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Taxation and the transmission of wealth

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THESIS

Taxation and the Transmission of Wealth

by

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I. INTRODUCTION

The problem of treating methods of transmission of wealth is generally referred to as estate planning. This should not be construed to imply that wealth is best or even ordinarily transferred at death, or for our purposes, that the estate tax is the main hurdle to cross. We, however, do not plan to be different, and therefore will refer to the total problem, which is a process continuing throughout life as well as after it, as estate planning. We shall limit our treatment of this considerable field to one small aspect of it, that is the effect of taxation on the various methods of transmitting wealth.

The purpose of this paper, is to assist the reader in evaluating the different possibilities available to him in the highly complex matter of effectively distributing his property. One should endeavor to effect this distribution in as intact a condition as possible, consistent with the basic aims of the individual program and within the possibilities of the law. The stress should be laid here on these two points: (1) to assist in evaluating and (2) as intact as possible. Many excellent books and articles are available if one desires information on the principles and problems of estate planning as a whole; many erudite texts treat the laws of estates, wills, and taxation in great detail; several services present the tax aspects and/or tax computations in all their complexities. These three areas
of the overall field have been avoided or minimized in this discussion. Instead we have attempted to create from these above sources an evaluation of the means of transmission of wealth consistent with the minimum tax burden, presented in relatively simple terms and in one continuous treatment. This paper is not intended to be a handbook on the subject, but rather aims at presenting a sufficient amount of the field so as to give the reader insight into the possible problems involved and some solutions therefor.

At the outset, it must be emphasized that tax planning is by no means the same as estate planning. Estate planning must consider all the factors affecting the disposition of the estate. Tax planning is only one aspect of this. While a sound tax plan is essential to a sound estate plan; tax considerations should always be considered as a means of implementing the estate plan, not as an end in themselves. Merely because in this work little or no attention has been given to considerations other than taxes, it should in no wise be construed to imply that taxes are the primary consideration in planning one's estate. While taxes are an integral part of estate planning and can make substantial dollar differences in the net estate, they should not be allowed to distract one from the principal concern which one wishes to accomplish by the distribution of his wealth.

Several points of tax planning should be noted before
further discussion: (1) Tax planning ultimately should be specific rather than general. The mathematical computational result may be at some variance from the theoretical approach: for example, the gift tax rates are fixed at three-quarters of the estate tax rates. Thus theoretically you save one-quarter by giving away your property. However, in actual operation, under certain circumstances, the total gift tax will exceed the estate tax; in other situations one can incur no gift tax at all.

(2) In tax planning for estates, the effect of the gift and income taxes must be included in one's estimates. No necessary correlation among the three types of taxes is present. One may benefit or suffer from two of them or all three. These other taxes are also important in building the estate; however, due to the limited size of this paper, taxes involved in this process, such as income or capital gains taxes, are largely ignored except as they are incidental to the transmission of already accumulated wealth.

(3) Estate planning must allow for future changes in the law. While the future cannot be predicted, an estimate of trends can be made. The current trend is generally toward an increased tax burden as government economic requirements increase. This points to lower exclusions and exemptions, and the possibility of an integrated gift and death tax law so as to limit tax benefits in the future. Due to the possibility of change, full consideration of all eventualities must be made before effecting
an irrevocable transfer. The need for constant review and possible revision of the estate program must always be kept in mind.

(4) Tax planning must be tailor made. Therefore, there is a need for full information, both financial and personal, concerning one's assets, liabilities, beneficiaries and aims.

In the process of planning one's affairs, all possible savings should be considered. However, no tax saving should be planned at the sacrifice of some other important objective, such as liquidity, flexibility or control.

The important point is that tax savings should not be used unless they will complement the overall plan. One simply should be alert to the tax savings possibilities which may be effected without diminishing the achievement of one's principal objectives. The problem is that often the individual, having the natural inclination to minimize taxes, tries to take advantage of every possible tax saving at the expense of sacrificing his basic aims. Especially since a device that minimizes his estate today may be included in his estate by the time he dies by reason of changes in the tax law, unnecessary or doubtful transfers from the basic economic point of view should be avoided. "Saving money is not the only end or the only satisfaction in life....(one) should not be led to discolor his real
desires and neglect his best interests or those of his family by over-emphasis on tax savings." On the other hand, to keep possible tax savings in mind is perfectly proper and legitimate. "Over and over again courts have said there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible.... Nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions."

* 6, p. 47.

** 6, p. 47 (Judge Learned Hand in Commissioners vs. Newman, 159 F. 2nd, 848 (2nd Cir., 1947)
II. Lifetime Transmission.

A. Gifts.

Major tax savings are effected most commonly by the use of inter vivos transfers, creation of successive estates, or a combination of both. Of these, the simplest method of minimizing the estate tax is to give away one's property while living. To be effective a gift may be outright or conditional, one of a life interest, use, or for a number of years, or with a contingent interest. While from a tax point of view the use of gifts is the easiest method, much care and consideration must be given before such action is taken. The non-tax factors, into which we generally will not enter here, are of a special importance in this matter. In addition to this point, tax savings by the use of gifts may be exaggerated unless the individual situation is examined. The most restraining thought is that to be valid for tax purposes a gift must be absolute and unconditional. Any possibility of reversion, such as a revocable trust, will invalidate a gift. Ostensible gifts which do not meet the above conditions will not be considered valid. Therefore mere documentary evidence of a gift is not

# We shall not generally discuss the pros and cons of whether or not a gift is advisable. Much of the contents of this section will assume that the decision to make a gift is basically sound, excluding the tax consideration, and we shall merely suggest some of the possibilities available to make the transfer to the best advantage consistent with the purpose of the transfer.
sufficient. To qualify, a complete gift requires delivery of the property or present title to it during life; therefore, ostensible gifts which require the donor's death before becoming effective will not qualify. "Generally speaking, a donor will not achieve any tax saving unless he is prepared to strip himself of every vestige of interest, control or benefit in respect of the transferred property."*

The making of a gift, which is a transfer without consideration (or if insufficient consideration, is a gift to the extent of the insufficiency), will generally involve a gift tax. Therefore, one must compare the net differences between the two methods. (In the consideration also must be included a recognition of the income tax factor applying to the property thus transferred.) The rates of the two taxes are fixed by law to three-quarters to one, but this is not the true ratio in practice. Under certain conditions the gift method might be more costly than the estate tax. For example, if a widower with three children with property valued at $100,000 gives it all away to his children (assuming he has already used up his lifetime exemption, and ignoring previous gifts) he will have to pay a gift tax of $13,625, whereas if he leaves it all by will, his estate tax will be only $4,800, a savings over the gift tax of $8,825. While on the other hand, proper use of the annual and lifetime gift tax exclusions allows for a substantial tax free reduction

* 7, p. 137.
in an estate. With the use of the marital deduction to in effect divide gifts and double exemptions, large amounts may be transferred tax free over a period of years. Assuming a family of husband, wife and three children, the husband may give away $300,000 over a ten-year period by giving the wife $60,000 tax free under the joint life-time exclusion plus $6,000 tax free per year to his wife and each child under the joint annual exclusion provision for a gross total of $300,000. (i.e. $6,000 each to the four donees for ten years equals $240,000 plus the $60,000 lifetime gift gives the total of $300,000).

Maximum tax savings will not result by transferring all one's property during life, but rather by giving away the proper amount so as to take full advantage of all possible exemptions under both tax schedules and to keep the total estate in the lowest possible tax brackets of each tax. One can take advantage of gifts to keep most modest estates tax free. A man, age 50, with a wife and no children and an estate of $240,000, can transfer his total estate to his wife tax free. This may be done by giving the wife $60,000 outright under the joint life exclusion plus $6,000 for each of ten years, making total gifts of $120,000. This will leave in his estate at death $120,000 of which $60,000 will be tax exempt by the specific exclusion and the other $60,000 will be tax free under the provisions of the marital deduction.

It is essential to remember that other tax factors
besides tax rates must be considered when contemplating gifts. For example, the present value of the money used to pay the gift tax now, with the accompanying loss of income attributable to that amount, must be compared to the estate tax which will be deferred until death and which one's heirs will have to pay. Also the value of the property involved is important. If the value will rise, it might be well to keep it and allow it to be valued at the time of death; if the value will drop, it may be better not to give it now, with the accompanying high gift tax, but wait for the drop and the resulting lower gift tax. The whole point is that you need predictions and decisions other than mere tax rates.

The Federal gift tax applies to all gifts beyond certain exclusions and exemptions, and is levied on the actual value at the date of the gift. There are exemptions and exclusions of $3,000 per donee per year plus a lifetime aggregate exclusion of $30,000 of all gifts in excess of the annual exclusion. The gift tax is computed on the current cumulative total of net taxable gifts made since 1932, the effective date of the present gift tax law. The gift tax, like the income tax, is a progressive or graduated tax, but unlike the income tax, it applies to the cumulative aggregate amount and not to each

# The basis to the donee (i.e. the recipient) for computing income tax gains for gifts made after 12/31/20 is the same as the basis to the donor (i.e. giver of the gift). The basis for determining income tax loss is the lower of either the basis to the donor or the fair market value at the date of gift.
year separately. The tax is levied at the highest current rate with deductions at the current rate for taxable gifts of previous years.

The gift tax should always be considered in conjunction with the estate tax for, as Congress intended in passing them, they supplement each other. (However, the gift tax, at any state of progression, is still considerably less than the estate tax on the same amount). It might well be noted that the trend seems to be toward a closer integration of the two, thus minimizing or eliminating altogether the present tax benefit accruing to the use of gifts. Already we have seen tax benefits reduced by the lowering of the gift tax annual exclusion from $5,000 in 1932 to the present $3,000. "It seems entirely possible that... (there might be).....an integration of the estate and gift tax into a single transfer tax payable at the time of death"*.

The gift tax applies to many transactions which at first do not appear to be gifts and on the other hand may not apply to many transactions which do appear to be gifts. For example, if property is purchased under a joint tenancy, one-half of the value of the property may be a gift to the joint tenant who contributes no consideration toward the purchase. However,

* 8, p. 238. Also compare (Federal & State Gift Taxation -- proposal for the integration and curtailment with the income tax (1947) - Office of the Tax Legislation Counsel (which would eliminate present savings through gifts, but would not be retroactive to gifts made before its passage.)
as is common with husband and wife, one may become a tenant by
the entirety. Here the value of the gift is not one-half but
the actuarial value of the spouses' interest as computed by
actuarial tables which consider the respective ages of the
spouses; only if the actuarial ages of the spouses are equal
will the value be one-half. With items such as savings bonds
and savings accounts, a gift only occurs when a joint tenant
actually withdraws the money for his own benefit. The amount
of the gift is the amount withdrawn up to one-half of the ac-
count. The essential nature of the transaction is important;
for if one withdraws the money for use to which the grantor is
legally obligated, such as to pay bills, it is not a gift.

To clarify apparent inconsistencies, the reader should
remember that the gift tax is a levy on (a) the irrevocable
and complete (b) transfer (c) of property (d) without any re-
turn for the value transferred. This theory will explain the
tax on so-called tax exempt securities. Securities are tax
free as to income, but the gift tax is paid on their transfer
(b). Similarly, care must be taken in the case of relinquish-
ing any rights, such as forgiving a debt; these may generally
be subject to a gift tax. (d). It likewise explains why
payments of premiums on life insurance belonging to another,
even if you are the insured, are taxable gifts (d), yet the
transfer of the life insurance policy is not a taxable gift
unless the assignment is irrevocable (a) and all rights under it, such as the right to change the beneficiary or to borrow on the policy, are surrendered to the donee (b). Conversely, this rule explains why it is not a gift to pay for the legal support and maintenance, including education, of your family, which is no more than your legal obligation, but it is a gift to transfer shares of your business to your family without payment or expected rendering of service to the business (d), for this is beyond your legal obligation.

The specific method used to transfer the gift will vary according to the specific aims and condition behind the gift.

Certain special considerations apply to gifts by spouses to their children (or others). As pointed out previously, the making of a gift involves relinquishing the income therefrom. One common method of circumventing this sacrifice is for the husband to create a living trust with income to his wife for life and the principal to his children on her death. The gift consists of the value of the life interest to the wife plus the gift of the value of the future interest in the principal to the children. The split-gift provision applies to both gifts, although the annual exclusion will not apply to the gift of the future interest.

Previously it was difficult to make a tax free gift to minors, for if the gift was in trust it was generally held to be one of future interest and therefore not eligible for the
annual exclusion. Now a gift to a minor, in trust or otherwise, will not be considered a gift of future interest, and thus eligible for the annual exclusion, if the principal and income may be expended for the benefit of the minor and, to the extent not so expended, will pass to him at age 21 or to his estate or testamentary appointee if he dies earlier.

A second major class of donors are unmarried persons. Ordinarily the unmarried person who gives substantial gifts is a widow or widower giving to his grandchildren or children. It might be argued that such persons should not make gifts because their gift tax, without benefit of the marital deduction or split-gift provisions, would be high. However, this point is quickly countered by the answer that their estate tax, under the same conditions, will be even higher, unless of course they will remarry. The answer therefore to their problem is to give the property in the excess of their estimated needs irrevocably to their family.

Previous paragraphs indicate some of the pitfalls in attempting to circumvent the rules. One typical case showing the problems resulting from such attempt, are revealed in sales of property to affiliated parties for less than fair market value. This often defeats its primary purpose of saving taxes. This results because the purchaser will have the low cost as his basis for future capital gains tax and the difference between cost and fair market value will be considered a taxable gift.
Therefor while the property is removed from the donor's estate and thus escapes estate tax, the gift tax and the capital gains tax that will result may be greater than the estate tax that was avoided.

Another problem that always arises is the consideration of the choice of the property to be given. While this generally is not related to taxes as such, one aspect does involve tax consideration; this is the case with property involving capital gains or losses. Where property has a capital loss accrued, it is often better to sell the property and take the loss for income tax purposes and then give the cash as a gift. On the other hand by giving away such property, such as real estate or stocks, at market lows, the gift tax value is minimized. This latter course is preferable when the income tax allowances for losses and offset against gains have been consumed. Where a capital gain has accrued, it is often best to neither give or sell the property but to keep it in your estate. If the property is given, the basis is the original cost, which means that a tax accrual is in effect being transferred with the property to the donee; if sold, the capital gains tax must be paid and thus less than the full present value is given as the gift; if the property is kept in the estate, the property will have a basis for valuation as of the date of death, thus avoiding any need for the capital gains tax which is generally greater than the estate tax.
The principle of joint treatment for spouses, familiar to us from our income tax, is also available both as to gift and estate taxes, only in these instances it is more commonly referred to as the marital deduction. (Interestingly enough, by the payment of joint tax there is a tax free gift to one's spouse. This occurs by virtue of the ruling that in the case of joint taxes, either income or gift, the tax may be paid by either spouse. Thus, where the wife has a separate income or makes gifts jointly, the husband by paying her share of the tax is in effect making tax-free gifts of that amount to the wife.) This marital deduction in effect treats all property as though held jointly by the spouses. Basically it provides that one-half of any gift made to a spouse is tax exempt without need for application of the annual or lifetime exclusion and, with the consent of the spouse, her gift tax exclusion and exemption, as well as one's own, may be applied to gifts to third persons; but if this joint election is chosen, it must be applied to all gifts made during that year.# It should be noted that the gift tax saving resulting from the marital deduction benefit is

# Use of this split gift procedure does not always result in tax savings. If one spouse has already used up his $30,000 exemption and the spouse who makes the gift has not, it may be better not to split the gift. For example, Mr. X gave his son $100,000 in 1951, using up his $30,000 exemption. Mrs. X gave her daughter $50,000 in 1952. If the couple should decide to split the 1952 gift, each will be considered to make a gift of $22,000 (after allowing for the $3,000 exclusions). The husband will add this amount to his prior gifts of $67,000 ($100,000 - $30,000 - $3,000) to figure his tax. The tax on the $22,000 will be $4,620. The tax on the half considered as given by Mrs. X is zero, since $22,000 is less than her exemption ($30,000). If the regular method is used a smaller tax will be due: the taxable gift will be $17,000 ($50,000 less $33,000 for Mrs. X's exemption and exclusion). The tax will be $952.50 or $3,667.50 less than the "splitting" method would cost.
One-half, as the half that is excluded is in effect removed from the highest tax brackets.

Due to the marital deduction, certain additional considerations must be viewed when gifts to spouses are contemplated. To begin with, although the marital deductions apply to both the estate and gift taxes, the marital estate savings accrue only where the spouses with the lesser estate survives the one with the larger estate, while the gift tax marital deduction is assured. On the other hand, outright transfer to the wife will involve a second tax on her estate at her death. Thus the problem is essentially how much should be given away and how much should be transferred at death. (As pointed out previously, non-tax considerations are not included in this discussion; generally speaking however, these other considerations should be of as great or greater importance in making this decision. Here we shall assume that the tax considerations are supported by the basic aims of the planner.) From a tax point of view, if it is planned eventually to give all the estate to the wife, or if it is planned to give none of the estate to the wife, the problem is simple. If the wife is to receive all the property, either the gift or testamentary method of transfer, with their respective marital deductions, may be used. On the other hand, if the wife is to receive no property, it is best

# As the spouse's consent is needed to split gifts, it is important that the executor of the estate authorize this consent so that the surviving spouse may give away the double amount for the year of death, which will be her last opportunity to do so.
to make inter vivos gifts, using the joint gift provisions; because since nothing will go to the wife at death, there will be no marital deduction at all. If part of the property is to go to the wife and part to others, as is generally the case, the problem is largely mathematical and no theoretical suggestion will be of too great value. On a general basis, however, the two estates might be equalized as insurance in case the spouse with the smaller estate dies first. This may be done by the wealthier spouse giving enough to the other to balance off the two amounts. By this means the question of who dies first, which is crucial in the estate tax marital deduction, is avoided, for the marital deduction is fully used while living and thus the estate tax marital deduction may or may not be applied as is desired.

The important features to remember about the gift tax marital deduction are (1) the marital deduction of the gift tax equals one-half of the gross property, while the marital deduction of the estate tax equals one-half of the net property after taxes and expenses (2) the receipt of the gift marital deduction is assured, while the estate marital deduction is received only if the wife survives the husband, assuming the husband is the wealthier (3) gifts may reduce the marital deduction amount for the estate.

Under certain conditions an otherwise valid gift will be included in the estate at death, although the property itself
was transferred at some previous date. This anomaly of the tax laws is the gift "in causa mortis" or contemplation of death. Basically, the law provides that any gift made within three years of death is assumed to be made in contemplation of death and therefore includable in one's taxable estate; however, credit will be given against the estate tax for any gift tax paid on any such gifts.

What constitutes a transfer in contemplation of death is a moot question. The only definite criteria is that if death occurs after three years from the date of gift, ipso facto, the gift is not considered in contemplation of death. In cases falling within the three year period, the size of the gift, its relation to one's total property, one's age, health, actual cause of death, and the making of a will or other testamentary transfer at the approximate time, are all possible factors to be considered. Motive generally associated with life that might refute the idea of contemplation of death might include such items as desire on the part of the donor to avoid income tax, reduce responsibility, train his family in financial affairs, discharge moral obligations, etc. The over-all conditions of and purpose behind the transfer are all relevant, but none may be conclusive.

An additional use of inter vivos transfers beyond the estate tax saving is the possibility of large income tax saving resulting from the transfer of income producing property. By giving this property to his children, for example (this benefit
would not apply between spouses due to the split-income provision of the income tax law), one spreads the tax base, thereby eliminating the top tax brackets and possibly gaining an extra personal exemption on each donee.

Another advantageous use of gifts should be remembered. By giving away property that is non-liquid, such as works of art or unimproved real estate, the value of the estate, and therefore the tax is reduced, which in turn reduces the amount of liquid assets which would otherwise be necessary to pay that portion of the tax. This in turn minimizes the need for forced liquidation to meet the estate tax.

Now let us recapitulate the fundamental tax advantage of gifts. First, one may benefit from both the annual and lifetime exclusions (both of which are doubled by the use of split-gift provisions for married persons.) Second, even if the gifts are subject to tax, the tax will be substantially less than the estate tax on the same property. Third, by making the gift one divides the tax on his property between the gift and the estate taxes, both of which have their own exemptions and graduated rates; this keeps the property out of the high brackets of both taxes. Fourth, even if the gift may be disallowed for some reason, one will receive credit on his estate tax for any gift tax paid. Fifth, any gift tax paid is money that escapes the estate tax, while any estate tax one's estate pays is included in the taxable estate. Thus, even if there were identical ex-
emptions and rates, which is not the case, the advantage would lie in giving away the property up to the amount of the estate tax exemption, rather than willing it at death. In addition to these above tax savings, the donor often will save income taxes by use of gifts; while the gift itself is not deductible, by making a gift of the property, the income attached to it will be taxed to the donee who probably will have a much lower tax bracket.

Of course there are obvious reasons for not saving the maximum possible tax by use of gifts. A natural objection would be that the gift tax must be paid now, while the heirs or estate will pay the estate tax later. The problem here is in the immediate value of the money. Also, after considering the net effect of a present gift and the subsequent loss of present income and control from both the gift and the amount used to pay the tax thereon, it is a real problem whether to give property as a gift or to leave it at death.
B. "Living" Trusts.

Technically, a trust is a legal device that effects the separation of the legal and equitable title to property. That is, the trustee holds the legal title to the property, under the conditions the donor (grantor) of the property specifies in the trust instrument, for the benefit of the beneficiary. The beneficiary of the trust may be one, or divided into income and remainder (principal after the income interest has dissolved); the trust may call for payment of income, income and principal or income and principal at the discretion of the trustee. The donor may reserve the right to amend the trust, change its beneficiary, or revoke it altogether. Under Massachusetts law all trusts are considered to be irrevocable, unless the desired rights are specified in the instrument. Although most tax advantages accrue to the irrevocable type of trust, much thought should be given before one creates a trust that cannot be altered.

One cardinal principle to observe in planning a trust is to conform to the legal restrictions designed to keep trusts within a reasonable time limit. This so-called "Rule against Perpetuities" basically states that to be valid, an interest must vest within twenty-one years after the death of any reasonable lives in being at the creation of the interest. This twenty-one year period is measured from date of creation of the trust if it is a "living trust", or from the date of death if it is a "testamentary trust"; or
if a special power of appointment or a general testamentary power is being exercised, from the creation of the power. While the legal considerations are highly technical and complex, "this (rule) is no great hardship because... a little care in the selection of the lives in being will cause any trust to last approximately a century".*

The living trust is a useful mechanism for the preservation of property and protection of beneficiaries. In addition, it may save death taxes, the so-called "second" tax, and income taxes for the creator and/or the beneficiary. The possibility of tax savings vary with the condition of the trust.

While a legally revocable trust is a separate entity with income and principal belonging to the beneficiary, tax-wise the grantor is taxed on the income as though he made no transfer, and the principal will be included in his taxable estate. While seemingly inequitable, this is necessary for the government; otherwise everyone would do this and thus keep control of his property while avoiding taxes on it. The tax law looks to the economics rather than the legality of the affair. The fact that the grantor is free to enjoy the benefit of the property, even though he doesn't choose to, makes it taxable to him. Therefore, if it is revocable only with the consent of one with a substantial adverse interest outside of the donor's control, it is considered tax exempt from an income tax point of view.

* 1, p. 231.
which makes the revocability to any degree the test. A similar problem is found where the donor cannot revoke, but a third person has the power to revest the property to the donor. The income tax liability depends here on whether he is an adverse party or not.

The whole estate tax problem can be solved, therefore, simply by unconditionally divesting oneself of the property; the crux is the total divesture. If the donor retains the right to income he will be subject not only to the obvious income tax but to the estate tax as well. Other reserved benefits will generally have the same effect as retaining income. The test as to income tax liability also covers distributions for which the donor would ordinarily have had to use his own funds, such as an irrevocable trust with income to pay the donor's insurance premiums. Though irrevocable, it is still for his benefit and thus taxable to him. Another example would be if income is used to discharge legal obligations such as support of one's family; the income is taxable to the extent so used.

Also generally subject to income tax are short-term trusts reverting to the grantor within ten years or, if payable to charity, within ten to fifteen years, or if the grantor beneficially reserves certain administrative powers such as substantial incidents or ownership or control of the property. (There is no tax under the above provisions if the death of the beneficiary is the cause of the reversion.) Likewise, the power to control the beneficial enjoyment of income or princi-
pal will make the income taxable to the donor. The question of whether a principle that will make an otherwise irrevocable trust subject to income tax will also make it subject to estate tax is not definitely settled as to all points. Reversionary interest, life-time control of benefits as to income or principal, etc., are definitely taxable if held by the donor, but not if held by a third independent person. Therefore there may be a difference between the income and the estate tax rule on any specific trust.

Generally the determination to create an irrevocable living trust is prompted by a desire to attribute the income therefrom to a second party, and to eliminate the value of the principal from one’s estate. If one is in effect, the second point generally will also be effective.

There are many possible arrangements available to accomplish either or both these aims. For example, the use of a short-term irrevocable trust will enable one to escape tax on the income during the life of the trust, yet have the principal returned to him. The requirement to accomplish this is that the trust will last at least ten years before possibility of reversion, unless reversion occurs previously due to the death of the income beneficiary (regardless of whether her life expectancy is ten years or not).

#Trusts are taxed on similar principles as individuals. "Simple" trusts, requiring a distribution of all current income, have a personal exemption of $300. (to cover capital gains); all others have a personal exemption of $100. They all receive the $50. and 4% credit for dividend income. Distribution of current income will be taxed to the beneficiary and deducted by the trust. Any excess deduction, excluding charity, and any unused capital gain or operating loss carryovers, are allowable as deductions for the beneficiary in the year the trust terminates.
The possible tax advantages for irrevocable trusts for the donor is that there is no tax on the income derived from it and the property is not included in his estate. The advantages for the donee are primarily that he can get most of the benefits of possession of the property without it being taxed in his estate. For example, he may have the benefit of life income with the trustee having discretion to pay principal; he may have the power to dispose of the property at his death, except in favor of his estate or creditors; the trustee may have discretion to distribute income with adjustment for the donee's current personal income. This "sprinkling" among the donee and/or other beneficiaries makes it possible to distribute income among those with the lowest tax brackets. This device can be used for almost any purpose except to pay legal obligations of the donee and still avoid income tax to the donee. The beneficiary may have the power to demand principal if the demand depends on some external standard cited in the instrument. He may draw up to an "ascertainable standard" relating to his "health, education, support or maintenance," without the principal amount being taxable to his estate.

Transfers depending on the grantor's death will be includable in his estate if he has greater than a 5% reversionary interest, either by the terms of the instrument or by effect, such as failure to provide for ultimate dis-
position of the property. This reversionary interest is valued at 5% of the value of the transferred property, computed by use of actuarial mortality tables. With transfers made after October 8, 1949, transfers are considered to take effect at the donor's death if possession or enjoyment can be had only by surviving the donor, or in fact by surviving the donor (even though an alternative method is provided in the instrument.) The mere fact of surviving the donor is not alone sufficient to include the property in his estate. As the rule is 5% valued at the date of death, it is best to have the instrument provide for all possible contingencies of disposition and eliminate all possible reversionary clauses; this is because it is easier to eliminate all these contingencies that might cause reversion than try to determine exactly when one will die.

An especially effective means of accumulating wealth for the benefit of a minor is afforded by irrevocable living trust. A tax free gift may be made in trust to be accumulated up to the age of twenty-one and then paid to the minor, if the trust provides that the principal and/or income may be expended for the benefit of the minor before he reaches his majority, or if he dies before twenty-one, the amount not so expended will be taxed to his estate. If these conditions are met, the gift is that of a present interest and will benefit from the annual exclusion. As
the income from the trust is taxed to the trust, as a separate entity, rather than to the donor, material income tax savings will result. If gifts to the minor already exceed the maximum annual exclusion, the conditions stated above need not be met, for in Massachusetts the total income may be accumulated to any age and then paid in full; thus the savings will be on the income tax differential rather than the gift tax. By the creation of a separate trust for each child, several tax entities will exist and thus all the income may be distributed to each child with the benefit of a $300 trust exemption plus a $600 personal exemption plus the benefit of the lowest tax brackets in each case. No physical segregation (actual division of the property) is necessary to create separate trusts.

A discretionary trust is one under which the trustee may pay out income and/or principal, or not, as he wishes. The income is taxed to the trust if it is not distributed. Distribution may be made only for emergency purposes to avoid the possibility of income tax complications. Such a complication is the so-called "5-year throw-back rule" which basically provides that deferred payment of accumulated income will be adjusted for increased income tax which would have been paid if the distribution was made in the year earned. Income can be accumulated without fear of this rule if it is for the benefit of a minor, and will be paid out at age twenty-one (this throw-back rule does not apply to simple trusts where all income is currently distributed, or to final distributions
made after nine years from the last transfer of property to the trust.) There is a $2,000 annual exclusion plus an exclusion for emergency payments. The trust is exempt from this rule, therefore, if the amounts involved are under $2,000; thus it can be avoided by creating separate trusts for each beneficiary, thereby providing each with the spread-out base and the resulting $2,000 exemption.

If the trustee has discretion as to payments of income and principal, income will be taxed to the donor unless half the trustees are not subservient to the wishes of the donor. Thus you may have a corporation and your wife as trustees and remain tax free because only the wife is subject to your wishes.

To sum up the tax situation of trusts:

1. Estate Tax: The principle of a living trust is taxed as part of the donor's estate if the donor reserves the power to revoke, amend or alter the trust so as to effect a substantial change in the beneficial interest in the property; if the donor reserves the right to income from the trust; or the actuarial value of a possibility of reversion to the donor is greater than 5% of the value of the property at the date of death, and it is considered a transfer to take effect at death.

2. Gift Tax: There is a gift and therefore a possible gift tax whenever there is an irrevocable disposition
of property. Where a fractional interest in a trust is given, either as to income or remainder, only that fractional part will be subject to tax. Now the $3,000 annual gift tax exclusion may apply to remainder interests, all of which are future interests. For example, gifts of income for life with the power also to pay out principal is a complete gift even though the possible capital distribution may complicate the value of the life interest.

3. Income Tax: Generally speaking the income of a trust is taxed to the donor if he reserves any interest in the trust whether it be as to income, remainder or principal, or if he reserves the right to revoke or amend the trust, alone or with the consent of a person not having a substantial adverse interest; if the donor reserves the right to determine who gets the income and/or the remainder; if the trust is created for the benefit of someone to whom the donor owes a legal duty and the income is used to discharge that duty, even if the trust is irrevocable and in every other way meets the test of income tax exclusion (e.g. a trust set up for the benefit of a minor child and the income used for his maintenance or education); if the trust is created essentially for the benefit of the donor and not for the benefit of others -- where the donor retains business control after a gift, this rule should be considered.

The tax aims of charitable transfers are that the donor of inter vivos charitable gifts desires an income tax deduction for the value of the gift up to the maximum allowance; a deduction for the total value of the gift for the gift tax; to exclude the income therefrom for income tax; and if testamentary, desires a deduction for the charitable gift for his net estate. The use of a charitable trust can avoid tax on income even if the life of the trust is less than two years, if the beneficiary is a school, hospital or church, but if the right to receive back the principal is valued greater than 5% of the property, the sum going to the charity will not be allowed as a charitable deduction for your income tax.

A prime advantage of a charitable gift while living is that income tax rates are much higher than death tax rates; therefore it pays to get the maximum income tax deduction for one's gifts. Such gifts may be outright, by trust, or in the form of a foundation.

The use of the charitable trust with a life income reserved to one's family is a multiple effective instrument, and will demonstrate the possible tax advantages of charitable trusts. For example, if one creates an irrevocable trust with life income to his daughter and grandchildren (already born) and at their death the principal is to go to a college, hospital, etc., there is a charitable gift of the value of the
future interest. The value depends on the ages of the persons involved and the conditions of transfer. The grantor may deduct the future interest value for his gift tax computation and also for his current year's income tax up to 30% of his adjusted gross income. If perchance the donor should die within 3 years of the gift and the gift be considered in contemplation of death, the donor's estate will receive an estate tax deduction for the gift. Also at that time the life interest beneficiary would be older, thus reducing the actuarial discount for the future interest value, giving an increase in the amount of the deduction. In addition, of course, the amount of income tax on the property would be taxed to the beneficiary and not to the donor, generally at a much lower rate.

With a charitable trust with an income to one's family, one must be careful not to allow an indefinite payment of principal to the life beneficiaries, for this might cause the charitable amounts to be considered too indefinite to be valued. All that is really required is a "presently ascertainable" value; this standard is quite liberal. "The leading case (on this point) is Ithica Trust Company v. United States, 279 U.S. 151 (1929), where the

A trust such as described above is a particularly excellent vehicle to avoid capital gains tax. If you have property with a large capital gain, you should give it as the corpus of the trust. The current market value will be the value of the trust, and therefore the basis of computing the charitable gift. If it is desirable to sell the property, the donor would have to pay the capital gains tax if he sold it, while if the trust sells it the gain is tax exempt, for the gain here is considered to be permanently set aside for the charity.
will authorized principal to be used in whatever amounts "that may be necessary to suitably maintain (the life tenant) in as much comfort as he now enjoys". Some standard, at least, was thus laid down... (and therefore)... the remainder was held deductible". An example of two liberal terms which lost the deduction are instructions to use discretion with "liberality" for the life tenant's "comfort, support, maintenance and/or happiness". "However it should be borne in mind that all these cases are based on situations ... where the court finds that it is unlikely that the discretionary power to invade principal will ever be exercised." Therefore, one must be very careful to keep discretionary powers over principal both limited and specific.

*See p. 249.
III. Testamentary Transmission.

A. General Considerations.

The first section of this work desired to give the reader insight into the various avenues through which to transfer property while living, with the resulting tax advantages and drawbacks. The second section shall attempt to accomplish the same ends as the first, only this time the treatment shall be designed to fit the testamentary manner of transmission. There can be no absolute division of the two means; just as the tax laws are constructed to overlap to some degree as to both inter vivos and testamentary transfers, so must the individual design his financial plans.

The tax situation creates an insidious and often over-looked problem immediately upon your death. The fact is that the ordinary death and attendant legal expenses will make large inroads on the cash available to the estate. The balance may be insufficient to pay the estate tax when due. Inasmuch as the executor may be surcharged (i.e. compelled to restore the loss to the estate) for any penalties assessed by reason of any late payment, he ordinarily will be under pressure to liquidate quickly even if realization losses are incurred thereby. This occurs more often than might be realized. Cases in point are ones involving large interests in closely held businesses with no active market; large blocks of listed securities; and large holdings of real estate or securities when death occurs at market low. In all these cases,
forced liquidation generally results in large losses. This liquidation is inevitable since the tax may not be paid "in kind", but only with dollars. Methods of compensating for this problem must be considered. Ideally, the solution is to keep one's estate sufficiently liquid so all expenses and taxes may be met by disposal of readily salable property; however, this is not always possible. In the following sections various means of accomplishing this, as well as other goals, will be discussed.

The first problem basic to testamentary transfer in general as well as for tax aspects is the desired distribution of the property. Thus the first objective in testamentary transfer should be to set down these desires in a properly drawn will. The general reasons for leaving a will are fundamental to your beneficiaries' best interests; from a tax viewpoint they are also of importance. Many of the testamentary problems of taxation discussed below depend upon who receives the property and by what means. Without a will the most effective method will often be lost. Without a will the estate passes purely by the laws of descent, and one's wishes and the best interests of his family may not be considered.

The method of distribution, under Massachusetts law, which is fairly typical, provides that a widow with children receives one-third and the children two-thirds of the estate; without children, the widow receives $10,000
plus one-half of the balance, and the rest of the estate goes to next of kin. This method of distribution will remove or limit many tax advantages. Obvious examples are the less than full advantage of the marital deduction, avoidance of a "second" tax, and incidence of the burden of the estate tax.

The tax consequence of estate planning are often more extensive than at first believed. An example in point is the problem of double state taxation due to double domicile. The New England states have reciprocal arrangements with each other; however, maintenance of two homes, one in another state, should always be attended with careful establishment of which is the legal residence. Intention is not the important factor, but rather the trend of behavior, such as where one votes, registers his car, etc.

Property with capital gains deserves special attention in testamentary planning. Capital gains expire at death because the estate pays a death tax on the value at the date of death. No consideration is given for gain or loss as computed on the purchase price. Therefore, if feasible from an economic point of view, it is often well to keep property with accrued or potential capital gains, rather than to sell the property.

Property may be given away while living, but then the donee must pay the tax on the gain when the property is sold, as the basis to the donee is the same as the basis to the donor. Thus gift tax is paid on the present value of the gift, while
the donee will have net cash, if he sells it at the present value, less the tax on the capital gain.

If, however, the gift is to a charity, it would be better to give it during life, up to the maximum charitable income tax allowance. An eleemosynary donee need pay no income or capital gains tax and therefore both the donor and the donee will benefit. The donor receives an income tax deduction, pays no capital gains tax, and receives the exemption for his estate tax. The donee receives the full value of the property before any deduction for either capital gain or estate tax.

B. Concept of the Federal Estate Tax.

A primary concept to be understood, before undertaking any study of the problem of the estate tax, is the proper understanding of the nature of the estate tax and upon what it is levied. The amount subject to the tax is called "the gross estate", an artificial conception of the tax laws. Because the tax is on the right to transfer property, not on the property itself, this gross estate includes many varied types of property, some of which do not seem at first glance to be properly includable. Such property items may include, in addition to property owned by the decedent at his death, life insurance, gifts made in contemplation of death, property subject to certain powers of appointment, revocable gifts, revocable trusts, gifts intended to take effect at death, etc.
The only property not subject to Federal estate tax is real estate located outside the United States. Even so-called tax-exempt securities are included; the tax exemption applies only to the income and not to the securities themselves. A second primary concept is the "adjusted gross estate," which is basically the gross estate less debts, administration costs, liquidation losses, and other death expenses. Certain deductions are allowable: most important are the $60,000 exemption and the marital and charitable deductions; in addition, there are certain credits allowed against the tax itself. The first of these credits is that for the State estate tax. As the State tax is always at least as much as the credit, the effective total tax is the Federal tax plus any amount of the State tax over the credit. Thus the Federal tax, computed without this credit, will give a relatively true tax picture. There is also a credit for gift tax previously paid on property included in the estate such as causa mortis gifts, up to the actual estate tax liability. This point is important when the value of the property drops from the date of gift to the date of death. However, there is no gift tax credit if the gift was to a spouse and is included in the marital deduction property. Only where part of the gift, plus the rest of the bequests to the spouse, exceeds the marital deduction limit, will this excess be eligible for the credit.
C. Burden of the Tax.

One's executor will have to pay the tax on the estate, but it is up to the testator to decide which beneficiary will actually provide the money. The tax may be paid as one of the debts of the estate and in effect have the residuary beneficiary bear the burden, the tax may be charged pro rata against each beneficiary's share. Even non-probate property, such as life insurance, and that subject to powers of appointment, must bear its pro rata share of the tax. However, property transferred in contemplation of death, joint property and revocable trusts are not so burdened. In all other cases, unless a choice is stated, the law will govern. The choice between these two methods of transmission is not essentially a tax matter, but rather a method of dividing property among the beneficiaries.

Where the property is left to a surviving spouse or charity, the method chosen will affect the tax because the marital and charitable deductions are measured by the actual amount passing. If the tax is taken from the spouse's or charity's share of the estate, the marital or charitable deductions will be reduced by the amount of the tax. The will should be arranged so that the adjusted estate will equal the residual share, and should give one-half of the residual share to the wife and one-half to the rest of the beneficiaries, providing that all expenses and taxes be paid from the second
half. The problem is complicated if much property is left outside of the will, such as insurance or joint property. Under these conditions one must give the wife half of his probate assets plus one-half of his non-probate assets. In most cases it is not too important if the amount passing to the wife is a bit over or below the exact marital deduction amount. One could arrange to leave greater than the marital deduction amount and have the wife disclaim the excess. However, there is the problem that this disclaimer may be considered a taxable gift, but this question can be avoided by disclaiming in favor of a charity.

If the marital deduction amount is not specifically exempt from the tax, there is the problem of the tax depending upon the amount of the marital deduction; yet the marital deduction is net after taxes. Thus the two become interdependent, and highly complicated computations are necessary to arrive at the mutually dependent sums. This problem will be avoided if the marital deduction amount is exempted from tax by the instrument, or the marital deduction amount is well above one-half the adjusted gross estate.

Therefore, with specific bequests, especially for marital deduction purposes, one should insure that the residual estate bears the total tax burden; this will cover property passing under the will. For non-probate property, specific
instructions to this effect should be provided. If the probate residue is insufficient, one should cite alternative sources to pay the tax. One must consider that the residual estate will be severely depleted, especially in the case of overlooked non-probate property, such as a taxable power of appointment.

D. Valuation Problems.

There is often a problem of valuation in the cases of assets not having well-defined fair market values. Thus the question of prime importance in many estates is what can be expected as to the taxable valuation of a business interest. There is a possibility of a valuation well beyond one's estimates. For example:

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of net tangible assets</td>
<td>$80,000</td>
</tr>
<tr>
<td>Average net earnings-5 previous years</td>
<td>$35,000</td>
</tr>
<tr>
<td>Minus earnings from tangible assets</td>
<td>$6,400</td>
</tr>
<tr>
<td>(8% of $80,000)</td>
<td></td>
</tr>
<tr>
<td>Earnings resulting from good-will</td>
<td>$28,600</td>
</tr>
<tr>
<td>Value of good-will ($28,600 capitalized at 15%)</td>
<td>190,600</td>
</tr>
<tr>
<td>Total value of business</td>
<td>$270,600</td>
</tr>
</tbody>
</table>

# "The Bureau of Internal Revenue approach to the valuation of a business for an estate tax statement is often Johnsonian: '...Johnson (one of the executors) on being asked what he really considered to be the value of the property which was to be disposed of, answered 'we are not here to sell a parcel of boilers and vats, but the potentiality of growing rich beyond the dreams of avarice!'" (Samuel Johnson, A Biograph, by J. W. Drutch, p. 505) 7, p. 161.
If no allowance is made for this high valuation, and no liquid assets are available to pay the tax on the added value, the executor may have to liquidate the business to get cash for the tax, with all the negative affects of a forced sale of a family business. To eliminate this type of problem, one must be sure to value all his assets, especially the indefinite ones, at the highest possible value, for his own use; when estimating the value for a tax return, however, one should consider the minimum fair market value fairly assigned to the property. An alternative solution is to bring one's family into the business by giving them part of the interest. This will reduce the amount of the estate, and the corresponding tax. One method would be to sell the amount to them as an annuity (i.e. compute the value of the shares to be sold and figure the annuity that amount would buy). The purchasers would pay that annual amount each year as payment for the interest. Thus, no part of the interest, or anything remaining in place of it, would be taxed to the estate. If the price is fair, there is no gift, and therefore no gift tax. However, there will be the problem of a possible large capital gains tax, or tax on the income from the annuity. But even if the net tax result yields no advantage, the business will have been kept intact for the family.
The use of buy and sell agreements is another method to fix fair valuation. The agreement must be binding on both parties during life and be at arm's length. One method of effecting this is to finance the purchase with a life insurance trust. If the estate sells the interest to the others in the business, there will be no capital gain because of the new basis at the date of death.

A third possibility to solve the tax payment problem is now available to the family corporation. The redemption by the corporation of the stock of the decedent will be considered a return of capital and not a dividend, if the amount of the redemption does not exceed the estate and inheritance taxes with interest, plus funeral and administration expenses, and if the value of the company stock included in the gross estate is over 50% of the taxable estate or 35% of the gross estate, and the redemption occurs within a specified period of time after death. This of course assumes that the company will be in a sufficiently liquid position to buy the stock and will be willing to do so.

Several other possibilities are available in a case of indefinite value.

# The two principal methods presently in use for the valuation of business interests in the absence of good market comparison are: (1) price times net earnings: the average annual earnings for a 3 to 5 year period times a ratio applicable to that particular type of business. The value thus obtained includes the value of both the tangible and intangible assets: the special factors of that type of business will be
One solution might be to make a gift of a small part of the property, such as a few shares of a family corporation, sufficient to require a gift tax return. From the treatment of the gift tax return, insight may be obtained into the probable estate value of the assets without much expense. With chattels of indefinite value, such as objects of art, it is often best to sell them now, or give as a gift, or bequeath to your wife with the power to disclaim in favor of a charity.

To protect against change in market value of the assets of the estate, the executor of the estate has the option on the estate tax return to value the estate at either the date of death or one year thereafter. However, the value is the exact disposal value if sold or distributed in between these two dates, and no allowance for decrease of value due merely to lapse of time such as depreciation or depletion will be allowed. The optional valuation must be claimed on the return and filed on time or the right to so value will be lost, and once having so valued, it is irrevocable.

# reflected by the particular ratio used (the classifications and ratios are based on Moody's Investors Service data):
(2) an apportionment of tangible and intangible asset valuation: the average annual earnings for a 5-year period, less an allowance of 10% return on the fair value (not book value) of the tangible assets will give the taxable average earnings attributable to the intangible assets (i.e. good-will). This amount will be capitalized on the basis of five years purchase (i.e. 5 times). The value of the good-will is added to the tangible assets for the total value. However, "the figure for determination of the return of tangible assets might be reduced from 10% to 8% or 9%, and that the per cent for capitalization of the return upon intangibles might be reduced from 20% to 15%" (Appeals and Review Memoranda, 34, C.B.-2, p. 31)*

* 4, p. 132.
E. Joint Property

Like life insurance, jointly owned property is often believed to be tax exempt inasmuch as it passes automatically without listing in a will; this belief, however, is erroneous. Unless the executor can prove otherwise, the total value of joint property will be included in one's estate (assuming one dies before the other joint tenant). The burden of proof is on the taxpayer; the source of the contribution that paid for the property is the decisive factor, but this is difficult to prove due to the problem of tracing the evidence and frequent absence of essential records.

In many respects the problem of joint tenancy is similar to the problem of direct versus indirect bequests in general. The advantage is assured immediate and full receipt and use, and qualification for the marital deduction; the disadvantage is the second tax on the property so left. Many of the other previous disadvantages accruing to concurrent ownership (i.e. joint tenancy by the entirety, etc.) have been alleviated. For example, one can now take full deduction in computing his adjusted estate for debts, expenses of administration, etc., even if these are greater than the amount of property included in the probate estate, if paid before the date of filing of the estate tax return. Likewise, all joint property, both real and personal, currently included in the taxable estate will give the surviving joint tenant the basis at the date of death.*

* I.R.C. Par. 1014 (b) 9.
Joint tenancy has a special advantage in the case of real estate. Here spouses can put the property in joint names with option of declaring the transaction a gift or not, as desired. If they do not elect to do so, there may be a gift when the joint ownership terminates. (e.g. when it is sold and half the receipts go to the wife,) except in the case of the death of one of the owners. This same rule applies to the cost of improvements of such property and to payments on indebtedness on the property. This latter provision allows one to take advantage of the annual gift exclusion for such payments. A further advantage, as mentioned above, is that when the spouse that actually paid for the property dies, the income tax basis to the survivor is the death date value of the property, not the cost. These gifts apply only to real property; with personal property, a taxable gift is made at the time of the creation of the joint tenancies, except as to joint bank accounts or savings bonds, where the gift is so considered to be made at the time the money is actually withdrawn for the benefit of the joint tenant who did not contribute that amount.

In general, therefore, concurrent ownership is an ideal method of immediate, simple and complete transfer. The primary problem with jointly held property is its inflexibility and its subjection to a second tax. Because of this disadvantage, property held jointly with a wife should be included in computing
the marital deduction property. It might well be said that unless it is to qualify for the marital deduction, or for special purposes, such as a bank account for a liquid source of tax and death payments, a family home, or special personal property, it is generally not to one's tax advantage to keep property in joint names.

F. Powers of Appointment

A power of appointment is a power given by one person (the donor) to another (the donee) to determine who shall enjoy the property or the income derived therefrom (the appointee). # Whatever the form of a power of appointment, the holder of the power is not the beneficial owner of the interest subject to the power, but is vested with authority, either qualified or unqualified, to select the beneficial owner." # The aim of a power of appointment is to provide flexibility in the distribution of an estate. The problem involved is that it must be decided not only whether to create the power, but from a tax viewpoint it is especially important whether to exercise the power.

Powers of appointment are divided into two main categories; general powers, whereby the power may be exercised for the benefit of anyone at all, including the donee; and special

# A power of appointment is not always labeled as such. For example, if you are under a company pension plan whereby a sum will be paid to your beneficiary if you die prior to retirement, it may be considered a power of appointment over that sum and included in your estate.

* 20, p. 456.
or limited powers, whereby the appointees are restricted or specified. From a tax point of view the distinction between the two divisions is all important. Another decisive tax factor is the date of the power.

If a power is created prior to October 22, 1942, it is subject to tax (estate tax if exercised by will, or in contemplation of death; and gift tax if exercised during the donee's life) only if it is general and it is exercised. Less than general powers created prior to October, 1942, are not liable to any tax, whether exercised or not. If a power is created after October 22, 1942, it will be subject to tax if it is general, whether or not it is exercised. Less than general powers are still not subject to tax.

The taxable definition of exactly what is classified in the category of general powers of appointment is that the power is exercisable in the favor of the decedent, his estate, his creditors or the creditors of his estate. Even if it falls within these broad definitions, it will be considered as a special rather than a general power if it actually is limited. For example, if the power to consume principal is limited by an "ascertainable standard" relating to the decedent's "health, education, support or maintenance" it is not general and therefore not taxable; or if the power is exercisable only with the consent of the donor of the power, or a third person having a substantial adverse interest (with a pre-1942 power, the adverse interest element is not necessary
to exclude it from tax), the power is not general and thus non-taxable. A taker in default (i.e. the one who would receive the property subject to the power, if the power were not exercised) is considered to be one with an adverse interest.

The only method available to avoid tax on a post-1942 general power of appointment is for the donee to renounce or disclaim the power within a reasonable period after it is offered to him or he learns of it. Any other course will make him liable for the tax on the property. Mere possession at death includes it in his estate; exercise during life makes it liable for a gift tax; and release or lapse also makes it liable for tax. However, a tax benefit is allowed in the case of lapses. A donee will receive an annual exemption for any lapse of a power to invade principal up to the greater of $5,000 or 5% of the value of the property; any amount in excess of this amount will be subject to tax if allowed to lapse just as if it had been exercised. Therefore, a donor of a power of appointment, might well limit the donee, for his own tax benefit, to the right to demand income for himself in annual increments in a lesser amount than these excludable values, thus giving automatically a tax free choice to the donee to lapse or not as desired without any tax problem.

Where the donee is also the trustee, the power to pay income to himself or for his own benefit and similar discre-
tionary powers may be considered a power of invasion and there­fore taxed as a general power. To avoid such problems one might have only adverse trustees authorized to so pay, and/or limit the payment to a fixed standard. This fixed standard approach is also good protection against treatment of releases as gifts, because it is not a gift if the instrument requires payments out of principal.

If the donee has the right to appoint principal or income for his own benefit, it will be taxable to him unless he disclaims the right. If he expends income for one whom he must support, it will be income taxable to the amount so expended. When the appointee is the son of the donee of the power is an example in point.

To sum up:

(a) With pre-1942 powers of appointment there is a tax only if the power is general and it is exercised. Therefore it is important to avoid the exercise of such powers unless it is essential to the aims of the over-all estate plan. An example of this would be where it is preferable to pay the tax rather than allow the takers in default to receive the property. Special care must be taken to avoid unintentional exercise of the power, in particular by the general residual clause in a donee's will.

(b) With a post-1942 power of appointment, property subject to the power will be taxed to the donee regardless
if exercised or not if it is unlimitedly exercisable for the
direct or indirect benefit of the donee. If limited, either
as to who may receive benefits to the exclusion of the donee,
by fixed standards to the amount passing to the donee, or by
approval of parties with adverse interests to the donee, it
will not be taxable to the donee. Only by immediately dis-
claiming a general power can the donee escape tax on it.
Mere release or lapse, except within certain annual limita-
tions, will not be of avail in eluding the tax burden.
G. Life Insurance

At death, substantial sums of cash are required by the decedent's estate to provide payment for last expenses, family support, and taxes; thus considerable liquidity must be provided to avoid hasty liquidation of assets, and consequent loss. Life insurance is probably the simplest method of insuring liquidity to an estate. One should always remember that life insurance, just as any other asset, will affect the tax levied on the estate. The way in which life insurance is arranged is therefore important to the overall estate plans. To minimize taxes, as well as to provide maximum benefits to the family, it is essential that life insurance be integrated into the plan for the distribution of all one's property.

Under present tax laws#, insurance on one's life is taxable to one's estate if it is payable to the estate, and/or if, at death, any of the incidents of ownership such as the right to borrow, designate the beneficiary, or select the options, are retained. The present law has eliminated the previously effective "payment of premium" rule. This rule stated that even if the two above conditions were met,

#From an income tax view, the earnings on the cash value are not subject to current income tax, but will be taxed, upon surrender of the policy, on the excess of the cash surrender value over the total net premiums paid. The cash value generally earns 2-1/2% or less; considering the loss of liquidity and flexibility of the investment under this method. An high grade tax exempt security would be a better investment.
the insurance could be taxed to the estate to the extent that
the decedent directly or indirectly pays the premium. The
'indirect clause' was especially troublesome. For example,
it was considered indirect payment if a fund was created from
whose income the premiums would be paid.

While the present law eliminates this rule, this
elimination is considered one of the less permanent revisions.
Therefore, if possible, it might be well to meet this currently
obsolete test. The methods previously used were: 1) in the
case of new insurance, the beneficiary (or a third person)
would take out the policy on the insured's life and pay the
premiums on it, or 2) in the case of outstanding insurance,
the policy would be assigned to the beneficiary with him to
pay further premiums, thus having the policy taxable to the
decedent's estate only to the extent that he actually paid the
premium. The assignment itself generally involved a gift tax.

The use of the irrevocable insurance trust in these
cases was very effective. In substance, the wife set up a trust,
by gift, whose income would pay the premiums on the insured's
life, payable to the trustee, and at death the income and prin-
cipal payment to the children. Thus neither the decedent's nor
his wife's estate would be subject to tax on either the original
corpus of the trust or the insurance receipts. If income was
payable to the children, and principal payable to the grand-
children, estate taxes would be avoided in the estates of both
the parents and the children. However this arrangement requires the wife to have independent sources for the original gift, for indirect payment by the husband would include the insurance in his estate.

As pointed out above, life insurance is not includable in one's estate if no incidents of ownership are reserved. However desirable tax exemptions may be, the special purpose for which the insurance is purchased should be considered. Many times it is better to forego the tax benefits and reserve the right to change the beneficiary or name the alternate beneficiary. Likewise it is a problem whether to transfer any of the other incidents of ownership. The decision must be based on the total property situation and the need for the liquid funds available to the estate. Savings on taxes on the life insurance can be lost many times if other assets have to be liquidated to meet the obligations of the estate because the assignee refuses to apply his insurance receipts to such obligations. Also, the gift tax cost if any, of the transfer of ownership must be considered. If the transfer is to a minor, it will probably be a gift of future interest and thus not qualify for the annual exclusion. Another problem presented by the new law is that, while one is allowed to pay the premium, there is a chance, if death occurs within three years the proportion of gross receipts, not
merely the premiums paid, will be included in one's estate as a causa mortis gift; therefore it is desirable not to pay premiums after the transfer of the policy.

The marital deduction is an important point to be considered when dealing with life insurance. If the policy is payable to the estate, it will be distributed according to the instructions in the will, or, if intestate, by the laws of descent. To qualify for the marital deduction, however, it must be included in the estate, and effectively passed to one's wife without reservation. No problem will arise if the policy is payable to the wife outright. Likewise, no question of qualification will arise if 1) all payments of installments or interest are payable only to the wife# and 2) such payments must be made at least annually or 3) the wife has in effect a full general power to appoint or otherwise include in her estate any balance left with the insurance company at her death, and/or an unlimited right to draw principal.

# Previously, proponents of insurance propounded its advantage due to its income tax saving for the beneficiary under installment payments. This is no longer so, as the interest element of the installments is taxable, except that the surviving spouse is exempted from $1,000 per year of this interest element. This $1,000 applies to all the policies of the spouse (but if there is more than one spouse, $1,000 per spouse).
The insurance installment options, incidentally, are an excellent method of taking full advantage of the marital deduction if the policy is included in the estate, and of simply avoiding the 'second' tax if the policy is not included in the estate. This is so because, under these options, the proceeds are set up in a decreasing fund; that is, the beneficiaries spend the annual installments as they are paid, and it is only the decreasing balance left with the company that will be subject to tax in her estate. It must be recognized, of course, that the reason for this is that the wife has consumed the capital.

For tax purposes, as well as generally, life insurance provides a large amount of flexibility; it is applicable under many varied conditions and for many varied purposes. For example, a tax free estate of $120,000. is allowed by the 50% marital deduction and the $60,000. specific exemption. If his assets are less than this amount, and one can afford to pay the premium, insurance is an ideal method to provide immediately this tax-free estate.

From a corporate point of view, life insurance is an excellent method of providing for stock redemption. From the tax viewpoint, as accumulation of surplus to purchase stock is taxably permissible, an insurance premium fund and/or its surplus reserve will not be held
to be an unreasonable accumulation of surplus.

If one desires to give a substantial charitable bequest or gift, such as to create a scholarship, the life insurance charitable trust provides an ideal vehicle by which to do so. If a sufficient sum is amassed and then given at once, the amount might exceed the maximum allowable income tax deduction, and if death occurs before the required amount is amassed, no income tax deduction will result. The solution might be to assign the policy on one's life irrevocably to a trustee with instructions for its payment to the designated charity. Upon payment of the annual premium, a charitable deduction for income tax purposes will be received; and at death the insurance proceeds will escape the estate tax.

Life insurance is an extremely valuable inclusion in any estate due to its liquidity and flexibility. For tax purposes, the only sure way to exclude insurance from an estate is to divest oneself of all possible incidents of ownership, control, or benefit. It should be remembered that this divesture may well outweigh the possible tax savings. If included in the estate, the eligibility for the marital deduction must be considered. Insurance will fully qualify for this deduction only if the wife is provided full effective control and ownership of the proceeds, either during her life or at her death.
H. The Marital Deduction

Property which qualifies for the marital deduction is not taxed in one's estate. To qualify, property must pass from the decedent to the surviving spouse; this means that the spouse must have outright and total ownership of the property. This is so because the aim of the deduction is to defer the tax, not eliminate it. Thus, while property is not taxed to the husband's estate, it will be taxed to the estate of the spouse when she dies. The deduction applies to not more than one-half of the adjusted gross estate, that is the total estate after funeral and administration expenses and debts, but before the statutory deduction of $60,000.

Property that passes by will, joint tenancy life insurance settlements, intestacy, powers of appointment, causa mortis gifts, and any other method by which the spouse gains outright control of the property, will qualify for the deduction.

# The "common disaster" clause of wills often defeats the marital deduction in that this clause provides that each beneficiary will predecease the testator if they both die as the result of a common disaster. As the deduction applies only to the surviving spouse, it must be specified that the spouse will be deemed to survive unless the fact is to the contrary; by law the testator will be deemed to survive unless he provides otherwise.
A terminable interest (an interest that will fail due to the occurrence or non-occurrence of an event; the most common example is a life interest to a wife until her death or remarriage, and then passage of the property to the children) ordinarily will not qualify for the marital deduction. It will qualify however, if (1) the property is placed in trust with life income to the wife, and a general power of appointment, or at her death the principal will go to her estate (2) life insurance under similar settlement options or (3) by the terms of the will, the wife must survive the husband by not more than six months and she so does survive.

One must remember that taking advantage of the marital deduction involves giving the wife eventual absolute control. The tax benefit will only apply to her; when she dies, the property will be taxed to her estate at rates applicable to her total estate. Therefore, if the wife has property of equal or greater amount than the husband, no advantage, and often a tax disadvantage, is incurred. In addition, under these circumstances, the wife would generally expect a high income of her own; with the added income from the marital property, she will be taxed in the highest brackets. Thus the income tax cost might outweigh the estate tax savings. However, the tax saved on the marital portion gives the wife an added
amount of capital on which to live; and if she does not need the extra capital, she may minimize the tax liability by gradual disposal of the property by gift, consummation or placement in trust.

The value of the marital deduction is not always appreciated. It is considered equivalent to cutting the tax in half, but it reduces it by more than half; this is so because the half deducted is taken off the higher brackets and thus the dollar saving is greater than one-half. It also enables one to (1) double his tax-exempt gifts each year (2) double his tax-free lifetime gifts (3) makes it possible to eliminate all estates under $120,000 from estate tax consideration (i.e. the marital deduction will exempt $60,000, and the statutory exclusion $60,000 leaving a zero taxable balance.

However, "the marital deduction is not...... to be taken automatically like a vitamin capsule on a general theory that no harm and some good may result"#. To better understand the use of the marital deduction, it can be compared with the split income provisions of the income tax. This understanding is important in deciding when the marital deduction may be used to advantage. Basically, the idea is that if one

*8, p. 242.
spouse had a large estate (or income) and the other has little or none, the joint principal allows each to treat half the total as his or her own. This saves taxes by giving each the standard deduction, and keeping the accumulated total out of the higher bracket. If the property (or income) of both spouses are equal, they are no better off with the split provisions than they were without them. Thus, in theory, one should try to equalize the two sets of property (or income). However, if the wife has property of her own, the tax savings for estate purposes is not identical in practice to the theory. One practical consideration may upset all the theoretical or mathematical calculations; without her husband's earnings, the widow may require the use of her capital to live on; therefore the two estates will not end up equal. Naturally one cannot estimate the amount the widow will need to spend, for this depends on how much income is derived from the capital and how long she lives. The immediate tax savings in the husband's estate due to the maximum marital deduction is capital available to the widow. Over a period of years, the income from the additional amount may be considerable. Also the widow's use of her capital will tend to reduce her net estate. Thus
the advantage of the marital deduction is often much
greater than the possible disadvantages of the "second" tax.
Other factors also might appear that will curb any doubts
about taking the maximum marital deduction. For example,
in the case of the absence of the need to provide for child-
ren, the wife could leave her estate to charity and thus
avoid any estate tax; or the husband's assets may consist
largely of investment in his business, thus making it im-
portant to keep his estate tax low so as to avoid liquida-
tion of part of the business to provide taxes. In both these
cases, the problem of a second tax on the wife's estate is of
little importance.

To sum up so far, at first glance in theory it is best
to keep both estates equal; but where the wife has property,
this will not always work out in practice.

Therefore, from the practical point of view of immediate
benefit, the maximum deduction should be used. This all as-
sumes the husband dies first; the contingency of the wife's
prior death should be contemplated. As the husband has his
own regular income, the wife should not use the marital deduc-
tion. Rather than leaving her property outright to him, it
seems better to put it in trust with life income to the hus-
band and the principal to the children at his death. If left
to him outright, generally more tax will be added to his estate
than would in her own. This all stems from the fact that
the marital deduction only works to full advantage when the
spouse with the greater amount of property dies first.
This apparent defect is mitigated when one considers that
the economic damage of the tax is not suffered by the liv­
ing richer spouse, for he still has full use of the property.
The tax burden will be on the children, and even this can be
minimized by the judicious use of gifts while living.

To sum up, the crux of whether or not the property
will qualify for the marital deduction is whether the spouse
gets full use of it and/or, if it is not expended, it will
be taxed to her estate. Full use means that she has the un­
reserved right to it; if for any reason she may lose that
right, it will not qualify. The essence of the marital de­
duction is to give immediate benefit by the postponement of
the estate tax to the wife's estate; therefore, to qualify,
it must be taxed in the wife's estate. Therefore, the deci­sion is whether or not to pay all or part of the tax in the
husband's estate and escape a second (and perhaps a third
and even fourth tax, to the extent allowed under 'the rule
of perpetuities'). The second tax may cause one to decide
to forego the marital deduction because the addition of the
marital property to the wife's own property will raise her
tax bracket and result in a net tax loss. The problem is complicated by (1) the State tax has no marital deduction (2) the comparative amount of property owned by each spouse (3) the method of disposition chosen (4) the wife's estate may be totally or partially dissipated before a second tax may be levied (5) the property value may change (6) the life expectancy and effective yield on the postponed tax, and (7) the Federal estate tax rates have a small differential, within large ranges, and therefore the addition of the marital property, even when the wife has a substantial amount of her own, may not make much difference. Therefore, one can see that it is difficult to generalize; it is best to make the specific computations before making a decision. However, in the majority of the cases, this is not necessary, because the husband has most of the property and the wife has very little; therefore, there is no problem of an increased second tax. In general, one might equalize the two estates by means of gifts so that each spouse will receive the $60,000 exemption and the lowest possible brackets. Finally, in the majority of ordinary cases, the maximum use of the marital deduction is most advantageous.
I. Direct or Indirect Transmission - The "Second" Tax

The general problem involved in considering the advisability of direct bequests are beyond the scope of this discussion. The problem from a tax point of view is that outright bequests will be taxed to the estate of the donee at his death, unless the property is already dissipated. This is so even if the property was previously taxed to the donor's estate, except that credit will be given if the previous transfer occurred within ten years. 

If the donee has the right to invade the principal or the unlimited right to name the final beneficiary, the property will be included in his estate. Flexibility can be maintained by authorizing the trustee of property in trust to pay some of the principal to the donee. This eliminates any second tax, yet the discretionary power provides for flexibility. Similar considerations must be contemplated when choosing the method of settlement of life insurance proceeds. If payable to the beneficiary in a lump sum or in-

# For example: If a parent leaves $200,000 to his son outright, the Federal tax is $31,500; if the son dies ten years later, leaving this net estate ($163,500) to his son, the tax will be $22,500; if this grandson dies after ten years, leaving this net estate ($146,000) to his brother, the tax will be $16,400; this leaves a net balance to the beneficiary of $129,600. The total of the three taxes is $70,400. This does not consider State inheritance taxes, and the estate costs. By leaving the original property to the son in trust with a life income, and the same for the grandson, approximately $40,000 in taxes are eliminated.
stalments, any unexpended amount in the beneficiary's possession or in balance with the insurance company is taxable to the beneficiary's estate. If the principal is left with the company, with interest payable to the beneficiary, it will be taxed if she has the right to withdraw, pay to her estate, or designate the ultimate beneficiary. There is no tax if she only has the right to receive the interest. Thus if an insurance trust is created, with income payable to the beneficiary, and principal only at the discretion of the trustee, material tax benefits will result. In all these situations the beneficiary only has the right to income; all other rights are limited. Thus one of the practical disadvantages of the use of successive estates is that they tend to limit the life beneficiaries to income, and the ultimate disposition of the property is fixed at the time of the original grantor's death. Flexibility may be provided, however, by giving the trustee the right to invade, and giving the life beneficiary a limited power of appointment.

The other disadvantage of indirect transmission is the conflict with the possible benefits of the marital deduction, for to benefit from this deduction, the property must be included in the spouse's estate.
The use of successive estates is especially good if the donee is other than the spouse; if it is the spouse, the problem is not so simple. No tax advantage accrues for outright bequests greater than the amount necessary to obtain the maximum marital deduction. Therefore, the use of successive estates is to advantage only for the amount in excess of the marital deduction. The problem is, once again, a case of mathematics. Both devices do essentially the same thing, that is, reduce the tax to one tax on two estates; one device merely benefits the first estate, and the other the second estate. The object is to use these two devices so as to minimize both estates, and thus get the maximum exemptions and lowest possible tax brackets for each.
J. Testamentary Trusts

We have seen that if property is left outright, and the original donees in turn bequeath it again, the property is taxed twice. But by the use of a testamentary or living trust, one can give a beneficiary life income with the principal passing to the final beneficiary at the life tenant's death. By this method, the fund is taxed only once at the original donor's death.

This same principle applies when the care of a widow is considered, except here the marital deduction is an added factor. One-half of the estate may be left tax free to the wife, and only the second half will be subject to the double taxation described above. A solution might be to give one-half of the estate outright (or the right to income and principal if desired, with the balance at her death to her estate) and one-half given in trust with the life income to the wife and the principal to the children at her death.

# An exception is a 100% credit for tax paid on the same property if transferred within the previous two years, 80% if within two to four years, 60% if within four to six years, 40% if within six to eight years, and 20% within eight to ten years; no credit is allowed after ten years. Also, the tax on remainder (future) interests are postponable for six months after the lapse of the present interest, at the election of the recipient.
Extra tax free protection may be afforded by provisions for the trustee to pay the widow principal in case of emergency or to maintain a given standard of living. The use of the marital deduction is feasible only if full control of the property is properly left with the widow. However the trust device can be used even if the marital deduction is not feasible. In addition, the end benefit for the children must be considered.

One must always remember that a tax saving on the husband's estate may increase the tax burden on the wife's estate. Only by careful computation of the alternative possibilities can the optimum choice be made.

By the use of a trust, it is possible, under certain conditions, for one to leave a life income to one's children, a life interest to their children (i.e. one's grandchildren), and the principal to their children (i.e. one's great-grandchildren). Whether or not this is applicable depends on the highly technical "rule against perpetuities", which we have previously discussed. The advantage of this system of successive estates, from a tax point of view, enables the property to be tax free for three or four generations, rather than have the property be taxed successively upon the death of each of the included generations. The tax saving is not
on the principal amount alone, but on the savings at the additional tax rate resulting from the addition of the bequest to the donee's own property.

It should be noted that several trusts may be used if necessary. One trust could be created to be kept intact, to be used for the marital deduction. A second trust, not to be used for the marital deduction, could be used to pay the estate expenses. Conversely, the wife should be allowed to draw principal from the first trust, with the second trust to be passed intact to the children.

The use of the charitable testamentary trust is especially suited for those with only contemporary dependents, such as a spouse, sister, etc. By the use of a trust with life income to the beneficiary and the principal to charity at her death, the gift of the future interest value will create a substantial tax saving. This amount will provide additional capital from which to provide income for the support of the beneficiary. A common example of this situation would be the instance of the married couple with no children. At the husband's death, half of his estate could be left to his wife and one-half in such a charitable trust. Thus, she would receive a life income from one-half of the property and the right to principal and/or income from the second half, with no estate tax at all.

A legal life estate will qualify for the marital deduction the same as 'a power of appointment trust'.
that is both will qualify if the wife has the power to
dispose of the property. A 'power of appointment' trust
will not qualify for the marital deduction, however, if
the income must be accumulated, or if it contains a sub-
stantial amount of non-income producing property (or if
the trustee has the discretion to accumulate income for
wife's benefit)#. Thus while one can give a life interest
and a power of appointment without a trust, the trust
method is generally considered to be better, except in the
case of special assets. In addition to the general reason
for the use of a trust rather than a life estate with the
general power to appoint, from the tax point of view (1)
as to the portion of the estate not intended for marital
deduction, if the life tenant can consume capital, that
capital covered by this right is included in the life
tenant's estate, while if the trustee is given the dis-
cretionary power to pay capital, there is no second tax, and
(2) the income tax on the income of the life estate is auto-
matically taxed to the tenant, whereas with the trust, some
discretion may be provided so as to possibly minimize the
income tax.

#to qualify for the marital deduction as a 'power of
appointment' trust, the trustee must be legally obligated
to (1) convert non-productive property into productive use
within a reasonable time (2) as a prudent man, decide whether
or not to sell it or (3) pay the wife a sum out of other
assets in lieu of income.
The 'beneficial interest' trust, where there is life income to the wife, or other beneficiaries, and principal to the wife's estate, is in contrast to the power of appointment trust. Under this beneficial interest type of trust there are two separate interests, one for the life interest and one for the principal. The value of the two may be separated, but if both are payable to the wife, the total should equal the value of the total principal. The advantage of this type of trust is that it is more liberal than the strict power of appointment trust, such as to accumulation of income, etc. However, there is a problem of valuing each interest separately if there are two beneficiaries. Only the value of the wife's interest will qualify for the marital deduction.
IV. Massachusetts Inheritance Tax Factors

Massachusetts has an inheritance tax rather than an estate tax. The difference between the two is that an estate tax, such as in effect by the Federal government, is levied on the total net estate of the decedent, while the inheritance tax is levied upon each separate transfer to each beneficiary, and at a rate depending on the amount of the transfer and the relationship of the decedent to the beneficiary.

In general, the Massachusetts rules are similar to the Federal rules; however, several classes of items are exempt under the Massachusetts rules which are taxable by the Federal rule. This apparent inconsistency is eliminated when the different natures of the taxes are considered.

The Massachusetts tax is not an estate tax levied on the decedent's estate, as is the Federal, but a tax on the right to receive property, taxable to each recipient (although the estate may be liable for the tax.)

Inter vivos trusts, regardless whether or not revocable, where the life of the donor is not a factor, are not included in the decedent's estate for State tax purposes. The 'life of the donor' clause is the important one. Under the Massachusetts rule, gifts or conveyances intended to take effect at or after the death of the grantor are included in
his estate. Therefore, a trust with the life income to the donor, transfers of real or personal property with a reserve life interest or use, or even transactions which are complete on their face, yet in effect provide a life interest, are includable. Thus a trust with life income to the spouse and principal to the children at her death is non-taxable even if the donor can revoke it or regain the property. As long as the trust does not depend on the death of the donor, the beneficiaries receive nothing new from his death. The important point here is not to include any reference, actual or implied, to the death of the donor in the instrument or related documents.

Another beneficiary of this concept of beneficial receipt is the holder of the powers of appointment. A power of appointment (if created after 9/1/07) is not includable in the estate of the donee even if it is a general power. This is because the donee will not receive the property at death, even if she had the life interest in it.

This all is not to imply that by the use of this device State tax will be eliminated. At the time of the donor’s death, the value of the life interest is taxable to the donee. As the remaindermen under the power are then not known, no tax may be levied on them. However, when the remainder is ultimately received, the tax will have to be paid
as if it were received directly from the estate of the donor, not the donee, i.e., at the highest effective rate and rate base bracket in effect at the death of the original donor. This tax on the future interest may be paid at the death of the original donor, if desired, to eliminate the future tax liability. On testamentary trusts with a life interest and the right to invade principal, the tax will be paid on the life interest plus on the amount actually withdrawn at the tax rate effective at the date of original death.

Several other tax advantages are available in the form of specific property excluded from tax. Primary among these is life insurance payable to name beneficiaries, regardless of who paid for it or had control over it. Only insurance payable to the estate or the executor thereof, or to one who has the duty to pay the tax or the debts of the estate is included.

As does the Federal rule, the Massachusetts rule includes property vesting by virtue of jointly held property rights. However, one big exception to this rule is available in Massachusetts. Here a single family residence, or a multiple family residence up to $25,000, occupied by a married couple as their home and held as tenants by the entirety, will be excluded from State tax. (However, make sure this property

# Under Massachusetts law, jointly held property will bear its share of the tax, unless the deceased owner declares to the contrary in his will.
will be included in the marital deduction property for Federal tax purposes, as the Federal tax cost otherwise will exceed the State tax saving.)

Another benefit available under the Massachusetts rules is the time limit under 'contemplation of death' transfers. The limit of applicability of this rule is two years, rather than the Federal three years. If given within one year of death, the burden of proof is on the estate, while if within one to two years, the mere weight of evidence by either party will carry.

The disadvantages of the Massachusetts rules are primarily (1) no marital deduction is allowed and (2) the deduction for Federal estate tax paid is limited to such tax levied on property subject to the Massachusetts tax.

It should also be remembered that the Federal law allows for a credit against the Federal tax for any death tax paid to the state, but only up to a certain maximum amount, regardless of the actual State tax paid. This State tax always will be at least as much as the maximum allowable Federal credit by reason of the 'Additional tax' designed specifically to take up the gap, if any, between the computed State tax and the maximum Federal credit.

Another point to be remembered is that the State tax often is relatively more of a factor in smaller estates because of the smaller exemption (i.e. $10,000 each for
spouse, parents, children, and $1,000 for grandchildren), with the provision that if the amount of the exemption is exceeded, it is no longer effective and the tax will be levied from the first dollar up. On the positive side, the State tax rates are much lower than the Federal rates, and are spread over several bases (i.e., one for each beneficiary) rather than one total amount.

Generally speaking, one should plan that the overall Massachusetts inheritance tax will be greater than the allowable Federal credit therefor. While dollar-wise, the State tax may be considerable, its rates are comparatively low, and much lower than the Federal tax. Also certain specific exemptions are available under the Massachusetts rule that are not under the Federal. All in all, while one should be cognizant of the applicable State inheritance tax, one's major tax care still remains with the Federal estate tax.
V. Conclusion.

"The power to tax... (can) ... do a multitude of things which are good or bad according to which side of the tracks you live on, which Sunday school you go to, whether you prefer Karl Marx's beard to Roger Babson's, and whose ox is being gored."* We, however, have not contemplated the propriety of our tax laws, but merely consider them as a factor affecting the transmission of wealth.

The present high tax structure has created a difficult problem if a reasonable part of one's property is to be passed on to others. Many people strive to accumulate property, yet do not exercise the same care in preserving it. Some do not even draw a will. Those who do generally consider that they have done enough. Comparatively few consciously extend their planning to the other effective means of preserving property for one's heirs, such as by the use of lifetime gifts, 'living trusts', insurance, etc.

Many have no realization of the thoroughness of the tax system. They may feel that their estate is not of sufficient size to be subject to a substantial tax. They do not realize that even if an estate is apparently less than $60,000, the statutory exemption, tax planning should be con-

* 1, p. 303.
sidered because (1) the estate may be larger than believed, e.g., property believed owned by another nevertheless may be included in one's own estate (e.g., life insurance, joint tenancy property, etc.) (2) government valuation of one's assets, such as business interests, may exceed one's own valuation of such property (3) the $60,000 deduction is not guaranteed, e.g., the exemption was originally $100,000 and then reduced to the current $60,000. In 1949, a bill was introduced in Congress to further reduce it to $30,000. It has often been suggested that Congress look to the Estate tax for new revenue. A similar history has occurred with the income tax: originally, the high exemptions and exclusions minimized the real effect of the tax; now everyone is subject to substantial tax contribution.

Many people also overlook that any tax saving is net. $20,000 earned might increase one's wealth by only $10,000 after taxes; but if the $20,000 were tax savings, the increase would be the full $20,000.

To many of us, mention of taxation and the transmission of wealth refers primarily to the death tax levied on an estate. Those of us who fall prey to this common misconception are overlooking the simple fact that the simplest method of avoiding estate tax is to minimize the potential estate while we still live. We must not, however, jump to the
conclusion that the solution to the problem is merely to give away our property. In addition to the obvious economic and personal drawbacks to such a course of action, it is not even to our best tax advantage to so behave.

The integration of all the devices available for the transfer of property, both during life and at death, is the answer. The judicious use of gifts and creation of trusts, while living, has an excellent place in the overall estate tax program. The drawbacks to too enthusiastic adoption of such a program is the irrevocable nature of the action required to eliminate such property from the estate. Nevertheless, some use of gifts is of advantage within the tax exclusions provided. Such exclusions include the annual exclusion of $3,000 plus a lifetime exemption of $30,000; with the marital joint gift provisions, these sums may be doubled. The use of a trust will provide more flexibility in the distribution program. Besides eliminating the property from the estate, and also the income produced from such property, the trust may be used to avoid the "second" tax on the property to the immediate donee. By the flexible nature of the instrument, the immediate beneficiary may possess almost complete enjoyment of the property, yet the property will not be subject to estate tax until it finally vests with the ultimate taker.
As has been pointed out, while lifetime transmission is both effective and advantageous, its irrevocable nature limits its over-extensive use in most cases. Thus the real problem of estate taxation arises at death. Therefore it is essential that the nature and problems of the testamentary transmission of property be fully comprehended.

Several problems involving tax considerations arise immediately at death. The requirement for ready sums of cash to pay death taxes requires liquidity in the estate; the distribution of the property will involve consideration of who will bear the burden of the tax, and what tax deduction will be made available, especially as regards the 'marital deduction'. In addition, the recognition of exactly what is included in the estate and its proper valuation may not be apparent without full examination of all assets. The use of joint tenancy, powers of appointment, and life insurance all may have their value from the point of view of assured receipt, flexibility, liquidity, etc. But we must remain aware of the tax problems involved with their use, especially the question of their includibility in the taxable estate.

One of the major decisions to be made in planning testamentary distribution is the respective value of direct versus indirect transmission. From the tax viewpoint, direct transmission will qualify the property for the marital deduction, but generally will require a second tax to be paid
at the death of the immediate recipient; indirect transmission, such as by use of the testamentary trust, will avoid these taxes on each successive estate.

One final consideration is the effect and the amount of the State inheritance tax consequences. Because of the additionally exempt items and the lower rates, however, this problem is generally of a secondary nature.

All in all, there is no simple answer to the problem of the taxation on the transmission of wealth, either living or testamentary. Each case is an individual matter, involving different desires and purposes. Each of the matters discussed herein is important, not as the solution to the quandary, but as a possibility to be pondered, both as to its advantages and its disadvantages. The factors primarily to be considered are those fundamental to the basic estate plan; the tax factor is only one single item involved. From all points of view, as well as from the tax viewpoint, an integrated program of living and testamentary distribution will provide the maximum results. Tax-wise, this integrated plan will be able to obtain the maximum benefits from the different tax exclusions, exemptions, and joint marital ownership provided by the tax laws.

At no point have we attempted to present a full technical presentation of the subject; neither have we endeavored to compile a handbook for the computation of the several applicable taxes; both of these approaches are obtainable
from various other sources. Our aim, which we hope has been successful, has been to afford to the reader insight into the various avenues of approach available in the establishment of a successful estate plan, with the primary aim of achieving the essential purpose of the plan with the minimum tax burden.
APPENDIX A

Example of Saving Taxes by Estate Planning*

There are three important ways to reduce Federal taxes on the typical estate, such as that mentioned herein:

1. By eliminating the unnecessary second set of taxes on certain property going eventually to the children;

2. By taking advantage of the 50% Marital Deduction;

3. By the use of gifts.

Four different methods of distributing an estate give four different dollar results.

To Illustrate:

A man is worth $300,000. His wife owns no property in her own name.

His first estate objective is to provide adequate income for his wife as long as she lives and he desires that the property is then to go to the children.

The desired estate objectives can be achieved in various ways, but . . . the cost varies widely, as explained below:

*12

# For simplification, only Federal Estate Tax is considered in the succeeding examples. A portion of the state taxes may be absorbed in the Federal Estate Tax. Principal value of investments is assumed to remain unchanged. Some Administration cost are necessarily estimated throughout.
PROGRAM 1
(saves Marital Deduction only)\#
PROGRAM 2
(saves unnecessary second set of taxes only)

Husband leaves in a trust for the lifetime benefit of his wife • • • • • • • • • • • $300,000
Principal at her death to go to children.
(Trust does not qualify for marital deduction)

Subtract:
Federal estate tax $59,100
Administration expense 12,000

Wife receives income from husband's estate during her lifetime.
Children receive • • • • • • • • • • • • $228,900

Less any additional shrinkage caused by additional state taxes

Saving to family
$18,964

Compared with Program No. 1, the most expensive way

Program No. 2 accomplishes essentially the same ends as No. 1. Yet where this program is used:

The saving is $ 3,149 on an original estate of $ 100,000
The saving is $ 4,645 on an original estate of $ 150,000
The saving is $ 8,118 on an original estate of $ 200,000
The saving is $18,964 on an original estate of $ 300,000
The saving is $42,236 on an original estate of $ 500,000
The saving is $96,902 on an original estate of $1,000,000
The saving is $411,153 on an original estate of $5,000,000
PROGRAM 3

(saves both Marital Deduction and second, unnecessary set of taxes on as much of property as possible)

Husband leaves in two trusts ........................................ $300,000

Administration expense .............................................. 12,000

Amount placed in
Marital Deduction Trust A* ....................................... $144,000

Subtract:
Federal estate tax
on wife's death ......................................................... 16,220

Amount placed in Trust B
(similar to trust in Program 2) .................................. $144,000

Subtract:
Federal estate tax
on husband's death ................................................... 16,220

Children receive (add 1 and 2) ................................. $255,560

Less any additional shrinkage caused by additional state taxes

Saving to family ................................................... $45,624

Compared with Program No. 1, the most expensive way.

Program No. 3 accomplishes essentially the same ends as No. 1. Yet where this program is used:

The saving is $ 7,229 on an original estate of $ 100,000
The saving is $19,425 on an original estate of $150,000
The saving is $30,258 on an original estate of $200,000
The saving is $45,624 on an original estate of $300,000
The saving is $72,936 on an original estate of $500,000
The saving is $145,402 on an original estate of $1,000,000
The saving is $375,953 on an original estate of $5,000,000

*This trust gave wife income for life, payable at least annually. She had general power of appointment of principal by Will. Assuming she does not exercise this power, under the terms of the trust, the children receive the property at wife's death.
PROGRAM 4
(saves both Marital Deduction and second, unnecessary set of estate taxes and takes advantage of gift tax savings)

Husband's estate ....... $300,000

25% of estate placed in Gift Trust for children, with wife's full consent.
One-half of remaining adjusted gross estate placed in Marital Deduction Trust A, remainder in Trust B to save second, unnecessary set of estate taxes (see Program 3)

Subtract:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gift tax</td>
<td>$488</td>
</tr>
<tr>
<td>Federal estate tax on husband's estate (Trust B)</td>
<td>6,508</td>
</tr>
<tr>
<td>Federal estate tax on wife's estate (Trust A)</td>
<td>5,508</td>
</tr>
<tr>
<td>Administration expenses</td>
<td>8,981</td>
</tr>
</tbody>
</table>

Total Subtract: $22,485

Children receive $277,515

Less any additional shrinkage caused by additional state taxes

Saving to family $67,579

Compared with Program No. 1, the most expensive way.

Program No. 4 accomplishes essentially the same ends as No. 1. Yet where this program is used:

- The saving is $8,229 on an original estate of $100,000
- The saving is $22,365 on an original estate of $150,000
- The saving is $38,978 on an original estate of $200,000
- The saving is $67,579 on an original estate of $300,000
- The saving is $110,458 on an original estate of $500,000
- The saving is $215,304 on an original estate of $1,000,000
- The saving is $1,351,425 on an original estate of $5,000,000
APPENDIX B

Federal Estate Tax Table

Taxable Estate before $60,000 Exemption

<table>
<thead>
<tr>
<th>From</th>
<th>To</th>
<th>Tax on Column 1 After Credit for State Taxes</th>
<th>Rate on excess</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>60,000</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>60,000</td>
<td>65,000</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>65,000</td>
<td>70,000</td>
<td>150</td>
<td>7</td>
</tr>
<tr>
<td>70,000</td>
<td>80,000</td>
<td>500</td>
<td>11</td>
</tr>
<tr>
<td>80,000</td>
<td>90,000</td>
<td>1,600</td>
<td>14</td>
</tr>
<tr>
<td>90,000</td>
<td>100,000</td>
<td>3,000</td>
<td>18</td>
</tr>
<tr>
<td>100,000</td>
<td>110,000</td>
<td>4,800</td>
<td>21.2</td>
</tr>
<tr>
<td>110,000</td>
<td>120,000</td>
<td>6,920</td>
<td>24.2</td>
</tr>
<tr>
<td>120,000</td>
<td>150,000</td>
<td>9,340</td>
<td>27.2</td>
</tr>
<tr>
<td>150,000</td>
<td>160,000</td>
<td>17,500</td>
<td>26.4</td>
</tr>
<tr>
<td>160,000</td>
<td>200,000</td>
<td>20,140</td>
<td>28.4</td>
</tr>
<tr>
<td>200,000</td>
<td>300,000</td>
<td>31,500</td>
<td>27.6</td>
</tr>
<tr>
<td>300,000</td>
<td>310,000</td>
<td>59,100</td>
<td>26.8</td>
</tr>
<tr>
<td>310,000</td>
<td>500,000</td>
<td>61,780</td>
<td>28.3</td>
</tr>
<tr>
<td>500,000</td>
<td>560,000</td>
<td>116,500</td>
<td>28.0</td>
</tr>
<tr>
<td>560,000</td>
<td>700,000</td>
<td>133,500</td>
<td>31.0</td>
</tr>
<tr>
<td>700,000</td>
<td>810,000</td>
<td>176,700</td>
<td>30.2</td>
</tr>
<tr>
<td>810,000</td>
<td>900,000</td>
<td>209,920</td>
<td>32.2</td>
</tr>
<tr>
<td>900,000</td>
<td>1,060,000</td>
<td>238,900</td>
<td>31.4</td>
</tr>
</tbody>
</table>
APPENDIX C

Massachusetts Inheritance
Tax Table

The Massachusetts Inheritance Tax rates vary with the relationship of the beneficiary to the deceased.

Class

A - Husband, wife, father, mother; child, adopted child, adoptive parent, grandchild

B - Lineal ancestor, except father or mother; lineal descendant, except child or grandchild; lineal descendant of adopted child; lineal ancestor of adoptive parent; wife or widow of a son; husband or a daughter

C - Brother, sister, half brother, half sister, nephew, niece, stepchild or stepparent

D - All others

<table>
<thead>
<tr>
<th></th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>on 1st</td>
<td>$10,000</td>
<td>1%</td>
<td>2%</td>
<td>4%</td>
</tr>
<tr>
<td>on next</td>
<td>$15,000</td>
<td>2</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$25,000</td>
<td>3</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$50,000</td>
<td>4</td>
<td>6</td>
<td>10</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$150,000</td>
<td>5</td>
<td>7</td>
<td>11</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$250,000</td>
<td>6</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$250,000</td>
<td>7</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$250,000</td>
<td>8</td>
<td>10</td>
<td>14</td>
</tr>
<tr>
<td>&quot; &quot;</td>
<td>$250,000</td>
<td>9</td>
<td>11</td>
<td>15</td>
</tr>
</tbody>
</table>

A 23% surtax is levied on the above amounts, to give the total Massachusetts tax. An additional tax is levied, if necessary, to insure a minimum state tax at least equal to the Federal estate tax credit.
# APPENDIX D

**GIFT TAX RATES (1943 to PRESENT)**

<table>
<thead>
<tr>
<th>Taxable Gifts</th>
<th>Tax</th>
<th>Rate on Next Bracket</th>
</tr>
</thead>
<tbody>
<tr>
<td>$5,000</td>
<td>$112.50</td>
<td>2 1/4%</td>
</tr>
<tr>
<td>10,000</td>
<td>375</td>
<td>5 1/4%</td>
</tr>
<tr>
<td>20,000</td>
<td>1,200</td>
<td>8 1/4%</td>
</tr>
<tr>
<td>30,000</td>
<td>2,250</td>
<td>10 1/2</td>
</tr>
<tr>
<td>40,000</td>
<td>3,600</td>
<td>13 1/2</td>
</tr>
<tr>
<td>50,000</td>
<td>5,250</td>
<td>16 1/2</td>
</tr>
<tr>
<td>60,000</td>
<td>7,125</td>
<td>18 3/4</td>
</tr>
<tr>
<td>100,000</td>
<td>15,525</td>
<td>21</td>
</tr>
<tr>
<td>250,000</td>
<td>49,275</td>
<td>22 1/2</td>
</tr>
<tr>
<td>500,000</td>
<td>109,275</td>
<td>24</td>
</tr>
<tr>
<td>750,000</td>
<td>174,900</td>
<td>26 1/4</td>
</tr>
<tr>
<td>1,000,000</td>
<td>244,275</td>
<td>27 3/4</td>
</tr>
<tr>
<td>1,250,000</td>
<td>317,400</td>
<td>29 1/4</td>
</tr>
<tr>
<td>1,500,000</td>
<td>396,150</td>
<td>31 1/2</td>
</tr>
<tr>
<td>2,000,000</td>
<td>564,900</td>
<td>33 3/4</td>
</tr>
<tr>
<td>2,500,000</td>
<td>748,650</td>
<td>36 3/4</td>
</tr>
<tr>
<td>3,000,000</td>
<td>947,400</td>
<td>39 3/4</td>
</tr>
<tr>
<td>3,500,000</td>
<td>1,157,400</td>
<td>42</td>
</tr>
<tr>
<td>4,000,000</td>
<td>1,378,650</td>
<td>44 1/4</td>
</tr>
<tr>
<td>5,000,000</td>
<td>1,851,150</td>
<td>47 1/4</td>
</tr>
<tr>
<td>6,000,000</td>
<td>2,355,650</td>
<td>50 1/4</td>
</tr>
<tr>
<td>7,000,000</td>
<td>2,878,650</td>
<td>52 1/2</td>
</tr>
<tr>
<td>8,000,000</td>
<td>3,426,150</td>
<td>54 3/4</td>
</tr>
<tr>
<td>10,000,000</td>
<td>4,566,150</td>
<td>57 3/4</td>
</tr>
</tbody>
</table>
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