Estate Planning

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In 1920 Sidney M. Spiegel, then a forty-seven year old widower, decided to set up a trust for his three children. He wished to provide them with security and independence. Accordingly he turned his fortune of about $1,000,000 into a trust, with the children (or their descendants) to receive the income and after he died the principal. As Mr. Spiegel received none of the income from the trust, and as it was irrevocable and unchangeable, he certainly did not think it would be included in his estate when he died.

However, he overlooked the ingenuity of the Bureau of Internal Revenue. The Commissioner claimed that when the trust was established there was a possibility that all of Mr. Spiegel’s children and descendants might predecease him, thus there was a “possibility of reverter”, making the entire trust includable in Mr. Spiegel’s estate as a trust intended to take effect upon his death. Although the initial value (actuarially computed) of this possibility of reverter was less than $4,000, and its value when Mr. Spiegel died was zero, since he was survived by six children and grandchildren, the result of the inclusion of the trust in Mr. Spiegel’s estate was an increased estate tax of about $450,000. The Supreme Court upheld the Commissioner in assessing the additional tax.¹

¹ Spiegel v. Commissioner, 335 U. S. 701 (1949). This decision, however, was overruled by Congress. On October 25, 1949, §811 (c) of the Internal Revenue Code was amended so that transfers prior to October 8, 1949, where the transferor did not expressly retain a reversion, are not includable in the transferor’s estate. The Spiegel executors were no doubt overjoyed at this legislation, since it may give them a refund claim for the tax paid on the trust. This legislation is discussed in a later section of this article dealing with a “possibility of reversion”.

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**Note:** All references to the “Code” refer to the South Carolina Code of 1942.
The actual decision in the *Spiegel* case is not nearly as significant in estate planning as is the illustration it gives of the readiness of the Bureau of Internal Revenue to increase the estate tax whenever technical circumstances permit an increase, regardless of the actual intent behind a transaction. The decision means that a taxpayer must plan every transaction with the technical rules and requirements of the Bureau in mind—not merely in accordance with his intention. In view of the attitude of the Bureau, as reflected in this decision, a taxpayer certainly cannot be criticized for making every possible legitimate arrangement for tax minimization. The Supreme Court has said:

"The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted."  

Judge Learned Hand of the Second Circuit Court of Appeals recently said:

"Nobody owes any public duty to pay more than the law demands; taxes are enforced exactions, not voluntary contributions."

The "law permits" two principal devices for reducing estate taxes—the testamentary trust and the *inter vivos* gift. In addition, specific matters may be planned so that the tax may be avoided. For example, if a testator wishes to create by will a testamentary trust for his family, and wants to provide that they shall be able to use the principal of the trust if they need it, if he provides that his widow shall have the right to invade the principal, the entire trust will be included in her estate, but if he provides that an independent trustee shall have the discretionary right to invade the principal for the family's benefit, it will not be so included. The difference in the amount of the tax to an estate of moderate size may amount to thousands of dollars. Another example: a bequest to charities is deductible in arriving at the taxable estate. But if the gift is of a remainder interest, and the life income beneficiary has

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too unqualified a right to use the principal, the charitable deduc-
tion will not be allowed. This is illustrated by the recent case of Henlsee v. Union Planters National Bank & Trust Co.\(^5\)

There Mr. W. B. Williams died a bachelor in 1943 and left his entire estate of about $500,000 to his aged mother for life, and thereafter principally to charities. Since Mrs. Williams was eighty-five years old, there was small value to her life interest. As most of the remainder was to go to charities, the estate tax would have been negligible. But Mr. Williams, despite his mother having independent means and frugal tastes, wanted to allow her the use of the principal. So he provided that the trustees could pay out principal for the mother’s “pleasure, comfort and welfare”. By making the power to in-
vade the principal so broad, the Court held, the entire amount was taxable in his estate. A tax of over $35,000 was paid merely because the unused power to invade the principal was broader than is permissable.

Further illustrations of ways in which the estate tax may be avoided by planning in connection with particular trans-
actions, are discussed in Chapter 5 of this article dealing spec-
fically with estate tax reduction. There is always a tempt-
tation to over-emphasize in a discussion of estate planning the feature of estate tax reduction. It is more dramatic and concrete and the figures for the amount saved may be large. As a matter of fact, the term estate planning has been criti-
cized as connoting tax avoidance.\(^6\) However, estate tax

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6. While the term “estate planning” is merely a modern designation for the ancient practice of prudent men in setting their affairs in order, unfortunately it has come into general use only since the estate tax rates have been high and for that reason some writers have objected to it on the ground that its connotation is principally that of tax avoid-
ance. Shattuck, An Estate Planner’s Handbook, Foreword:

“The term ‘Estate Planning’ is in some disrepute... It has been colored, moreover by motives of tax avoidance to an extent which is unfortunate.”

Joseph Trachtman in his monograph on “Estate Planning” in Current Problems in Federal Taxation, published by the Practicing Law In-
stitute, says at p. 3:

“Sometimes ‘estate planners,’ in their zeal to show the uniqueness of their services, have produced unnecessarily elaborate plan-
ing and have promoted doubtful tax schemes. ‘Estate planning’ has thus acquired an undesirable secondary meaning—something
avoidance or reduction is only one, albeit an important one, feature of an estate plan.7

The basic objective of any testator is to leave his dependents adequate financial security. This means first, the realization of the full value of estate assets that are sold, or otherwise disposed of, and it means secondly, that proper arrangements should be made so that the estate assets or their proceeds will not be immediately consumed. A testator certainly will not wish his family to be rich one year and poor the next. Arrangements to provide a family with regular income throughout their lives, or perhaps until children are grown, is probably preferred. However, no matter what arrangements are made to provide financial security for dependents, it is an essential part of such arrangements to reduce the administration expenses and estate taxes to a minimum.

In the problem of full realization of estate assets that are sold, the only asset which might present difficulty in a sale is that of a business interest or of stock of a closely held corporation. Accordingly the first question discussed is that of the effective disposition of a business interest. This asset is normally not liquid and it could increase enormously the estate taxes and administration expenses. By arranging for the disposition of this normally unliquid asset, prior to his death, a testator relieves his administrator of a difficult task and also Assures his estate a sufficient amount of cash to meet the taxes and administration expenses. The best arrangement a testator can make for the disposition after his death of his business interest or closely held stock is the so-called “buy and sell agreement” with the most likely buyer. Such an agreement in no way interferes with the owner’s use and control of the business interest or stock during his lifetime, as it is operative only upon his death. However, it assures his estate administrator of the sale of this usually unliquid asset and it will supply all or a part of

which has to do primarily with tax avoidance. The title of this monograph was not chosen by the author, who dislikes it and used it only because it seems to be on the way to attaining desirable connotations.”

7 All estate planning problems dealt with in this article with the exception of federal estate taxes apply irrespective of the amount of the estate. The federal estate tax, however, applies only to estates of $60,000 and larger.
the cash needed to pay the taxes and administration expenses. Such an agreement may also have value for tax purposes, as it would fix the value of the asset for estate tax purposes. In the case of an employee however, the agreement should not give the buyer the right to purchase the stock at below its market value, as the unpurchased increment of value will be considered taxable income to the employee. This matter will be discussed in more detail later. If, on the other hand, a buy and sell agreement is not made, other means for the disposition of a business interest may be provided by a will, although for several reasons, which will be mentioned, such arrangements are not as satisfactory as an agreement would be.

The second matter which will be discussed is the problem of arrangements to provide the necessary financial security for dependents. If the estate assets or their proceeds are paid out immediately to the dependents it is conceivable that they will be lost or consumed. On the other hand, if they are not to be paid immediately, some form of testamentary trust must be used. The testamentary trust is the only way (aside from insurance) principal funds of an estate may be withheld from immediate use or consumption by dependents. The testamentary trust is also a useful device in over-all estate tax reductions, as the later chapter on that subject will show. But here the only matter considered is its use as a means of furnishing financial security to dependents. There are some problems involved in its establishment, such as the investment powers to be given the trustee, whether the trustee shall be a corporate one or an individual, delineation of the rights of the income beneficiaries and the remaindermen and the like. Certainly the most important problem is the question of whether or not the fiduciary's investment powers should be charted by the testator. In the absence of directions by the testator or trustor, a fiduciary can only make investments in conformity with the laws of the state in which he is acting. In many states the responsibility is placed on the fiduciary\(^8\) but in this state the legislator has taken over the responsibility by listing the

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\(^8\) This is the so-called Massachusetts or "prudent man rule". Here the fiduciary is permitted to make investments in accordance with a policy of "soundness" which a "prudent man" would utilize in making non-speculative investments for himself.
investments which may be made.  

Life insurance is quite an important subject in planning an estate. In view of its importance it is discussed in a separate chapter. To the extent that estate assets consist of life insurance no testamentary trust is necessary, as the insurance company, under settlement options will retain the principal fund and pay it out in the form of interest or principal and interest, such as an annuity, as may be elected by the owner of the insurance policy. In addition to its usefulness in supplying an income to dependents, life insurance may also be useful for financing business or stock purchases in connection with buy and sell agreements, and in supplying the cash needed for the payment of administration expenses and taxes.

The second part of this article deals with the ways in which administration expenses and estate taxes may be reduced. In essence the reduction of administration expenses is accomplished by eliminating the need for constant judicial proceedings for the guidance of fiduciaries. The legitimate reductions in the estate taxes are principally accomplished, aside from the ways in which particular transactions may be arranged, by the use of two tax saving techniques. The first of these is the testamentary trust and the second is the inter vivos gift. Tied closely with the testamentary trust is the marital deduction. This is a substantial tax benefit applicable to married persons only and introduced into the Internal Revenue Code for the first time last year. The inter vivos gift is complicated by reason of its being effective during the life of a grantor, rather than, as in the case of a testamentary trust, at his death. All of the complications have to do with whether the gift is sufficiently removed from his death so as to be considered an independent transaction.

We will first, however, consider the business disposition.

1. Disposition of Business Interest:

(a) The Problem:

In the case of a sole proprietorship, when death strikes,
the wheels of a business stop. A legal representative is not allowed to continue the business, but may fulfill outstanding contracts. If he continues the business anyway, he is personally liable for any obligations of the business thereafter incurred; he is also personally responsible for any loss of the business; and he cannot claim any compensation therefor as a legal representative, no matter how profitably the business has been operated. He may, however, in South Carolina, bring a separate action for that purpose.

If the business of the decedent was done in the form of a partnership, rather than as a sole proprietorship, his death dissolves the partnership. If the surviving partner or partners carry on the business, they do so for their sole account. Furthermore, they have no prior right or option to purchase the deceased partner's interest from his legal representative or heirs. A provision in a partnership agreement that the death of a partner does not dissolve the firm may be hazardous, especially in a limited partnership, since it could cause the partnership to be taxed as a corporation.

You do not have this problem of business continuance in the case of a corporation, as it continues despite a principal

10. Laikin and Lichter, Survivor—Purchase Agreements, 26 Taxes 931 (October, 1948). In footnote 1, Lord Mansfield is quoted as having said in the Old English case of Barker v. Parker, I. T. R., 286 (1786):

“A trade is not transmissible; it is put to an end by the death of the trader. Executors eo nomine do not usually carry on a trade; if they do so, they run great risk; and without the protection of the Court of Chancery, they act very unwisely in carrying it on.”


“... There is no authority in this state for an administrator to carry on the business previously conducted by the deceased.”


15. §9018 of the Code; Ruff v. Summer's Ex'rs, 4 Desaus. Eq. 529; Glenn v. Worthy, supra; Carolina Life Insurance Co. v. Arrowsmith, supra.

16. Jones v. McMichal, 12 Rich. 176; Crane on Partnerships, §77, and cases there cited; see also Crane supra, §225.

stockholder's death. You do, however, have the problem of continuity of management and of the stock being general assets and subject to sale to pay taxes and creditors. Or the stock may be distributable to the distributees or legatees of the decedent; thus, harmonious management relations, or the important element of "control" may be lost.

(b) A Solution—the Buy and Sell Agreement:

The Usual Buy and Sell Agreement. The most effective solution to the problem of a business disposition or "control" continuance is for the owner of the business to make during his life a contract to sell it at his death to the most likely buyer. The buyer agrees to buy and the owner agrees to sell, but the agreement is operative only when the owner dies. This type of agreement is known as a buy and sell agreement. In the case of a sole proprietorship the most likely buyer is a key-employee; in a partnership, the prospective buyers are probably limited to the surviving partner or partners; where the business interest is stock of a closely held corporation, the most likely buyers are the other important stockholders.

The Stock Liquidation Agreement. If there are many important stockholders so that agreements between them to purchase and sell the stockholdings of each would be impractical, a stock liquidation agreement between each stockholder and the corporation might be considered. The corporation would agree with each stockholder that it would purchase and retire his stock upon his death. Such an agreement, however, normally should not be made if any other arrangement is feasible, as it presents several difficult questions. Unless the corporation has the power to purchase its own stock, such an agreement would be ultra vires and could not be enforced.\[18\] Moreover, the corporation can make the purchase only from surplus. This brings up what may be a serious tax difficulty. If there is a substantial surplus and it is used to purchase

\[18\] The authority of corporations to acquire their own stock is not specifically given by the statutes of this state. The statute does, however, (§§7685 and 7745) impliedly give a South Carolina corporation this power by providing that the corporation shall have a lien on any stock subscribed until it is fully paid for. By giving the corporation a lien on the stock necessarily implied is the power to enforce the lien and thus acquire ownership of the stock. See Creech v. South Carolina Public Service Authority, 20 S. E. (2d) 645, 200 S. C. 127.
stock of a deceased stockholder, the Bureau of Internal Revenue may contend that the surplus accumulation is unreasonable and should be taxed under Sec. 102 of the Internal Revenue Code. (Sec. 102 of the Internal Revenue Code provides for a penalty tax of from 27 1/2% to 38 1/2% of any surplus deemed by the tax authorities to be unreasonably large. The tax is on the surplus of a corporation "formed or availed of" to avoid surtax on stockholders; the Statute is applied however, only where surplus had been accumulated beyond the "reasonable needs" of the corporation.) Rather large accumulations of surplus are generally permitted for the reason that a substantial surplus may be needed for corporate expansion or protection. This reason could not be advanced to justify a surplus used to purchase stock from the estate of a deceased stockholder.

Another objection to the corporation purchasing the stock for retirement, where the corporation is family owned, is that the payment for the stock may be treated as a "dividend" and the entire amount taxed to the stockholder's estate as ordinary income. The theory of the Bureau would be that since the remaining stock is owned by the family of the deceased stockholder, the purchase and retirement of the stock does not affect control and was not a true purchase and sale. This theory however, could not properly be applied where the purchase and retirement of the stock would affect control of the corporation outside of a family group.

Also, if the corporation purchases the stock, the tax basis of the remaining outstanding stock and the corporate assets in the hands of stockholders, would not include the payment by the corporation in purchasing the stock, although the value of the stock would be greater and the cost of the assets to the corporation would be more. Thus, if the remaining stock, or the corporate assets in the hands of stockholders should later be sold, or otherwise disposed of, the income tax would be substantially greater. However, there may be a partial compensation in that if corporate earnings distributed to the stockholders are used to make the purchase, the money for the purchase will be reduced by the amount of the individual income tax thereon, which would not be true if the corporation made the purchase itself. Where the stock is purchased by the corporation to hold, and not for retirement, many of the above objections do not apply.
Life Insurance to Fund the Agreement. The cash necessary for the purchase by the partner, key-employee, stockholder or corporation can be raised through insurance on the life of the owner. As a matter of fact, it would be unwise for any person, unless he is quite wealthy, to enter into a survivor-purchase agreement that is not adequately funded with insurance, since the partner, employee or stockholder might find himself with a heavy financial obligation and no cash with which to meet it.\(^1\) This is not to say however, that the insurance policy must be owned by a party to the agreement. An obligation to purchase the business interest or stock of an associate requires merely that funds should be available for that purpose; it does not necessarily mean that the buyer must own the insurance. Nevertheless, if the party to the agreement does not own the insurance policy, he should have adequate assurance that the insurance funds will be available to him to purchase the interest of the decedent. This situation might arise where there are two stockholders of a corporation, and they have an agreement whereby the stock of the first one to die will be sold to the other, but the corporation purchases the insurance to fund the agreement. In this case the surviving stockholder is obligated to purchase the stock of the decedent but since the corporation owned the insurance the funds for the purchase are paid to and held by the corporation. Thus, the surviving stockholder should have a contract whereby the funds will be loaned to him by the corporation for the purpose of buying the stock. It would make no difference whether or not the stock was posted as collateral security for the loan. If the corporation has surplus and the stockholders agree to the loan contract, its validity could not be questioned.

But where the parties to the buy and sell agreement do own the insurance, each party to the agreement should purchase and own the policy on the life of the other party or parties to the agreement. If the insured "directly or indirectly" paid any of the premiums for the insurance on his own life (subsequent to January 10, 1941) or held an

\(^{19}\) See Harwood, *Disposition of Business Interest*, proceedings of Probate and Trust Law Divisions, American Bar Association (1946), p. 16.
"incident of ownership" over that policy, the proceeds are included in his taxable estate.

The problem of when premium payments may be held as indirectly paid by the insured has been perplexing. The most obvious situation of an indirect premium payment is that by a spouse or child with money furnished by the insured. It has been held that where a partnership paid premiums for insurance on the life of a partner, such payments were indirectly made by the partner. In 1940 it was held in Lehman v. Commissioner that where two brothers established reciprocal trusts for each other, each indirectly established a trust for himself. Until 1947 there was some fear that this doctrine of reciprocity might be applied to life insurance acquired to fund a buy and sell agreement, and that the payment of premiums for insurance on the life of a partner or business associate might be held an indirect payment of premiums on a similar policy of insurance on one's own life. In 1947, however, the Bureau took official recognition of this danger and ruled that it will not attempt to tax both the insurance proceeds where there are reciprocal policies on the lives of partners and the value of the business interest it is designed to purchase. The rulings probably will not afford protection if the partnership or business itself owns the policy or pays the premiums. If insurance on the life of a stockholder is owned and paid for by the corporation, there is only slight danger that it will be considered an indirect premium payment by the stockholder—except when the stockholder owns all or substantially all of the stock of the corporation and the premiums are attributed to him under the alter ego theory. If the insurance is included in the estate of the deceased partner or associate, the income tax position of the survivor or survivors is precarious. If the business interest or stock so acquired is disposed of, the cost basis may not include the in-

20. "Incident of ownership" includes the right to change the beneficiary, the right to assign or borrow on the policy, the right to convert and the like.
21. I. R. C., §811 (g) (2) and Reg. 105, §81.27.
22. Reg. 105, §81.27 (a).
24. 109 Fed. (2d) 99 (CCA 2, 1940).
surance proceeds. If the agreement is funded with insurance owned by the parties to the buy and sell agreement on the lives of each other, the agreement should also provide that the survivor or survivors shall have the right to purchase (for its cash surrender value) from the estate of the deceased partner or business associate any policy or policies of insurance which the estate owns on the survivor's lives. A similar right to purchase the insurance on their own lives if the agreement is terminated for any reason should also be provided.

(c) Tax Aspects of the Buy and Sell Agreement:
Under certain circumstances the purchase price fixed in the agreement will be binding on the Bureau of Internal Revenue as the estate tax value of the business interest or stock so sold. This could be a great advantage to the administrator, in that it eliminates what might be an exceedingly tiresome and long drawn out dispute with the government. On the other hand, the purchaser, if he is an employee, will find that to the extent he has bought the interest or stock for less than its market value he has received taxable income by reason of the bargain purchase, and will have to pay tax on the benefit at the ordinary rates.

The Effect of a Buy and Sell Agreement on Value. The valuation of a business interest is required for state inheritance and federal estate taxes. The valuation is most complex and the result is inconclusive until the return has been finally audited. A recent analysis of all litigated cases concerning the value of a partnership interest, where there was no buy and sell agreement, shows that the average time consumed in such valuation dispute is slightly over five years. The viewpoint of the estate tax collector has been referred to as similar to Dr. Johnson's remarks of the worth of a deceased friend's business.

26. In Legallet v. Commissioner, 41 BTA 294 (1940) two partners allowed the partnership to buy the insurance and pay the premiums therefor. The Board held that the cost basis of the interest of the deceased partner, acquired by the surviving partner under a buy and sell agreement, did not include insurance paid to the widow of the deceased partner. The effect of this holding is, from a tax viewpoint, to disregard the fact that the insurance proceeds were intended as part payments for the indivisible partnership interest.
27. Advanced underwriting service by Insurance Research and Review Service.
“Boswell, somewhat maliciously, repeats 'a very good story, which, if not precisely exact, is certainly characteristic' namely, that 'when the sale of Thrale's brewery was going forward, Johnson (one of Thrale's Executors) appeared bustling about, with an ink-pen in his buttonhole, like an exciseman; and 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 Biography, by Joseph Wood Krutch, pp. 504-5. As this highly difficult and uncertain matter of valuation can usually be avoided by the making of a buy and sell agreement, such an agreement should, by all means, be made, as it is justifiable for that reason alone. The subject is comparatively new and the applicable legal principles are not fully developed. However, some conclusions may be drawn.

Where there is no family relationship involved, that is, where the agreement is made at arm's-length, and where the owner definitely obligates himself to sell the business interest or stock at his death, and the other party definitely obligates himself to buy, the price fixed is a "pegged value" and will be binding for estate tax purposes. Where, how-

29. Matthew v. Commissioner, 3 TC 525. In Wilson v. Bowers, 57 Fed. (2d) 628 (CCA 2, 1932) and in Lomb v. Sugten, 82 Fed. (2d) 166 (CCA 2, 1936) it was held that stock-purchase agreements which provided for a value of considerably less than the market value of the stock at the time of the decedent's death, were binding upon the Bureau. In each of these cases the prospective purchaser was not bound to purchase the stock but merely had an option to buy it at the agreed figure. The Court viewed the matter as of the date of death, and not as of the date the agreement was made. The Court found the agreements to sell were specifically enforceable. The effect of a buy and sell agreement value for estate tax purposes has never come before the United States Supreme Court, but in Helvering v. Salvage, 297 U. S. 106 (1936) it was held that an outstanding option agreement was binding for the purpose of determining value for income tax purposes.

In the more recent cases of Hoffman v. Commissioner, 2 TC 1160 (1943); Estate of Edwin R. Armstrong, 3 TCM 77 (1944) and Matthews v. Commissioner, 3 TC 525, the Tax Court has said that a restrictive agreement is not binding upon the Commissioner unless it gives the prospective purchaser an unqualified right to buy the stock, and requires that it be available at the owner's death. See Varney, How Re-
ever, there is a family relationship or the agreement is effective only at death, and does not restrict the owner's right of disposal during his lifetime, the courts will probably consider the agreement as merely a substitute for a testamentary disposition, and not effective for estate tax valuations. Therefore, of complications arising in connection with family arrangements, the so-called "business purpose doctrine" may be applied, under which the agreement will not be considered binding for tax purposes unless made for a business purpose.

Moreover, if the agreement applies only if the owner's legal representative elects to sell, and gives the prospective purchaser merely a prior right of purchase, it is not binding. A restrictive agreement of this kind, while not binding in fixing value, nevertheless is a depressing factor which should be considered in the fixing of value. An agreement to sell at a certain price upon death is not binding as to value for an *inter vivos* gift.

**Income to an Employee.** If the agreement is made with an employee and provides for a sales price which is not, in measure at least, fairly reflective of the actual market value when the agreement becomes effective, the difference between the sales price under the agreement and the actual market value will probably be regarded as additional com-

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If there is a real reason for the agreement, that is to say, if the agreement to sell the stock or business interest can be supported by adequate consideration, the agreement will be held binding despite family relationships. Commissioner v. Childs, 147 Fed. (2d) 368 (CCA 3, 1945), and Bensel v. Commissioner, 100 Fed. (2d) 639 (CCA 3, 1938).

30. See Hoffman v. Commissioner, 2 TC 1160 (1943); Matthews v. Commissioner, 3 TC 525.


33. Worcester County Trust Co. v. Commissioner, 134 Fed. (2d) 578 (CCA 1, 1943).

pensation to the employee, and the price fixed will not be binding for estate tax purposes.\footnote{35} If the difference between the price to the employee and the market value is considered additional compensation, that difference will be taxed to the employee as ordinary income.\footnote{36} If the difference is not considered additional compensation, the cost basis to the employee will undoubtedly be what he actually paid for the stock.\footnote{37} Furthermore, this result cannot be avoided by bequeathing the stock to someone else subject to a right of purchase by the employee.\footnote{38} Probably an agreement with an employee for a sale at a price lower than market value is inadvisable.

(d) \textit{Other Solutions for a Business Disposition:}

\textit{Option or Prior Purchase Right.} If an \textit{inter vivos} arrangement is not desired, provisions may be included in a will so as to give key-employees, a surviving partner or partners, or stockholders, the \textit{option} to purchase the business interest of the testator at a stated price or at a price to be reached by a formula. Or the will may give such persons a \textit{prior} right of purchase for a certain length of time. The price fixed for such purchase, if it differs materially from the market value of such business interest at the time of the death of the owner, will probably not be accepted by the Bureau as the value of such interest for the estate tax. In the first place it applies only if there is a sale, and in the second place, it is not in effect during the lifetime of the owner. The difference between the sales price and the market value of the business interest may be considered a bequest, but probably it will be considered a sale at the lower figure and although

\footnote{35} Certainly if the employee was given the right to purchase the stock or business interest during the lifetime of the employer, any difference between the market value of the stock, or business interest, when it is acquired by the employee and the price which the employee is required to pay, would be considered additional compensation and taxed to the employee as ordinary income. Reg. 111, §29.22 (a)-1; Commissioner \textit{v.} Smith, 324 U. S. 177 (1945). There is no justification for the application of a different rule where the option is effective at the death of the owner. See \textit{Van Dusen v. Commissioner}, 166 Fed. (2d) 647 (CCA 9, 1948), where the option could have been binding on the estate of the owner for five years.

\footnote{36} Commissioner \textit{v.} Smith 324 U. S. 177 (1945).


\footnote{38} \textit{Delone v. Commissioner}, 6 TC 1188.
it will not be effective for estate tax purposes, will have the basis of the low sales price.\(^{39}\) However, if the sale is to an employee, the difference will probably be regarded as income to the employee, and its basis will be its value.

Aside from the fact that such provisions do not dispose of the difficult valuation question, they are not as satisfactory in that they do not furnish any assurance that the assets will be conserved in the estate, since the option or right of purchase may or may not be exercised.

The Estate a Limited Partner. Where the owner does not wish the business to be sold, other arrangements can be made. If it is an interest in a partnership and the other partners agree, a new and limited partnership may be formed and the testator's interest may continue with the estate participating as a limited partner. Of course, specific authorization to that effect would have to be contained in the will. The executor, in the absence of authorization would be obliged to liquidate the interest. Funds would also have to be available elsewhere to pay the proportionate part of the taxes and administration expenses without liquidation of this investment.

The Business May be Specifically Bequeathed. If the business is conducted as a sole proprietorship, it may be specifically bequeathed or the will may create a trust of the business for named beneficiaries and authorize the trustees to continue to operate the business. If the business is to be continued by trustees, their powers must be carefully defined. They must be authorized to spend whatever funds are required in the business, and if it is intended for them to have additional compensation for the continuance, that must be specified. It has been held that even though a business was continued by trustees pursuant to a court order, nevertheless, the trustees were not entitled to additional compensation.\(^{40}\) It may be advisable also to authorize incorporation of the business. This could be done tax free and it would protect the trustees against individual liabilities.

Periodic Review. Whether the arrangements are by \textit{inter vivos} agreement, or by provisions in a will, it is very desirable

\(^{39}\) See Mack \textit{v.} Commissioner, \textit{supra}.

to either review the matter periodically or else have the purchase price reached by use of an agreed formula, rather than provide a fixed price. Circumstances might change considerably between the time of the making of the agreement or will and the time of death.

Usually the only serious problem presented on the full realization of estate assets concerns the appropriate disposition of a business interest. With this matter taken care of, where it is present, the next problem is arrangements for the continuation of support and maintenance for dependents.

2. The Testamentary Trust—Financial Security for Dependents:

The testamentary trust is an effective device for the reduction of over-all estate taxes, but its use for that purpose is discussed later in this article. Here the discussion of the testamentary trust is confined to its use for the furnishing of financial security to dependents.

The function of the executor is solely to collect the assets, convert them into cash if necessary and to pay the creditors and taxes, and to make distributions to the legatees or distributees. The function of the testamentary trustee, on the other hand, is to hold and manage the trust assets and use them, for the benefit of the named beneficiaries; to invest the uninvested portion of the trust fund and, where authorized to do so, to continue the operation and management of the decedent's business.

Investment Powers of a Fiduciary. Legatees or distributees are often inexperienced in investments. Where a trustee is limited to the "legal" list of investments, experience is not particularly important as the legislature has, to a large measure, assumed the investment responsibility. However, where a trustee is given investment powers beyond those specified in the Code, competency and experience in making sound investments are qualities that are second only to honesty. Dependents are usually more interested in regular income than they are in principal. A too cautious investment policy may be very hard on the income beneficiaries, and the "loss" from an overly-cautious investment policy may be

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substantial. For example, a 4% return on $300,000 produces the same income as a 3% return on $400,000. On the other hand, a speculative investment policy may result in a substantial part of the principal fund being actually lost. The primary problem of investment policy for a person who wishes to provide adequately for his dependents is whether or not he wishes a fiduciary to be limited to the statutory list of legal investments.

A trustee, unless authorized to make investments beyond those in the "legal" list, cannot even retain investments of the decedent, or of a predecessor trustee, which are not "legal" trust investments. Neither can he sell any portion of the trust property, unless he is authorized, directly or impliedly, to do so, or unless the property is not a proper investment and he is not authorized to retain it. Normally a trustee has full powers to vote securities held in the trust but the power to give proxies and to participate in corporate reorganizations will probably be denied. There is however, some belief to the contrary. Usually the legatees or distributees of a decedent are his widow and children, and they probably do not have investment experience. Also the decedent may not wish them to have the burden and responsibility of investing and managing substantial sums of money. Therefore, unless a legatee or distributee is experienced in making investments or unless he is closely advised by someone in whom the testator has confidence, it may be well to make the bequest in trust, and this is always true where there are minor children involved.

42. See Vol. 31, Bogert Trusts, §686 and cases there cited. The common law rule in this regard, in force in this state, is well stated in the case of Mobley v. Phinizy, 155 S. E. 73 (Ga.)

"The power of a trustee to retain investments other than those authorized by law to be made by the trustee, received from the creator of the trust, in the absence of statute or a contrary provision contained in the instrument creating the trust, is not different from his power to make such investments."

See Bass v. Adams, 161 S. E. 697, 163 S. C. 381.


Selection of a Trustee. Many men dislike the creation of a trust—either testamentary, or inter vivos. One difficulty is the selection of an appropriate trustee. Where broad and discretionary powers are given to the trustee, the trustee’s judgment is very important. Where such powers are not given, the advantage of the trust arrangement may be largely lost. Where there are minor children involved the trustee is usually given considerable discretion as to the distribution of funds. Many testators wish to limit discretionary powers to fiduciaries named in the will. Other testators, particularly where the trustee is a corporate one, wish to have some surviving family member exercise the discretion. A testator may wish his widow to have the right to use all or a portion of the principal. The power to distribute the trust funds, whether income or principal, to a beneficiary is a matter requiring judgment and discretion, where it is often desirable or even necessary that the trustee be very close to the family.6 These problems may be resolved by the naming of two trustees; only one of them to have the discretionary powers mentioned. The cost will be no greater since in this state two or more trustees must share the single commission.7 If two trustees are named, it may be desirable for one to be corporate and the other an individual.47a

While an individual trustee will probably be preferred for the exercise of the discretionary powers, there is no doubt that a corporate trustee is in a better position to make investments. It does not get sick, or go away on vacations.

6. Most discretionary powers given to a trustee, or to a person who may direct the trustee, are personal. Bogert on Trust, Chapter 9, p. 314 et seq. If discretionary powers are given to an individual trustee, they do not survive the trustee’s death. General powers may be interpreted to go with the office of trustee. It is difficult to distinguish between powers that will be held to be personal and do not survive the trustee’s death, and those which go with the office. A power to accumulate trust income for a minor will probably be held to be personal, whereas, a power of sale will be held to apply to the office, see Bogert, supra.

47. §9019 of the 1942 Code.

47a. Since in this state, there is some question as to whether the corporation will succeed to the title of the entire trust property upon the death of the individual trustee (see Karesh, Devolution of Interest in Trust Estates, 1 S. C. LAW QUARTERLY 367) it probably will be wise to provide that the corporate trustee shall have title to the entire trust estate.
Where an individual trustee alone is named, it is desirable to provide for his successor. If this is not done the court will appoint a successor who may be a stranger to the family.\textsuperscript{48} Where a corporate trustee is named the problem of successor does not arise. Many people feel, however, that a corporate trustee may be too impersonal and coldly objective in its trust administration.

\textit{Delineation of Rights Between Income Beneficiary and Remainderman.} It is often felt that a trustee is inclined to resolve any doubt on allocation or apportionment in favor of the remainderman and against the income beneficiary.\textsuperscript{49} Of course, it would be expected that a trustee would do this

\textsuperscript{48} See §9046 of the Code.

\textsuperscript{49} The problem of allocating and apportioning between principal and income is one of great difficulty, and has been the source of much litigation (see Chapter 15, of Bogert's \textit{Hornbook on Trusts}, at p. 480). This question arises frequently where stock dividends are paid, also dividends of so-called wasting-asset corporations, and it frequently arises where a trustee forecloses a defaulted mortgage. Many states have statutes specifically covering these situations, but in this state there are no such statutes. In the absence of a statutory direction, or of a specific authorization, in the case of stock dividends, the allocation has produced three different views: The so-called "Massachusetts Rule" allocates the entire dividend to income. The so-called "Kentucky Rule" allocates the entire dividend to principal. The so-called "Pennsylvania Rule" apportions the value of the stock dividend between principal and income by attributing to income the portion of the value of the stock representing a distribution of earnings and attributing the balance of the value of the stock to principal. Apparently the latter rule is followed in this state. (See Bogert, \textit{supra}, p. 451, footnote 68). Dividends by a wasting-asset corporation in the absence of specific authorization, must be attributed to income. In the case of foreclosed mortgages, some Courts have worked out a very complicated formula where the total amount received by the trustees are apportioned by taking a percentage for principal representing the ratio of the total amount received to the total amount due, principal and interest. Thus, if the total amount due is $2,000—$1,500 principal and $500 interest, and the total amount received is $1,000, the ratio of the total received is one-half of the total due. Therefore, applying the ratio of 50% to the principal due of $1,500 results in $750 of the amount received being attributed to principal. Applying the ratio of 50% to the $500 interest due gives $250 as attributable to income. The formula is widely used by trustees in some states (\textit{Matter of Chapal}, 269 N. Y. 464; \textit{Matter of Otis}, 276 N. Y. 101), but apparently the question has not yet arisen in this state. The proper allocation of amounts spent for repairs or improvements to real estate is another question that gives trustees headaches.
since, except for a surcharge based on loss due to improper investments, amounts improperly paid out are gone, whereas, income improperly held is still available. But most trusts are for the primary benefit of the income beneficiaries; the usual trustor has more interest in being assured that the income beneficiaries are amply provided for, than that the remaindermen will receive adequate distributions at the termination of the trust. It is also likely that a trustee will be more conservative in investments than the trustor wishes since the trustee is naturally concerned primarily with the safety and conservation of the corpus, rather than with the adequacy of the income. Statutory restrictions on the investment powers of a trustee, requirements as to segregation of trust funds and the like have to do entirely with the protection of the principal fund. There are no statutes or rules of law designed to aid the income beneficiary.

This problem can be alleviated somewhat by a provision in the trust, or in the testamentary paragraph dealing with the trust, providing that the income beneficiaries are the chief objects of the trustor’s interest, and that doubts shall be resolved in their favor. Such a provision could be included along the following lines:

My primary purpose in creating this trust is to provide adequately for the named life beneficiaries. I therefore direct that in the administration of this trust my trustees, to the fullest extent consistent with law, shall resolve any doubts in apportionment in favor of income. No remainderman of this trust or guardian or anyone claiming for, under, by or through a remainderman, shall question the apportionments made by my trustees, in the manner aforesaid.

If the trustees are given the discretionary authority to invade the principal of the trust for the income beneficiaries, no provisions for liberality in apportionment between income and principal are needed. If the trustees are directed to exercise their discretionary authority to invade principal in a manner favorable to the income beneficiaries, the Bureau of Internal Revenue may question whether in such a case the discretion of the trustees is “untrammeled”. This could cause the entire trust fund to be included, for federal estate tax purposes, in the estate of the life beneficiaries. Such a provision is therefore probably unwise.
Children. Where children are involved it is very desirable that benefits to them should be trusted during their minority, otherwise the benefit must be paid to the parents or to a guardian on the child's behalf. If both parents are alive, they are joint natural guardians of the person and of the property of their minor children, and if one parent only survives, that surviving parent is by law the guardian.\textsuperscript{50} A parent may appoint a guardian of the person and of the property by will or deed, effective only when both parents are dead.\textsuperscript{51} Such an appointive guardian must make an annual accounting to the Probate Court;\textsuperscript{52} but a surviving parent is under no such obligation. If a parent of the children is not alive and a guardian has not been appointed by such parents, then property of the child can only be turned over to a guardian appointed by the Probate Court.\textsuperscript{53} The guardian so appointed is required to make annual accountings and is limited like a trustee in investments of the minor's property. Of course, a guardian is authorized by law to pay out such amount as is necessary for the infant's proper support, education and welfare.

A testator should not be misled by the thought that the beneficiary under a testamentary trust can only be given a life interest in the property. A right to invade the principal of the trust, and a power of appointment over the trust remainder can, for all practical purposes, make the beneficiary's interest tantamount to an outright ownership. At the same time, by somewhat limiting those rights, the testator can avoid the full impact of the federal estate tax; a matter which will be discussed later.

3. THE USES OF LIFE INSURANCE IN ESTATE PLANNING:

The ways in which life insurance may be used in the formulation and adoption of a sound program for the administration of an estate, are numerous. It can be used as a

\textsuperscript{50} §8638 of the Code.
\textsuperscript{51} §8633-36 of the Code.
\textsuperscript{52} §8637 of the Code.
\textsuperscript{53} If property is less than $500 in value, the Court may direct the sum to be paid to the infant, or to some other person for the benefit of the infant, without the appointment of a guardian. §350 of the Code, as amended in 1945, by Act No. 158, p. 234 of the 1945 Statutes.
substitute for the testamentary trust in providing regular income for the support and maintenance of dependents. By use of settlement options, the insurance company is required to invest and manage the fund, without shrinkage or the cost of a trustee.\footnote{In this state a trustee's commission is by statute allowed to be 5\% of principal and 10\% of income. Code §9048 and 9017. Corporate fiduciaries, however, usually contract to receive only 5\% of income.} Insurance can also provide funds to a business associate or partner of the decedent, so that the former may acquire the business or stock of the decedent. But probably the most helpful use of insurance may be to furnish the cash necessary for the payment of administration expenses and taxes. If the estate assets are not liquid, insurance for this purpose is not only helpful but may be absolutely necessary.

\textit{Insurance for “Financial Security” for Dependents.} We shall consider first the situation where insurance is acquired to provide financial security for the insured's dependents. Here the use of a settlement option is necessary, or the insurance will merely provide a lump sum cash payment to the beneficiary, and thus fail in its objective of providing the beneficiary with a regular income.

Settlement options in general, provide for the retention of the principal amount of the insurance proceeds by the company, with the beneficiary of the policy receiving only interest (guaranteed at a certain rate) or regular payments comprising both principal and interest, either for the beneficiary's life or for a number of years certain, or for the life of the beneficiary and a certain number of years whichever is longer. Most settlement options will permit the principal to be withdrawn by the beneficiary so long as the fund is held at interest, but will only permit a beneficiary to convert (if given that right under the settlement agreement with the policyholder) from an interest basis to a life income basis at a stated date. Some companies with very liberal settlement policies will allow the conversion at any time. The retained fund is not required to be segregated from other funds of the insurance company, and it has now been settled that the company is a debtor of the beneficiary, and not a trustee for the beneficiary's benefit.\footnote{See \textit{Vance on Insurance}, Chapter 10, §158.}

Since the fund is not required to be segregated from the
general funds of the insurance company, it manages the fund for the beneficiaries, without cost to them. If the company is financially strong this is an exceedingly valuable right, but not all policy holders take advantage of it. To anyone familiar with the problems of investments and management of trust funds, and with the likelihood of losses of principal of the trust fund in the event of a depression, the offer of the insurance companies to take over this responsibility and burden without additional cost to the policy holders should be accepted with alacrity. Furthermore, insurance companies are more able adequately to invest and manage funds than any individual investor. For one thing, they have personnel engaged entirely in examination of sources for investment, they have information and means of getting information that are not available to the ordinary investor. For another they command, by reason of their size, a position in the investment market which would not be had otherwise. They are able to purchase privately at a lower price, securities which if marketed publicly, could only be purchased for a larger amount or producing a somewhat lower return.\(^5\) Since the insurance funds are not segregated, the insurance company, not the beneficiary, bears the risk of loss.

Settlement options have been criticized for rigidity.\(^5\) But this criticism is not justified in the case of all companies. Where a company is involved which has liberal policies regarding the making of settlement agreements, they can be utilized for almost any purpose. Insurance companies are in many states prohibited from exercising discretionary powers in the administration of insurance funds which they retain under settlement options. In many cases, though not prohibited by law from the exercise of discretionary powers, they will refuse to do so. It may therefore be desirable, or necessary where infants are concerned, and the settlement agreement provides for the use of the principal funds for certain purposes, to accompany the settlement agreement with a trust agreement or a trust declaration. Most com-

\(^5\) The advantages of an insurance company making investments over an individual investor are summarized in an excellent little book entitled, "Why Life Insurance?" by James Sutton Drewry (1946), at pp. xvi \textit{et. seq.}

\(^5\) Shattuck, \textit{supra}, pp. 43 \textit{et. seq.}
panies will not permit settlement options to be exercised by trustees, but they will pay out funds to a named trustee in accordance with an option previously elected by the owner of a policy.

*Insurance for Administration Expenses and Taxes.* Insurance may be used to pay estate administration expenses and taxes. Unless there are sufficient liquid assets in the estate, insurance is very advisable for this purpose. However, it may be absolutely necessary if there is no market for the estate assets, or if the testator does not wish the estate assets sold. The objection is sometimes made that the proceeds are taxable in the estate and, therefore, a sufficient amount of additional insurance must be obtained in order to pay the taxes on the cash received from the insurance. Thus, if the estate is in a 30% tax bracket (which is reached by a net taxable estate of $100,000), slightly more than 30% additional insurance would have to be obtained than the sum required ("slightly more" because all additional insurance increases the size of the taxable estate). If the decedent's spouse is his legal representative, this objection can be met by the decedent (insured) having such a policy payable to his spouse so that the proceeds are deductible under the so-called marital deduction, which is discussed in more detail later. Since the proceeds will be consumed, they will not add to the estate of the spouse, and be taxable at his or her death.

The insurance proceeds will not, of course, be included in the insured's estate if someone else acquires the insurance and pays the premiums themselves. If, therefore, a spouse or an adult child for example, has separate income sufficient to pay the premiums, they may acquire, own and pay for insurance on the life of the decedent. The proceeds would be available to pay the taxes and administration expenses. However, the person who buys the insurance should make appropriate provisions in a will or otherwise, for the policy,

58. See Trachtman, *supra*, "It is not possible under the optional settlements to give someone a discretionary power to vary the scheduled payments from time to time."

59. A bill has been introduced in Congress to exempt from estate tax insurance proceeds ear-marked for the purpose of paying the tax on the estate. The proposed bill has been criticized as favoring life insurance. Its opponents say that cash or government bonds, or any other property, should likewise be exempted if it is ear-marked to pay taxes.
after his death, to pass into the ownership of persons other than the insured. Some insurance companies will provide in the insurance contract for the succession of ownership of the policy.

Where both husband and wife have sizeable estates, either or both can set up funded insurance trusts, by an irrevocable transfer to trustees of a sufficient amount of income producing property to purchase life insurance on the life of the other spouse (the gift tax is, of course, payable). The trust will be for the benefit of children or descendants of the husband or wife; it cannot be for the benefit of the spouse purchasing the insurance. At the death of the insured spouse the insurance proceeds added to the original fund, can be made available for the payment of taxes and other administration expenses by a provision authorizing the trustees to purchase assets of the estate, whether or not legal investments, or to lend money to the estate on the security of the estate's assets. Such a provision is not sufficient, under present law, to make the decedent's estate a beneficiary of the trust, consequently the doctrine of reciprocity heretofore discussed is not applicable. The proceeds are not taxable in the estate of the decedent since he neither paid the premiums nor owned the policy. Moreover, there is not here the problem of the policy succession if the spouse who created the trust dies before the insured. The insurance is an asset of the trust, not of the spouse creating the trust.

From an income tax viewpoint such an arrangement is desirable. Since the trust income is used to pay premiums of insurance on the life of a person other than the grantor, the trust income is not, under present law, taxable to the grantor under Sec. 167 (a) (3) of the Internal Revenue Code. The

60. Commissioner v. Jergens, 127 Fed. (2d) 973 (CCA 5, 1942); Lucy A. Blumenthal, 30 BTA 591; Baldwin, 36 BTA 364; Bloomingdale, 3 TCM 1163. However, if the grantor is directly or indirectly the beneficiary of the life insurance policy the trust income used to pay the premiums is taxable to her, Commissioner v. Wilson, 132 Fed. (2d) 255 (CCA 6, 1942). There can be no possibility of a reversion to the grantor, nor can it be possible for her to obtain any benefit from the trust, Commissioner v. Van Dusan, 138 Fed. (2d) 510 (CCA 6, 1943). It is advisable for the trust to take out the insurance policies rather than for the spouse to assign them to the trust, Commissioner v. Morton, 108 Fed. (2d) 1005 (CCA 7, 1940); Phipps v. Helvering, 124 Fed. (2d) 288 (CA of DC, 1941).
trust is a separate taxable entity and its income tax rate will be much lower than that of the individual grantor, thus substantial income tax savings on the income used for insurance premiums are realized.

A somewhat similar plan is for a grandparent to create a funded insurance trust for the benefit of his grandchild, to acquire and own insurance on the life of the child's parent. The trust property, including the insurance proceeds, could, by appropriate provisions in the trust instrument as mentioned above, be made available for the cash requirements of the parent's estate. Where this plan is feasible, it has several attractive features. First, the trust property, including the insurance proceeds, is not taxed in the estate of the grandparent or the parent. Second, the income from the trust is not taxed to the grandparent. The insurance is not on the life of the grantor, and therefore the trust is a separate taxable entity. Thus, if $20,000 is set up in trust and the income therefrom is $800 per annum, the trust income tax will be approximately $100, whereas the tax to the grandparent, if the latter is in a 50% tax bracket, would be $400. Third, if the purpose of the trust is to save income taxes, and the corporea is available for the education of the grandchild, or to set the grandchild up in business, or to enable the grandchild to get married, etc., there is less danger of the gift being "in contemplation of death" than if the gift were outright. Such a trust could also be created by the will of the grandparent, with substantial income and estate tax advantages. 61 In some states a legal problem concerning improper accumulations of surplus in violation of the rule against perpetuities would arise where the income from the trust is used to pay insurance premiums beyond the child's minority, but this problem would not arise in South Carolina.

Insurance to Fund a Buy and Sell Agreement. Life insurance may also be used to finance an inter vivos agreement with a business associate or partner, obligating the latter to purchase the business interest of the decedent at death. Such an agreement permits the value of the decedent's business interest to be fully realized by his estate. It may also dispense with the very difficult and troublesome question of the valuation for tax purposes of that business interest.

It will not avail the decedent taxwise to have insurance taken out by a corporation wholly owned by him. Under the regulations of the Treasury Department the corporation is considered his alter ego and the proceeds are includible taxwise in his gross estate. Furthermore, unless there is some basic reason for the corporation owning the insurance, the Bureau of Internal Revenue might contend that the premiums should be subjected to income tax by the individual as a distribution of profits from the corporation. Where the beneficiary of the insurance is the wife or children of the insured rather than the corporation, the premiums will always be taxed to the individual—whether the premiums will be treated as additional compensation or as a distribution of profits depends on the facts. If, however, where the corporation is the beneficiary and its purchase of the insurance can be justified as a proper business move, such as, an economic compensation for the loss of the personal services and good-will contributions of the insured, it would seem that it would be immaterial whether the proceeds are includible in the estate or are reflected in the value of the stock of the corporation.

II

4. REDUCTION OF ADMINISTRATION EXPENSES:

Most lawyers have heard the anecdote about the young son, just out of law school, who closed up an old estate while the father was taking his first vacation in years. When the father returned and his son proudly announced what he had done, the father sadly said: "Son, that estate brought you

62. Reg. 105, §81.27.
63. Bonwit v. Commissioner, 87 Fed. (2d) 764, (CCA 2, 1937), cert. den'd. 302 U. S. 694. The theory upon which insurance proceeds payable to a corporation which decedent owns or controls, is taxable in the decedent's estate, is that the premiums were paid indirectly by the decedent. Logically it would seem that since the decedent is charged with having paid the premiums he would, for income tax purposes, be charged with the receipt of the money with which they were paid. A somewhat similar situation is where a corporation permits a stockholder to occupy, rent free, premises owned by the corporation. This results in the reasonable rental value of the property being charged to the stockholder as additional compensation or as a corporate distribution. (Chandler v. Commissioner, 119 Fed. (2d) 623).
into the world and gave you your education—I had counted on it to support me in my old age."

The story is a modern version of an age-old layman criticism of lawyers—that legal matters are unnecessarily drawn out. Of course if a lawyer should keep an estate open only so that he may draw out fees, he should be suspended or disbarred from practice. A competent lawyer, however, is usually indispensable in the administration of an estate; although he may do most of the work of administration, his fee is commonly less than the commission of an executor. If a testator is concerned with the prospective fee of his estate lawyer or with the commissions of his executor, he should be very much interested in the steps he can take now to reduce the expenses which will be incurred in the ultimate administration of his estate. Some of the ways in which this may be done are discussed.

Clarity and Sufficiency of Instrument. A will or trust must be in writing. However, if the document is too brief or ambiguously worded, it may require judicial proceedings for interpretation at many stages of its administration. Indeed it is probably more economical, in the case of a will, if the State Statutory plan of descent and distribution is satisfactory, to have no will at all rather than an ambiguous or insufficient one. Judicial proceedings for interpretation and instructions are expensive and all expenses are payable out of the estate or fund. No one will dispute the fact that brevity is more often than not a virtue, but its charm may not be appreciated in a will or in an inter vivos trust. Testators or creators of trusts had probably rather save dollars than words. Professor W. Barton Leach of the Harvard Law School has said:

64. See §8916 and 9041 of the 1942 Code of South Carolina.

65. The classical fictional example of the extent to which prolonged administration of an estate or trust, can support and educate the families of lawyers, trustees, guardians and judicial hangers-on, is Jarndyce v. Jarndyce, in "Bleak House", by Dickens. Many modern cases reflect a record of estate or trust administration that was undoubtedly very expensive, see e.g. Scovill v. Scovill, 191 S. C. 323, 4 S. E. (2d) 286; Lemmon v. Wilson, 205 S. C. 297, 31 S. E. (2d) 745; Wingard v. Hennessee, 206 S. C. 159, 33 S. E. (2d) 390; Snelling v. McCreary, 14 Rich Eq. 291; Boggs v. Ried, 3 Rich. 450. Where the event on which instructions are requested may or may not occur, the Court will not give instructions to the trustee. O'Cain v. O'Cain, 51 S. C. 348, 29 S. E. 68.
"Nobody doubts the proposition that a thought is best expressed in the fewest words. But it is too often true that conciseness of expression is a cloak for incompleteness of thought." 66

Probably the most frequent occasions for seeking judicial interpretations of wills or trusts deeds occur when the beneficiaries are named as a class. A common instance is when there is a bequest to, or trust for children. Questions may arise as to whether the word "children" includes grandchildren, 67 illegitimate children, 68 or adopted children. 69 If a bequest of a remainder interest is made conditional on survivorship, the question arises as to whom the beneficiary must survive in order to be eligible for the bequest. Is it the testator or is it the life beneficiary? Proceedings for interpretation are often necessary in connection with a provision for distribution to remaindermen in accordance with the laws of descent and distribution of the state of residence. Did the testator mean that the distribution should be in accordance with the law in effect at the time of his death or in effect at the time of the ultimate distribution?

The rule against perpetuities must always be watched when a gift is not outright. If the rule applies and is violated in any respect, plans for ultimate distribution may not be fulfilled. While it is not intended here to discuss the rule, it may be pointed out that the most frequent inadvertent violations of the rule occur in giving remainders to persons who may not be in existence at the time of the death of the testator or at the time of the creation of an inter vivos trust, such as a future spouse or child of the beneficiary. 70

Powers of Fiduciaries. The failure to give sufficient powers to the executor or a testamentary trustee may cause consider-

67. Probably it does not, Logan v. Brunson, 56 S. C. 7, 33 S. E. 737, but other provisions in the will or trust deed may indicate that it was so intended. See Green v. Green, 210 S. C. 391, 42 S. E. (2d) 884.
68. Probably not. See Wish v. Kershaw, Bailey's Equity 352, note.
69. The question apparently has not been decided in this state. At common law an adopted child would inherit from its immediate adopting parents but not from others through the adopting parents. See Wheeling Dollar Savings and Trust Co. v. Stewart, 37 S. E. (2d) 563, West Virginia (1946).
70. For an excellent and comprehensive discussion of this question see Perpetuities in a Nut Shell, 51 Harv. L. Rev. 638 (1938).
able expense to the estate. As has been mentioned before, the executor, by law, is given no power other than what is necessary to collect, liquidate and distribute the estate; and he has no power to sell assets of the estate without court approval.\footnote{\textsection 9059 of the Code (personal property); \textsection 9054 of the Code (real property).}

Probably the power to compromise claims is less essential than a power of sale, but if the fiduciary does not have this power, it may be embarrassing to the fiduciary and it may also be costly in the administration of an estate. Of course, if the claim is against the estate, the fiduciary is authorized, nay, it is his duty to pay as little as he can. But if the claim is by the estate, the fiduciary has no authority to compromise it for less than its face amount. No doubt there have been instances where the claim was entirely lost because of the lack of authority in the fiduciary to accept less than its par value. The theory is that a fiduciary has no authority to give away assets of the estate, and by compromising a claim he is, in effect, giving away estate property to the extent that he accepts as payment in full the payment of less than the full amount due. The proof which a court will naturally require for approving settlement of a claim at less than par involves evidence of the financial worth of the debtor. Such evidence might be difficult to obtain and time consuming in its preparation and presentation. This authority therefore might be essential.

Obviously any executor or trustee who contemplates any action where his power is doubtful, will first seek judicial instructions. The request for instructions are involved and all interested parties must be joined in the proceedings and brought before the court.

Such proceedings may be eliminated by giving adequate powers to the fiduciaries in the first place. In addition to giving them the power to sell both real and personal property in the estate and to compromise claims of the estate, it is desirable also to provide that they (either only those named in the will or trust deed or anyone serving) shall have the authority to lend money, either on security or otherwise; to make leases for any term; to retain the investments of the testator; to vote stock; give proxies therefore; to join in reorganizations; to rescind or vary the terms
of contracts and claims; to carry the legal title to property in the name of a nominee; to provide for depreciation of depreciable property, and, if necessary, to carry a reserve therefor; to make distributions in kind; to make distribution of funds to infants in the discretion of the fiduciaries; to employ legal and clerical assistance, if needed, and, in the case of trustees, to resign without judicial authorization. The fiduciary should also be given the authority, under certain circumstances, to borrow money, a power which, as a matter of law, he would not have. In the absence of authority therefor, a Court will be reluctant to grant the authority unless the need is clearly shown, and the proving of such need in the form of judicial evidence might be difficult. It would seem therefore desirable to authorize a fiduciary to borrow money if, in his judgment, the borrowing is desirable or necessary in order to prevent the loss of or increase the estate assets.

If the trustees are not, by the will or trust instrument, given a broader authority to make investments, they are limited to those specified in the Code as legal for trustees and other fiduciaries.72 Certainly if the fiduciary is not experienced in this respect, such a limitation is desirable. On the other hand, if the fiduciary is a corporate one, or if an individual is qualified by knowledge and experience to make investments, the limitations are probably not desirable. This matter is discussed in more detail in another section of this paper.

Guardians. A third item which may entail unnecessary expense in the administration of an estate is judicial proceedings for the appointment of a guardian for infants. In this state such proceedings may be avoided by naming a guardian in a will or by including a so-called "minority clause", which directs an executor or trustee to accumulate funds for an infant except for that portion which is needed for his welfare and support. On the other hand, when an infant is a party to a litigation he can only appear by a guardian ad litem. The general guardian or parent of the infant is not automatically the guardian ad litem, but the latter is specially appointed to that office.73 Thus, if any proceedings are brought for the interpretation of the will or trust, or for fiduciaries to be au-

authorized to take appropriate action, if any of the beneficiaries are infants, guardians ad litem will have to be appointed for them.

Reducing Size of the Estate to be Administered. Since almost all expenses of administration, including court costs, the estate attorney’s fee and the executor’s commission, are directly related to the size of the probate estate, such expenses can be reduced by inter vivos arrangements tending to reduce the size of that estate. The “probate estate” is a different thing from the “taxable estate”. The probate estate includes, generally speaking, only the property of the decedent at the time of his death. It is this estate which is administered and it is also this estate which is looked at when computing the South Carolina inheritance and estate taxes.

On the other hand, the federal estate tax is assessed on the “taxable estate” which includes property items specified in the Internal Revenue Code which are not a part of the probate estate. Thus the taxable estate, in addition to the probate estate, includes (a) all of the insurance on his own life owned by the decedent (it makes no difference to whom it is payable); (b) gifts by an incomplete trust (“incomplete” for tax purposes) and (c) gifts that are in contemplation of death.\(^74\)

The usual way of reducing the size of the probate estate is to give property away in the form of a revocable trust—retaining the income therefrom, or the right to designate the persons to whom the income should be paid. Such trusts are not recognized for either federal estate or gift taxes, or for federal income taxes, but they are not a part of an estate for purposes of administration, nor for state inheritance tax in South Carolina.\(^75\) Since they are not recognized for federal tax purposes, there is no problem of making them comply with the requirements for a complete gift or of the gift being “in contemplation of death”.

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\(^74\) §2480 (c) of the South Carolina Code provides that there shall be included in an estate, for the purpose of the state inheritance tax, any gift to a relative by blood or marriage made within five years of death, as such gifts shall be presumed to have been in contemplation of death.

5. The Federal Estate Tax—Its Minimization:76

Normally it is a fairly simple accounting problem to compute the estate taxes. Not so simple however, is the arranging of an advance program for their minimization. A full and complete discussion of this problem would undoubtedly require several volumes,77 but here it must be compressed within the confines of a single article. Accordingly many important subjects, such as gifts in contemplation of death and that of the "basis" of property owned by a taxpayer, can only be summarized not developed.

Naturally no one, in his right mind, wishes to pay more taxes than he has to. Unfortunately the Bureau has adopted the policy of assessing the maximum tax possible in a particular transaction, regardless of the taxpayer's actual intention. Because of this and also because many lawyers have evolved schemes solely for tax avoidance, the amount of estate tax in a particular case may depend on whether the testator's tax lawyer was more or less astute than the Bureau attorneys. Federal taxes have now become an unbelievably important item in family budgets. The income tax rate rises to over 90% of the taxpayer's annual income

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76. The discussion is limited to the federal estate tax, and does not include references to the state tax, except in certain important particulars. The state tax is relatively unimportant. Its inheritance tax rates are from 1% to 14%. In addition there is a state estate tax imposed up to the 80% credit of the federal basic tax, discussed below. The federal estate tax consists of two separate taxes, one called the basic tax and one called the additional tax. The basic tax is applicable only to estates of $100,000 and over and an 80% credit against this tax is allowed for any state inheritance or estate taxes payable. Prior to the marital deduction, this credit would normally be sufficient to take care of South Carolina inheritance tax, where the estate was larger than $100,000. Now, however, if the marital deduction is taken in full, the credit would not be sufficient for the state inheritance taxes unless the estate was substantially greater than $200,000. The additional tax ($60,000 exemption) is the important one.

77. Paul's Federal Estate and Gift Taxation is the standard work in the federal estate and gift tax field. It comprises two volumes of some 1600 pages, with a 1946 supplement of over 900 additional pages.
and the estate tax rate to 77%. Last year Congress recognized that these taxes were in reality a family, rather than an individual, burden and enacted amendments to the Code which authorized the total income of a married couple to be split between them, thereby permitting the total tax to be computed by the application to their joint income of the rate attributable to only one-half thereof. In the estate tax field, the amendment introduced a marital preferment which permits bequests by will or inheritance to a surviving spouse to be deducted from the total taxable estate, up to 50% of the total “adjusted gross estate”. The amendment to the gift tax law permits one-half of a gift to a spouse to be deducted from the taxable gift, and permits gifts to third persons to be split between the spouses.

In order to take advantage of the marital deduction, it is necessary that the bequest or devise, or the gift, conform with certain technical requirements so that it will qualify for deduction from the estate or the gift. The requirements for qualification for deduction from the estate are discussed in the next section, but the requirements for qualification in the case of the gift tax are discussed later under inter vivos gifts.

78. The tables below give some round figure illustrations of the application of the tax in 1931 and today.

### FEDERAL INCOME TAX

<table>
<thead>
<tr>
<th>Taxable Income</th>
<th>1931 Tax</th>
<th>Present Tax (assuming separate return)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 15,000</td>
<td>$ 590</td>
<td>$ 3,900</td>
</tr>
<tr>
<td>25,000</td>
<td>1,155</td>
<td>8,600</td>
</tr>
<tr>
<td>50,000</td>
<td>4,664</td>
<td>23,300</td>
</tr>
<tr>
<td>100,000</td>
<td>15,813</td>
<td>58,000</td>
</tr>
</tbody>
</table>

### FEDERAL ESTATE TAX

<table>
<thead>
<tr>
<th>Taxable Estate</th>
<th>1931 Tax</th>
<th>Present Tax (assuming no marital deduction)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 100,000</td>
<td>$ 0</td>
<td>$ 4,800</td>
</tr>
<tr>
<td>160,000</td>
<td>700</td>
<td>20,700</td>
</tr>
<tr>
<td>300,000</td>
<td>4,500</td>
<td>68,000</td>
</tr>
<tr>
<td>1,000,000</td>
<td>40,000</td>
<td>300,000</td>
</tr>
</tbody>
</table>

79. §812 (e) of the Internal Revenue Code. The term “adjusted gross estate”, a new one in the estate tax law, is defined to be the gross estate less the deductible expenses specified in §812 (b). The marital deduction percentage while generally spoken of as 50% of the adjusted gross estate is not that, since it can only be computed after the estate taxes on the remainder of the estate has been taken into account. (I. R. C., §812 (e) (1) (E) (i).
(a) The Marital Deduction in the Estate Tax:

To qualify for the marital deduction the bequest or devise to the surviving spouse must be so absolute that there can be no question that the property, if unconsumed, will be taxable in the spouse's estate upon the latter's death.\(^80\) A property interest which will terminate upon the spouse's death or earlier, will not qualify for the marital deduction if a continuing interest in the same property is a gift or bequest from the testator to someone other than the spouse.\(^81\) A bequest or devise to a spouse, which will be entirely consumed during her lifetime qualifies. But by specific exception, where the testator's executor or trustee is directed to purchase such an interest (for example an annuity) for a surviving spouse it does not qualify.\(^82\) This specific exception produces the odd result that if a testator leaves his widow an annuity, it qualifies for the marital deduction, but if he directs his executor to use estate funds to purchase an annuity for his widow, it does not qualify.

The bequest or devise to the surviving spouse must be to her alone. In other words, it cannot be left in a joint tenancy with survivorship rights, nor can anyone else be given the right to share in the income therefrom. If, therefore, a testator desires to create a trust for his widow and children, a single trust cannot qualify for the marital deduction; separate trusts must be created for them. A bequest or devise, however, may be absolutely to a spouse even though the interest left to her is an undivided one. That is to say, a surviving spouse may receive by bequest or devise an undivided interest in real or personal property, but since the spouse

\(^80\) We can assume that there will be much litigation and probably helpful judicial interpretations on the question of when such a transfer is sufficiently absolute for the marital deduction. Heretofore, litigation has often occurred on the contention by the taxpayer, that a gift by testamentary trust with a surviving spouse having the right, under certain circumstances, to use the corpus, was a "terminable" interest, so as to save the "second" tax. Under the marital deduction, if the gift is not a terminable interest the "first" tax will be avoided. Therefore, it is reasonable to assume that "adroit legal minds" will be devoted to trying to prove that such a trust is not a terminable interest rather than, as before, trying to prove that it was a terminable interest.

\(^81\) I. R. C., §812 (e) (1) (B) (i) (ii) and Reg. 105, §81.47a and 81.47b (d).

\(^82\) I. R. C., §812 (e) (1) (B) (iii) and Reg. 105, §81.47b (e).
has, in South Carolina, a right of partition, the bequest or devise qualifies for the marital deduction. If the devise or bequest is in the form of a testamentary trust and the spouse is given the power to consume the entire fund or is given a power of appointment of the entire fund running to her estate, the bequest qualifies for the marital deduction; but if the right to consume or to appoint is of a portion only, no marital deduction whatever is allowed. The fact that contingent takers of the remainder are named, or that other persons are named to take upon failure of the spouse to appoint to her estate, makes no difference.

Many testators will certainly wish to establish testamentary trust for their surviving spouses, with their children named as the ultimate beneficiaries. In order to qualify such trusts for the marital deduction, they will naturally provide that the spouse shall have a general power of appointment over the property, including the power to appoint the property to her estate. But in South Carolina a general residuary legacy includes any property over which the testator had been given a general power of appointment. In this state therefore, it may be desirable to limit the spouse’s power of appointment to her own estate. This is quite sufficient to qualify for the deduction.

The marital deduction, where it is taken advantage of, will always reduce the estate tax in the case of the first spouse to die. It may not however, result in the over-all

83. Reg. 105, §81.47a (c). It is interesting to consider the hiatus, or no-man’s land, of transfers to a spouse that will not qualify for the marital deduction, but at the same time are sufficiently absolute to make the property taxable in the surviving spouse’s estate. This hiatus should certainly be avoided.

84. I. R. C., §812 (e) (1) (F) and (G) and Reg. 105, §81.47a (c). See also discussion of §812 (e) (1) (D) (E) (F) and (G) in the report of the Senate Finance Committee on the changes made by the Revenue Act of 1948.

85. In the case of Thomson v. Ehrlich, 148 S. C. 330, 146 S. E. 149 (1928) it was held that a residuary devise did not include real property over which the testatrix had a general power of appointment. Thereafter the Code was amended by the addition of §8928 to provide that a residuary bequest or devise should include real and personal property over which the testator has a power of appointment. This section does not apply if the power of appointment must be exercised specifically, nor does it apply if the residuary clause of the will indicates that it is not intended to cover the appointive property.
reduction of estate taxes. Unless the property is consumed by the surviving spouse, it will be taxed in that spouse's estate and if the surviving spouse has as large or a larger estate than the deceased spouse, the tax will be as great or greater. The use during the remainder of the surviving spouse's lifetime of the money which otherwise would be used to pay the tax, may or may not be compensatory. As the amendments to the Code which introduced the marital deduction also repealed the section providing for a credit for property previously taxed, in the case of a spouse, a bequest to or inheritance by a surviving spouse of an entire estate, might cause the over-all taxes to be greater than they would have been prior to the amendment.

Whether or not and the extent to which the marital deduction should be used presents questions which should be given serious consideration. The marital deduction, of course, as has been pointed out earlier, may be used in the form of a testamentary trust. But wherever the marital deduction is not used, a testamentary trust presents major tax advantages.

(b) The Testamentary Trust:

The primary estate tax saving factor in the testamentary trust is its saving of the "second tax". That is to say, in all situations there will be an estate tax on the taxable estate of the testator at his death, and in the case of an outright bequest to a beneficiary there will also be an estate tax upon the inherited property on the death of the beneficiary.66 If the beneficiary is not the spouse, and dies within five years of the testator, the Code permits a deduction of the property previously taxed.67 Where, however, the beneficiary does not receive the property outright, but only receives the use of the property, or its income, for his or her lifetime, by use of the testamentary trust, the property is not included in the estate of the beneficiary at the beneficiary's death, re-

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66. In addition to the "second tax" there could also be a "third" or more estate tax on the same property, all of which, except one, can be avoided by the use of the testamentary trust, but only one of which can be avoided by the marital deduction.

67. I. R. C., §§812 (d), Reg. 105, §§1.41. See Paul, Federal Estate and Gift Taxation, §§11.29 and 11.30. In South Carolina a "second tax" is payable if the beneficiary dies after one year from the date of the death of the first decedent. 1948 Supplement to the 1942 Code, §2491.
gardless of when that occurs.

If a testamentary trust qualifies for the marital deduction, even though it is not effective taxwise (since it might be in excess of the 50% limitation) the "second tax" cannot be avoided, nor can there be a deduction for property previously taxed. On the other hand, if the beneficiary of the trust is not a spouse, or if it is not intended as a marital deduction trust, the testamentary trust is very definitely the only way in which the "second tax" can be saved. The other important tax considerations in the testamentary trust are the power to consume principal and the power to appoint the remainder interest.

(1) Power to Consume Principal

If the life beneficiary of a testamentary trust has the right to appropriate or consume all or any part of the principal trust fund, this right makes the portion of the trust principal, which can be obtained or used, although unconsumed in fact, taxable in the estate of the beneficiary.\footnote{88} Treasury Regulation 105, Sec. 81.24 (b) (1) specifically says:

"For example, if a settlor transfers property in trust for the life of his wife, with a power in the wife to appropriate or consume the principal of the trust, the wife has a (taxable) power of appointment."

Where the right to obtain or consume the principal of the trust is subject to a limitation, the result from the estate tax viewpoint depends entirely on the nature of the limitation. If it is purely as to the amount of invasion permitted, such as a limited sum annually, the portion of the corpus includible in the estate of the beneficiary will be the annual amount of invasion of principal permitted, multiplied by the life expectancy of the beneficiary. If the amount of the invasion of principal permitted depends on the income earned by the trust fund, the earnings will be estimated and the deficiency multiplied by the life expectancy of the beneficiary.\footnote{89} Where the right of the beneficiary to invade prin-

\footnote{88. I. R. C., §811 (f). Prior to the 1942 amendments to the Code, a power in the beneficiary to consume the principal of the trust did not cause the unconsumed principal to be taxed in the beneficiary's estate. Estate of Gertrude L. Royce, 46 BTA. 1090 (1942). The Commissioner formally acquiesced in this holding (1942-2 Cum. Bull. 16).

89. Banker's Trust Co. v. Higgins, 158 Fed. (2d) 957 (CCA 2, 1947).}
principal depends on the occurrence of some outside event, such as sickness, the question is more or less in an unsettled state. If the beneficiary is permitted to decide whether or not the occurrence permitting an invasion is applicable, or if the invasion is permitted upon a sufficiently definite "external standard" so that the beneficiary can enforce legally her right of invasion, the corpus is probably includible, but not otherwise.90

If the right to invade the principal of a testamentary trust is given to an independent trustee, and he is authorized to make the invasion for the beneficiary only in "his untrammeled discretion", the corpus is not included in the beneficiary's estate.91 Moreover, the power in the trustee is specifically a non-taxable power.92 A distinction must be recognized between authorizing and directing an independent trustee to invade principal for a beneficiary upon the happening of certain enumerated events. That is to say, where an independent trustee is authorized to invade principal for the beneficiary only in certain events, the corpus is clearly not taxable in the beneficiary's estate. The trustee has "untrammeled discretion" only upon the occurrence of any of the enumerated events. On the other hand, where a trustee, even though independent, is directed to invade the principal fund for the beneficiary upon the happening of certain enumerated events, and the right of the beneficiary to the principal in such events is absolute, the question of taxability depends on the probability of any of the enumerated events happen-

90. Estate of Virginia H. West, 9 T.C. 736 (October 22, 1947). Where the trust is a testamentary one, naturally no question could arise as to whether the "external standard" is sufficiently definite so that the grantor, as a trustee, could be said to have no retained power. Logically a sufficiently definite "external standard" to avoid the inclusion of an inter vivos trust in a grantor-trustee's estate should be precisely the same as that which will make the testamentary trust taxable in the beneficiary's estate. See Estate of John J. Toeller, 6 T.C. 832; Estate of Milton J. Budlong, 7 T.C. 756; Jennings v. Smith, 161 Fed. (2d) 74.

91. The distinction between invasion in the discretion of a trustee and invasion by a beneficiary was clearly brought out in Commissioner v. Dravo, 119 F. (2d) 97 (CCA 3, 1941). See also Estate of Walter E. Frew, 8 T.C. 1240 (June 24, 1947); Jennings v. Smith, 161 Fed. (2d) 74; Estate of J. M. Budlong, 7 T.C. 756; Estate of John A. Lucey, 6 T.C.M. ... (October 28, 1947).

92. I. R. C., §811 (f); see also Reg. 105, §81.2.
ing. If the occurrence upon which the trustee is directed to invade principal for the beneficiary is unlikely to occur, the principal will probably not be included in the beneficiary’s estate. On the other hand, if the enumerated events are so broad and general that it would be extremely difficult to say that they will or will not occur, the principal is likely to be included. Thus, if the trustee is directed to invade principal for the “comfort”, “happiness” or “welfare” of the beneficiary, the power to invade for the beneficiary is so broad and general that it may not be in the trustee’s “untrammeled discretion” and it is quite likely that the entire corpus would be included in the estate of the beneficiary. 93 These views have also been controlling in determining whether or not a charitable deduction is allowable where the charitable remainder is after a life income with invasion permitted in the discretion of trustees. 94

If the life beneficiary of an inter vivos trust is given the right to invade the principal, or if trustees are directed to invade the principal for the benefit of the life beneficiary, the results may be somewhat different. This subject is discussed under the inter vivos gift in trust.

(2) Powers of Appointment

The usual understanding of a power of appointment is where the life beneficiary of a trust has the power to name or appoint the remaindermen. This power over trust principal is an extremely useful arrangement, and is best used to avoid the inflexibility which otherwise would invariably result from a gift to take effect in the future. Its use enables the owner of property to defer its ultimate division among the “objects of his bounty”, until consideration can be had of factors which he could not possibly have foreseen at the time he made his will, or created the trust, such as the needs of his descendants at the time of the death of his child or grandchild, etc. 95 In view of the social and the economic

93. See Estate of Mary E. Wenger, 42 BTA. 225.
94. Ithaca Trust Co. v. U. S. 279 U. S. 151; Merchant’s National Bank v. Commissioner, 320 U. S. 256; Henslee v. Union Planter’s National Bank and Trust Co., 335 U. S. 239 (January 3, 1949); see also Estate of Winfred Runyan, 5 TCM 531 (June 28, 1946); Estate of L. H. Elmer, 6 TC 944; Estate of Arthur M. Briggs, 5 TCM 1114 (December 26, 1946).
95. See Paul, Federal Estate and Gift Taxation, Chapter 9.
desirability of the use of powers of appointment, and having in mind that the object of the estate tax is to tax property transfers occurring by reason of the owner's death, the conclusion is inevitable that the power in a donee of a power to transfer the property to "strangers" should be taxed, but that the power only to allocate or distribute the property among the objects of the donor's bounty, in accordance with their needs, or with what it is thought the donor would have wished, should not be taxed. The Statute attempts to follow this distinguishing line, and we find that a power to appoint property to one's own estate (which is equivalent to ownership) and to "strangers", that is, to persons other than the donor's spouse, and descendants or the donee's spouse and descendants, makes the power taxable. 96 Also a person who is a "stranger" and has had no beneficial enjoyment of the property, but who has the limited and discretionary power to name the beneficiaries among a restricted class, is not taxed for having that responsibility. Thus, a friend is given the right to decide which children of the testator takes certain property; this is not a taxable power; or an independent trustee is given the right to say which of the descendants of the testator has the greatest need, and this is not taxable.

A customary form of testamentary trust with a non-taxable limited power of appointment would be a trust created by the will of a testator providing that his child should receive the income therefrom for his life and at the child's death the principal of the trust should be distributed to any or all of the children of the income beneficiary in accordance with directions in a will or deed of the income beneficiary. The testator, if he so desired, could indicate what considerations should influence the directions for ultimate distribution among his grandchildren. 97

96. I. R. C., §811 (f) and Reg. 105, §81.24.
97. Before October 21, 1942 (the effective date of the amendments reflecting the present law) many persons had been given powers of appointment, which were not then taxable but which were made taxable by the 1942 amendments. Congress accordingly provided that any power given prior to the effective date of the amendments can be renounced free of gift tax in whole or part at any time prior to July 1, 1950. This date may or may not be further extended. If it is not, any renunciation of powers subsequent to that date will probably be taxable as a gift to the persons taking in default of the exercise of the power.
In South Carolina the tax is an inheritance tax and not an estate tax. The Code provides that the transfer of property, either by the exercise of a power of appointment or by default in its exercise (by the death of the donee of the power without its exercise, or by the expiration of the time for its exercise), shall be taxable under the inheritance tax provisions. While the Code is silent on the subject, since the tax is on inheritance, it would seem that property devised or bequeathed under a power of appointment would not be taxable in the estate of the donor of the power since it would not be known, at the donor's death, who the ultimate beneficiaries would be.

(3) Conclusion as to a Testamentary Trust

A testamentary trust for a spouse will not result in the reduction of over-all estate taxes as before the Revenue Act of 1948, unless a testator wishes to take advantage of the marital deduction by leaving other property to his spouse. However, the testamentary trust device may, for a surviving spouse, be used so as to qualify it for the marital deduction and still retain its many non-tax advantages. The Code permits a trust to qualify if the spouse may consume the principal or has an unlimited power to appoint the remainder to her own estate, but regardless of this it continues as a very beneficial means of providing income and, in a trustee's discretion, principal to a widow and children without business experiences.

On the other hand, a testamentary trust for children or other objects of a testator's bounty, and even for non-marital deduction property left to a surviving spouse, is highly advantageous taxwise. It is the only effective legitimate device for avoiding subsequent estate taxes on the same property in the beneficiary's estate. In those instances where a surviving spouse has a substantial separate estate, it may be unwise to take advantage of the marital deduction, especially where the age of the spouse is such that no substantial advantage can be anticipated from the use of the money resulting from the tax savings in the estate of the first spouse to die. In such case a testamentary trust is clearly indicated.

98. §2480 (d) (S. C. Code of 1942).
(c) *Inter Vivos Gifts*:

The testamentary trust is established by will and is effective only upon the death of the testator. The *inter vivos* gift, on the other hand, is made during the lifetime of the donor. It not only is a useful device in reducing estate taxes, but is effective also for the reduction of income taxes (where the gift is not to a spouse). As it is made during the lifetime of the donor, it presents several tax problems which do not arise from the use of the testamentary trust. If the gift is found to be in "contemplation of death", it is ineffective from an estate tax viewpoint; if it is in trust, the trust must be complete, that is, the donor must not have retained income or the right to name beneficiaries; and there must be no condition that the beneficiary survive the grantor. As the Code imposes a separate tax on gifts, there must be a consideration of the gift tax liability. The tax basis of property given away also differs materially from the tax basis of inherited property; this also must be considered.

However, where a gift is sufficient, and is advisable, the advantages are real. There may be material savings in the income tax and the gift tax rates are substantially lower than the estate tax rates.99 Here the marital deduction should always be used and is of great importance. The $30,000 exemption, as well as the annual exclusion of $3,000 to each donee of a gift of a present interest100 is doubled by

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99. The gift tax rates are uniformly three-fourths of the estate tax rates.

100. In using the words "present interest" and "future interest", Congress apparently did not have in mind that these are words of art in conveyancer's language. What is meant, is whether or not the beneficiary has an immediate use and enjoyment of the gift. An outright gift to an adult presents no question. Neither does a gift in trust to an adult where the beneficiary is entitled to the income, even though he is not the remainderman. However, gifts in trust for children are more likely than not to be held to be gifts of future interest. This would certainly be the case where the trustee is directed to accumulate the income until the child's majority. In Fondren v. Commissioner, 324 U. S. 18, it was held that a trust where the income was to be paid out only as the trustees believed it was necessary for the support, education or maintenance of the children was a gift of a future interest. The Court held that the children did not have an unqualified right to the enjoyment of the gift at the present. This whole question is discussed at length in an article in the October 1948 issue of "Taxes", (Anderson, *Gifts to Children and Incompetents*, 26 Taxes, 911).
reason of the marital deduction. A gift moreover, removes the property given away from the top bracket of the estate tax to the low bracket of the gift tax. Thus, a net gift of $10,000 (that is, after the exemption and exclusion) would be subjected to a gift tax of 2 1/4% on the first $5,000 and 5 1/4% on the next $5,000, or a total of $375; but if the donor has a taxable estate of $100,000, the gift would have been subjected to a 30% estate tax or $3,000. By making a gift of income producing property, income taxes may also be saved. For example, in the illustration used; suppose the property valued at $10,000 produces $1,000 annual income. If the donor is in a 50% tax bracket, he received only $500. spendable income. If, on the other hand, the donee is in a 20% income tax bracket, $800 spendable income is retained.

(1) The Marital Deduction in Gift Taxes

Where the gift is to the spouse of the donor, the marital deduction permits the amount of the gift to be reduced by one-half. If the gift is outright, naturally no question as to its qualification for the deduction arises. But where it is in trust, it cannot qualify if it is of a terminable interest. The type of interest which is terminable has been discussed under the marital deduction in the estate tax and since it is the same in both instances, will not be further discussed here. A gift, whether in trust or not, cannot qualify for the marital deduction if it is of a joint interest, with survivorship rights, with any person other than the donor spouse.

101. In his Mid-year Economic Report to Congress on July 11, 1949, President Truman recommended the immediate increase of estate and gift tax rates so as "to restore the revenue from this source lost under the Revenue of 1948" (the marital deduction). Promptly after this recommendation a bill was introduced in Congress to reduce this exemption in gift taxes to $15,000 and to reduce the annual exclusion to $1,500. Probably this bill will not be enacted, but it is highly probable that the exemptions and exclusions will be somewhat reduced.

102. There is no South Carolina gift tax. However, it is provided that all gifts to blood or marriage relatives made by a decedent within five years of his death are presumed to have been in contemplation of death. §2480 of the Code.

103. I. R. C., §1,004 (a) (3) (A), and Reg. 108, §86.16a (a).

104. I. R. C., §1,004 (a) (3) (B), and Reg. 108, §86.16a (b) and 86.16b.

105. I. R. C., §1,004 (a) (3) (D).
If the gift is to a third person, that is, to someone other than the spouse of the donor, it is considered a gift of one-half by each spouse. This permits two exemptions and exclusions but in addition, like the split income provisions of the 1948 Revenue Act, it will permit the gift tax rate to be that applicable to only one-half of the taxable gift. For example, if the net gift is $100,000, by treating it as one-half by the husband and one-half by the wife the rate of 18½% applicable to $50,000, instead of the rate of 22½% applicable to $100,000, would apply. Probably to obtain the benefit of the lower rate it will be necessary for both the donor and the spouse to file gift tax returns. While the statute does not say anything about separate returns being filed, nor about the tax rate bracket applicable to such gifts, separate returns would have to be filed if advantage is taken of the new Code provisions. The statute does, however, provide that if the gift is to be treated as one-half by each spouse, consents must be filed with the Commissioner.

Where the donor dies and a gift which has been attributed equally to a husband and wife, is deemed to have been in contemplation of death, the corpore is considered to be taxed in its entirety in the donor's estate.

(2) Gifts in Contemplation of Death

If a gift is in contemplation of death, it is included in the taxable estate of the donor decedent. A credit on the estate tax is given for the gift tax actually paid, but if the gift is found to have been in contemplation of death, any estate tax advantage resulting from the gift is wholly lost. Also lost are the gift tax exemptions and exclusions. Moreover, the property will have the tax “basis” of gift property rather than inherited property, even though it is taxed as though it was the latter. This question of basis may be vitally important in connection with gifts and is discussed more fully in a later section.

What is meant by “contemplation of death”? The Court and the Treasury Department are not fully agreed on this.

106. I. R. C., §1,000 (f).
107. I. R. C., §1,000 (f) (B); 1,000 (f) (2).
108. The Revenue Act of 1948 provides that the donor shall receive the full credit for the gift tax paid, I. R. C., §813 (a) (2) (C).
109. I. R. C., §811 (c), and Reg. 105, §81.16.
question. The Treasury Regulation says in part: (Reg. 105, Sec. 81.16).

"The phrase "contemplation of death", as used in the Statute, does not mean, on the one hand that general expectation of death such as all persons entertain, nor, on the other, is its meaning restricted to an apprehension that death is imminent or near. A transfer in contemplation of death is a disposition of property prompted by the thought of death (though it need not be solely so prompted). A transfer is prompted by the thought of death if it is made with the purpose of avoiding the (estate) tax, or as a substitute for a testamentary disposition of the property, or for any other motive associated with death. The bodily and mental condition of the decedent and all other attendant facts and circumstances are to be scrutinized to determine whether or not such thought prompted the disposition."

From this Regulation, it would seem that where the motive for a gift includes, among others, that of saving estate taxes, the gift will be in contemplation of death, even though avoiding the estate tax was not the controlling or dominant motive. On the other hand, the Supreme Court has very clearly indicated that only where the controlling or dominant motive is estate tax avoidance will the gift be in "contemplation of death".

In United States v. Wells,110 one of the leading cases on the subject of gifts in contemplation of death, the Supreme Court said that a gift can be inspired by mixed motives, and that it should be included in the donor’s estate only if the thought of death was the "controlling motive" for the gift.

"If it is the thought of death, as a controlling motive prompting the disposition of property, that affords the test it follows that the statute does not embrace gifts inter vivos which spring from a different motive."

This decision was re-affirmed in the more recent case of Allen v. Trust Company of Georgia.111 There the gift in trust was originally made for "life motives" but the donor retained a "string" which was only relinquished when he found the re-

tained "string" would make the corpus includible in his estate. In holding the gift not to have been in "contemplation of death", despite the fact that the "string" was relinquished only to avoid the estate tax, the Court said that the motive for the original gift (to protect children from business misadventures) was controlling and reiterated its holding in United States v. Wells, supra, that for a gift to be in contemplation of death, the controlling motive in making the transfer must be the savings in estate taxes. The Court recognized that in making a gift the savings of estate taxes are always considered, saying:

"* * * every man making a gift knows that what he gives away today will not be included in his estate when he dies. All such gifts plainly are not made in contemplation of death in the statutory sense. Many gifts, even to those who are the natural and appropriate objects of the donor's bounty, are motivated by "purposes associated with life, rather than with the distribution of property in anticipation of death."

The Tax Court and lower federal courts have consistently followed the above Supreme Court decisions rather than the Treasury Regulations so that if a gift was made primarily for reasons associated with "life", it will not be held to have been in contemplation of death, despite the fact that consideration was given to the estate tax savings.112

Perhaps a leading motive deemed to be associated with "life" is the saving of income taxes. A gift made for this purpose is not considered particularly "commendable"113 but the reason is a valid "life motive".114 To provide others with independent incomes adequate for their needs is a sufficient "life motive",115 and the fact that they are dependent on the donor for support, or that they are the object of the donor's bounty, would not seem to be material. Other reasons for making a gift, which have been held to be "life mo-

114. Estate of J. B. White, 21 BTA 500; Estate of B. P. O'Neal, 6 TCM 713.
as: fear of incompetency; prevention or settlement of litigation; fulfillment of prior promises to children; gifts made in accordance with an established custom or pursuant to a fixed plan; to equalize gifts to children; to teach the donees to handle property and to give them experience in business responsibilities; relief from the burden and responsibilities of business management; the protection of property against hazards of age and business; marriage settlements on children; helping a child in a business venture; the education of grandchildren.

Naturally the "life" in question is that of the donor of the gift. Accordingly it is necessary that he have a reasonable expectation that his "life" will continue. Thus his age and health are of importance. Of these two, the health of the donor, or rather, his state of mind as to his health, is by far the most important since the life expectancy of even the oldest person continues until a very advanced age is reached. For example, in Estate of Oliver Johnson, a gift was held not to have been in contemplation of death though the donor was over ninety when the gifts were made. It was mentioned as of some importance that the donor looked and acted twelve or fifteen years younger than he actually was. On the other hand, even if a donor is comparatively young, if he is suffering from a fatal illness and has knowledge of that fact, the gift will be included in his estate. But a transfer will not be held in contemplation of death where

118. Estate of Heiver Shausen, 18 BTA 218.
122. Estate of Romberger, 21 BTA 193; Estate of Johnson, 10 T. C. 680.
125. Commercial National Bank, 36 BTA 239.
126. Estate of Mary Torrance, 6 T.C.M. 1249 (1947).
128. 10 T.C. 680 (1948).
the donor did not know he was in a serious physical condition prior to the gift, even though the gifts were made within a few months of his death.\textsuperscript{130}

Motives associated with death aside from the savings of estate taxes have been held to include gifts made for the purpose of avoiding marital claims upon a proposed remarriage.\textsuperscript{131}

Important considerations on the question of whether or not a gift is a substitute for a testamentary disposition are: Whether the gift was made simultaneously with the execution of the will.\textsuperscript{132} Whether or not the gift represents a "material" part of the total estate of the donor and whether or not recognition of the gift is made in the donor's will, such as bequests equal to the gift to similar relatives. As a practical matter the motive and the circumstances are not important if the gift is made when the donor is comparatively young and vigorous. However, it will probably be unwise to accumulate evidence showing the gift not to be in contemplation of death. Such an accumulation would indicate that some thought was given to the matter at the time of the gift, and the estate tax was prominently in the mind of the donor. In Proctor \textit{v. Hassett},\textsuperscript{133} the government argued that memoranda executed at the time of the gifts, explicitly denying that they were made in contemplation of death, indicated that they were so made because it showed an awareness of the estate tax consequences of the gifts.

Treasury Regulation 105, Section 81.16 provides that an \textit{inter vivos} gift made within two years of the death of the donor is presumed to have been in contemplation of death unless the contrary can be shown.

"Any transfer without an adequate and full consideration in money or money's worth, made by the decedent within two years of his death, of a material part of his property in the nature of a final disposition or distribution thereof, is, unless shown to the contrary, deemed to have been made in contemplation of death."

\textsuperscript{130} Estate of Earnest Hinds, 11 T.C.\textemdash (1948).
\textsuperscript{131} Estate of B. H. Kroger, 2 T.C.M. 644 (1943).
\textsuperscript{132} See O'Neal \textit{v. Commissioner}, 170 Fed. (2d) 596 (CCA 5, October 26, 1948).
The federal estate tax return (form 706) requires the listing of all such gifts. In addition, it also requires the listing of all *inter vivos* gifts of over Five Thousand ($5,000.00) Dollars regardless of when made, and of all trusts created by the decedent at any time but which were in effect at his death. As a practical matter, the two year presumption is unimportant since the proof which the executor is required to produce in order to rebut the presumption is no greater than the proof required to show that gifts made before two years prior to the decedent’s death were not in contemplation of death. However, the South Carolina Code provision that gifts within five years to relatives by blood or marriage are presumed to have been in contemplation of death presents a more difficult question. The language of the statute makes it seem that the presumption was intended to be conclusive, but such an interpretation would undoubtedly make the provision unconstitutional. Because of inadequate enforcement machinery, the State will, in this regard, probably follow the rulings of the federal government.

As we have seen, gifts made purely to save income taxes are definitely not “in contemplation of death”. But if such gifts are in trust and the grantor is taxable on the income of the trust, they fail in that purpose. Where the motive gave the gift immunity from being held in contemplation of death, does the immunity continue despite the failure of the motive? It may be argued that “motive” and “realization” are two different things; that a “life motive” prompts the transfer and whatever occurs thereafter is immaterial. It may be argued on the other hand, that every one is presumed to know the law. The Court could say that a motive prompting a transfer cannot be shown where, because of a failure to comply with law, that motive or purpose failed. However, the dominant consideration is the motive prompting the gift. It would seem under the Code as well as cases that it would

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134. The fact that a gift in trust complies with the requirements of the government so as to escape the estate tax does not necessarily mean that it is also sufficient to escape the income tax. For example, where a donor retains a power to direct the trustee in his investments, the gift, from the income tax standpoint, is nullified, as the donor remains taxable on the income therefrom. From the estate tax viewpoint, however, the gift is complete and the property is not included in the donor’s estate.
be immaterial what occurred after the motive for the gift was established.

If a gift is outright and successfully avoids the "contemplation of death" pitfall, that is the end of the matter. But if the gift is in trust, the legal requirements for a complete trust must be satisfied. We shall therefore next discuss those requirements.

(3) Gifts in Trust

As in the case of gifts in contemplation of death, where a gift tax is paid on a gift in trust but the trust is held to be ineffective for estate tax purposes, in computing the estate tax a credit is allowed for the gift tax actually paid.\(^{135}\) Nevertheless, the gift tax exemptions and exclusions are lost and, although the gift is taxed at the estate tax rates, the property has the tax basis of gift property rather than inherited property.

There are two basic requirements for a complete gift in trust. They are: First, that the gift not be, directly or indirectly, conditioned on the death of the donor and second, that the donor not retain, alone or with anyone else, the right to designate or change beneficiaries, amend, revoke, alter or terminate the trust, or in any other way affect the beneficial enjoyment of the trust by the beneficiaries.

(i) Income Retained by the Donor:

On January 17, 1949, the Supreme Court decided in the case of Commissioner v. Church, that a gift in trust with the grantor reserving a life income from the trust was a transfer conditioned upon the death of the grantor.\(^{136}\) Prior to that decision, the Court had held on March 2, 1931, in May v. Heiner,\(^{137}\) that such a trust was not a transfer conditioned upon the death of the grantor. Although the day after the May v. Heiner decision, Congress amended the law by a Joint Resolution to provide that a transfer in trust with a reserved life income to the grantor was includible in his estate at his death, it was held that the Joint Resolution was not retroactive.\(^{138}\) Accordingly, until the Church decision on January

\(^{136}\) 335 U. S. ....... (January 17, 1949).
\(^{138}\) Hassett v. Welch, 303 U. S. 303 (1938).
17, 1949, a trust created prior to March 3, 1931, was not taxable in the grantor’s estate merely because he retained the income therefrom for his lifetime.

However, on October 25, 1949, Congress in effect overruled the Church case by amending Sec. 811 (c) of the Internal Revenue Code. The amendment provides that transfers made before October 8, 1949 shall not be included in the estate of the transferor, solely by reason of the transferor retaining the income from the transfer, if the property would not for that reason have been included in the estate of the transferor prior to the Church decision on January 17, 1949.

The distinction heretofore made between (a) a reserved enjoyment of the property during one’s lifetime (such as a reserved life income), and (b) a transfer conditioned upon one’s death was necessary because of the decision of the Supreme Court in the May v. Heiner case, supra. This distinction is now, of course, unnecessary by reason of the Supreme Court’s decision in the Church case as well as by the new Act, and has been removed from the Regulations as to transactions after the Church decision. As a matter of fact, the distinction seemed quite nebulous, and May v. Heiner has been characterized as “a very sad mistake”.139

If the income or other enjoyment is not actually retained by the grantor but is used to take care of his legal obligations, the trust is nevertheless includible in his estate—the grantor is considered as retaining the income.140 Where the income may be so used at the election of the beneficiary-dependent, the same result follows, that is, the trust corporea is included in the grantor’s estate.141 Where someone other than the beneficiary-dependent has the right to direct the trustee in this respect, the question is an open one. But probably if the person who has the right to direct the trustee is not “independent” of the grantor, the corporea will be included in the grantor’s estate, on the theory that if the person who has the right to direct the trustee is not “independent” his judgment might be influenced by the grantor. On the other hand, if independent trustees are given the untrammeled discretion to apply the

141. See footnote 140, supra.
income for the support of the grantor's dependents, the grantor is not considered as retaining the income and the corporea will not be included in his estate.\textsuperscript{142}

If the question is the grantor's liability for income taxes rather than whether or not the trust will be included in his estate, the applicable rules are slightly different. If the income of the trust is specifically ear-marked for the support of the grantor's dependent, and is used for that purpose, the income is taxed to the grantor.\textsuperscript{143} But if the trustee (whether or not the grantor or whether or not "independent") has discretion to so apply the income, only the amount of income actually applied for such purposes is taxed to the grantor.\textsuperscript{144}

(ii) Possibility of Reversion:

Until October 25th of this year, the problem of whether a gift in trust was includable in the taxable estate of the donor because of the gift being conditioned on his death if there existed a "possibility of reverter", was a very active one. Now, however, this entire problem is moot. On October 25th, an Act\textsuperscript{145} known as the "Technical Changes Act of 1949" was enacted. Section 7 of this Act amends the Internal Revenue Code, Sec. 811 (c), and deals with the problem specifically. It provides that no transfers in trust prior to October 8, 1949, shall be part of the taxable estate of the grantor because of a possibility of reverter, where in fact a reverter did not occur, unless the reversion was expressed, in which case the trust is includable in the estate only if the reversion is valued at more than 5\% of the trust immediately prior to the death of the grantor. On transfers of October 8, 1949 and later, the trust is includable in the estate of the grantor if the interest of the beneficiaries is conditional upon their sur-

\textsuperscript{142} Commissioner v. Douglass, 143 Fed. (2d) 961 (CCA 3, 1944). In distinguishing the facts of the Helvering v. Mercantile-Commerce & Trust Co., supra, Judge Goodrich said:

"There is certainly an important difference of fact between the trust set up for the very purpose of providing for the settlor's legal obligation to his wife and the one in which disinterested trustees have an option to apply a portion of the income for the support of the settlor's minor child."


\textsuperscript{144} I. R. C., §167 (c).

\textsuperscript{145} Public Law 878 (H.R. 5268), 81st Congress, 1st Session, Approved October 25, 1949.
viving the grantor. Thus, there is no longer any question of a possibility of reverter.

This act is a legislative overruling of the Spiegel case which held that if under the State law there could be a failure of remaindermen and that if upon such failure the trust corpus would revert to the grantor, the entire corpus is includible in the grantor’s estate as a transfer conditioned upon his death.

The doctrine of a “possibility of reverter” was first established by the Supreme Court in the case of Helvering v. Hallock.\(^\text{146}\) In that decision the Supreme Court considered a number of trusts, but they all provided expressly that the trust should cease and determine, with the corpus payable immediately to the grantor, if the grantor outlived the beneficiary. Accordingly many lower federal courts and the Tax Court at first held that the Hallock decision applied only where the possibility of reversion was expressed in the trust instrument.\(^\text{147}\) Later decisions held that this was not the proper criterion and that the Hallock case did not apply where the possibility of reverter was remote.\(^\text{148}\)

All doubts as to the application of the Hallock case were resolved by the Supreme Court in the case of Spiegel.\(^\text{149}\) There the Court said that whether or not the reversion is expressed is immaterial, and that the sole question is whether under the law of the state, there could be any possibility whatsoever of a reverter to the grantor.\(^\text{150}\)


\(^{148}\) Frances Biddle Trust, 3 TC 832 (1944); Estate of Nina Companari, 5 TC 488 (1945); Estate of Edward P. Hughes, 7 TC 666 (1946); Estate of Lucy B. Platt, 6 TCM 110 (1947); see also Marion v. Glenn (U. S. D. C. of Kentucky, July 28, 1948) 79 Fed. Sup. 96; see the 1946 Supplement to Paul’s Federal Estate and Gift Taxation, §7.23.

\(^{149}\) 335 U. S. 701, January 17, 1949.

\(^{150}\) In many states a distinction is made between the failure of a trust created by will and the failure of a trust created \textit{inter vivos}. In fact in the Spiegel case, precedents indicating no reversion in the circumstances there, where the trust was created by will, were brushed aside by the Court on the ground that there all were concerned with the failure of trusts created by will. Apparently this distinction is not recognized in this state. Tyson et al v. Weatherly et al, 214 S. C. 336, 52 S. E. (2d) 410.
The question of whether or not a “possibility of reversion” existed in a given situation was at issue in hundreds of cases. Moreover, this question was in controversy or would have arisen in many thousands of situations in the future. The Act of October 25th puts an end to actual litigation as well as prospective litigation, and eliminates from all future controversy the question of whether or not a transfer involved a “possibility of reversion”.

(iii) Retained Power to Designate or Change Beneficiaries or to alter or amend:

All gifts in trust with the right retained to designate any future beneficiary of the trust, whether as to principal or income, and whether the right to designate such beneficiary is exercisable individually or as a trustee, either alone or with any other person whomsoever, renders the entire trust includible in the estate of the grantor.\(^1\) If the right is retained to designate any beneficiary as to a portion only of the gift, a corresponding proportion only of the property is includible.\(^2\) A necessary corollary with the retained power to designate future beneficiaries is a gift in trust with the retained power similarly to change the beneficiaries. This is expressly precluded.\(^3\) A retained power by the grantor to alter, amend, revoke or terminate the trust, whether acting individually or as trustee, alone or with any other person whomsoever, also makes the entire trust taxable in the grantor’s estate.\(^4\)

But the reserved power to add to the corpus of the trust and to deal with the mechanics or details of the management of the trust does not make the property includible in the estate of the grantor.\(^5\) Such reserved powers may, however, cause the income to be taxed to the grantor under the income tax laws, and this may cause the gift to be nullified from the estate tax point of view, as a gift in “contemplation of death”. This matter is discussed in the section following the next one.

(iv) Power to Consume or to Appoint the Remainder:

The consequences of a power in the beneficiary to consume

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\(^1\) I. R. C., §811 (d), Reg. 105, §81.15, 81.19 and 81.20.
\(^2\) Reg. 105, §81.19.
\(^3\) Reg. 105, §81.20.
\(^4\) I. R. C., §§11 (d), Reg. 105, §81.15 and 81.20.
\(^5\) Estate of Johnson, 2 TCM 299; Estate of Fisk, 5 TCM 42, see Estate of Storer, 41 BTA 1156.
the principal of an *inter vivos* trust, or to appoint the remain-
der interest, where the grantor is neither the beneficiary nor a trustee, are the same in the case of an *inter vivos* trust as in the case of a testamentary trust. However, where the bene-
fiary is the grantor,\(^{166}\) any right to principal or income, which is not discretionary with an independent trustee, is considered a retained right which would make the corpus includi-
bale in the grantor's estate.\(^{167}\) If the grantor is a trustee, an untrammeled discretionary power in the trustees to invade the principal on behalf of beneficiaries is a retained power which will make the entire trust includible in the grantor's estate. On the other hand, if the power to invade is conditioned upon a sufficiently definite "external standard" to permit a Court of Equity to compel invasion, it is not includible in the grantor's estate.\(^{168}\) Where the grantor is not a trustee, if the trustees are independent and have absolute discretion as to the payment of corpus, the fund will not be included in the estate of the grantor.\(^{169}\) A discretionary power in trustees to pay income to the grantor-beneficiary would seem also to be exempt.\(^{166}\)

(v) *Income Tax Liability Upon the Creation of an Inter Vivos Trust* (Clifford Regulations):

Prior to the decision of the United States Supreme Court in *Helvering v. Clifford*,\(^ {161} \) in 1940, persons with substantial investment incomes had often created short-term trusts for members of their family, making themselves or their wives,  

156. In South Carolina a trust established for oneself is void. §9037 of the South Carolina Code of 1942.
157. Toeller v. Commissioner, 165 Fed. (2d) 665 (CCA 7, 1948); Blunt v. Kelly, 131 Fed. (2d) 632 (CCA 3, 1942); Estate of Ida Rosen-
wasser, 5 TC 1943 (1945).
158. Jennings v. Smith, 161 Fed. (2d) 74 (CCA 2, 1947); Estate of Milton Budlong, 7 TC 756.
159. Commissioner v. Irving Trust Co., 147 Fed. (2d) 946 (CCA 2, 1945) there the Court said:

"We have found no decision in which a settlor has parted with power to control the application of any part of the corpus and the disposition of it is left to the judgment of the trustee, independent of any prescribed standards, and yet the corpus has been included in the estate because the settlor might receive a part of the corpus through the exercise of an uncontrolled discretion by the trustee."

trustees. In this way they would split their income among their family members, lower the applicable tax rates and a smaller aggregate tax was paid. The Clifford case, however, put an end to this practice. There the Supreme Court held that such a trust was ineffective and that the income therefrom was nevertheless taxable to the grantor. Mr. Clifford had established a trust for his wife which was to continue five years, at which time the trust corpus was to revert to him, and he himself was the trustee. The Supreme Court held that in view of the short-term of the trust, and as Mr. Clifford had retained such a substantial “administrative control”, he was, in substance, the owner of the trust property, and the income should be taxed to him and not to his wife.

The Treasury, using this decision as its authority, introduced an extremely broad Regulation (Reg. 111, Sec. 29.22 (a)-21) which taxes to the grantor of a trust all income therefrom, (a) where the trust is for a term not greater than ten years (fifteen years under certain circumstances) or (b) where the grantor, or someone else not having a substantial adverse interest, has the power to appoint future beneficiaries of the corpus or income therefrom or (c) where the grantor, or someone else not having a substantial adverse interest, has a measure of administrative control over the trust.

The Clifford Regulations draw a sharp distinction between the right of an independent trustee to designate future beneficiaries and such a reserved right in the grantor, or in someone else lacking a substantial adverse interest. The Estate of Johnson, supra. The Clifford Regulations disregard the separate entities of certain members of the same family group. However, all family members are likely to be held ineligible to be an independent trustee.
adverse interest, has administrative control over the trust, which can be used for the benefit of the grantor, the grantor is taxable on the income therefrom under the Clifford Regulation. The Regulation specifically says that administrative control in the following respects makes the grantor taxable on the income of the trust:

(a) Either the grantor (in any capacity), or another person lacking a substantial adverse interest, has power to transfer the trust property for less than an adequate consideration.

(b) Either the grantor (in any capacity), or another person lacking a substantial adverse interest, has power to borrow any part of the trust corpus or trust income without adequate security or interest and, in any event, has not repaid the trust before the end of the taxable year.

(c) Either the grantor (in a non-fiduciary capacity only), or another person lacking a substantial adverse interest (non-fiduciary), has the power to vote stock and control the trust investments.

(d) Either the grantor (in any capacity), or someone lacking a substantial adverse interest, has the right to reacquire the trust corpus by substituting "other property of an equivalent value".

(4) Liability for the Gift Tax

When a gift is not within the annual exclusion and a gift tax return must be filed, both the donor and the donee are required to file a return—the donor must file a donor return and the donee must file a donee return.163 The tax, if any is payable, should be paid by the donor but the donee is secondarily liable for the tax up to the value of the property.164 The property given away is subjected to a ten-year tax lien for the payment of the tax, but this lien is divested in the case of a bona fide sale.165 The responsibility of the donee to pay the tax if the donor does not do so is not altered by the fact that the gift is included in the estate of the donor. While the estate fiduciary is required primarily to pay the tax on the gift property as well as the tax on the other property in the estate, it is entirely conceivable that the estate will not have

163. I. R. C., §1006 and 1007 and Reg 108, §86.20 and 86.21.
164. I. R. C., §1009; Reg. 108, §86.35.
165. See footnote 164 supra.
sufficient funds to pay this additional tax—especially if the gift was of a substantial part of the property of the decedent.\textsuperscript{166}

When gift property is included in the estate of the donor, as a gift in "contemplation of death" or as a gift by an incomplete trust, it is included in the estate at its value at the date of death (or one year thereafter if the executor chooses the optional valuation date pursuant to Sec. 311 (j) of the Code) and this value might be greater or less than the gift tax value. If the estate value of the property is less than the gift value, the estate obtains an advantage as the credit for the gift tax paid may be greater than the estate tax actually due on such property. If the gift tax were paid by the donee however, he is not given the right of recoupment against the estate fiduciary. If, on the other hand, the property has increased in value from the date of gift to the estate valuation date, there may be a substantially greater tax due than the credit. And this, of course, will always be true where the property was non-taxable as a gift. The donee, however, remains secondarily liable for the greater tax.\textsuperscript{167} The fact that the donee is also liable for the tax on the gift means that in every case where a gift is made, the donee has a contingent tax liability until the death of the donor and the estate tax is paid.\textsuperscript{168} The fact that the property has been lost or disposed of by the donee of the gift before the donor's death is irrelevant.\textsuperscript{169}

\textbf{(5) The "Basis" of Gift Property}

The "basis" of property sold or otherwise disposed of is highly important to the seller. The profit or loss from such sale or other disposition is probably includible in the income tax of the owner; and it depends entirely upon the "basis" of the property. The Code provides that if the property was purchased its basis is its cost (subject to adjustment for capital charges, depreciation and the like); if it were inherited its basis is its value at the time of the death of the former owner; if it were received by gift its basis is that of the former owner unless a loss is claimed, in which case its basis is the value

\textsuperscript{167} Milliken v. U. S., 283 U. S. 15.
\textsuperscript{168} I. R. C., §827 (b), Reg. 105, §81.99.
\textsuperscript{169} Humphrey v. Commissioner, 162 Fed. (2d) 1 (CCA 5, 1947).
at the time of the gift or the donor's basis, whichever is lower.\textsuperscript{170}

However, rulings and court decisions have resulted in some important variations of these general Code provisions which may be highly significant in developing an estate plan. While the general problems of basis will not be discussed here,\textsuperscript{171} the more significant variations will be mentioned in the next paragraph.

If property is bequeathed or devised with a direction for its sale at a specified price, or at a price which can be developed from a stated formula, its basis will not be its value at the death of the former owner, but will be the specified or formula price.\textsuperscript{172} The fact that estate tax was paid on its date of death value is immaterial. If the property were owned by the decedent in a joint tenancy with someone else, with the right of survivorship, the basis of the portion contributed by the decedent is not its value when the decedent died, but rather its cost.\textsuperscript{173} That the estate tax paid was based on the value of the property at the date of death of the decedent (joint owner) is immaterial here also. The fact that property previously given away \textit{inter vivos} is included in the estate of the donor because it is deemed to have been given away in "contemplation of death" or by an incomplete trust, is insufficient to permit the property to have the basis of its estate valuation.\textsuperscript{174} Where a testator by will gives a son the right to purchase assets of the estate at greatly below its value, the basis of the property to the son will not be its estate value but his actual cost.\textsuperscript{175} Where a legatee accepts estate assets in lieu of a cash legacy or of a bequest, his basis for the property acquired is not its value but is the value of the bequest or legacy surrendered in exchange for it.\textsuperscript{176}

\textsuperscript{170} I. R. C., §113 (a).
\textsuperscript{171} The author has discussed this problem elsewhere in some detail "Basis Problems", 27 Taxes 375 (October, 1949).
\textsuperscript{172} Delone v. Commissioner, 6 TC 1188.
\textsuperscript{173} Lang v. Commissioner, 289 U. S. 109 (1933).
\textsuperscript{174} Wurlitzer v. Commissioner, 81 Fed. (2d) 923 (CCA 6, 1936); Everett v. Commissioner, 4 TCM 454 (1945).
\textsuperscript{175} Mack v. Commissioner, 148 Fed. (2d) 62 (CCA 3, 1945), cert. den'd, 326 U. S. 719.
The rule that property given away *inter vivos* in contemplation of death or by incomplete trust has the basis of gift property rather than inherited property, although taxed as part of the estate, is an important factor to consider on the question of whether a gift should be made. If there is some danger of the gift being nullified for either of these two reasons, and the property has increased greatly in value since it was acquired, probably the gift should not be made. Naturally this would not be a factor if the property is in trust and cannot be sold or disposed of by the donee of the gift. On the other hand, if the property has decreased substantially in value and can be disposed of by the donee, it should by all means be given instead of bequeathed or devised. It will retain its high basis, despite the gift being nullified for estate tax purposes, and upon its disposition the income tax of the recipient will be much less.

(d) *Conclusion as to Estate Tax*:

If a gift in trust is sufficiently complete so as not to be includible in the estate of the donor because of being conditioned on his death or of a "string" retained by him, and there is no contemplation of death question, the beneficiary can be given a limited power of appointment over the remainder, and the trustee can be given the discretionary right to make such payments to the beneficiary from principal as the trustee deems appropriate, and the fund will not be included in the estate of the donor, nor will it be included in the estate of the donee. If a gift is outright and there is no contemplation of death question, it escapes estate tax in the estate of the donor but not in the estate of the donee. Moreover, substantial income tax savings, in either case may be realized. On the other hand, where a testamentary trust is created, while it is taxable in the estate of the testator, it is not taxable in the estates of the beneficiaries (unless the beneficiaries can, at their pleasure, consume the principal).

The question frequently arises, where there is a specific bequest, as to where the burden of the estate and inheritance taxes shall fall. The state inheritance tax is based upon the value of the bequest, so naturally it is payable from the bequest. On the other hand, the federal tax is upon the estate. Whether or not it should be apportioned among the beneficiaries is a matter to be determined by the state law.177

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Although many states, in the absence of specific testamentary directions, require the tax to be apportioned among the beneficiaries in accordance with the value of bequests to them, in this state there is no such requirement and, in the absence of testamentary directions, the tax must be paid out of the general residuary estate.\(^{178}\)

A factor which should be considered is that of the "common disaster" provision in statutes and in wills or trusts instruments. This state now has the uniform Simultaneous Death Act, but by its terms, it does not apply if there are will provisions on this question.\(^ {179}\) Many wills do include a provision for the eventuality of the simultaneous deaths of the testator and a beneficiary. The statute, and most will clauses on this question, provide that in the event of simultaneous deaths the testator shall be presumed to have survived. Now, in view of the marital deduction, which applies only if a decedent is survived by a spouse, it might be desirable to include in a will a provision that is just the opposite from the usual common disaster provision; namely, that if a testator and spouse die in or from a common disaster, it shall be presumed that the spouse survives the testator. The Statute would not be a deterrent, since it does not apply if the will provides for this eventuality. The new Treasury Regulation under the marital deduction, indicates that such a presumption would be recognized.\(^ {180}\) The effectiveness of such a presumption, however, might be limited to bequests, and not apply in the case of a power of appointment.\(^ {181}\) But if there are no children or joint heirs of the spouses, probably the usual common disaster provision will be more acceptable, regardless of tax consequences. If the spouse is presumed to survive the decedent, the marital deduction will be available, but the estate would

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178. CCH. Federal Estate and Gift Tax Reporter, §§3140 et seq.
179. Adopted on April 3, 1948; see the excellent discussion of this new Act by James M. Perry, Esq. of the Greenville Bar in "South Carolina Law Quarterly" 64.
181. In Matter of Fowles, 222 N. Y. 222, a power of appointment given by the will of one spouse to the other, and exercised by the will of the other, was upheld despite the simultaneous deaths of both spouses. In states other than New York, however, it is open to question as to whether a presumption as to survivorship will be effective where a power of appointment is involved; especially where the power involves real property. This might be important in the case of a power of appointment which will qualify a bequest for the marital deduction.
be inherited by the spouse's, rather than the decedent's family.

Another factor to consider is that where a gift is made the tax benefits may be entirely lost if the amount of the gift comes back to the donor by inheritance. Thus, when the donor may in the future inherit property from the donee, the latter should provide for a testamentary trust in a will so that there is no danger of the donor inheriting the gift property. It is also advisable for an insurance policy, which the insured neither owns nor on which he has paid the premiums since January 10, 1941, to be kept out of the ownership of the insured. Thus, if a wife buys and owns insurance on the life of her husband, it is advisable for her to provide for the succession of ownership or to bequeath the policy to someone other than the husband, who is able to pay the premiums on the policy. Of if that is not expedient, it is advisable for the wife to leave the policy to a trustee and also leave the trustee sufficient funds to continue paying the premiums until that responsibility can be taken over by the beneficiary.

6. General Conclusion:

In preparing an estate plan it should be kept in mind that while the applicable law concerning the administration of an estate is likely to remain constant, the field of tax law has been highly changeable, and probably in the future it will continue to be so. An illustration has already been given of the great changes in the income and estate tax rates in the last eighteen years. But in 1931, there was no gift tax whatsoever. Before 1940 the problems of making an inter vivos gift sufficient to avoid the income tax, as well as the estate tax, presented no great difficulties. The administrative control and broad decisions as to requirements for completeness in inter vivos gifts designed to nullify the income as well as the estate tax benefits of a gift, have come about entirely since the Clifford and Hallock decisions, which were in 1940. Prior to 1942, an unexercised power of appointment was not subjected to the estate tax and a beneficiary could consume the principal of a trust without any unused portions being taxable in the beneficiary's estate. Prior to 1948, there was no marital deduction.

Recognition must be accorded to the present pronounced trend of Congress, the Treasury Department and the Courts, in tax matters, to treat the family as an economic unit. The
Clifford Regulations were inspired in large measure by an awareness of the economic unity of husband and wife. The distinction between a family trustee and an independent trustee runs through the Court decisions on such matters as invasion of trust principal and the appointment and change of beneficiaries of trusts. The "marital deduction" in both the estate and gift tax is based on the theory that husband and wife are co-owners of the family wealth. The split income of the 1948 Act is also a recognition of this fact as applied to income.

Any plan designed primarily to avoid or minimize taxes may be ineffective within the next few years. A sound estate plan must, therefore, be designed primarily to accomplish aims other than the reduction of taxes. But where the plan is sound in other respects, consideration is proper of all methods which may be utilized to bring about the largest possible tax savings, bearing in mind the trend as well as the current estate tax law. Furthermore, any such plan should be reviewed periodically. For example, the 1948 Revenue Act undoubtedly threw many estate plans, designed primarily for tax savings, into limbo.