife may have a similar will leaving everything to the husband.

In estates which are confronted with the Federal estate tax, this is an expensive plan because it runs squarely into a double Federal estate tax. The husband's estate will be subject to tax at his death, and if the wife survives him by 5 years or more, the assets which she received from her husband's estate, as well as her own assets, of course, will again be subject to Federal estate tax upon her death. In many instances, particularly where there are no children involved, the husband will want to leave his affairs in this manner in spite of the additional cost which you may point out to him, primarily because he wishes his wife to feel that all of his property is to become hers to do with as she may please.

However, if children are involved, it is of course the desire of both the husband and wife to pass on as much as possible of their worldly goods to their children and they would much prefer to have their children receive the second tax than Uncle Sam. The second tax can be avoided by the husband providing in his will that the residue of his estate be held in trust to pay the income to his wife for life, with power given to the trustee to advance so much of the principal to the widow as, in its discretion, may seem necessary in the event of sickness, emergency, or other cause. Upon the widow's death, the trust assets may be distributed equally to the children or the will may provide that upon the death of the widow, the trust shall be divided into as many separate equal trusts as there are children then living, or issue of deceased children by right of representation, and that the income from each child's trust shall be paid to him until he becomes a certain age, at which time the principal shall be distributed to him outright. It is often provided that the children should receive one-third of their trust outright at about 25, one-third at the age of 30, and the balance at the age of 35, or, of course, any other appropriate ages may be picked for the distribution points. By such an arrangement, almost as much latitude is given to the beneficiaries as though the property had been willed outright to them, and yet the Federal estate tax upon the death of the widow is entirely avoided. Such an arrangement in many instances provides a real saving in dollars. For instance, let up assume that the husband has an estate of $200,000.00 which he leaves outright to his wife. The Federal estate tax payable upon his death would be based on a net estate, after the $60,000.00 exemption, of $140,000.00, and would result in a tax payable of $32,700.00. Let us assume that the wife had no assets. Omitting for the purposes of this illustration the costs of administration and other expenses, the wife would then receive from the husband's estate $167,300.00. If she should survive five years or more, the tax on her estate would amount to $22,890.00, all of which could be saved for her children had the husband's will provided that the residue be held in a testamentary trust for the benefit of his wife, with remainders over to the children.

One word of caution, however, in connection with the discretionary power in a testamentary trust to invade principal. For instance, if the widow and a corporate trustee are named co-trustees and given the power in their discretion to advance principal to the widow, if necessary, because of emergency or other cause, it has been held that the right of the widow to join in this discretion amounts to a power of appointment held by her, which is sufficient to cause all assets in the trust to be subject to Federal estate tax in her estate. In drafting the testamentary trust, the attorney should be very careful to confine this discretionary power to the corporate trustee alone, which under the present cases will be sufficient to prohibit the second tax being imposed upon the assets of the trust.

General Considerations

You will no doubt frequently be confronted by people having no will at all and they will ask what will happen to their property upon their death. If domiciled in Michigan the distribution of their property is of course governed by the intestate laws of the State of Michigan. I will not attempt to cover all the situations prescribed by the statute, but to give you a general idea of how the statute affects some of the more common situations, I might mention the following:

If a married man or woman dies with no will, leaving more than one child, one-third goes to the surviving wife or husband and two-thirds to the children. If there is only one child, then one-half to the surviving husband or wife and ½ to the child.

If a married man or woman dies with no will, leaving no children, then ½ of the estate goes to the surviving wife or husband and ½ to the mother and father, or the survivor, of the deceased. If neither parent survives, then that ½ goes to the brothers and sisters of the deceased. If no brothers or sisters or children of any deceased brothers or sisters are living, then the entire estate goes to the surviving wife or husband.

If a single person dies leaving no will, his or her entire estate goes to the father and mother or the survivor. If both have died, then to brothers and sisters.

If a widow or widower dies with no will, but leaving issue, then all goes to the issue.

These are very brief summaries of certain provisions of the statute and should not be relied upon as being complete statements in all respects.

Sometimes a person may be perfectly well satisfied with the distribution of his property arranged for him by the intestate laws. Even so, there are still strong reasons why he should have a will which would enable him to name his own executor to ad-

minister his estate, which is a very important consideration. By a will he can also stipulate the disposition to be made of his automobile, clothing, and other personal effects. He can confer a power of sale on his executor. This power is particularly important if there is real estate which will have to be sold during the course of administration because it avoids the necessity of obtaining a license to sell from the Probate Court. Obtaining such a license takes time and increases the costs of administration. Thus it is advisable for everyone to have a will, even though the distribution provisions may follow closely the provisions of the intestate laws.

Minor children cannot execute a receipt for their share of an estate because of the disability of being under age. Therefore, before their share of an estate can be distributed to them, it is necessary that a guardian be appointed. This fact should be kept in mind when a will arrangement under consideration may call for a possible distribution to minors.

Another provision in the Michigan law which should not be overlooked in preparing a will is that which gives the widow a right to three elections after the death of her husband testate. She may:

1. Elect to abide by the terms of his will.
2. Elect to take her dower and homestead rights.
3. Elect to take against the will. If she so elects, she will receive the same share of the real estate that she would have received if her husband had died without a will and she will receive the same share of personal property that would have passed to her, had her husband left no will, until the sum of the personal property amounts to $5,000.00. Of the rest of the personal property, she will receive one-half of the amount she would have received had her husband died without a will.

The moral of this is never to approve of a will for a husband unless under it he leaves his wife at least as great an interest in his real estate as she would have received had he died intestate and at least ½ as much of his personal property as she would have received had he left no will.

Conclusions

Estate planning has been a very much neglected field in the past. More and more people are becoming conscious of its importance, however, due largely to the increased burden of State and Federal taxation and the activities of accountants, life underwriters, the legal profession and trust men. Yet many men today are so busy making money that they seem to have no time or inclination to lay careful plans for its preservation during life and its use after death. The primary purpose of any estate plan should be to carry out the wishes of the individual, both during life and after death. Tax avoidance, as distinguished from tax evasion, should never be the sole purpose of any plan but should be constantly considered in determining the methods to be used in bringing about the individual's wishes. Furthermore, any plan should be kept as simple as possible. The administration of any estate or trust today, under present tax and administrative laws, is a very complicated undertaking fraught with pitfalls at every step in the procedure. Naming a close friend or relative as executor or trustee of a will is no longer appreciated as a gesture of confidence. The individual in all probability will have neither the knowledge nor the time to fulfill his duties properly. It is now becoming more and more advisable and even essential to name a corporate executor and trustee in one's will. Their charges for acting as executor are the same as though an individual should act, being set by statute in Michigan, and it is their *business* to keep abreast of all requirements and procedures necessary in the administration of estates and trusts. It would seem only good business to employ a corporate fiduciary which specializes in this highly technical work.

EXCERPT FROM PAPER READ AT AMERICAN INSTITUTE CONVENTION IN MIAMI

We all hope to see the day when accountants may be in the same situation as lawyers and doctors. The shyster lawyer and the unethical physician certainly should be subject to claim or suit, and likewise I think the accountant who is guilty of dishonesty, or who deliberately fails to do what he considers a good job, should be subject to claim and suit. But the lawyer who exercises reasonable skill usually is not sued for what may turn out to be poor judgment. The physician is not sued for a poor diagnosis if he exercises reasonable skill. We all feel that the accountant should not be subjected to claim and suit if he does the best job of which he is capable and follows reasonably good practice.

Norman J. Lenhart

The injuries we do and those we suffer are seldom weighed in the same scales.

—Aesop