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DISPOSITIVE METHODS

JOEL T. DAVES III and DANIEL DOWNEY*

In this article some of the more common methods of achieving desired results in the planning of estates will be discussed and analyzed. Certainly the most important advantage by which a specific method is to be judged is its propensity to preserve principal for the ultimate beneficiaries. Since the advent of the federal estate tax in 1916 and its maturity as a revenue measure in 1933 preservation has come to depend largely on tax avoidance; for this reason, although many estate planning methods are as old as the law itself, their efficacy must be measured in terms of taxation. The general problems of shrinkage and forced sale common to every estate, large or small, will not be overlooked, but in selecting the proper dispositive methods for the distribution of estates primary attention will be directed to tax problems.

Whether one, a number, or all of the available dispositive methods should be used in the planning of an estate depends on individual requirements that are discovered only after complete analysis of the particular case. For the purpose of this article the methods are discussed singly and in the order that seems most logical in terms of progressive use.

THE WILL

The will is probably the most fundamental, and surely the most widely used, of all dispositive methods, even though, according to a recent survey,[1] it apparently is not used enough in these so-called enlightened times. A valid will, properly drawn, effectively disposes of property in the manner desired by the testator, thereby avoiding

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[1]"In a survey conducted among 62,000 graduates of Columbia University, approximately one-half of the responding alumni did not have wills . . . . The answers given by those who replied revealed that many members of the group did not understand the disadvantages of intestacy. One of the most common replies was 'my family knows what to do if anything happens to me'." Taxes and Estates, Jan. 1957, p. 1.

intestate distribution according to a state statute[2] that may not conform to his desires. The will achieves greater importance than ever when other dispositive methods depend on the will for their execution. Generally speaking, in the planning of an estate the drafting of the will is the last item of business, the capstone and correlator of disposition after taking into consideration and giving effect to all other appropriate dispositive methods. Use of the will in conjunction with other dispositive methods will be emphasized.

Estate Tax Marital Deduction

The Revenue Act of 1948 created the important device of the marital deduction,[3] which, combined with the income-splitting provisions[4] and the joint treatment of gifts so returned,[5] created a new social concept in federal taxation. Thenceforth in the eyes of the assessing and collecting authorities a man's estate was to be considered the estate of his wife as well, his income held to be income to both, and his gifts to others held to be jointly made, if all the proper legal requirements were complied with. Thus Congress added its stamp of approval to the growing concept of the equality of the sexes, and American women were provided with their greatest gift since suffrage. And, as with other advances women have made through the course of recent history, this one too came not without its incidental benefits to cushion the blow.

The technical qualifications are plainly stated.[6] Basically the deduction is allowed for property passing from the decedent to the surviving spouse to the extent of one half the value of the decedent's adjusted gross estate.[7] The property that may be the subject of the deduction includes all objects or rights susceptible of ownership.

The estate tax deduction is not allowed for property that will not be included in the testator's gross estate[8] or for any interest generally

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[2]See Fla. Stat. §731.23 (1955).

[3]Int. Rev. Code of 1939, §812 (e), added by 62 Stat. 117 (1948) (now Int. Rev. Code of 1954, §2056).

[4]Int. Rev. Code of 1939, §51 (b), as amended, 62 Stat. 115 (1948) (now Int. Rev. Code of 1954, §6013).

[5]Int. Rev. Code of 1939, §1000 (f), added by 62 Stat. 127 (1948) (now Int. Rev. Code of 1954, §2513).

[6]Int. Rev. Code of 1954, §2056; see also U.S. Treas. Reg. 105, §81.47a (1948); S. Rep. No. 1013 80th Cong., 2nd Sess. (1948).

[7]Int. Rev. Code of 1954, §2056 (c) (1).

[8]Int. Rev. Code of 1954, §2056 (a).

referred to as a "terminable" interest. Thus no deduction will be allowed with respect to property interests passing to the surviving spouse that will terminate on a contingency, or the failure of a contingency, if some other person may enjoy the property on the termination of the spouse's interest because of an interest acquired gratuitously from the decedent.[9] For example, if property is devised to the wife for life with remainder to a third person, the wife's life estate or any interest she receives with another to hold jointly with right of survivorship will not qualify for the deduction.[10] The deduction is allowed for a life interest, however, if the wife is entitled for life to all the income payable and may appoint the remainder either to herself or to her estate; this power may be made exercisable by her during her life or in her will.[11] The Commissioner has set forth the following specific situations in which property "passes" within the meaning of the section:[12]

(1) An interest devolving, by virtue of a right of survivorship, upon a person who jointly owned property with the decedent passes to that person.
(2) An interest devolving upon a person because of the decedent's exercise, release, or nonexercise of a power of appointment passes to the appointee or the taker in default.
(3) A dower or curtesy interest, or a statutory interest in lieu thereof, passes from the decedent to the surviving spouse.
(4) Proceeds payable under an insurance policy on the life of the decedent pass to the person entitled at the time of the death to receive them.
(5) Subject to the four foregoing rules, an interest transferred by the decedent during his lifetime or by his will, or inherited from the decedent by the transferee, passes to the transferee.

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[9]INT. REV. CODE OF 1954, §2056 (b) (1). For amplification of this subject see U.S. Treas. Reg. 105, §81.47b (d) (1948), applicable specifically to the 1939 code but explanatory of INT. REV. CODE OF 1954, §2056.

[10]INT. REV. CODE OF 1954, §2056 (b) (1).

[11]INT. REV. CODE OF 1954, §2056 (b) (5).

[12]U.S. Treas. Reg. 105, §81.47a (b) (1948), supplementing §2056 (e). A sixth rule is included in the Proposed Estate Tax Regulations, §20.2056 (e)-1 (a) (6) (1956): generally, the survivor's interest in an annuity or other payment described in code §2039 passes to the survivor to the extent that the value of the interest payable to the particular survivor is included in the decedent's gross estate. For portions of the proposed regulations especially applicable to "passage" from the decedent to the surviving spouse, see §20.2056 (e)-2.

The actual tax saving that may be derived from the use of the marital deduction is substantial, though not so great as may be initially imagined. Most modern businessmen with sizable estates will be generally familiar with the deduction, and many may consider that they have solved the problem by extensive use of tenancies by the entireties. The task of the estate counselor is to provide the most expeditious manner of moving what is in most cases the husband's property through his estate to benefit his widow and children, and then through his widow's estate to the ultimate beneficiaries, with the least possible loss in estate taxes, probate expense, and general shrinkage. If all the joint property is held in an estate by the entirety the result will be taxation of one half the value of the property in the husband's estate and of all the property in the widow's estate.[13] A similarly unfortunate result occurs when the husband makes an outright bequest of his entire estate to his wife.[14] The substantiality of the initial saving in the husband's estate through use of the marital deduction depends upon various factors that will be subsequently discussed, but the ultimate tax burden on the wife's estate will be to a large extent unnecessary.

There may often be eminent practical benefits resulting from use of the marital deduction even in estates in which there is no immediate apparent tax saving. The competent estate planner will be called upon to determine, among other things, the amount of liquidity that will eventually be required of the estates of both spouses. The immediate shrinkage that will take place upon the death of a person whose estate consists solely of real estate and fixed nonliquid assets is readily discernible. Certain expenses must be met, and the time in which these must be dealt with is comparatively short. Use of the marital deduction may result in an extension of that time, for at least a portion of the expenses, to the death of the surviving spouse. The first advice of the planner to the husband should therefore be to convert during his life from nonliquid to comparatively liquid assets to the extent necessary to avoid the impending shrinkage problem. If this advice is rejected, as it may be for a variety of practical reasons, the next step might well be to use the deduction to the extent that seems to be required to postpone these liquid needs; the price of this advantage may be a considerable amount of taxable value in the wife's estate.

There is one basic formula that may be employed as a starting point

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[13]See U.S. Treas. Reg. 105, §81.47a (1948).
[14]Int. Rev. Code of 1954, §2056.

for the use of the marital deduction. The formula calls first for computing the estimated value of the estate of each spouse. Assuming that the husband has the larger estate and that he will be the first to die, the formula calls for a bequest or devise from the husband to the wife of one half of the difference in value between the two estates. For example, if it appears that the husband will die with an estate of $400,000 and the wife's separate estate is valued at $100,000, the marital deduction apparently may be used most advantageously if the husband leaves to the wife property valued at $150,000, which results, other factors not considered, in taxable estates of equal value.

As soon as the marital deduction is spoken of in concrete terms such as these, the problems inherent in the practical application of general principles become, as always, more apparent. How is it possible to project the husband's present estate into the future? When will the husband die? Will there be dissipation or increment between the planning and his death? The lawyer-planner, not being a prophet, can only apply sound common and legal sense to factors in existence when the plans are made and advise reappraisal of the plans upon the eventuality of changed circumstances. He has at hand mortality tables, valuation rules, and his personal knowledge of the persons for whom he drafts the plans. Their lives, habits, personalities, requirements, and abilities all go into his concept of the over-all disposition that should be made of the estate.

The stated basic formula rules out the use of the deduction if the wife's estate approaches in value that of her husband. As it approaches that value the deduction is of less and less benefit. The only result to be obtained from use of the deduction in such cases is the increase of death taxes that must be paid on the wife's death to the extent that they offset the tax benefit in the husband's estate. If, however, the testator's wife is young and has ability to manage financial matters, extensive use of the deduction may be in order even in the face of a substantial separate estate, for income earned during her life may well offset the tax losses at her death. Here, as in the other considerations determinative of estate planning matters, her age and personality are decisively important factors. A reasonably long life expectancy encourages plans for further distribution of her enhanced estate by gifts during her lifetime. If she is young at the death of her husband, she may make gifts for many years without concern over the inclusion of their value in her estate.[15]

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[15]See INT. REV. CODE OF 1954, §2035. Only those outright gifts made within 3

If the wife has evident spendthrift qualities or a number of young children, factors militate again in favor of greater use of the deduction. The children will require support and education during the life of their mother. The wife may speedily go through what is left to her by her husband if the compound estate has relatively little income potential. An ideal estate composition will be one in which expected income will be sufficient to provide for all anticipated needs of the family during the remaining life of the survivor. This composition may be arranged by the planner in some cases and not in others. If a surviving spouse will require, either for her own needs or for the needs of her children, an income exceeding that expected to be gained from the compound estate, it can be anticipated that the corpus itself will diminish during her remaining life. This justifies greater use of the marital deduction than called for by the basic formula, in anticipation of the dissipation of the joint estate during the life of the survivor.

Certain independent factors may militate against or restrict the use of the deduction, or the testator may for various reasons rule out this instrumental tool. The surviving wife may have expectations of inheritance from other sources. As has been noted, the deduction becomes of less and less importance as the size of her estate approaches that of her husband. Bequests in favor of charities may enter the picture. If the wife is receiving considerable income of her own, additional income from a marital deduction bequest may place her in a high-bracket situation in which income taxes will cancel estate tax savings. Finally, the testator may fear that his wife has not sufficient judgment to manage a large portion of his estate. Although a bequest or devise in trust of a portion of his estate, giving her the income for life and a general power of appointment over the remainder, will qualify the entire corpus for the deduction, certain technical restrictions have been placed on such a gift:[16]

(1) The surviving spouse must be entitled for life to all the income from the corpus.
(2) This income must be payable annually or at more frequent intervals.
(3) The surviving spouse must have the power, exercisable in

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years of death may be treated as having been made in contemplation of death.

[16] INT. REV. CODE OF 1954, §2056 (b) (5); U.S. Treas. Reg. 105, §81.47a (c) (1948).

favor of herself or her estate, to appoint the entire corpus free of the trust.

(4) The power must be exercisable by the spouse alone and must be exercisable in all events.

(5) No part of the corpus may be subject to appointment by any other person in favor of any person other than the surviving spouse.

Another factor restricting the use of the deduction may be the desire of the testator to maintain intact certain business enterprises or real estate holdings that comprise the major portion of his estate. If, however, his present estate is peculiarly nonliquid and insurance proceeds adequate to solve the liquidity problem will not be available, extensive use of the deduction may be required if the integrity of the nonliquid interest is to be retained. The marital deduction may be used to insulate assets subject to the provision from possible sale to pay the expenses of administration and taxes. Since the marital deduction property is not included in the taxable estate, provision must be made to assure sufficient estate liquidity to pay the taxes. An estate owner who does not desire to have his wife interfere with his business after his death may be called upon to determine whether he will save the integrity of his business by leaving her half of it in order to avoid forced sale to raise tax funds.

The law provides that a surviving spouse may disclaim her right to an interest in property passing to her that may otherwise qualify for the marital deduction.[17] A disclaimer may be useful if it is difficult, when drawing the will, to determine what use should be made of the marital deduction. The chief difficulty is in guarding against having the Commissioner rule that the disclaimer was in fact a taxable gift.[18] If use of the disclaimer is anticipated, the testator should expressly give the spouse the right to reject or take and should name contingent beneficiaries to take in the event of her disclaimer.

Warning should always be given that the marital deduction is not a panacea for saving taxes and for providing sufficient liquidity. The best estate plans have often been thwarted by premature death of the wife. This event should always be anticipated by providing sufficient liquidity in the living estate of the husband for payment of her death taxes and probate expenses in the event she is the first to die. The

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[17]INT. REV. CODE OF 1954, §2056 (d) (1).

[18]This subject has been thoroughly treated in Note, 5 U. FLA. L. REV. 179 (1952).

possibility that the wife may die with or shortly after her husband should also be carefully calculated. If the marital deduction transfer in the husband's estate is dependent in part on the wife's life use of the savings in her husband's estate, her premature death a few months after or simultaneously with his death will nullify the reason for employing the marital deduction in the husband's estate. This situation may be averted by making the marital deduction provision of the will contingent upon the spouse's survival of the testator for six months or subject to a common disaster clause; neither of these limitations will affect the tax deduction of the testator's estate if the premature death or the common disaster does not in fact occur.[19] In the usual common disaster clause the testator provides that the interest given to the surviving spouse as qualifying for the marital deduction will lapse if the spouse dies as the result of a common disaster.[20]

Perhaps the most difficult thing in estate planning is the planning of the wife's taxable estate simultaneously with that of the husband while both are still living, especially if there is a great difference in the ages of the two. The position may well be taken that the most important thing is the immediate saving. Economic forces and pictures change. Taxing concepts are subject to the gradual metamorphosis of society and its ideas. What is today may not be tomorrow. The deduction itself may someday be discarded. Perhaps we should save today the things that can be saved today and fly not in too great haste to those things we think may exist tomorrow.

GIFTS

The quick, uncomplicated way of disposing of property is by outright gift, but it can also be highly impractical and dangerous when viewed in relation to the future security of the donor. A prospective donor should consider well his own financial independence in this light before making gifts. Also to be considered is the possibility that donees may subsequently be regarded in a different light by the donor; later developments may indicate that others than the donee should have been the objects of his bounty. The age of the intended beneficiary is also an important consideration. The older the prospective donee the more real the possibility of subjecting the gift to immediately

[19]INT. REV. CODE OF 1954, §2056 (b) (3).

[20]Florida has adopted the Uniform Simultaneous Death Law, FLA. STAT. §736.05 (1955).

successive taxes. First the gift tax is imposed on the donor, and then a tax may be imposed on the transferred property in the estate of the donee. If the age of the donee indicates that this is a probability, the better method is to make a gift in trust, naming persons to take the property after the prime donee-beneficiary gains the use and benefit of the property for life, rather than to make an outright gift. This scheme eliminates estate taxes by preventing the donated property from falling into the estate of the first beneficiary, who has no interest at death.[21]

The present exemptions and exclusions permit a husband and wife to give jointly, free of tax, during their married life $60,000 in value over and above their combined annual exclusions of $6,000 to each of any number of donees.[22] Beyond this lifetime exemption and these annual exclusions, gifts are taxed at rates that approximate three fourths of estate tax rates.[23] This tax saving of one fourth in the case of lifetime gifts as opposed to testamentary gifts is further magnified by the fact that donated property most frequently comes off the top of the estate, where it would be taxed at the highest bracket rate. From there it usually falls into the lowest gift tax bracket first. For example, a $100,000 initial gift by a donor having taxable assets of $1,000,000 would prevent an estate tax in the thirty-nine per cent bracket, saving $39,000 in estate taxes. The gift would fall in the two and a quarter to twenty-one per cent gift tax brackets, costing $15,525 in gift taxes and resulting in a net tax saving of $23,475.

It should be recognized that the gift tax is computed only on the amount successfully given by the donor and received by the donee; the fund from which the tax on the transaction is paid by the donor escapes tax. On the other hand, estate taxes are imposed on the total value of property parted with at death, which includes the fund from which the tax is paid. Because the property whose value determined the amount of tax due is the only source of funds with which to pay the tax, the result is a tax levied on the tax fund itself. For example, a client with $120,000 to part with by gratuitous transfer and taxes may elect to effect the transfer during his lifetime as a gift or at his death by bequest. Assuming the fiction that the tax rates are the same — say twenty per cent — as a gift he will donate $100,000 and pay a tax of $20,000. Through his will he might leave $120,000, but only

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[21]See INT. REV. CODE OF 1954, §2033.

[22]INT. REV. CODE OF 1954, §§2503 (b), 2513 (a), 2521.

[23]*Compare* INT. REV. CODE OF 1954, §2001, *with* §2502 (a).

$96,000 will reach the hands of the beneficiaries because twenty per cent of the bequest, or $24,000, is taken by the tax collector. Stated differently, the same amount of property may be "parted with" in the case of gifts as in the case of bequests; but, even aside from rate considerations, less tax will be paid if the former method is used.

Not only does the outright gift effect substantial estate tax savings, but it is also an effective means of saving income taxes within that group comprised of the immediate family and all intended ultimate beneficiaries by taking income away from the high-bracket donor and giving it to the low-bracket donee. For example, a father in a fifty per cent bracket may make gifts to his minor children of income-producing property the income from which would be taxable to each child in the initial twenty per cent bracket, thus saving up to thirty per cent of such income.[24] It is even possible for the head of a family to accomplish this and still claim the dependency exemptions on such donees for income tax purposes, regardless of the fact that the donees may have had gross income of $600 or more in the taxable year.[25]

If the donee is the donor's spouse, the Internal Revenue Code of 1954 provides for a gift tax marital deduction whereby one half of the value of the gift is deductible in computing the taxable gift.[26] This deduction makes gifts between spouses attractive at first blush; but, since the estate tax marital deduction allows one half of the estate to be passed to the surviving spouse tax free, the gift tax marital deduction is not quite the bonanza it appears to be. Further, as shown under the section devoted to the estate tax marital deduction, that deduction is most effectively used when its value is determined by reference to the taxable value of each of the two estates. Since the idea is to equalize the taxable values of the estates, the amount of the estate tax marital deduction may be most effectively expressed in the husband's will by percentage terms if his wife has no individually owned property, whereas it may be expressed in dollars if both spouses own property. It will be readily seen that, once the expression is made by will, future gifts between spouses may throw out of kilter the desirable amount of the estate tax marital deduction, so that constant revision of the will may be necessary. Nevertheless, gifts between spouses are an effective hedge against loss of the marital deduction by the prior death of the spouse to be benefited. A planned program of gifts

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[24]See INT. REV. CODE OF 1954, §1 (a).
[25]INT. REV. CODE OF 1954, §151 (e).
[26]INT. REV. CODE OF 1954, §2523 (a).

between spouses, if completed, could settle the estate affairs of both and result in the lowest possible estate tax and the greatest possible economic protection to each, eliminating the necessity for a marital deduction in the will of either. This possibility hinges, of course, on the life expectancy of each spouse.

The use of gifts in estate planning received a shot in the arm in 1950 when the contemplation of death rule was changed.[27] Under prior law any inter vivos transfer without consideration, regardless of when made, was considered part of the donor's gross estate if the transfer was made in contemplation of death.[28] The new rule provides that any gratuitous transfer taking effect on a date prior to three years before death may not be considered to have been made in contemplation of death, and there is an opposite rebuttable presumption as to transfers taking effect on any date within three years prior to death. This new rule has taken much of the risk out of the tax effectiveness of gifts, for under the old rule the Commissioner was extremely zealous in inquiring into the deceased donor's motives.

Other conditions in addition to contemplation of death may cause the gift to be included in the estate of the donor. Care must be exercised in the making of gifts to insure that the legal requirements of intent, delivery, and acceptance are met. Generally speaking, for a gift transfer to escape subsequent estate tax it need only be made with no strings attached. It must not be of some present or future benefit to the donor.[29] The donor may not retain the right to income from the donated property[30] or the right to alter the property or change the donee.[31] The gift may not be intended to or in fact take effect at the death of the donor.[32] Even if the transfer or gift is subsequently included in the estate of the donor for estate tax purposes, a benefit is still gained; the amount of any gift tax paid may be used as a credit against estate taxes,[33] although it is not itself considered as a part of the gross estate for estate tax purposes.

Consideration should be given to the advantages that may be obtained by proper selection of the property to be donated. If one

[27]Int. Rev. Code of 1939, §811 (c) (1) (A), as amended, 64 STAT. 962 (1950) (now INT. REV. CODE OF 1954, §2035 (b)).

[28]Int. Rev. Code of 1939, §811 (c) (1) (A), 53 STAT. 121.

[29]INT. REV. CODE OF 1954, §2033.

[30]INT. REV. CODE OF 1954, §2036.

[31]INT. REV. CODE OF 1954, §2038.

[32]INT. REV. CODE OF 1954, §2037.

[33]See INT. REV. CODE OF 1954, §2012.

of the purposes of the gift is to deplete the size of the estate, the property should be of a low market value that is expected to increase, thereby taking out of the estate tax picture not only the value of the gift as of the date made but also the expected increment to the date of death. If the donor is in the higher tax brackets, the subject matter of the gift should be income producing, so that income tax savings through the lower bracket of the donee may be realized. Conversely, if the donor needs the income he is receiving, nonincome-producing property may be transferred with little if any loss of economic position to the grantor. It should be remembered that the donee's basis will be that of the donor for determination of gain in the event of subsequent disposition.[34] Thus a high basis will effectively reduce future taxable gain, and in so doing it will preserve the full value of the gift. Since a new basis is assigned to all property passing through an estate,[35] it is always advisable to hold low basis property for inclusion in the estate while making high basis property the subject matter of gifts.

In order for the annual exclusions to apply, a gift must be of a present rather than a future interest.[36] A "future interest" includes vested and contingent reversions, remainders, and other interests that are limited to commence in use, possession, or enjoyment at some future time.[37] Under the Internal Revenue Code of 1954 a transfer to a minor will not be considered a gift of a future interest if the property may be expended by him or for his benefit before he reaches the age of twenty-one and will, to the extent that it is not expended, pass to him at that age or to his estate if he dies before that age.[38]

The problem of effectuating a valid gift of securities to a minor has been corrected by some states through adoption of a model "gifts of securities to minors act,"[39] providing the manner in which securities may be held for a minor. A recent revenue ruling[40] indicates that a transfer to a minor in accordance with the provisions of this act is a transfer of a present interest and therefore qualifies for the annual exclusion.

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[34]INT. REV. CODE OF 1954, §1015 (a).

[35]INT. REV. CODE OF 1954, §1014.

[36]INT. REV. CODE OF 1954, §2503 (b).

[37]U.S. Treas. Reg. 108, §86.11 (1943); Proposed Gift Tax Reg. §25.2503-3 (1956).

[38]INT. REV. CODE OF 1954, §2503 (c).

[39]*E.g.*, N.Y. PERS. PROP. LAW §265. Florida has no such act.

[40]Rev. Rul. 86, 1956-1 CUM. BULL. 449; see also 1956 INT. REV. BULL. No. 40, at 8, providing that income from property transferred into such a trust is, to the extent that it is actually used to discharge the settlor's local law obligation to support, in-

POWERS OF APPOINTMENT

A power of appointment is an authority granted by deed or will to a donee to nominate a person or persons to enjoy the benefits of property. All powers were broadly classified in the common law as general or special; a general power was one exercisable in favor of any person,[41] and a special or limited power was one exercisable only in favor of members of a class or persons designated by the donor.[42] The code now defines general and special powers in somewhat different terms. Only the general power is taxed, and it is defined as a power exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate.[43] No special words are required to create the power, and local property law connotations are immaterial if the power falls within the stated definition.[44]

Prior to 1942 the code placed a tax only on the exercise of a general power.[45] The 1942 act[46] taxed the exercise of general powers, the possession at the time of death of unexercised general powers, the exercise of certain limited powers, and the possession at death of unexercised limited powers. The 1951 Powers of Appointment Act[47] was passed to relieve the harshness of the earlier provisions and also to remove doubt concerning the extension of the limited powers provisions to powers granted trustees and fiduciaries.[48] The 1951 act radically reorganized the then existing law, and the 1954 code[49] merely restates the provisions of the 1951 act.

The present law divides the powers into two broad chronological divisions. Basically, powers created on or before October 21, 1942, can result in tax only if exercised,[50] but the exercise cannot be renounced, as it could prior to 1942.[51] In the case of powers created after October

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cluded in the settlor's gross estate.

[41]Phipps v. Palm Beach Trust Co., 142 Fla. 782, 196 So. 299 (1940); Jackson v. Franklin, 179 Ga. 840, 177 S.E. 731 (1934).

[42]Phipps v. Palm Beach Trust Co., *supra* note 41; *In re* Lidston's Estate, 32 Wash.2d 408, 202 P.2d 259 (1949).

[43]INT. REV. CODE OF 1954, §2041 (b) (1).

[44]U.S. Treas. Reg. 105, §81.24 (a) (2) (1954).

[45]Int. Rev. Code of 1939, §811 (f), 53 STAT. 122.

[46]For a discussion of this history and development see S. REP. No. 382, 82d Cong., 1st Sess. (1951).

[47]65 STAT. 91 (1951).

[48]See note 46 *supra*.

[49]INT. REV. CODE OF 1954, §2041.

[50]INT. REV. CODE OF 1954, §2041 (a) (1).

[51]Helvering v. Grinnell, 294 U.S. 153 (1935).

21, 1942, the chief factor is the possession of a general power as of the date of death, regardless of whether it is exercised at death.[52] If, however, the power was exercised or released during the lifetime of the decedent in such manner that if the exercise or release were a transfer it would be included in the decedent's estate,[53] the property subject to the power is included in the decedent's estate.[54]

The importance of this brief excursion into this field is twofold insofar as the estate planner is concerned. The use that may be made of the power as a device in planning the decedent's estate is extensive in certain cases and restricted in others. It may, for example, be employed to qualify a marital deduction trust[55] when only the income is to be paid to the testator's wife during her life. Powers of appointment add a degree of flexibility to an estate plan that may be employed to meet expected contingencies. The choice of the type of power to employ will be dictated by the purposes sought to be accomplished and by the election of the particular estate in which the saving is sought. If the power is special or limited, the property subject to it will be taxable in the estate of the donor; if the power is general the donee's estate will bear the tax.

The planner should be certain that his client is not the donee or possible appointee of some power long since created and forgotten. The size and composition of the decedent's estate may be affected to a marked degree by such a situation, and adequate provision must be made beforehand to provide for such a contingency.[56]

TRUSTS

The trust has been a major factor in estate planning since it was first conceived as a device to avoid the statute of uses, and in modern estate planning it has found a new place as a means of shifting tax burdens.

In general, the word "trust" means the status that is created when one or more persons transfer legal title to property to one or more

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[52]INT. REV. CODE OF 1954, §2041 (a) (2).

[53]See INT. REV. CODE OF 1954, §§2035-38.

[54]INT. REV. CODE OF 1954, §2041 (a) (2).

[55]See INT. REV. CODE OF 1954, §2056 (b) (5).

[56]See U.S. Treas. Reg. 105, §81.24 (b) (2) (iii) (1954), relating to the release of powers created after Oct. 21, 1942; see also FLA. STAT. §§709.02-.07 (1955) for the Florida law on methods of releasing powers; Note, 5 U. FLA. L. REV. 179 (1952), for a discussion of disclaimer by the donee before the vesting of the power.

other persons for the benefit of a third person or persons. The reasons for the transfer can be many and varied, such as the desire to benefit another for a period of time, the natural inclination of the human being to hold strings on what he owns and to decide which of his descendants shall enjoy his accumulations, the desire to provide for others who are unable to do so for themselves, and many others too numerous to mention, not the least of which is the very common motive of doing all in one's power to escape the long fingers on the tax hand of Uncle Sam.

Inter Vivos

The inter vivos trust, generally understood to mean a trust that springs into existence during the life of the settlor, includes the revocable trust — one in which the settlor retains the power to terminate at will — and the irrevocable trust. The latter term is generally used to describe a trust that the settlor has no power to terminate, but it also includes the type of trust that is irrevocable for a term of relatively short duration. This "short term trust" has its chief use in avoiding income tax liability in the higher brackets.

Revocable. The revocable inter vivos trust is a transfer by a settlor for a term to be determined by the pleasure of the grantor; it may be used when the grantor finds it necessary or desirable to provide financial assistance to another without permanently giving up control of the property transferred. It also affords a means of passing administrative and investment burdens to others while retaining sufficient control to effectively supervise the management of the property. Revocable inter vivos trusts offer no income tax benefits to the settlor.

Irrevocable. The irrevocable trust is so called simply because it may not be altered to return the legal title to the settlor. If the settlor is not the beneficiary, economic conditions or the settlor's beneficent intentions may change to the extent that the property is needed for his own support. For these obvious reasons the adviser and one contemplating such a transfer should be certain that the irrevocable trust is the proper course.

The problem of having the income of an irrevocable short term trust taxable to the beneficiaries has been solved to a considerable degree by the Internal Revenue Code of 1954. Under prior law the income was taxable to the settlor if the term was of insufficient dura-

tion and the powers retained too broad.[57] Under the present law the trust term must be longer than ten years,[58] and the powers and control retained by the settlor may not, generally speaking, be such as could result in any benefit or use to him.[59] A properly drawn short term trust allows the grantor to split high-bracket income with members of his family, resulting in tax savings that are limited only by the earning power of the trust property.

Care should be taken to insure that the irrevocable long term trust is not included in the estate of the settlor by the retention of too much control. Property given in trust is not taxable in the settlor's estate if he simply retains management rights as a trustee, but if he retains any of the following rights the corpus will be included:

(1) To alter, amend, revoke, or terminate, regardless of whether the change may be for the benefit of the settlor.[60]
(2) A reversion, if the donee can acquire possession or enjoyment of the property only by surviving the decedent.[61]
(3) To make testamentary disposition of the corpus.[62]
(4) To change beneficiaries or alter beneficiaries' shares.[63]
(5) The right to the income.[64]

A gratuitous transfer in trust ordinarily results in a gift of an amount determined by the value of the property transferred and therefore may be taxable. Tables published by the Treasury Department[65] show the factors to be applied in measuring the value of property transferred in an irrevocable short term trust; the value of property transferred in an ordinary irrevocable trust is the usual fair market value on the date of the transfer.[66] Needless to say, if the trust is revocable at the will of the settlor no gift is effected and no income tax or estate tax benefit is gained.[67] The usual rule regarding transfers

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[57]Helvering v. Clifford, 309 U.S. 331 (1940).
[58]INT. REV. CODE OF 1954, §673 (a).
[59]INT. REV. CODE OF 1954, §§671-78.
[60]INT. REV. CODE OF 1954, §2038.
[61]INT. REV. CODE OF 1954, §2937 (a).
[62]INT. REV. CODE OF 1954, §2038.
[63]*Ibid.*, Cook v. Commissioner, 66 F.2d 995 (3d Cir. 1933).
[64]INT. REV. CODE OF 1954, §2036.
[65]U.S. Treas. Reg. 108, §86.19 (f) (1943).
[66]See INT. REV. CODE OF 1954, §2512 (a).
[67]INT. REV. CODE OF 1954, §§2501, 2038, 671, 676 (a); U.S. Treas. Reg. 108, §86.3 (1943).

in contemplation of death applies to gratuitous transfers in trust.[68] Even though a transfer in trust may subsequently be determined to have been made in contemplation of death, estate tax savings will be accomplished to some extent. The amount of the saving is the estate tax that would have been paid on the amount of gift tax paid and its natural increment had the gift in trust not been made.[69]

Testamentary

The testamentary trust, which springs into existence at the death of the settlor, usually is created in the will of the testator, although there are other ways in which such a trust may come into being.[70] It is often employed for dual purposes in the planning and drafting of wills.

Marital Deduction. The estate tax marital deduction may be obtained through use of a testamentary trust in which the surviving spouse has the right to all the income for life and a general power to appoint the remainder.[71] The beauty of using the trust device in qualifying property for the marital deduction is its tendency to conserve principal by putting the problems of administration and investment in the hands of those usually more experienced in such matters than, for example, a surviving widow. Furthermore, it allows the testator to name contingent beneficiaries to take if the surviving spouse fails to exercise the power of appointment.

The mere existence of a general power of appointment is sufficient to throw the trust corpus into the estate of the surviving spouse, regardless of whether the power is exercised.[72] If the settlor names ultimate beneficiaries who will succeed if the surviving spouse fails to appoint, the risk of misdirection of property to undesired beneficiaries by reason of the intestacy of the surviving spouse is eliminated. The naming by the testator of desired ultimate beneficiaries has the additional salutary effect of discouraging the surviving spouse from

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[68]INT. REV. CODE OF 1954, §2035.

[69]For an explanation of the manner in which the estate tax falls upon the very property used to pay the tax, see discussion under Gifts *infra*.

[70]See, *e.g.*, Seymour v. Seymour, 85 So.2d 726 (Fla. 1956); *In re* Totten, 179 N.Y. 112, 71 N.E. 748 (1904).

[71]INT. REV. CODE OF 1954, §2056 (b) (5).

[72]INT. REV. CODE OF 1954, §2041. This assumes that the power is general and that it was created after Oct. 21, 1942.

actually exercising the power of appointment. In any event the property subject to a power exercisable only in favor of the surviving spouse's estate is qualified for the marital deduction.[73]

Nonmarital Deduction. The other current employment of the testamentary trust is in the nonmarital deduction trust, so called because it does not and is not intended to qualify for the marital deduction. The nonmarital deduction trust may be used to insure that the surviving spouse will be adequately provided for when the interest passing to the surviving spouse under other bequests may not be sufficient. The trust benefits the remaining members of one generation and prevents the imposition of a second tax in that generation. To the extent that a trust qualifies for the marital deduction it is taxed in the estate of the surviving spouse and not in the estate of the settlor; the nonmarital trust is taxed in the estate of the testator.

The marital deduction and the nonmarital deduction trusts may be used effectively together in the same will, particularly when the estate is not large. The estate tax saving possible by leaving property directly to the ultimate beneficiaries of both spouses rather than through the estate of the survivor may be accomplished through use of the trust, and sufficient provision may be made for the lifetime needs of the surviving spouse by directing the distribution of income and principal to her in the discretion of the trustee.

In all situations in which a trust is employed the ordinary precautions must be followed to insure that the Rule Against Perpetuities is not violated. In Florida the common law rule applies, and vesting may not be postponed for a period longer than lives in being plus twenty-one years and the usual period of gestation,[74] the postponement period measured as of the date of the creation of the trust.

Pouring Over. Often a testator will establish a trust for the benefit of some member of his family and direct in his will the distribution of a portion of his estate into the inter vivos trust previously created. The subject of the bequest or devise may enter the trust immediately or its entrance may be postponed if, for example, it comprises the remainder portion of a life estate or of a testamentary trust paying income benefits to some member of the testator's family. In any event

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[73]INT. REV. CODE OF 1954, §2056 (b) (5).

[74]*E.g.*, Montgomery v. Carlton, 99 Fla. 152, 126 So. 135 (1930).

the distribution of the assets of the estate into the trust has been termed in the trade as a "pouring over" of the assets from one account into the other. Questions as to the validity of the pouring provisions have been resolved to varying degrees of certainty by the courts of the several states.[75]

The great difficulty lies in incorporating into the will by reference an instrument that may not have been executed with the formalities required by law for the execution of wills, and there is considerable additional difficulty if the incorporated trust is amendable or revocable by the settlor. If the trust is in fact revoked or amended after the execution of the will, the probate courts will be called upon to determine what the will actually says and what portions of the will, if any, are to be upheld. Several states have passed statutes on this subject,[76] but Florida has no such act. Most authorities agree that the best practice in the absence of controlling common or statutory law is to set forth in the will itself the terms of the trust into which the assets are to be poured, so that the possibility of unnecessary litigation in the future may be minimized.[77]

Life Insurance as Corpus

The trust device can be used regardless of the nature of the property to be transferred; however, one type of property — the life insurance policy — seems to enjoy a large play in transfers in trust, perhaps because insurance has itself become an important business as well as estate asset.

Under prior tax law attempts to prevent the taxation of life insurance proceeds in the insured's estate was fraught with danger;[78] under present law this may be accomplished with greater ease,[79] and the trust device lends itself in this respect to practical and flexible use. The first requirement is that there be no reversionary interests retained in the policies. The insured should transfer his policies to a trustee

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[75]See, *e.g.*, Montgomery v. Blankenship, 217 Ark. 357, 230 S.W.2d 5 (1950); Continental Illinois Nat'l Bank and Trust Co. v. Art Institute, 409 Ill. 481, 100 A.2d 625 (1951); Stouse v. First Nat'l Bank, 245 S.W.2d 914 (Ky. 1951); *In re* Amor's Estate, 99 N.H. 417, 112 A.2d 665 (1955); Clark v. Citizen's Nat'l Bank, 38 N.J. Super. 69, 118 A.2d 108 (1955); *In re* Snyder's Will, 125 N.Y.S.2d 459 (Surr. Ct. 1953).

[76]ILL. REV. STAT. c. 3, §194a (1955); IND. ANN. STAT. §6-601 (1953); N.C. GEN. STAT. §31-47 (1955); WIS. STAT. §231.205 (1955).

[77]Lauritzen, *Pour-Over Wills*, 95 TRUSTS AND ESTATES 992 (1956).

[78]Int. Rev. Code of 1939, §811 (g), 53 STAT. 122.

[79]See INT. REV. CODE OF 1954, §2042.

and designate as many successive beneficiaries as are necessary to avoid the possibility of reversionary interest.[80] He may, for example, want to name a charitable institution in the event other named beneficiaries fail to qualify. The insured settlor should of course pay over to the trustee annually an amount sufficient to pay the policy premiums, although the annual transfers by the settlor do not qualify for the annual gift tax exclusion because they constitute a gift of a future interest.[81] Generally, it is the better practice to transfer income-producing property to the trustee, so that there will be no question of the trustee's having funds out of which to pay premiums. The transfer of income-producing property to the trustee can possibly have the incidental advantage of saving the income from the settlor's high tax rates. The trust income is taxable to the settlor, however, to the extent that it is used to purchase insurance on the settlor's life without the permission of an adverse party or in the discretion of someone who is not adverse to this use of the income.[82] Thus, if the trust income is payable to *A* annually or, in the unbridled discretion of the settlor or the trustee, is to be used instead to purchase insurance on the settlor's life for the benefit of *B*, the trust income so used is taxable to the settlor. It seems to be irrelevant for the purpose of this section that the policy was initially bought by the trustee instead of contributed by the settlor; it is likewise irrelevant that the trustee is expressly empowered to pay premiums if in a particular tax year no policy was outstanding. If an adverse party's permission is involved in the insurance investment, the tax savings afforded may be sufficient to carry on the premium payments; otherwise the income is taxable to the settlor and he neither gains nor loses income tax in the transaction.

Although the use of life insurance in connection with trusts has many facets too broad to be discussed in detail in this article, one other common use should be mentioned — the use of a trust of life insurance to fund the purchase of business interests. For example, *A* and *B*, equal partners, each binds his estate to sell his partnership interest to the other at one half the stipulated partnership value of $100,000. Each insures the other's life for $50,000, thereby providing

[80]Proposed U.S. Treas. Reg. §20.2042-1 (c) (3) (1956) provides that a reversionary interest valued at greater than 5% of the value of the policy immediately before the insured's death will be treated as an incident of ownership; see §20.2037-1 (c) (3) for principles to be used in computing the percentage.

[81]INT. REV. CODE OF 1954, §2503 (b), Helvering v. Hutchings, 312 U.S. 393 (1941).

[82]INT. REV. CODE OF 1954, §677 (a) (3); see also Kimbrough, *Short Term and Controlled Trusts*, 94 TRUSTS & ESTATES 857, 865 (1955).

a fund with which to pay for the purchased interest. In this situation a trustee should be employed to hold the policies to protect the rights of all, and if possible the trustee should have funds with which to pay the premiums. There is no chagrin like that of a trustee holding policies of insurance no longer in force for lack of premium payments.

Selection of Trustee

The trustee is subject to the statutes covering fiduciaries.[83] An ideal trustee is one who has keen business judgment tempered by years of experience, a knowledge of investments, and an awareness of problems that sometimes require for solution special training in law, banking, taxes, and accountancy. This combination of talents is seldom found in one individual, and to find them in a particular settlor's family is too much to expect. In view of this fact, and assuming that the prospective trustee is to have actual and real duties to perform, the case for the corporate trustee is a good one. Having perpetual existence and always in a fiduciary climate, the average corporate trustee employing trained personnel is in an excellent position to administer trusts in a highly professional manner and at a minimum of expense to the trust.

Very often the nature of the trust property or the purpose of the trust is such that the trustee will not be called upon to exercise functions much beyond those of a stakeholder or disbursing agent, as, for example, when the trust property is an insurance policy or a promissory note the proceeds of which are to be paid over to the beneficiaries. Such duties may not require the special skills of a corporate trustee. In all other cases the adviser will do well to have the settlor consider the ordinary individual trustee's lack of experience and training, future death or disability, and other factors that may interfere with the smooth administration of the trust.

CONCLUSION

In this day the typical Horatio Alger of the last century has only a fleeting existence; the channels through which he might develop his material assets are rapidly being diked. If he has the good fortune to accumulate material goods he will find it increasingly difficult to pass this accumulation on to his heirs at his death. What little success he

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[83]See FLA. STAT. cc. 518, 690, 691, 737 (1955).

may have in passing on the fruits of his toil to others will depend exclusively on the wisdom of his counselors in advising the manner in which he should make this distribution. The devices at hand for this purpose will not be known to him.

The lawyer who would purport to plan estates must first see that he is competent to do so. And his duty to his client extends to apprising the client at every opportunity of the necessity for adequate estate planning. Without regular prodding many people will refuse to face the fact that all men die, and some sooner than others, and the prospective beneficiaries are reluctant to raise this delicate though fundamental question. After death the propitious moment has passed, and the only question is the extent of the unnecessary loss. This prototype deserves a nobler end.