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A PRACTITIONER'S GUIDE TO ESTATE PLANNING IN WASHINGTON

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I. THE NATURE AND OBJECTIVES OF ESTATE PLANNING

ESTATE planning in the broad sense is an individual’s planning for the acquisition, conservation, use and distribution of his property. In the more restricted sense of the phrase with which we are here concerned, estate planning is an individual’s planning for

the most beneficial transfer and transmission of property to estate beneficiaries integrated with planning against unnecessary estate shrinkage. Such planning involves provision for efficient and prudent management, provision for estate liquidity sufficient to prevent unnecessary sacrifice of estate assets, provision for minimizing the costs of administration and management, and provision for minimizing income, gift, inheritance and estate taxation.

II. MARITAL PROPERTY

The nature of marital property interests is a question of state law. It is that law to which one must turn to determine the characteristics of property with which one deals in estate planning. Nevertheless, federal law—primarily because of federal tax law—must be considered so that planning in the field of marital property may not prove costly taxwise.

It is not enough, however, to be familiar with the marital property law of a particular state in which an estate plan is being worked out. It is occasionally necessary to be familiar with marital property law of other state or states in which marital property of the individual may be located or which after being derived therefrom has been transferred to the state of residence or domicile of the individual concerned. In addition, it is necessary to have a knowledge of the marital property law as it is affected by the doctrines of the Conflict of Laws.


Legal fees incurred in estate planning have been held deductible for income tax purposes under Int. Rev. Code § 23(a)(2) Bagley v. C. I. R., 8 T. C. No. 24.

2 Restatement, Conflict of Laws (1934) c. 7; U. S. Const. Amend. X.
Although systems of marital property in the United States vary from state to state, two principal systems exist, namely, the common law system (in very much modified form, however), and the community property system. Let us briefly consider the common law system on which is based the great majority of marital property systems in this country.

A. THE COMMON LAW SYSTEM

At common law, marriage was a much more serious matter from the standpoint of legal consequences than it is today. By marriage, the wife's legal personality for many purposes merged with that of her husband. He became entitled to the society of his wife, her services and her obedience. He became the owner of her personal property, whether acquired before or after marriage, of which she had actual or legal possession, such as money or chattels, and, on reducing them to his possession, he acquired her choses in action and limited interests in personality. In addition, he acquired the right to the possession, use, income and usufruct of her freehold real estate, whether owned by his wife before marriage or acquired thereafter. In addition, during marriage he obtained a life estate as tenant by curtesy initiate in the real property of which his wife was seized of an estate of inheritance during marriage if a child had been born of the marriage alive and capable of inheriting. This estate by the curtesy initiate which

"Only the broad outlines of the common law marital property system, with appropriate illustrations, and as affected by equity and statute are here attempted.

1 Thompson v. Thompson, 318 U. S. 611, 54 L. ed. 1180, 31 Sup. Ct. 111, 30 L. R. A. (n. s.) 1153, 21 ANN. Cas. 921 (1911)
6 McNeer v. McNeer, 142 Ill. 385, 32 N. E. 691, 19 L. R. A. 258 (1892)
the husband acquired during the lifetime of his wife became an estate by the curtesy consummate upon her death during his lifetime.\textsuperscript{11} These property rights were the husband’s, available if necessary to satisfy the claims of his creditors.\textsuperscript{12}

The unity of personality had other effects. The wife’s power to contract, which as an adult \textit{feme sole} she fully enjoyed at common law,\textsuperscript{13} was for most purposes suspended by marriage.\textsuperscript{14} A wife could not sell, contract to sell, transfer, give away, lease, or otherwise deal with or dispose of her real and personal property, whether owned prior to marriage or acquired thereafter.\textsuperscript{15} Nor could such disabilities be removed through the operation of the doctrines of estoppel.\textsuperscript{16} Any ante-nuptial indebtedness of either spouse to the other was extinguished.\textsuperscript{17} The husband became liable for his wife’s ante-nuptial debts.\textsuperscript{18} Even ante-nuptial settlement agreements defining post-nuptial property rights of the spouses were extinguished by marriage\textsuperscript{19} The husband became entitled to his wife’s services, labor, profits and earnings\textsuperscript{20}—so much so that in a suit by the husband for wages payable for


\textsuperscript{12} Ocklawaha River Farms Co. v. Young, 73 Fla. 159, 74 So. 644, L. R. A. 1917F 337 (1917), Hanlon v. Thayer, Quincy 99 (Mass. 1765), 1 Am. Dec. 1; annotation: 133 A. L. R. 637 (1941)

\textsuperscript{13} Sex, as such, is not a disqualifying factor at common law if legal capacity otherwise exists. As to her separate estate, however, the wife’s power to contract is substantially the same as if she were “feme sole.” Chew v. Henretta Mining & Smelting Co., 2 Fed. 5, 8 (1880)


\textsuperscript{20} Standen v. Penn. R. Co., 214 Pa. 189, 63 Atl. 467, 6 ANN. CAS. 408 (1806), Jackson v. Jackson, 91 U. S. 122 (1875); Belford v. Crane, 16 N. J. Eq. 265, 84 Am. Dec. 155 (1863)
the wife's services, payment to the wife was no defense.\textsuperscript{21} Neither husband nor wife could sue one another.\textsuperscript{22} The husband was liable for his wife's torts (not mixed with elements of contract) before or during marriage,\textsuperscript{23} although the wife was not liable for her husband's torts.\textsuperscript{24} Neither spouse could act as agent for one another;\textsuperscript{25} and hence they could not be partners.\textsuperscript{26} A husband could not directly convey, transfer, or give property to his wife, nor in general enter into a contract with her.\textsuperscript{27}

It must not be thought, however, that the wife in our early law was utterly devoid of legal personality. She was entitled to be maintained and supported by her husband.\textsuperscript{28} If he was derelict in his duty to support her, she could pledge his credit for necessaries.\textsuperscript{29} She had the capacity to take real and personal property by grant, gift, or otherwise, from any person other than her husband.\textsuperscript{30} She could dissolve the marriage for cause.\textsuperscript{31} She was liable with her husband for her torts simpliciter;\textsuperscript{32} she had the capacity to commit crimes\textsuperscript{33} although there was a presumption that if committed in her husband's presence, she

1 L. R. A. 1917E 283.
was acting under coercion and, therefore, not responsible86 (with certain exceptions such as murder and treason) 88 She could be a tenant in an estate by entireties, i.e., an estate created by conveyance or devise to husband and wife, the wife thereby acquiring a right of survivorship upon her husband's death.86 She could also be a joint tenant or tenant in common with her husband when such tenure arose otherwise than by conveyance or devise to them during marriage, e.g., continuing such pre-existing tenancy after marriage.87 Upon her husband's death, she had the right to her paraphernalia except as against her husband's creditors.88 She also had the right to dower, i.e., a life estate in one-third of any land in which the husband in his lifetime had been beneficially seized of an estate of inheritance.89

The law did not, however, rest content with such a primitive system of marital property. The lead in emancipating married women from the disabilities of coverture and the consequences of the theory of merger of personality by marriage was taken by courts of equity.10 It began to be established that if property was given to a married woman with the intention that it should be her sole and separate property, such intention would be enforced by courts of equity.41 With respect to such separate estate or property, the wife was substantially

84 Butler v. Buckingham, 5 Day 492 (Conn. 1813), 5 Am. Dec. 174; Barnum v. Le Master, 110 Tenn. 633, 75 S. W 1045, 69 L. R. A. 353 (1903)
emancipated from the disabilities of coverture so far as the terms of the trust permitted. This was true regardless of the husband's consent or any ante-nuptial agreement. Such separate estate could be settled by conveyance, devise or bequest to the wife before or after marriage. It could exist with respect to real or personal property. It could come about by ante-nuptial or post-nuptial agreement. It could arise from a deed from the husband to the wife, or from gifts by him to her during coverture, or from third persons to her or by the woman herself.

With respect to such separate estate, where the instrument conferred the necessary power, a married woman could in equity appoint, alienate, encumber, sell and devise the same. In some jurisdictions she could enter into certain contracts with her husband such as partnership. She could convey, transfer, encumber, mortgage and assign property to her husband. A court of equity recognized the right of a wife to her separate earnings if her husband deserted her or settled them on her. In equity, a wife's separate estate was not subject to

54 Mews v. Mews, 15 Beav. 529 (Eng. 1852), 51 Reprint 643; Ashworth v. Ontran, 5 Ch. D. 923 (Eng. 1877); Loomus v. Brush, 36 Mich. 40 (1877)
55 In re Benton, 19 Ch. D. 277 (Eng. 1882), Graham v. Londonderry, 3 Atk. 393, 29 Reprint 1026 (Eng. 1746)
her husband’s debts. Equity also permitted the spouses to sue one another concerning the wife’s separate property and permitted the entry of a decree *in rem* with respect thereto. The wife’s right to her separate estate was not dependent on her living with her husband.

The protection afforded by equity was, however, dependent upon the intention of the donor. The next step was the enactment of statutes by which the separate property of the wife would be recognized in much the same way as the separate property of the husband was recognized—not as something dependent on donor’s intention, but as a permissible status recognized by law. So, in England and the United States, statutes were enacted to remove the disabilities of coverture, both contractual and proprietary. Except in limited respects, such statutes have attempted to give as full legal recognition to the factual personality of the wife as the law gave to that of the husband. The situation in the State of Oregon, for example, is a good illustration of this principle. There neither spouse is liable for the debts and liabilities of the other incurred before marriage. Neither is liable for the contracts and liabilities of the other contracted after marriage except for family supplies furnished for the use of the family. Expenses of the family, and education of the children are charges on the property of both or either of them. A married woman has the same civil rights and privileges as the husband. Property owned by a married woman at the time of her marriage or afterward acquired by her is hers, and is not subject to the debts of the husband. Husband and wife may contract with each other except that conveyances between them intended to cut off or relinquish estates growing out of the marriage relation are void. Neither spouse has any rights in the property of the

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5 Izod v. Lamb, 1 Crompton J. 35, 148 Reprint 1325 (1830)
57 Woodward v. Woodward, 148 Mo. 241, 49 S. W 1001 (1899)
58 Barnum v. LeMaster, 110 Tenn. 638, 75 S. W 1045, 69 L. R. A. 353 (1903), Doubts are resolved in favor of husband’s common law rights. Lippincott v. Mitchell, 94 U. S. 767 (1876)
59 See CHESHIRE, MODERN REAL PROPERTY (2d ed. 1927) 799, describing the evolution of English law statutes—“Thus in effect separate property in equity has given way to statutory separate property.”
60 This has been accomplished in England by a series of statutes. See CHESHIRE, ibid 798–800.
61 Ore. Comp. Laws § 63-204 (1940), see note 95 infra.
62 Id. § 63-206-7.
63 Id. § 63-204.
64 Jenkins v. Hall, 26 Ore. 79, 37 Pac. 82 (1894)
other which can be the subject of a contract between them.65 A mar-
ried woman is liable on her contracts and for her torts as if unmarried.66 A married woman may sue or be sued without her husband being joined as a party.67 Husband and wife may sue each other on contract and possibly on tort.68 Conveyances, transfers and liens executed by either spouse to the other are as valid as if between strangers.69 Either spouse may dispose of his or her property, real or personal, without joinder of the other, but without such joinder rights of curtesy and dower are not affected.70 Furthermore, either spouse can act as agent or attorney in fact for the other.71 It is obvious, therefore, that in Oregon the contractual and proprietary disabilities of coverture have been substantially removed.

B. THE WASHINGTON MARITAL PROPERTY SYSTEM

Let us now turn to the marital property system of Washington.72 Under Washington law, the separate legal personality of the wife receives almost full and complete recognition. She has a right to retain the ownership and control of the separate property she owns at mar-
riage.73 This right extends to the rents, issues and profits of such separate property.74 It extends also to separate property she acquires after marriage by gift, devise or descent and the rents, issues and profits therefrom.75 What is true of the wife's legal personality with respect to her separate property is also true of the husband. He retains full freedom of ownership and control as to his separate property, whether acquired before or after marriage, and the rents, issues and profits therefrom.76 From this it follows that neither spouse is liable for the antecedent debts of the other77 and the separate property of either spouse or the rents, issues or profits therefrom are not charge-
able with the debts of the other.78 All civil disabilities of the wife

65 ORE. COMP. LAWS § 16-205 (1940).
66 Id. § 63-210.
67 Id. §§ 17-101, 8; 401, 8.
68 Id. § 63-211.
69 Id. § 63-210.
70 Id. §§ 63-210, 17-108. See Griffith v. Griffith, 74 Ore. 225, 145 Pac. 270 (1915)
71 Id. § 63-211.
72 For a history of the former system, see (1936) 11 WASH. L. REV. 1; (1939)
14 WASH. L. REV. 118.
73 REM. REV. STAT. § 6891.
74 Id. § 6891.
75 Id. § 6891.
76 Id. § 6890.
77 Id. § 6905.
78 Id. § 6905.
which are not imposed or recognized as existing as to the husband are abolished. 9 Each spouse may contract with the other as if unmarried 80 except when public policy forbids; 81 each may sue the other in respect of such spouse's separate property; 82 the wife is liable for her own torts 83 and is alone liable unless the husband would be responsible jointly if the marriage did not exist. 84

With respect to family expense and the education of children, husband and wife are both liable, jointly and separately 86 Their responsibility as parents is equal, with the mother as fully entitled to the custody, control and earnings of the children as the father. 88 Indeed, if the wife lives separate and apart from the husband, she may keep the earnings of herself and minor children living with her, or in her custody, as her own. 87 Whether living with her husband or not, she may receive the wages of her personal labor and sue therefor in her own right. 88

In their dealings with each other, husband and wife are, with rare exception, completely free. Each may give, grant, encumber and assign to the other any proprietary interest in real or personal property 89 Each may contract with the other; 90 and may appoint the other attorney in fact to sell real property 91 The law has imposed certain requirements to protect the spouses in the exercise of these rights; thus, agreements made upon consideration of marriage—other than mutual promises to marry—must be in writing. 92 Furthermore, in cases when the good faith of a transaction between husband and wife is involved, whether the transaction be between them directly or by intervention of a third person, the burden of proof is upon the party asserting the good faith. 93 Again, because of claimed public policy considerations, a contract of partnership between husband and wife is void. 94 Such

79 Id. § 6901. 80 Id. § 6902.
81 Board of Trade v. Hayden, 4 Wash. 263, 30 Pac. 87, 32 Pac. 224 (1894)
82 REM REV. STAT. § 6903.
83 Id. § 6904.
84 Id. 6904. See Elliott, Liability of the Marital Community for Torts of the Husband and Wife (1941) 16 WASH. L. REV. 209.
85 REM REV. STAT. § 6906.
86 Id. § 6907. 87 Id. § 6896.
88 Id. § 6895. Cf. §§ 181, 182, 7348.
89 Id. §§ 6800, 6901, 6890, 6891, 10572.
90 Id. § 6902.
91 Id. §§ 10573-10576.
92 Id. § 5826.
93 Id. § 5828.
94 Board of Trade v. Hayden, 4 Wash. 263, 30 Pac. 87, 32 Pac. 224 (1894)
protective provisions, it will be noticed, apply equally to husband and wife; they do not militate against the conclusion that as to the separate property of either spouse marriage creates no disabilities.

As to post-nuptial marital property transactions, a different situation exists insofar as concerns what is known in a number of states of the Union as community property. With respect to such property, special rules and disabilities exist. Such property and the rights of the spouses therein are quite different from common law marital property even as influenced by equity and the Married Women's Property Acts.

Community property in Washington is all property acquired after marriage by either spouse or both of them and the rents, issues and profits from such property, regardless of the name in which the property is held, and except post-marital separate property as above described. Separate property may become community property through commingling and loss of identity. As to community property, each spouse has a present equal undivided interest therein. Notwithstanding such interest, however, the husband is the sole manager of the whole of the community property. He may enter into contracts so as to bind such property. He may do so improvidently and even over his wife's objections, because her concurrence is not necessary.


Tenancy by entireties and joint tenancy except when created by contract do not exist in Washington. See Rem. Rev. Stat. § 6892.}

Hughes v. Boyer, 5 Wn. (2d) 81, 104 P. (2d) 760 (1940); Patterson v. Bowes, 78 Wash. 476, 139 P. (2d) 225 (1941).


Jacobs v. Hoitt, 119 Wash. 283, 205 Pac. 414 (1922). No attempt is made to discuss the limits of this principle. (In re Binges Estate, 5 Wn. (2d) 446, 105 P. (2d) 689 (1940)) or the application of the principle of estoppel. Federal Land Bank v. Schidler, 193 Wash. 455, 75 P. (2d) 1010 (1938).


Hanley v. Most, 9 Wn. (2d) 429, 461; 115 P. (2d) 933 (1941) reviews the authorities.

necessary in any disposition of personal property. Nevertheless, the husband is not the owner of such property. He cannot so act in relation thereto as to defraud her or give away substantial amounts of community property even in good faith. As to the real estate, the wife's joinder in or consent to any sale, conveyance or encumbrance by the husband is necessary—not because of her dower interest (dower and curtesy having been abolished)—but because of the statutory requirement for such joinder.

As owner of an equal undivided interest, each spouse may dispose of his or her own interest to the other as, for example, by gift. Consent of the other spouse is, of course, essential. Likewise, each spouse may dispose of his or her community interest by will, or, if there is no will, the deceased spouse dies intestate as to his or her interest, and in case of such intestacy community property goes to the legitimate issue of such decedent, and if there be no legitimate issue it goes to the surviving spouse. Upon death, the marital community ends. The community interest of the deceased becomes the separate property of the heir, whether he be child, or surviving spouse, or other beneficiary. The surviving spouse's interest in what was community property becomes the separate property of such spouse when distributed under the decree of distribution, or by the nonintervention executor. The entire community interest is, however, subject to administration expenses, debts chargeable against the community property, family allowance, homestead exemption, and the inheritance and

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105 Hanley v. Most, 9 Wn. (2d) 429, 115 P (2d) 933 (1941), Fields v. Andrus, 20 Wn. (2d) 452, 148 P (2d) 313 (1944) REM. REV. STAT. § 6892.
106 This result is implicit in decisions involving gifts by husbands.
108 REM. REV. STAT. § 6897.
109 Id. § 6893.
111 REM. REV. STAT. §§ 1342, 1394.
112 Id. § 1342.
113 Community property presupposes acquisition during marriage (REM. REV. STAT. § 6892) which is dissolved by death.
114 REM. REV. STAT. §§ 6890, 6891.
115 Id. §§ 6890, 6891, 1533.
116 Schirmer v Nethercutt, 157 Wash. 172, 288 Pac. 265 (1930)
estate taxes, if any. Upon divorce the marital community also ends. If the Washington court's decree omits to mention any item of community property, the divorced spouses become tenants in common of such property and the interest of each spouse as such tenant in common becomes that spouse's separate property.

C. CONFLICT OF LAW PRINCIPLES IN MARITAL PROPERTY

The common law and community marital property systems having been described, what is the relationship between the two when the marital property of one system impinges upon or comes in contact with the marital property system of the other? The two systems interact in at least two ways: first, when marital property is removed from a common law to a community property jurisdiction or vice versa, the problem of the legal effect of such removal immediately presents itself; second, if marital property is removed, what effect can local law have on such removed property? As to the first problem, the important governing principles may be summarized as follows: In general, pre-existing marital property interests in movables or immovables are not divested or affected by removal of the property or its proceeds across state lines, nor by the mere fact of change of domicile of its owners. Hence, interests of spouses in community property are retained when such property is


218 An interlocutory decree of divorce probably ends marriage for community property acquisition purposes (See Brown v. Brown, 192 Wash. 333, 73 P (2d) 795 (1937)) although marriage relation is not terminated until entry of final divorce decree. Chisholm's Estate, 159 Wash. 674, 294 Pac. 973 (1930); Madden's Estate, 175 Wash. 51, 28 P. (2d) 280 (1934). If, however, final decree is never entered or cannot be, interim accumulations would probably be community property.

219 REM. REV. STAT. § 989, et. seq.

220 Harvey v. Pocock, 92 Wash. 625, 159 Pac. 771 (1916); James v. James, 51 Wash. 60, 97 Pac. 1113 (1908).

221 For a discussion of these and other conflict of law problems, see Horowitz, Conflict of Law Problems in Community Property (1936) 11 WASH. L. REV. 121.

222 Re Gulstines' Estate, 186 Wash. 325, 6 P (2d) 628 (1932), RESTATEMENT, CONFLICT OF LAWS § 291.

223 Reference here, of course, is to proceeds, Cooke v. Fidelity Etc. Co., 104 Ky. 473, 47 S. W 328 (1898) wrongfully applies the domiciliary law of owner.

224 Succession of Popp, 146 La. 464, 83 So. 785 (1920); Bonati v. Welsch, 24 N. Y. 157 (1861); annotation: 82 A. L. R. 1947, 1348, Bates v. Papesch, 80 Iowa 929, 118 Pac. 270 (1917) applied same rule as to debt between husband and wife.
removed to a common law jurisdiction, and separate property removed from a common law to a community property jurisdiction remains separate property. Removal of property may, however, have an important effect upon the consequences of ownership. The new jurisdiction may have laws differing from the old as to descent and distribution following death or as to the availability of dower and curtesy or homestead exemption and liability on execution, or as to remedies available for the protection of property rights, or as to the character of the property being real or personal or as to other consequences of ownership. The consequences of ownership in the old jurisdiction do not attach to the property removed so as to be part and parcel of it and entitled to the same constitutional protection as is applicable to the ownership itself.

As to the second problem, the effect of local law on removed property, the governing principles may be summarized as follows: Removed marital property may be used in the acquisition of new property in


127 The law of situs applies as to immovables. The situs law may, however, adopt the domiciliary law. See Frick v. Pennsylvania, 268 U. S. 473, 69 L. ed. 1058, 45 Sup. Ct. 603, 605 (1925) Or a state may provide that the situs law should control distribution of a deceased's movables, e.g., ILL. REV. STAT. ANN. (Smith Hurd, 1929) c. 6, § 7; c. 39, § 1; MISS. CODE. ANN. (1930) § 1401.


129 In Moody v. Barker, 188 Ky. 401, 222 S. W 69 (1920) it was held that homestead exemption is governed by the lex fori.

130 Wick v. Dawson, 42 W Va. 43, 24 S. E. 587 (1896) In Walker v. Goetz, 218 S. W. 569 (Tex. Civ. App. 1920) 569, it was held lex loci contractus governs. See Leselle v. Woolery, 14 Wash. 70, 44 Pac. 115 (1896).


133 This seems preferable to the term "incident" as used in McKay, COMMUNITY PROPERTY (2 Ed. 1925) § 652; Leflar, Community Property and the Conflict of Laws (1933) 21 CALIF. L. REV. 221, 227.

134 Any attempt by a state to divert interests in marital property by the mere fact of removal from another state into its own, or by a mere change of domicile, would probably be in violation of the due process, and equal privilege and immunities clauses of the 14th Amendment to the Federal Constitution. Brockenbrough v. Durkee, 48 Wash. 576, 90 Pac. 814 (1907), Re Thornton's Estate, 1 Cal.(2d) 1, 32 P (2d) 1, 92 A. L. R. 1343 (1934), cf. Spreckles v. Spreckles, 116 Cal. 399, 48 Pac. 228 (1897).
the new jurisdiction by purchase, exchange or other dealing, or may become the source of rents, issues and profits. In general, in both common law and community property states, the character of interests in the new property is the same as that of the old. Thus, if community property is used to purchase land in the common law state, the interest of the spouses in community property will be retained in the land by making the husband a resulting trustee of his wife's interest therein. If the husband uses the separate property from a common law jurisdiction to acquire movable or immovable in a community property jurisdiction, the property so acquired will be treated as his separate property both at law and in Equity. Again, local law may determine the status of rents, issues and profits of foreign-acquired property brought into the state as partaking of the character of the property from which they issue, or as partaking of a different character. Thus, a statute might provide that property locally acquired by residents or non-residents with the proceeds of separate property shall become community property. This was once the law in Washington. Today, however, the proceeds of separate property, no matter where derived, are treated as separate property. Finally, the local law may permit the spouses to determine the nature of their marital property by agreement. Thus, under Washington law, it is competent for spouses by agreement to change their separate property into community property or community into separate property. Even an oral

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186 Depas v. Mayo, 11 Mo. 314, 49 Am. Dec. 88 (1849); annotation: 92 A.L.R. 1347, 1352. Proof of community interest must be had, but courts indulge presumption that foreign law is the same as lex fori. See Thorn v. Weatherly, 50 Ark. 237, 7 S. W. 33 (1887).


188 Such is the domestic rule of Arizona, California, New Mexico, Nevada, Texas and Washington. McKay, Community Property (2d Ed. 1925) § 200.

189 The domestic rule in Idaho and Louisiana makes such proceeds common. In Louisiana proceeds of wife's separate property are common unless she retains its administration in her hands. McKay, Community Property (2d ed. 1925) § 200.


agreement to such effect is sufficient as to personal property, although as to real property a written agreement is necessary because of the Statute of Frauds. In connection with the matter of agreement, it might be well to further point out that if the spouses permit their separate and community property to be commingled so that the identity of the separate property is lost, the local law will treat the whole as community property. Such commingling may occur by agreement, but such agreement is not necessary. If commingling occurs, no matter how or for what reason, the result follows.

D. CONTRASTING TAX CONSEQUENCES OF MARITAL PROPERTY SYSTEMS

The common law and community property marital property systems have well-known tax consequences based upon their contrasting natures. Thus, in a community property state each spouse is subject to a federal income tax on only one-half of the community income, and each spouse has the benefit of certain deductions as if unmarried. In common law states, however, the income subject to federal income tax is reportable by and taxable solely to the husband. Again, for gift and inheritance tax purposes, the vested interest of each spouse is fully recognized in Washington. Hence, a gift of community property in Washington to a third person is deemed a gift of one-half thereof made by each spouse. Upon the death of a spouse, the inheritance tax assessable is assessable solely with respect to the half of the com-

149 Jacobs v. Holtz, 118 Wash. 283, 265 Pac. 414 (1922).
147 Since he owns all the income. See Poe v. Seaborn, 282 U. S. 101, 75 L. ed. 239, 51 Sup. Ct. 58 (1939). Rabkin & Johnson, Federal Income, Gift and Estate Taxation, 903, et seq. If a tenancy by entireties is involved, however, the income is reportable one half by each. Sandberg v. C. I. R., 8 T. C. No. 52 (1947) involving Oregon tenancy. See also discussion of joint tenancies infra. The use of "family partnerships," particularly in common law jurisdictions, has been resorted to to split the family income, but the field of permissible use has been much narrowed. C. I. R. v. Tower, 327 U. S. 280, 80 L. ed. 670, 66 Sup. Ct. 532 (1946). See Paul, Taxation for Prosperity, 297-300. An attempt has been made to apply the principle of the Tower case to gifts of family corporation stock. See Mannheimer, Income Tax Status of Family Corporation Stock (July, 1947) 25 Taxes—The Tax Magazine 604.
munity property left by the decedent. Furthermore, a decedent Washington spouse is entitled, for example, to the statutory insurance inheritance tax exemption as if the community property interest left was the decedent’s separate property.

In common law jurisdictions the gift tax would be imposed upon the entire gift, and the inheritance tax would be imposed upon the entire estate of the husband if he died, and no inheritance tax would be assessed upon the death of the wife because she did not own any property transmitted by her death.

By virtue of the 1942 Federal Gift and Estate Tax Amendments, Congress has attempted to obliterate the differences taxwise between common law and community property. Thus, all gifts of community property are deemed made by the husband except to the extent that the community property can be shown to have been derived from the personal earnings of the wife or derived originally from such earnings or from the separate property of the wife. Likewise, the Federal Estate Tax is computed on the basis of the entire community estate except to the extent that the survivor can show that the community estate was derived from compensation for personal services rendered by the survivor or derived originally from such compensation or from the separate property of the survivor, with the minimum of one-half of the community estate (because subject to testamentary disposition in Washington) being taxed in any event. The matter of the tax consequences to be considered in estate planning will be considered in greater detail hereinafter, but enough has been here stated to point out


149 Re Coffee’s Estate, 195 Wash. 379, 81 P (2d) 283 (1938) permitted entire $40,000 insurance proceeds exemption (REM. REV. STAT. § 11211(b)) to be taken from the deceased husband’s half of the community insurance estate. To same effect prior to the 1942 Revenue Act Amendments, see Lang v. C. I. R., 304 U. S. 264, 82 L. ed. 1331, 58 Sup. Ct. 880 (1938)

150 See 1 RABKIN & JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION, 931, 903, et seq. The test is that provided by local law: whose property is it?

151 Rev. Act of 1942 §§ 404 (life insurance) 453 (gifts) 402 (community estate tax). INT. REV. CODE §§ 811 (d) (5), 811 (e) (2), 811 (g), 1000 (d).

152 INT. REV. CODE § 1000 (d); Reg. 108, § 86.2 (c) Corresponding provision has been made for transfers in contemplation of death. INT. REV. CODE § 811 (d) (5) This changed the prior law, except where wife’s interest was a mere expectancy. Gillis v. Welch, 80 F. (2d) 165 (1935) cert. denied, 297 U. S. 722, 80 L. ed. 1008, 58 Sup. Ct. 668 (1936)

153 INT. REV. CODE §§ 811 (e) 2, (g) (1), 811 (d) (5)
important differences taxwise resulting from the contrasting marital property systems above reviewed.\textsuperscript{184}

\section*{III. THE GIFT TAX SCHEME AND ESTATE PLANNING IN WASHINGTON}

\subsection*{A. INTRODUCTORY}

It will be recalled that income tax, gift tax, inheritance tax and estate tax rates are each placed on a progressive basis rather than on a flat basis.\textsuperscript{185} If, therefore, property ownership can be split up so that the tax base is smaller, tax savings necessarily result because the applicable top bracket of such tax is lower; and if a gift tax is payable, the tax is on the lower brackets and at rates less than corresponding inheritance and estate tax rates. Furthermore, the timing of property division makes available cumulative tax exemptions with resulting tax savings.\textsuperscript{186} It becomes important, therefore, to briefly outline the available methods of property division both before and after death in view of the applicable tax consequences, state and federal.

The obvious method of property division \textit{inter vivos} is through the medium of gifts.\textsuperscript{187} For state and federal tax purposes, a gift is not merely one as defined at common law; any transfer of property for less than an adequate and full consideration in money or money's worth involves a taxable gift if the fair value of the property transferred is in excess of the annual exclusions and gift tax exemptions recognized by law.\textsuperscript{188} In that connection, attention should be called to the fact that income cannot be divided for tax purposes merely by turning it over as received or assigning the right to receive it. The property which produces the income must be given away as well as

\textsuperscript{184} For a discussion of conflict of law principles in respect of taxation of trusts and trust income, see 2 Nossaman, Trust Administration and Taxation, c. XLIII, p. 226, et seq.

\textsuperscript{185} Int. Rev. Code \textsection{} 12002, 12202 (gift tax, inheritance tax) Int. Rev. Code \textsection{} 810, 935 (estate tax), 1001 (a) (b) (c) (d) (income tax)

\textsuperscript{186} Donor's taxable estate is also reduced by the amount of gift tax. But for the gift, the beneficiary would have to pay an estate tax based upon the deceased's estate augmented by the amount of the gift tax. See also note 269 infra.

\textsuperscript{187} Income tax savings are effected by donee if gifts of low market value but of high cost are given away. In event of sale by donee, donor's cost basis may be used for his income tax purposes.

the income itself before a gift (though recognized for gift tax purposes

199) is recognized for income tax purposes.200

A gift tax is payable on the amount by which the value of the property transferred exceeds the value of the consideration in money or money's worth received therefor.201 Thus, bargain purchases may involve a gift tax liability. This is true regardless of donative intent.202 The phrase “money or money's worth” renders taxable many transfers that would otherwise not be gifts as that term is understood at common law,203 e.g., transfer in consideration of an intended wife's giving up her right to income from the trust created by a former husband.204 This does not mean that common law considerations are not important; they are important,205 especially on the question of delivery. Thus, a revocable gift is not a delivered gift, neither is a transfer in trust with reserved power to change the beneficiaries or their interests in the trust—and, hence, they are not taxable gifts.206 Furthermore, the date of the gift may be important on the question of the taxable year applicable. The date is to be determined by the date of delivery—a common law concept.207

199 Cerfe v. C. I. R., 141 F. (2d) 564 (C. C. A. 3d, 1944)
202 Reg. 108, § 86.3.
206 Reg. 108, § 86.3.
Before considering the different types of gifts for tax purposes, let us briefly outline the Washington and Federal gift tax scheme.

B. WASHINGTON GIFT TAX

Under the Washington law since 1941, gifts of separate or community property, if in excess of the annual exclusions and applicable exemptions, are taxable. The tax applies whether the gift be in trust or otherwise, whether direct or indirect, and whether the property is real, personal, tangible or intangible. As to residents of the state, the tax applies to gifts of any property except real or personal property permanently located outside the state. As to non-residents, the tax applies only if the property is real or tangible personality permanently located within the state. Thus it would seem that a gift of a New York bank account by a resident of Washington would be taxable whether or not made within the state; but the same gift by a non-resident made within the state would not be taxable.

If the gift is one of community property by one or both spouses to a third person, two gifts are deemed to be made—one by each spouse for one-half of the whole value of the property transferred.

The Washington gift tax is imposed on the aggregate total of all "net gifts" for each calendar year and all prior years at rates and with exemptions based on the relationship of donor and donee. The term "net gifts" means the total amount of gifts made during the calendar year less authorized charitable deductions and less an annual exclusion of $3,000 per donee other than a gift of future interests in property. Donees are divided into three classes: Class A, B and C. The gift tax rates and exemptions for each class vary. Class A beneficiaries are grandparents, parents, spouses, children, step-children, adopted children, or lineal descendants of any adopted child, son-in-law, daughter-in-law, or any lineal descendant of donor or adopted child of lineal descendant of donor. The donor is permitted a $25,000 exemption of any amount passing to Class A, such exemption to be taken from the first $25,000 of the gift. The rates are small, being 90% of the corresponding inheritance tax rates as to Class A beneficiaries. They commence with 90% of 7% of the first $25,000 and end with 90% of 10% of all amounts in excess of $500,000. Class B beneficiaries are brothers and sisters of the donor. The exemption is $1,000 to be taken

169 Id. § 11118-11.
170 Id. § 11118-11 (b)
171 Id. § 11118-12.
172 Id. § 11118-12.
173 Id. § 11118-12, 15.
174 Id. § 11118-12.
from the first $5,000 of gifts to such beneficiary or beneficiaries. The rates are higher than Class A rates. They commence with 90% of 3% of the first $5,000 and end with 90% of 20% of all amounts in excess of $100,000. All other beneficiaries (other than charitable) fall in Class C, for which class no exemption exists. The rates are fairly high. They commence with 90% of 10% up to $10,000 and end with 90% of 25% on amounts in excess of $50,000. From the total tax on all net gifts during the calendar year and all prior years since the commencement of 1941, there is deducted the amount of all gift taxes previously paid the state. The balance is the gift tax owing. The tax is payable the March 15th following the close of the calendar year in which the gift is made, a gift tax return being required to be filed on or before that time.

As a result of the annual exclusions and exemptions provided by the Washington Gift Tax Law, spouses may make tax-free gifts of as much as $26,000 in community property to a Class A beneficiary, e.g., a child, since each spouse is deemed to make one-half of the gift and each spouse is entitled to a $3,000 annual exclusion and a $10,000 exemption. Likewise, each spouse can make a gift to a Class A beneficiary of as much as $13,000 of separate property.

As to Class B beneficiary; spouses may make a tax-free community property gift of $6,000 since each is entitled to a $3,000 exclusion whether it be separate or community property. If the gift exceeds $6,000 in community property, the donor spouse whose brother or sister is involved may take the benefit of a Class B exemption up to $1,000, but the other spouse may not do so since the donee is neither brother nor sister, but rather brother-in-law or sister-in-law.

As to Class C beneficiaries, a community property gift of $6,000 is tax-free, or a gift of $3,000 each of their respective separate property, because of the annual exclusion provisions.

Prior to June 6, 1945, the annual exclusion of $3,000 could be taken even with respect of future interests in property. This is no longer true. Hence, a gift in trust payable when a minor child becomes 21

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174 Id. § 11218-12. The last amendment was Wash. Laws 1945, c. 206. The exemptions for gifts to persons in Classes A and B are not stated to be lifetime exemptions as is the $30,000 lifetime exemption for federal gift tax purposes. It would seem possible, therefore, to take the exemptions repeatedly every year. There is a question whether this is the intended result.


178 Id. § 11218-14 (b) Wash. Laws 1941, c. 119 § 4.
years of age is a gift of a future interest and the donor is not entitled to the benefit of the annual exclusion with respect to such gift. 177

C. FEDERAL GIFT TAX

The Federal Gift Tax Law (after which, in certain respects only, the Washington gift tax law is apparently patterned) taxes every transfer by an individual of property by gift, whether in trust or otherwise, whether the gift be direct or indirect, whether the property be real or personal, tangible or intangible. 178 Here, too, the tax is not limited to gifts as known at common law. As in the case of taxable transfers in Washington, gift taxes are imposed on transfers (sales or exchanges) for less than an adequate and full consideration in money or money's worth, measured on the amount by which the value of the property exceeds the value of the consideration paid by the "donee." 179 The tax is imposed on all donor individuals, resident or non-resident citizens or aliens, save that in the case of a non-resident not a citizen of the United States, it applies only to gifts of property situated within the United States. 180

Prior to October 22, 1942, gifts of community property were treated as gifts by each spouse to the extent of one-half thereof just as if each spouse made a gift of separate property. 181 Since October 22, 1942, all gifts of community property are deemed made by the husband as if from his property, except to the extent that it can be shown that the property given away was received as compensation for personal services actually rendered by the wife or derived originally from such compensation or from the separate property of the wife. 182 The language of the statute is so sweeping that a gift by a wife of her community interest to her husband would be a gift by the husband to

177 Id. § 11218-14 (b) Wash. Laws 1945, c. 206, § 2, p. 591.
178 Int. Rev. Code § 1000 (b) The gift tax is designed to supplement the Estate Tax. Sanford v. C. I. R., 308 U.S. 39, 84 L. ed. 21, 60 Sup. Ct. 51 (1939)
180 Int. Rev. Code § 1000 (a) (b)
181 Id. §§ 1000, 1003, 1004. Where the wife's interest was not a vested right but a mere expectancy, the gift was treated as a single gift by the husband. Gillis v. Welch, 80 F. (2d) 165 (1935), cert. dened, 297 U. S. 722, 80 L. ed. 1006, 56 Sup. Ct. 668 (1936)
182 Int. Rev. Code § 1000 (d) The constitutionality of this section has been upheld in Charles I. Francis, 8 T. C. No. 91 (1947) and G. H. Beavers, T. C. Mem.
himself—hence a nullity, and hence not taxable.\textsuperscript{183}

The gift tax is imposed on the aggregate of the “net gifts” made since the enactment of the 1932 Revenue Act, and from such tax is deducted the amount of the tax on the aggregate sum of net gifts for each of the calendar years preceding the calendar year for which the tax is being computed, such tax being computed at the rates and with the exemptions in effect in the year for which the return is being filed.\textsuperscript{184} The applicable annual exclusions, however, are those in effect in the years when the gifts were made.\textsuperscript{185} For the year 1938 and prior thereto, the annual exclusion for each donee other than a future interest in property was $5,000.\textsuperscript{186} For the calendar year 1939 to and including 1942, other than gifts of future interests in property and gifts in trust, it was $4,000.\textsuperscript{187} Commencing with 1943, and with respect to gifts other than those of future interests in property, it is $3,000.\textsuperscript{188}

Against gifts made by a citizen or resident, there is allowed a specific exemption of $30,000,\textsuperscript{189} less the amount claimed and allowed since June 6, 1932, whether the gift be one in trust or of a future interest in property.\textsuperscript{190} The donor may take this exemption in a single year or spread it over a period of years.\textsuperscript{191} Prior to 1936, the specific exemption was $50,000; from 1936 to 1942, inclusive, it was $40,000; since then it has been $30,000.\textsuperscript{192} However, the exemption for years prior to 1943 may not exceed $30,000, if the tax is being computed for 1943 or thereafter.\textsuperscript{193}

The tax rates are progressive and are based on “net gifts.” The rates have changed four times (Act of 1934, 1935, 1940 and 1941), but today they start at 2\(\frac{3}{4}\)% on the first $5,000 and go as high as 57\(\frac{3}{4}\)% on gifts over $10,000,000.\textsuperscript{194}

\textsuperscript{183} Cf. Rev. Rev. Stat. § 11218-11 (b) Corresponding provision has been made for transfers in contemplation of death. Int. Rev. Code § 811 (d) (5) However, a gift by the husband of community property to his wife is prima facie a gift of the whole for federal gift tax purposes, Reg. 108, § 86.2 (c) If either spouse converts separate into community property on or after Jan. 1, 1943 there is no federal gift tax, Reg. 108, § 86.2 (c).

\textsuperscript{184} Id., §§ 1000, 1003, 1004.

\textsuperscript{185} Id. § 1003 (b)\textsuperscript{186} Id. § 1003 (b) (1)

\textsuperscript{187} Id. § 1003 (b) (2)

\textsuperscript{188} Id. §§ 1003 (b) (3) Future interests are defined in Reg. 108, § 86.11.

\textsuperscript{189} Id. § 1004 (a) (1)

\textsuperscript{190} The statute contains no limitation on the gifts with respect to which this exception may be taken.

\textsuperscript{191} Int. Rev. Code § 1004 (a) (1); Reg. 108, § 86.12.

\textsuperscript{192} Id. § 1004 (a) (1)

\textsuperscript{193} Id. § 1001.

\textsuperscript{194} Id. § 1001.
It will be noted that the relationship of donor and donee has nothing whatsoever to do with the rates. The tax is imposed on net gifts, regardless of the donee and his relationship to the donor. Charitable gifts are, however, tax-free.\(^\text{105}\)

It follows that a gift may be taxable simultaneously by both the State of Washington and by the United States. A spouse may make an initial gift free of federal tax up to $33,000 in one calendar year to one donee, but if the property is community and the donee is a Class A beneficiary, such as donor's child, then only $26,000 thereof will be free of the state gift tax. Both under the Washington gift tax law and the federal gift tax law, a donor may make tax-free gifts except of future interests in property to any number of donees and regardless of their relationship if the gift to each does not exceed $3,000.\(^\text{106}\) Thus, spouses with children may transfer a substantial portion of their estate initially and thereafter annually, taking advantage of their annual exclusions and exemptions, free of tax and thereby obtain important tax savings which would otherwise be payable on the transmission of property at death.\(^\text{107}\)

\section*{D. TYPES OF TAXABLE GIFTS}
\subsection*{1. COMPLETE AND INCOMPLETE GIFTS}

We have been largely considering the gift problem in its simplest form—usually a money or tangible property transfer of an out-and-out character. Gifts are not, of course, confined to conventional and simple gifts of money or tangible property. The following types of gifts, for example, are for federal gift tax purposes, taxable gifts: The transfer of a contingent interest;\(^\text{108}\) the exercise or release of a power of appointment\(^\text{109}\) created since October 22, 1942\(^\text{110}\) (except a release

\(^{105}\) Id. § 1094 (a) (2)

\(^{106}\) Id. § 1003 (b) (3), Rem. Rev. Stat. § 11218-14. To obtain maximum income tax advantage to the donee in the event he sells the property, assets of high cost value should be given away because the donee retains the donor's cost basis for income tax gain purposes. Int. Rev. Code § 113 (2)


\(^{109}\) Int. Rev. Code § 1000 (c) amended by Rev. Act. of 1942 § 452 (a), Reg. 108, § 86.2 (b)

\(^{110}\) Rev. Act of 1942 § 452 (b)
prior to the 1st day of July, 1948; the transfer of a joint interest; the assignment of a life insurance policy or irrevocable designation of a life insurance beneficiary, even though the right of the assignee or beneficiary to receive the proceeds is conditioned upon his surviving the insured; transfers for consideration to the extent that they are made for consideration not in money or money's worth; surrender of powers to revoke or amend a trust; an agreement between spouses dividing community property into separate property.

Taxable gifts should be distinguished from what for tax purposes at least are incomplete gifts or invalid gifts and hence non-taxable gifts. The following types of gifts illustrate this principle: A gift in trust with power reserved in the trustor to change beneficiaries even to others than himself, or to otherwise amend or revoke the trust, is incomplete until the reserved power is relinquished; a revocable gift whether or not in trust is incomplete unless the consent of an adversely interested


202 Reg. 108, § 86.2 (a) (4) (5) See also Reg. 108, § 86.19 (h), tenancy by entirety on war savings bond. See Mm. 5202, 1941-2 C. B. 241, setting forth the gift and estate tax status of U. S. savings, defense and war bonds, C. C. H. FEDERAL, ESTATE & GIFT TAX REP. § 3391.909.


person is necessary to effect revocation, a gift of community property by a wife to her husband is ineffective as a gift by the wife because the statute makes all gifts of community property gifts by the husband. Gifts which are incomplete for gift tax purposes may be complete even though certain reversionary rights in gifts in trust are retained. Thus a gift in trust subject to reversion to the donor on the beneficiary predeceasing him is a valid gift of the entire interest, less the value of the reversionary interest, determinable by recognized actuarial methods. If a gift is incomplete for gift tax purposes, the subject of the gift is includable in the estate of the donor for estate tax purposes and the income from such gift is taxable to the donor. Indeed, if such income is paid to a person other than the donor the Commissioner contends that a gift of such income occurs.

2. JOINT TENANCIES AND GIFTS: TAX CONSIDERATIONS

Related to the subject of what constitutes gifts are joint tenancies. Although joint tenancies have been abolished in Washington as part of our property law, it is still possible to create joint tenancies by contract, as in the case of bank accounts. In addition, the Washington statutory law expressly authorizes joint bank accounts with right of survivorship subject to inheritance and gift tax law. No gift

210 Revocable trusts may be desirable independently of tax considerations, e.g., as a substitute for an agency or power of attorney, or for preservation of continuity in business management notwithstanding trustee's death. Rem. Rev. Stat. § 11218-11(c), Reg. 106, § 86.3. C. I. R. v. Warner, 127 F. (2d) 913 (C. C. A. 9th, 1942)
211 Int. Rev. Code § 1000 (d)
212 Smith v. Shaughnessy, 318 U. S. 176, 87 L. ed. 690, 63 Sup. Ct. 545 (1943)
214 Income of a trust used to discharge a legal obligation of trustor is taxable to trustor even though he has parted with all rights to the trust property. Douglas v. Willcuts, 286 U. S. 1, 80 L. ed. 3, 56 Sup. Ct. 59 (1935), Halvering v. Stuart, 317 U. S. 154, 87 L. ed. 154, 63 Sup. Ct. 140 (1942)
215 The Commissioner's contention has been rejected by the Tax Court, however. Hogle v. C. I. R., 7 T. C. No. 114 (Oct. 17, 1946); Strong v. C. I. R., 7 T. C. No. 108 (1946), Rem. Rev. Stat. § 11218-11(c)
217 In re Ivers Estate, 4 Wn. (2d) 477, 104 P (2d) 467 (1940) See Crutcher, Survivorship in Joint Bank Accounts and Wilson v. Ivers (1941) 16 Wash. L. Rev. 105; Tacoma Sav. & Loan Ass'n v. Nadham, 14 Wn. (2d) 576, 128 P (2d) 932 (1942)
218 Rem. Rev. Stat. § 3348 (Mutual Savings Banks), § 3717-41 (Building and Loan Ass'n), §§ 3249, 3249-1, 3249-2 (National, State Bank, and Trust Company)
occurs when community property bank account is placed in a joint tenancy nor when the separate property of one is so placed. The gift would seem to occur, however, when and to the extent of the amount withdrawn by the person who has contributed nothing thereto. In the case of community property, a gift should be deemed to occur when either party withdraws more than his or her one-half of the account. The same would seem to be true, in the absence of local statute, in the case of jointly owned war and defense savings bonds. No gift for federal tax purposes occurs until the bonds are redeemed and the proceeds retained. Beneficiary registration alone in such case does not create the gift. However, if donor is not a joint payee the gift occurs on registration and delivery

Where one person places his or her property (separate or community) in joint tenancy with another, with right of survivorship, which rights may be defeated by either party severing his interest, a taxable gift then occurs. If a tenancy by entirety is created by either spouse the gift is measured by the value of property placed in tenancy by entirety, less the donor's right to the income therefrom during the joint lives of the spouses and his right to take the whole on survivorship, using life expectancy tables as an aid. However, jointly held property (as well as property held by entireties or community property) is taxable in full in the estate of the one first to die except such part as belonged to the other person and was not received as a gift from the

220 Id. § 11201 (Inheritance Tax); § 11218-11 (Gift Tax) does not deal specifically with bank accounts, but to the extent a gift is involved, gift tax statutes apply.
221 Wolfe v. Hoefke, 124 Wash. 495, 214 Pac. 1047 (1923); Meyers v. Albert, 76 Wash. 218, 155 Pac. 1003 (1913) Cf. The Old Nat. Bk. & Union Trust Co. v. Kendall, 14 Wn.(2d) 19, 126 P (2d) 603 (1942)
222 This is implicit in the Washington decisions. See Daly v. Pacific Sav. & Loan Assn., 154 Wash. 249, 282 Pac. 60 (1929) It is the federal ruling. Reg. 108, § 86.2 (4).
223 This conclusion follows from the nature of spouses' interests in community property.
225 Mm. 5202, 1941-2 C. B. 241, reported at C. C. H. supra note 202, § 3391.909. For local law purposes, however, the gift is complete at latest upon death of a co-owner. Wash. Laws 1943, c. 14.
226 Note 224, supra.
227 Under state law (Div. v. Chamberlan's Estate, 21 Wn.(2d) 790, 153 P.(2d) 305 (1944), and federal law. (Note 224, supra.)
228 Reg. 105, § 86.2 (a) (5).
229 Reg. 108, § 86.2 (6), 86.19 (h).
decedent, regardless of the gift tax, if any, previously paid. Joint tenancy with right of survivorship has undesirable tax consequences. It is true that like community property income, joint tenancy income during the joint lives of the joint tenants and losses may be equally divided both for ordinary income and capital gain purposes. The whole of property jointly held is includable in the estate of the joint tenant first to die (with credit for gift tax previously paid) and if the second joint tenant dies more than five years thereafter, the whole of the property which the joint tenant owns by right of survivorship is taxed again. Furthermore, the cost basis of property jointly held in the case of the surviving joint tenant is the cost basis of decedent donor, or fair market value at date of gift, whichever is lesser, rather than the fair cash market value at the date of death. Furthermore, jointly held property does not eliminate state inheritance taxation and if debts exceed deceased's property, debts are not deductible to the extent of such excess. Tenancy in common or co-

239 INT. REV. CODE § 811(e), Reg. 105, § 81.22 as amended T. D. 5239 (March 10, 1943), REM. REV. STAT. § 11201.
240 Rabkin & Johnson, Federal Income, Gift and Estate Taxation, E 4, § 6, p. 288; Reg. 108, §§ 88.2 and 88.19 (h)
241 Edmonds v. C. I. R., 90 F (2d) 14, cert. denied, 302 U. S. 713, 82 L. ed. 551, 58 Sup. Ct. 32 (1937)
243 INT. REV. CODE § 936 (b), Reg. 105, § 81.8 (b), Wm. H. Horner Est., 44 B. T. A. 1138 (1941), affd. 130 F (2d) 649 (C. C. A. 3d, 1942) (whether gift tax is paid by decedent or another)
244 INT. REV. CODE § 812 (c); Reg. 105, § 81.41(a) (1), the status means five years between the deaths, not between the estate distributions. Second Natl. Bank & Tr. Co. v. C. I. R., 63 F (2d) 815 (C. C. A. 5th, 1933) REM. REV. STAT. § 11202.a limits the exemption to transfers within a limited class of persons, including spouses and children. This is not true under the federal act.
245 INT. REV. CODE § 811. Surviving tenant doesn't take by "bequest, devise, or inheritance" as required by § 113(a) (5)
246 Carpenter v. C. I. R., 27 B. T. A. 252 app. dis., 68 F (2d) 995 (C. C. A. 7th, 1934), INT. REV CODE § 113(a) (2)
247 INT. REV. CODE § 113(a) (6)
248 REM. REV. STAT. § 11201; Wash. Laws 1937 c. 106 § 1.
249 See Bascom Little Estate, B. T. A. Memo. Dock. 112651, C. C. H. 13, 174; INT. REV. CODE § 812(b) as amended Rev. Act. 1942 § 405(a)
munity property interests are, however, includable in the estate and hence permit debt deduction *pro tanto.*

3. GIFTS WITH PERMISSIBLE STRINGS

a. GIFTS IN TRUST: TAX PROBLEMS

It must not be thought, however, that the gift must be entirely without strings. Certain strings are permissible. A gift in trust, if the trust is irrevocable, is still a taxable gift even though possession free of the trust is postponed to a future date. It should be pointed out, however, that such transfer may constitute a future interest and hence not qualify for the annual gift tax exclusion of $3,000. Thus a gift in trust to a trustee for the benefit of a minor until he becomes of age is gift of a future interest, but such a gift with provision for annual disbursements of income is not a gift of a future interest. Furthermore, a gift in trust with a right of reversion in the donor is a permissible gift qualifying both for purposes of annual exclusion and gift tax exemption.

Gifts in trust may, however, raise important income tax questions under Sections 22(a), 166 and 167 of the Internal Revenue Code. Those sections have been frequently and successfully invoked under the doctrine of *Helvering v. Clifford, Commissioner,* to permit the donor to be taxed on the trust income (even though the gift is subject to gift tax) on the theory that the donor or his subservient trustee has retained such controls over the trust that in effect the donor is still the owner. Such controls include reservation of management powers for

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241 *Int. Rev. Code* § 811(e)(2); *Estate of I. A. Smith v. C. I. R.,* 45 B. T. A. 59 (1941) For a recent discussion of the relative advantages and disadvantages taxwise of joint tenancies, see Dane, *Tenancies, Joint or Common and by the Entireties* (July, 1947) 25 TAXES—The TAX MAGAZINE 634.

242 Reg. 108, § 86.3; Lasker v. C. I. R., 1 T. C. 203 (1942)

243 *Int. Rev. Code* § 1003; Reg. 108, § 86.11; notes 176-7 supra.


246 *Gifts in trust are excluded from the benefits of the annual exclusion from 1939 through 1942. Int. Rev. Code* § 1003. Mere existence of reversionary interest doesn't prevent a transfer from qualifying as a taxable gift, the value of the reversionary interest being excluded. Smith v. Shaughnessy, 313 U. S. 176, 87 L. ed. 690, 63 Sup. Ct. 545 (1943)

247 *Helvering v. Clifford,* 309 U. S. 331, 84 L. ed. 788, 60 Sup. Ct. 554 (1940)

248 Lockhard v. C. I. R., 7 T. C. No. 135 (1946)
the donor's own benefit or the reservation of power to shift income or principal as among beneficiaries either in connection or not in connection with a short-term trust. The decisions have been in such confusion as to what constituted a Section 22(a) trust with resulting income tax liability to the donor that finally the Treasury Department, on December 29, 1945, promulgated Treasury Decision No. 5488, effective December 31, 1945, laying down definite though somewhat arbitrary rules to guide the taxpayer in a determination of the question. The rules were subjected to much criticism as being too restricting with the result that the rules have been amended to permit more trusts to qualify so as to free the donor from income tax liability on trust income. It is, therefore, now possible to create a gift in trust for a minor by complying with the above mentioned Treasury Decisions so that the income from the trust will not be taxable to the trustor except to the extent actually used to discharge the trustor's legal obligation to support and educate the minor. It is still not possible, however, to create a gift in trust for the purpose of discharging or being available to discharge the trustor's legal obligations except as last mentioned even through the medium of a corporate


250 Hopkins v. C. I. R., 157 F (2d) 679 (C. C. A. 6th, 1946)

251 Reg. 111 § 29.23 (a)-21.

252 The three general determinative factors considered are (1) reversionary interest, (2) power to dispose of beneficial enjoyment, (3) powers of administrative control.


254 Treasury Dept. Release Dec. 26, 1946. For summary of proposed changes, see (1947) 33 A. B. A. J. 294. In Mimeograph 6071, the Treasury stated that the release of Clifford trust powers so as to make the trust conform to T. D. 5488 prior to Jan. 1, 1947 would render 1946 income non-taxable to the trustee. The Bureau of Internal Revenue announced the changes July 2, 1947.

255 If principal of the trust is actually used, the trust income for that year taxable to grantor to extent not paid out or credited to beneficiary. G. C. M. 24946 interpreting 1943 Rev. Act. § 167(c)
trustee. Thus, a trust to provide funds with which to pay insurance premiums for the benefit of the donor;\textsuperscript{256} or to pay the donor’s debts;\textsuperscript{257} or to support, maintain and educate his children to the extent used\textsuperscript{258} would result in income tax liability on the trust income to the donor.\textsuperscript{259}

b. GIFTS WITH POSSIBILITY OF REVERTER

Gifts in trust, even though the trust is irrevocable, frequently provide for right of reversion in the donor. Such trusts raise gift tax, income tax and estate tax questions.

If a right of reverter exists and has value, the gift is complete for gift tax purposes, the value of the right of reverter being deducted in determining the value of the property being given away.\textsuperscript{250} If such right of reverter exists, even though the possibility of reverter be remote, the law prior to May 1, 1946, required the entire trust estate to be inventoried in and taxed as part of the trustor’s estate for estate tax purposes as a transfer to take effect in possession or enjoyment at or after his death.\textsuperscript{251} Due to much criticism, the Treasury Department promulgated Treasury Decision No. 3513, effective May 1, 1946, attempting to lay down rules for the guidance of taxpayers who create gifts in

\textsuperscript{250}\textit{Int. Rev. Code} § 167 (a) (3) Foster, 8 T. C. No. 22 (1947) Cf. C. I. R. v. Jergens, 127 F (2d) 873 (1942) The rule is otherwise if the policy is payable to a charity. If the trust income is payable to trustor’s wife and he suggests she use the trust income to pay insurance premiums on policy insuring husband’s life, the trust income is taxable to husband. Dunning v. C. I. R., 38 B. T. A. 1222 (1937). But if wife does so without suggestion from the husband, as where she did so before and after the creation of the trust, husband was held not taxable on trust income (Hexter v. C. I. R., 47 B. T. A. 483 (1942)) or where the suggestion and decision was wholly that of the wife (Booth v. C. I. R., 3 T. C. 605 (1944)); or where wife voluntarily, without any agreement with the husband, paid the premiums, the trust income was not taxable to the husband (Barker, T. C. Memo. (Sept. 9, 1943))

\textsuperscript{251}\textit{Int. Rev. Code} §§ 166, 167, 22A.

\textsuperscript{252}\textit{Id.} § 167 (c).

\textsuperscript{253}For a short summary of the history of the use of the trust device to reduce federal income taxes, see RANDOLPH E. PAUL, TAXATION FOR PROSPERITY, 293-296.

\textsuperscript{256}Smith v. Shaughnessy, 318 U. S. 176, 87 L. ed. 690, 6 Sup. Ct. 545 (1943)

trust with a right of reverter. In general, no part of the trust estate containing such right of reverter will be includable for estate tax purposes in the donor's estate unless possession or enjoyment of the transferred interest can be obtained only by the beneficiaries who must survive the decedent and the decedent or his estate possesses any right in the property. In other words, a reversion contingent on the grantor's death is includable, but a reversion contingent on a beneficiary's death is not includable.

A gift in trust with right of reverter also raises income tax questions, because the existence of such right may result in a determination that the grantor is the "owner" of the trust property under Section 22 (a) of the Internal Revenue Code. However, the existence of a mere right of reverter prior to Treasury Decision No. 5488 without more is not enough to render the trust income taxable to the grantor.

4. QUASI-TESTAMENTARY GIFTS

From what has heretofore been said, it follows that any plan of estate division that contemplates the use of gifts requires that such gifts in general be by gift absolute, but if in trust that the trust be irrevocable and unamendable, that it comply with Treasury Decision No. 5488 for income tax purposes, comply with Treasury Decision No. 5513 for estate tax purposes, and if the annual exclusion of $3,000 is to be obtained, that the gift does not create a future interest.

Certain additional principles in connection with gifts should, however, be borne in mind. One purpose of such gifts is to avoid their

In case of insurance proceeds, a mere right of reverter as to decedents dying after Oct. 21, 1942 is not enough to render the proceeds includable in decedents' gross estate. Rev. Act 1942, § 404 (a) See Estate of Hock v. C. I. R., 152 F (2d) 574 (C. C. A. 8th, 1946)


As construed in Helvering v. Clifford, note 247 supra.

inclusion in the estate of the donor for inheritance and estate tax purposes. It is, therefore, necessary to briefly notice statutory attempts to defeat what may be termed quasi-testamentary inter vivos transfers, namely, gifts in contemplation of death, transfers intended to make or take effect in possession or enjoyment at or after death and whether or not in trust, transfers with life income or possession retained, revocable trusts and powers of appointment.

a. GIFTS IN CONTEMPLATION OF DEATH

Gifts or transfers (to the extent that they are not for money or money's worth) in contemplation of death are subject to gift tax but are includable in the donor's estate for estate and inheritance tax purposes although with credit given for federal estate tax purposes for gift tax paid. The amount of the gift tax is not, however, subject to the inheritance or estate tax and hence a gift in contemplation of death will still effect an inheritance or estate tax saving by the amount of the tax otherwise payable on the gift tax paid or payable. The phrase "in contemplation of death" does not mean the general expectation of death common to all men, but rather a gift prompted by the thought of death. The finding of the Tax Court on such a matter is final. In determining whether a gift is in contemplation of death, the age and health of the donor will be considered; his motives will be inquired into in order to determine whether the motives were associated with life or with death. Fundamentally, the inquiry should be

268 Int. Rev. Code § 813(a) There is no corresponding statute in Washington. See Rem. Rev. Stat. § 11201, although unpaid gift tax would seem to be deductible as a "debt."
269 For an illustration of such a possible tax saving, see I Tax L. Rev. 33, stating "In the case of a five million dollar estate, half of which was transferred in contemplation of death, the saving, at present rates would amount to approximately $500,000."
270 Reg. 105, § 81.16.
273 E.g., to teach children how to handle money; to enable children to maintain their social position; to induce children to enter into business with parents; to provide a wife with an independent income; to save income taxes; to relinquish active control of a business so as to lead a life of ease; to protect one's family from financial worry; to free donor from burdens of unproductive property. See C. C. H. Fed. Estate & Gift Tax Reporter, § 3423.42.
274 See U. S. v. Wells, 283 U. S. 102, 75 L. ed. 867, 51 Sup. Ct. 446 (1931)
directed to the issue of whether the gift was intended as a substitute for a testamentary disposition. However, the motive to avoid estate taxes, as evidenced by an estate plan should not render the transfer subject to estate tax, although the Commissioner contends that it should, and the cases are divided. If the transfer was within two years prior to death, both the federal and Washington law create a presumption that it was in contemplation of death.

Transfers in contemplation of death, as in the case of gifts, are not limited to the conventional situations of money or tangible property transfers. Thus they include gifts in trust. Relinquishment of powers of appointment within two years prior to death are presumptively in contemplation of death to the extent of the amount of each beneficiary's interest in excess of $5,000. A division of community property into separate property may be a transfer in contemplation of death.

b. TRANSFERS INTENDED TO TAKE EFFECT IN POSSESSION OR ENJOYMENT AT OR AFTER DEATH AND WHETHER OR NOT IN TRUST.

A second type of transfer subject to estate and inheritance taxation is a transfer (in trust or otherwise) by decedent prior to death, intended to take effect in possession or enjoyment at or after death.


278 See C. C. H. FED. EST. & GIFT TAX REPORTER, § 3423.10. Applies to a "transfer of a material part of his property in the nature of a final disposition except in case of a bona fide sale for an adequate and full consideration in money or money's worth."

279 REM. REV. STAT. § 11201(a) applies regardless of whether the form of the transfer be by "deed, grant, sale or gift without a valid and adequate consideration therefor."


281 INT. REV. CODE § 811(d) (4) Relinquishment of power to amend a trust of life insurance policies has been held to be in contemplation of death. Louis Diamond Estate v. C. I. R., 159 F (2d) 672 (C. C. A. 2d, 1947)


283 INT. REV. CODE § 811(c), Reg. 105, § 81.17 renders such transfers includable in estate if possession or enjoyment of the transferred interest can be obtained
This, likewise, does not apply to transfers for an adequate and full consideration in money or money's worth.  

**c. TRANSFERS WITH LIFE INCOME OR POSSESSION RETAINED**

A third type of transfer is one with life income or possession retained other than a transfer for full and adequate consideration. Although the remainder interest is subject to a gift tax, the entire trust estate is includable in the donor's estate at death.  

The husband's right of management in a community property estate with respect to community property transferred to a wife is not the possession or enjoyment contemplated by the statute so as to be includable in the husband's estate under the Pre-1942 Revenue Act.  

The right to possession or enjoyment may exist from a consideration of all the controls retained, e.g., the right to fix salary as president of corporation and vote stock thereof transferred in trust, or other economic benefit. Contingent right to income has been held insufficient to render property includable in decedent's estate.  

Only by beneficiaries who must survive the decedent and the decedent or his estate possesses any right or interest in the property. Hence, if decedent in his lifetime transfers such retained interest to a charity, no interest would be retained, and the transfer would not be includable for estate tax purposes. The For inheritance tax-liability, see INT. REV. CODE § 811; INT. REV. CODE § 811(c); REM. REV. STAT. §§ 11201, 11201(a)  

INT. REV. CODE § 811(c); REM. REV. STAT. §§ 11201, 11201(a) effective March 3, 1931. See Reg. 105, § 81.18. Prior thereto, it was held in May v. Heiner, 281 U. S. 238, 74 L. ed. 826, 50 Sup. Ct. 286 (1930) that mere retention of life income from the trust by grantor was insufficient to require value of trust property to be included in grantor's estate. See also, Drummond v. Clausen, 67 F. Supp. 872 (U. S. D. C. Mar. 1943) The right to have income applied in discharge of settlor's continuing obligations is the equivalent of retention of income. Helvering v. Mercantile Commerce Bank & Trust Co., 111 F. (2d) 224 (1940) cert. denied, 310 U. S. 654, 84 L. ed. 148, 60 Sup. Ct. 1104 (1940) (income to wife to be used for family expenses, her support) For inheritance tax liability see REM. REV. STAT. § 11201.  

INT. REV. CODE § 811(c) effective March 3, 1931. See Reg. 105, § 81.18. Prior thereto, it was held in May v. Heiner, 281 U. S. 238, 74 L. ed. 826, 50 Sup. Ct. 286 (1930) that mere retention of life income from the trust by grantor was insufficient to require value of trust property to be included in grantor's estate. See also, Drummond v. Clausen, 67 F. Supp. 872 (U. S. D. C. Mar. 1943) The right to have income applied in discharge of settlor's continuing obligations is the equivalent of retention of income. Helvering v. Mercantile Commerce Bank & Trust Co., 111 F. (2d) 224 (1940) cert. denied, 310 U. S. 654, 84 L. ed. 148, 60 Sup. Ct. 1104 (1940) (income to wife to be used for family expenses, her support) For inheritance tax liability see REM. REV. STAT. § 11201.  

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control investments and to manage trust property may be reserved, however, but not a power of invasion for settlor's benefit. The statute cannot be circumvented by A making a gift to B, followed by the creation of a trust for A's benefit as part of a plan, or by cross-trusts, as where A and B create trusts similar in terms, for each other's benefit or with reciprocal rights of termination.

d. REVOCABLE TRUSTS

Property held under a revocable trust at the date of trustor's death is part of his taxable estate. Power of settlor trustee to invade corpus or accumulated income for his wife, trust beneficiary, renders the trust a revocable one.

e. POWER OF APPOINTMENT

A fifth type of inter vivos transfer that should be noticed here is the power of appointment. In general, the power of appointment is the power or authority to designate what persons should enjoy the ownership of the property not belonging to the donee of the power. Thus, a father may transfer property to a son for life, coupled with a power in the son to designate who shall take the remaining property after the son's death, or the transfer may be one whereby property is transferred for a term of years, coupled with a power in the son to designate who shall take the remaining property after the end of the term.

Powers of appointment do not have the same tax treatment by the state and federal governments. Under the state law, the exercise of a power of appointment by a donee is a transfer subject to inheritance tax as if the donee owned the property bequeathed, unless the donee was a non-resident and the donor a resident at the time the appoint-
ment takes effect, in which case the appointed property is taxable as if it had been transferred by the donor. For state gift tax purposes, no express provision is made that the exercise of a power of appointment shall be treated as a gift by the donee of the power exercising it. Under the federal law since the Revenue Act of 1942, taxable powers of appointment are redefined both for gift tax and federal estate tax purposes. Both for federal gift tax purposes and federal estate tax purposes, a power of appointment means any power of appointment exercisable by an individual either alone or in conjunction with any person, with certain exceptions, namely, familial powers of appointment, fiduciary powers, and powers exercisable in favor of specified charities. If a taxable power exists, its exercise or release may be subject to a gift tax, and upon the death of the donee of the power, the property subject to the power is includable in the estate of the donee of such power unless meanwhile the power has been made, created, exercised, or relinquished for an adequate and full consideration in money or money's worth. Property is also includable if the power exists or is exercised or released in contemplation of death or by disposition intended to take effect in possession or enjoyment at or after death.

1. CONCLUSIONS AS TO GIFT TRANSFERS

In view of the State and Federal law certain factors should be borne in mind in any plan of property division inter vivos: 1. Inter vivos gifts enable estate and income tax savings to be effected through the use of annual exclusions and gift tax exemptions and by virtue of the

299 REM. REV. STAT. § 11201.1c; State v. Dobson, 188 Wash. 211, 61 P. (2d) 1302 (1936)
299 See note 481, infra.
301 INT. REV. CODE §§ 1000 (c), 811 (f)
302 Id. §§ 1000 (c) (1), 811 (f) (2) (A).
303 Id. §§ 1000 (c) (2), 811 (f) (2) (B)
304 Id. § 812 (d) as amended 1942 Rev. Act., § 403 (b) (1), § 1004 (a) (2)
305 Id. § 1000 (c)
306 Id. § 811 (f) (1) Ex'rs of Henderson v. Rogan, 159 F. (2d) 855 (C. C. A. 9th, 1947); Estate of Charles B. Ducharme, 7 T. C. 85 (1946), Penn. Co. v. U. S. (D. C. Pa. 1946) (under pre-1942 law) However, unless the will of the deceased otherwise directs, the executor may recover from the person receiving the apportioned property, the estate tax attributable thereto, based on a specific formula. INT. REV. CODE; see note 491, infra.
307 INT. REV. CODE § 1002.
308 Id. §§ 811 (f) (1), 811 (d) (4) This applies whether the powers were created before or after October 21, 1942. Prior to Rev. Act. of 1942 only property passing by the exercise of a general power of appointment was subject to the Federal Estate Tax.
fact that the tax base is reduced through estate splitting, and gift tax rates are less than estate or inheritance tax rates.

2. Maximum savings can be effected if the gifts are outright and do not create future interests in property. Gifts in trust may, however, be made with tax savings, provided that care is taken to make them complete and to have them comply with Treasury Decisions No. 5488 and No. 5513, so as to avoid income tax liability to the donor and estate tax liability by virtue of rights of reverter. If gifts in trust are made to more than one beneficiary, separate gifts in trust should be made in order to enable each trust to take advantage of the annual income tax exemption of $100 and to keep the trust income in the lower income tax brackets.

5. Gifts of community property should take into account the federal rule that such gifts are deemed gifts by the husband.

6. Division of community into separate property by an agreement of the spouses may be desirable taxwise, but the matter should await further clarification.

7. Joint ownership arrangements are not desirable in Washington except for procedural purposes in connection with bank accounts and war or defense savings bonds.

8. Any inter vivos transfers should take into account the statutory attempts to tax what may be termed quasi-testamentary gifts, namely, gifts in contemplation of death, transfers intended to take effect in possession or enjoyment at or after death, transfers with life income or equivalent benefits or possession retained, revocable gifts or trusts and powers of appointment.

9. Gifts which are complete for gift tax purposes may still result in income tax liability to the donor and estate tax liability to the donor unless safeguarded in the manner hereinabove pointed out.

IV
DONATIVE INSURANCE AND ESTATE LIQUIDITY
A. ESTATE LIQUIDITY

It is obvious from the foregoing summary of estate problems that the availability of cash in or to the estate is of the highest importance in order to pay funeral expenses, debts, taxes, cash bequests, administrative expenses, costs and fees. If cash is not available, estate assets may have to be sold at a sacrifice with resulting capital loss and income shrinkage. An estate with frozen and difficult-to-market assets (such as stock in a closely held corporation, or real estate) may well be in a very difficult position.

In any estate plan, provision should be made to meet this conting-
Estate planning

Such provision could be made by seeing to it that the estate has cash, bank deposits or marketable securities, insurance moneys through personal or business insurance. In any case, the executor should be empowered to borrow money for the payment of demands, obligations, taxes, or administrative expenses, costs and fees.

In connection with the problem of estate liquidity, insurance may play an important part. We, therefore, turn to a consideration of personal and business insurance problems.

B. LIFE INSURANCE WITH PARTICULAR REFERENCE TO FEDERAL TAX LAW

Most persons interested in estate planning have, or contemplate having, life insurance, and, frequently, accident, health or hospital insurance are obvious and need not detain us in connection with our present inquiry.

Under Washington law, life insurance policies are separate or community, depending upon the separate or community character of the premiums paid. If such premiums are paid partly from separate and partly from community property the proceeds are separate or community in that proportion that the kind of premium paid bears to the entire premium cost of the policy.

Under state law, life insurance proceeds up to $40,000 are exempt from state inheritance tax if payable to persons other than the insured's estate or for his benefit. They are likewise exempt from the claims of creditors of the insured or beneficiary without limitation as to amount if the policy is payable or is assigned to a person other than the insured or the person effecting the insurance. Under federal law, life insurance proceeds, as such, are not exempt from estate tax.

In re Coffee's Estate, 195 Wash. 379, 81 P (2d) 283 (1938), Occidental Life Ins. Co. v. Powers, 192 Wash. 475, 74 P (2d) 27, 114 A. L. R. 531 (1937) A spouse cannot give community property away. Hence, a husband cannot name as beneficiary one other than his wife or his estate. In re Towey's Estate, 22 Wn. (2d) 212, 155 P (2d) 273 (1945) There is a rebuttable presumption of consent if the beneficiary is a child, parent, brother or sister of either spouse, regardless of size of policy. Wash. Laws 1947, c. 79, § 18.44(2)

In re Towey's Estate, 22 Wn. (2d) 212, 155 P (2d) 273 (1945) There is a rebuttable presumption of consent if the beneficiary is a child, parent, brother or sister of either spouse, regardless of size of policy. Wash. Laws 1947, c. 79, § 18.44(2)

Beneficiaries may be trust beneficiaries other than insured's estate. In re Killien's Estate, 78 Wash. 335, 35 P (2d) 11 (1944)

Beneficiaries may be trust beneficiaries other than insured's estate. In re Killien's Estate, 78 Wash. 335, 35 P (2d) 11 (1944)

Int. Rev. Code § 811(e) (2); (g) (1) Prior to October 22, 1942 a $40,000 insurance proceeds exemption in case of policies payable to other than insured, was allowed. § 811(g)
Certain special rules should, however, be noted in that connection. If the insurance proceeds are payable to the insured's estate or for his benefit, they are, of course, subject to the estate tax. If the proceeds of the policy are payable to other beneficiaries, they may still be included in his estate for estate tax purposes if at the time of his death the decedent possessed any of the incidents of ownership with respect thereto, either alone or in conjunction with another person. A person is said to possess an incident of ownership if the deceased at the time of death owned the policy as community property or if he has any rights under the policy, such as the right to the cash surrender value or loan value, the right to change beneficiary, or any other right conferred upon him by the policy Even in the absence of such incident of ownership, the proceeds of such a policy are included to the extent that they are attributable to the premiums paid, directly or indirectly, by the decedent. The application of this premium test depends upon whether the policies were transferred before or after January 10, 1941. If a policy has been transferred on or before January 10, 1941, a modified premium test is applicable, even though the decedent retains none of the incidents of ownership in the policy If he paid no premiums after January 10, 1941, none of the proceeds is includable in the insured's estate. If he paid part of the premiums after January 10, 1941, the proceeds are includable in his estate in the proportion that the insured's post-January 10, 1941 payments bear to the total premiums paid.

If a policy has been transferred after January 10, 1941, the premium test is applicable even though the decedent retains none of the incidents of ownership in the policy Consequently, the entire proceeds are includable in the insured's estate if he has paid all the premiums.

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814 Id. § 811(e) (2), (g) (1)
815 Id. § 811(e) (2), (g) (2) See Hodge, Life Insurance and the Estate Tax (Apr'1, 1947) 25 TAXES—THE TAX MAGAZINE, discussing inter alia the constitutionality of Int. Rev. Code § 811 (g)
816 Reg. 105, § 81.27; see C. C. H. Fed. Estate & Gift Tax Rep. § 3473.38. Proceeds of a group insurance policy held subject to estate tax of decedent employee. Welliver v. C. I. R., 8 T. C. 165. Dec. No. 15557 (Jan. 28, 1947) Incident of ownership does not, however, include a mere right of reverter as to decedents dying after October 21, 1942; Estate of Simmons v. C. I. R., 152 F (2d) 574 (C. C. A. 8th, 1946), Int. Rev. Code § 811 (g) (2)
817 Int. Rev. Code § 811 (g) (2) (4)
818 Revenue Act of 1942, § 404(c), 26 U. S. C. A. § 811 (g)
819 Ibid.
820 Ibid.
821 Int. Rev. Code § 811 (g) (2) (3) amended 1942 Rev. Act § 404(c)
If he has paid only part of the premiums, then the proceeds are includable in his estate in the proportion which the insured's payments bear to the total premiums paid. The dates of the premium payments are not material.

Certain rules should be noted with respect to insurance trusts. If the trust is revocable, the proceeds are taxable under the incidents of ownership test. If the trust is irrevocable and the insured has retained no other incidents of ownership the proceeds are probably taxable under the premium test as indirectly paid by the insured. Since the premium test is applicable if a payment is made directly or indirectly by the decedent in his lifetime, premiums paid by the trust, whether from corpus or income, may properly be held to be indirect payments by the trust or deceased.

Death payments under accident or health policies, or under the double indemnity provisions of life insurance policies, are treated as the proceeds of ordinary life insurance.

In addition to the estate tax payable upon insurance proceeds, there may be an income tax liability in the case of a purchaser of a policy for a consideration. If the policy has been transferred by way of gift, no portion of the proceeds is subject to income tax, but if the policy has been acquired for consideration the proceeds are subject to income tax to the extent that they exceed such consideration, plus the amount of subsequent premiums paid by the assignee. This rule does not apply to gifts of policies which retain the transferor's basis. Where proceeds are payable after death in installments, pursuant to a settlement option exercised either by the beneficiary or insured, such installments are entirely exempt and no portion of the proceeds.

This was also the prior law. Waldo Rohnert Estate, 40 B. T. A. 319 (1939). See, however, Helvering v. Reybune, 83 F. (2d) 215 (1936) suggesting a different result.

Reg. 105, § 81.25.

Under Int. Rev. Code § 22(b) (1) and § 22(b) (1)-1 insurance proceeds are exempt from income tax liability. Nor are premiums paid for life insurance deductible expenses; § 24(a) (1); § 29.24-1, §29.22(a)-12; see G. C. M. 10793, C. B. XI-2, 58. However, the gain on assigned policies is taxable income, even though insurance proceeds create the gain; Int. Rev. Code § 22(b) (2)

See, however, Hacker v. C. I. R., 36 B. T. A. 659 (1937)

Int. Rev. Code § 22(b) (2) However, if the insured acquires the policy by assignment for consideration, death proceeds are not taxable to the beneficiary. I. T. 3212, C. B. 1938-2, 65.


Pierce v. C. I. R., 2 T. C. 832, affirmed 146 F (2d) 388 (1944)

Reg. 111, § 22.22(b) (1)-1 as amended by T. D. 5231 (Feb. 23, 1943)
is reportable as income. If, however, the entire face amount is retained by the insurance company, the annual interest received by the beneficiary is taxable income.381

If an insured makes a gift of a policy by assignment or otherwise, the transfer is subject to gift tax.382 The subsequent payment by the insured of the premiums on such a policy will also create gift tax liability.383 Despite the gift, the insurance proceeds, in whole or in part, will be included in the insured's estate under the premium test.384

The necessity of providing for liquidity of an estate in order to meet tax and administration expenses suggests the necessity of doing so without at the same time augmenting the base on which the inheritance or estate tax will be computed. Thus, if the policy were paid to the insured's estate, the proceeds would augment the base, and the estate and inheritance tax would be increased by reason thereof.385 On the other hand, if the insurance policy were made payable to a beneficiary other than the insured, there would be available $40,000 inheritance tax-exempt insurance,386 and if the insured did not retain either the incidents of ownership and if he were not subject to the premium test the insurance proceeds would not be taxable for federal estate tax purposes.387 For example, if a policy were transferred on or before January 10, 1941, and the insured paid no premiums thereafter, the...

382 Reg. 108, § 86.2(a) (8) Guggenheim v. Rasquin, 312 U. S. 254, 85 L. ed. 813, 61 Sup. Ct. 507 (1941), Ryerson v. U. S., 312 U. S. 405, 85 L. ed. 917, 61 Sup. Ct. 656 (1941) If insured retains a reversionary interest (as where he assigns the policy to his wife and upon her death to her children, but upon their death to his estate) the reversionary interest may result in the full value of the policy being taxable in donor's estate as to decedent's dying before October 22, 1942. Estate of Thierot, 7 T. C. 1119 (1946) Cf. note 261 supra. The assignment may easily constitute a transfer in contemplation of death. Cronin v. C. I. R., 7 T. C. 1403 (1946), Ex'rs of Flick v. C. I. R., 5 T. C. M., Jan. 30, 1947; Estate of Diamond v. C. I. R., 159 F. (2d) 672 (C. C. A. 2d, 1947)
383 Reg. 108, § 86.2(a) (8) Donor may make a gift of initial or subsequent premiums gift tax free up to $3,000 per year, as well as the federal lifetime exemption of $30,000. See note 171 et seq. supra.
384 Int. Rev. Act § 811(g) (2) (3), amended 1942 Rev. Act § 404 (c)
385 Id. § 811(e) (2), (g) (1), Rem. Rev. Stat. § 11211(b) An inter vivos gift in an amount equal to the insurance proceeds may be used as an offset to the increased estate tax resulting from the inclusion of insurance proceeds in the estate tax base.
386 Rem. Rev. Stat. § 11211(b)
387 Int. Rev. Act § 811(e) (2); (g) (2); (g) (4)
insured upon his death would not have any incidents of ownership in
the policy and would have paid no premiums after January 10, 1941,
and accordingly none of the proceeds would be includable in his
estate. In such a case, likewise, if such a transfer were without con-
sideration, the proceeds would not be subject to income tax liability,
even though at the time of the transfer they might have been subject to
gift tax liability, unless within the annual exclusion of $3,000 or the
lifetime exemption of $30,000.

However, in planning an estate now, the January 10, 1941 date is
no longer available for use. Consequently, it becomes necessary to
ascertain if it is possible to work out a plan that will enable the use
of life insurance proceeds without augmenting the tax base. The fol-
lowing is suggested:

A beneficiary heir can take out a life insurance policy upon the
donor, such beneficiary heir paying all the premiums therof. Upon the
death of the donor, the beneficiary then will have life insurance pro-
cceeds available with which to either purchase frozen assets from the
estate or with which to lend to the estate to enable the estate to pay off
its obligations. In that way the insurance proceeds are used by the
estate but without augmenting the estate base. Another variation of
this plan is to have the beneficiary take out such insurance under a
trust arrangement whereby the trustee is authorized to attend to the
details of buying out frozen assets of the estate or lending it money and
thereby accomplishing the same result. If the donor takes out the
insurance, naming a beneficiary other than himself, or naming a trus-
tee, with instructions to use the proceeds to purchase estate assets or
to lend money to the estate, this plan will not work, because the donor
in such a case at the time of his death either has the incidents of owner-
ship, or has paid the premiums so as to become subject to the premium
test, or both. Consequently, the insurance proceeds program, while
economically justifiable, does not accomplish any tax savings.

Furthermore, in any system of estate planning it is necessary to
integrate the payment of the insurance proceeds with the distribution
to be effected by the will. For example, if the insured elects an installment payment option, he should be sure that the amount payable is taken into account in connection with any sums payable under the terms of any testamentary trust that he creates under his will. Thus, it can be provided that the payments payable under a testamentary trust shall not exceed a stipulated amount, taking into account the insurance installment payments—or, if that is not desired, that the amounts payable under the insurance policy shall not be considered in determining the amount payable under the testamentary trust. Again, in view of the fact that under the federal and state law both, the additional inheritance and estate tax payable by reason of the inclusion in the estate of insurance proceeds may be subsequently recovered from the insurance beneficiary, this may have the effect of either requiring a lump sum payment to be made by the beneficiary in advance of the receipt of insurance proceeds by installments, or it may require a deduction pro rata from the insurance installments of the tax payable. If this is not desired, affirmative provision should be included in the will to the effect that the personal representative shall not claim any reimbursement from such insurance beneficiaries. Sometimes, it is desirable that the tax should be paid from the insurance proceeds, because the return on insurance proceeds is usually much less than can be obtained from trust investment. In that case, if nothing is said in the will, the tax will be paid from the insurance proceeds.

C. SOCIAL SECURITY BENEFITS

Related to the problem of personal insurance, account should be taken of the benefits available under the Social Security Act. The benefits payable thereunder to wage-earners in private industry and business in "covered employment" are of two types: retirement benefits and survivor's benefits. In general, monthly retirement benefits are payable to the wage-earner when he is 65 or older and stops work;

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848 Personal life insurance can be made payable inter alia (1) in lump sum to a named beneficiary, or to the personal representative of the insured; (2) under settlement options for interest income purposes or fixed installment payment purposes; (3) or to a trustee under a life insurance trust with more flexible powers than is possible by use of settlement options, especially where more than one insurance company is involved, when policies contain dissimilar settlement options.

848 See Polisher, Prorating of Federal Estate Tax Among Life Insurance Beneficiaries (1945) 50 Dick. L. Rev. 1-6, discussing In re Scott's Estate, 286 N. Y. S. 188, 293 N. Y. S. 126 (1936) and Maryland's Estate, 351 Pa. 623, 42 A. (2d) 63 (1945)

849 IRC Rev. Code § 822(c), Reg. 105, § 81.84.

850 Ibid.
to his wife when she is 65; and to his unmarried children until the age of 18. To qualify for these benefits, a worker must be "fully insured"—that is, must have worked in a covered job approximately half the time between January 1, 1937 (or his twenty-first birthday if that came later) and the date on which he reaches 65 or died, whichever is earlier. In no case can a worker become fully insured unless he has at least six quarters (three months each) of coverage. However, once he has acquired forty quarters of coverage he is fully insured for life. As he continues to work in covered employment his benefit, generally speaking, increases. If he leaves covered employment it decreases.

As for survivors' benefits, generally speaking, monthly benefits are payable to the following survivors of fully insured workers: (a) Unmarried dependent children (natural or adopted, and usually step-children), who receive monthly payments until they are 18, (b) Widow, regardless of age, with a child entitled to benefit in her care, the payments to continue until her youngest child is 18 or until she remarries, whichever first occurs, but the payments to begin again when the widow is 65 and continue until her death; (c) The widow without a child in her care receives monthly payments when she reaches the age of 65 if she has not meanwhile remarried; (d) If the deceased worker leaves neither widow nor child under 18 entitled to monthly benefits, his parents 65 or over may receive monthly payments if wholly supported by the wage-earner at the time of his death.

If a worker is not fully insured but is "currently insured"—that is, if he has worked in a covered job roughly half the last three years of his life, then children under 18 and widows with such children in their care are entitled to monthly benefits. The widow without young children nor dependent parents of a worker who died currently insured cannot receive the monthly payments at 65.

A lump sum benefit (one cash payment) is payable in case of either a fully or currently insured person when he leaves no survivor immediately eligible for monthly payments at the time of his death. Such payment may go to the widow or widower, child, grandchild, or parent,

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847 42 U. S. C. A. § 402 (a) (b) (c)
848 Id. § 402, 409 (g)
849 Id. § 402, 409 (g) (1)
850 Id. § 409 (g) (2)
851 Id. § 402.
852 Id. § 409 (h) ; 402.
853 Id. § 402 (e) (1).
in the order named. If the worker is not survived by any such relative, the lump sum may be paid to other relatives or friends who pay the burial expenses. The monthly retirement benefits payable to the worker vary from $21 to $56, to the worker and wife from $31.50 to $84.

The monthly survivor’s benefit payments payable to the widow vary from $15.45 to $42, to the widow and one child, from $25.75 to $70; to one child or one parent, from $10.30 to $28.

It will not be noted from the foregoing summary that although the payments provided for survivors are modest and apply only to workers or salaried employees, they do provide benefits which may properly be taken into account in any estate plan. It should be noted, however, that the statute thus far does not apply to self-employed persons, although there is legislation pending in Congress to extend social security coverage to groups not now covered, including self-employed persons.

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BUSINESS INSURANCE

Heretofore discussion has been had of what has been called “Donative Insurance,” which is the usual type of insurance wherein provision is made for spouses and dependents or other relatives. When the individual involved is also the partner or the owner of stock in a closely held corporation, it is desirable that provision be made whereby the survivor will be enabled to buy out the interest of the deceased partner or shareholder if that is otherwise desirable. This can be effected by the use of life insurance. The matter has been fully analyzed in the writer’s discussion of the matter entitled “Problems in Partnership Agreements Coupled with Life Insurance.”

In general, the best plan, both for practical and tax reasons, is for Partner or Shareholder A to take out life insurance on Partner or Shareholder B and vice versa in connection with and as part of an agreement by which the survivor agrees to buy the deceased’s interest in the order named. If the worker is not survived by any such relative, the lump sum may be paid to other relatives or friends who pay the burial expenses. The monthly retirement benefits payable to the worker vary from $21 to $56, to the worker and wife from $31.50 to $84.

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864 Id. § 402 (g)
865 Id. § 402 (g)
866 As per published tables.
867 As per published tables.
869 H. 3046 (in Committee on Ways and Means)
870 Pacific Northwest Underwriter, May, June, 1946.
in the firm, using insurance proceeds for that purpose. If desired, the proceed can be paid to a trustee for disbursement to the deceased's estate, either in a lump sum or by the use of settlement options in the policy. To effect protection against creditors of the survivor that might interfere with the buy-and-sell agreement, the policy owner can assign the policy by way of security to the assured or the trustee for the assured to secure performance of the survivor's obligation to purchase the interest of the deceased. The agreement should also contain provision permitting the partners or shareholders to buy each other's interest in the policies in the event of dissolution of the firm inter vivos and the deceased's interest in the policy on the survivor upon the decedent's death. The agreement should also contain a method or formula for valuing the interest of the deceased. If the policy contains double indemnity provisions, special provision should be made for the disposition of the proceeds of the double indemnity features. If one or more of the partners or shareholders are uninsured, special provision should be made for the creation of a fund so far as possible to purchase the interest of the uninsured partner or shareholder. The whole problem as to this plan of business insurance has been elsewhere discussed in detail by the writer and hence

61 See Re Killien's Estate, 178 Wash. 335, 35 P. (2d) 11 (1934); Proutt's Estate v. C. I. R., 125 F. (2d) 591 (C. C. A. 6th, 1942); 2 RABEN and JOHNSON, supra note 311, at p. 3625, reviews the federal cases. The trustee is merely a conduit, the proceeds not being available to creditors. If so available the rule is otherwise. Morton, Adm'r, 23 B. T. A. 238, Dec. 6961 (1931) If partnership owns or pays for the policies under agreement that the partnership as such is to purchase the decedent's interest in the business the deceased may be held to have indirectly paid the premium so as to render the insurance proceeds includable in his estate for estate tax purposes.

62 The 1942 Act does not define "incidents of ownership," although prior decisions and the regulations illustrate the meaning of the phrase. Reg. 105, § 81.27. From such illustrations it appears that rights of a pledgee are not included. See analogous case, Pierce Co., Inc. v. Riley, 23 Wn. (2d) 97, 160 P. (2d) 505 (1945)

63 E.g., fixing amount now; using book value as of date of death; capitalizing earnings for designated period or average of annual periods; providing for appraisement; fixing good will value or providing for the exclusion thereof, etc. Cf. Spitzer v. C. I. R., 153 F. (2d) 987 (C. C. A. 8th, 1946), discussing gift valuation of stock subject to a restrictive agreement. See Gutken and Beck, Restrictive Stock Agreements and Estate Tax Minimization (May, 1947) 25 Taxes—The Tax Magazine.

64 By contract, it may be provided that the life insured shall reimburse the other partner for that portion of the premium paid by the other partner which represents the cost of the double indemnity feature, the proceeds of which go to the life insured. However, federal estate tax liability may attach as to double indemnity proceeds under the "payment of premium" test.
will not be further pursued at this time. 808

An alternative plan for utilizing business insurance in connection with a stock acquisition program is one in which the corporation takes out insurance on the life of an office-stockholder or employee-stockholder. At the last legislative session, a corporation was given the power to purchase its own shares out of its surplus. 806 No provision was made, however, for giving the corporation an insurable interest in the life of a shareholder. 807 In view of the fact, however, that in closely held corporations the shareholders are also officers or employees of the corporations involved, and in view of the further fact that a corporation does have an insurable interest in the life of an officer or employee, 808 the matter is probably not important as long as the shareholder is also an employee or officer. Before adopting the corporate business insurance plan (whereby the corporation pays the premiums rather than the shareholders), consideration should be given to the following matters:

1. The premium is not deductible for income tax purposes, although the proceeds are not includable for income tax purposes when the proceeds are received. 809

2. The proceeds are subject to the claims of creditors, and if the proceeds are taken by them, the business insurance program will be defeated. 870

3. Even though the corporation receives the insurance proceeds, then unless the insurance proceeds have the effect of creating a sufficient surplus to purchase the share interest of the deceased shareholder the purchase cannot be effected except to the extent of such surplus. 871


807 Stockholders of close corporations have an insurable interest in the life of one another. Wash. Laws 1947, c. 79, § 18.03.3(3) That corporation has no insurable interest in life of a stockholder. See Tate v. Com'l Bldg. Ass'n, 97 Va. 74, 33 S. E. 382, 75 Am. St. Rep. 770, 45 L. R. A. 243 (1899); 37 C. J. 396-7, § 65.


870 No exemption from creditors' claims is provided when the life insurance proceeds are payable to the payor of premiums. Wash. Laws 1947, c. 79, § 18.41.

871 "Surplus" is not defined by Wash. Laws 1947, c. 195. Presumably it is made up of net assets in excess of the "capital stock" as defined in Rev. Rev. Stat. § 3803-1-10.
4. The value of the stock interest of the deceased in the corporation will be augmented by the receipt of the insurance proceeds. This will increase the tax base for inheritance and estate tax purposes.\(^872\) Furthermore, under the "premium test" or "incidents of ownership test"\(^878\) upon application of the doctrine of disregarding the corporate entity\(^874\) the insurance proceeds may be held includable in the insured’s estate.

5. The use of surplus (including insurance proceeds) to purchase the stock interest of the deceased may be evidence that the surplus is not reasonably needed in the business and so will operate to subject the corporation to Section 102 Income Tax—the surtax on undistributed profits.\(^875\)

Should it be decided that the alternative plan must nevertheless be used, despite the disadvantages noted, care should be taken to obviate so far as possible the possibility that the program will not be carried out—as, for example, by providing for reorganizing the corporate structure so as to create a paid-in surplus if one does not exist in sufficient amount at the time when the stock purchase is to be effected,\(^876\) and by providing for appropriate protection against contingencies of sale or corporate dissolution in the stock purchase agreement under which the corporation agrees to purchase the stock of the deceased employee stockholder.\(^877\)

(To be continued in February, 1948, Issue)

\(^872\) Assets will be augmented by the difference between the cash surrender value of the policy immediately before death and the proceeds payable on death. However, the loss sustained by the corporation through the death of the officer is an offsetting factor. Newell v. C. I. R., 65 F.2d 102 (C. C. A. 7th, 1933)

\(^878\) See notes 315-317 supra.


\(^876\) Int. Rev. Code § 102, imposes a special surtax on corporations "formed or availed of for the purpose of preventing the imposition of the surtax upon its shareholders through the medium of permitting earnings or profits to accumulate instead of being divided or distributed". The test is permitting earnings to accumulate "beyond the reasonable needs of the business" § 102 (c)

\(^877\) Wash. Laws 1947, c. 195, does not require surplus to be "earned surplus." It may, therefore, be "paid in surplus" created by allocating the stock subscription price partly to capital and partly to paid in surplus.

\(^878\) See Lacovara, Business Insurance Trusts (1943) 43 Col. L. Rev. 323; Marion, Life Insurance and Purchase of Its Own Stock by Domestic Corporation (May, 1947) Pacific Northwest Underwriter; Wash. Laws 1947, c. 195.