A Practitioner's Guide to Estate Planning in Washington (Part II)

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VI. ESTATE PROVISION
A. Testate and Intestate Succession
B. Methods of Avoiding Probate
C. The Death Tax Structure
   1. The Washington Inheritance Tax
D. Testamentary Planning
   1. The Substantive Provisions
   2. Retaining Unitary Management of Marital Property Following
      Death of a Spouse
      a. Introductory
      b. Methods
      c. Evaluation of Methods
      d. Conclusions as to Best Plan

VII. LAW REFORM IN ESTATE PLANNING
A. Criteria of Excellence
B. Reform Dealing with Provident Substantive Law
C. Reforms Dealing with the Elimination of Gift and Estate
   Transfer Tax Inequities
D. Reform Seeking to Simplify Gift, Income and Estate
   Transfer Tax Applications

CONCLUSION

VI. ESTATE PROVISION
A. TESTATE AND INTESTATE SUCCESSION

IN THE ABSENCE of a will, the law of the domicile will govern the
distribution of movables and the law of the situs will govern the
descent of immovables. If, therefore, a person domiciled in Wash-
ington dies leaving real and personal property in Washington and real
property in Oregon, the Washington law will govern as to the descent
and distribution of the real and personal property in Washington, but
the Oregon law governs as to the descent and distribution of the real
property in Oregon. Under the Washington law, separately owned real
estate and separately owned personal property descends or is distrib-
uted in accordance with special statutes, applicable thereto. With
respect to community property, however, a special statute deals with
the descent and distribution of such community property.

Rules of descent and distribution as provided by statute are, how-
ever, inflexible. Property must go in the manner provided by law without deviation and without adjustment to the particular need of the particular beneficiary. Thus trusts cannot be established without a will; provision cannot be made to dispense with an unnecessary administrator's bond; provision cannot be made to simplify the necessary probate procedure as in the case of nonintervention wills. The appointment of an administrator cannot be controlled because the statute must be followed, nor can protection be afforded in the absence of a will against the claims of future creditors, where their claims would constitute a grave hardship upon beneficiaries.

The advantages of testamentary distribution are, therefore, apparent. Not only can the executor be named, the executor's bond be dispensed with, the provisions of the nonintervention will statute invoked, but it is also possible to select beneficiaries and to so adjust the distribution of benefits under the will and the taxes thereon as to meet needs as they change from time to time as in the case of the establishment of testamentary trusts. By so doing, the testator also avoids the risk of changes in law applicable when there is no will.

B. METHODS OF AVOIDING PROBATE

Testate succession, as has already been pointed out, need not be effected solely by medium of a will, although a will is the most efficacious way of securing such succession. Other methods have been used, most of which are highly undesirable. A contract supported by consideration can bring about post mortem benefits in accordance with its terms; but a contract is not a donative transfer, and it is the donative transfer that is by far the most important type of testate succession. Mutual deeds or bills of sale to be effective on death are ineffective from want of delivery in the lifetime of the grantor or transferor. Endorsing stock in blank or leaving bearer securities in a

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882 Id. § 1437
883 Id. §§ 1462-4.
884 Id. § 1431.
885 E.g. Spendthrift trusts, 69 C. J. 697
886 A testator may even appoint a poor executor, but it is his executor. State ex rel. Lauridsen v. Superior Court, 179 Wash. 198, 37 P.(2d) 209 (1934).
887 See Bonneville & Lyons, Problems Arising Under Nonintervention Wills, 16 Wash. L. Rev. 195 (1941), Foster, Powers and Duties of Executors and Administrators C.T.A. Under Nonintervention Wills, 16 Wash. L. Rev. 196 (1941).
888 As to nuncupative wills, see 1 Wash. L. Rev. 61 (1925). See also Shepherd & Pruyn, Some Federal Tax Aspects of Will Draftsmanship, 25 Taxes 433 (1947).
889 See In re Lewis' Estate, 2 Wn.(2d) 458, 98 P.(2d) 654 (1940).
safety deposit box to which both spouses have access does not effect a transfer because of want of delivery *inter vivos*.\textsuperscript{891} Even United States Government bonds or war bonds payable to a beneficiary did not prior to the enactment of Sess. L. '43, Ch. 14, constitute an effective transfer by gift\textsuperscript{892} and were considered an ineffective testamentary transfer in this state. Gifts *causa mortis* may effect a saving in inheritance or estate tax,\textsuperscript{893} but such gifts are outright and their value is limited to cases where outright gifts are sufficient to meet the situation. The creation of *inter vivos* trusts with remainder interests does have value as part of an estate plan, but such a method of succession is hardly a substitute for the disposition of the entire estate. No trustor wishes to leave all of his estate by *inter vivos* trust and thereby deprive himself of the benefits that go with property ownership. Even if the trustor retains a life income in the property given away in trust, no federal tax advantage is obtained\textsuperscript{894} and the individual assumes the burdens of trusteeship if he is the trustee, or the restrictions on fiduciary handling of property if another is named as trustee. Transfers *inter vivos* to take effect in enjoyment or possession at or after death have no tax advantages.\textsuperscript{895} The execution of an agreement relative to the disposition of community property as between husband and wife (REM. REV STAT. of Washington, § 6894) is possible,\textsuperscript{896} but the method still leaves unadjudicated the question of whether the property is in fact community property and not separate (the agreement is inoperative as to separate property) and, like all the preceding methods requiring a delivery *inter vivos*, the question as to whether the claims of creditors of the deceased have been paid or barred by limitations is not adjudicated.\textsuperscript{897}

\textsuperscript{891} See cases in preceding note.
\textsuperscript{893} There is no inheritance or estate tax on the amount of the gift tax which, but for the gift *causa mortis*, would be part of the tax base for inheritance or estate tax purposes.
\textsuperscript{894} INT. REV. CODE § 811(c).
\textsuperscript{895} INT. REV. CODE § 811(c), Reg. No. 105 § 81.17
\textsuperscript{896} The validity of REM. REV. STAT. § 6894 was upheld in McKnight v. McDonald, 34 Wash. 98, 74 Pac. 1060 (1904). For a recent example of such an agreement see *In re* Estate of Josephine L. Brown, 129 Wash. Dec. 20, 185 Pac. (2d) 125 (1947).
\textsuperscript{897} *In re* Collins' Estate, 102 Wash. 697, 173 Pac. 1016 (1918), *State ex rel.* Speckart v. Superior Ct., 48 Wash. 141, 92 Pac. 942 (1907). An affidavit is no substitute. See *State ex rel.* Mann v. Superior Ct., 52 Wash. 149, 152; 100 Pac. 198 (1909).
Under these circumstances a will is the person's only assurance that he can make an effective and thoughtful and economical disposition of his property upon his death.898

C. THE DEATH TAX STRUCTURE

1. THE WASHINGTON INHERITANCE TAX

No intelligent estate plan can be devised that does not take into account the tax structure in the event of death. Let us briefly outline the situation. Under the Washington law, an inheritance tax is levied on the privilege of a beneficiary to receive property from a decedent.900 Property subject to inheritance tax includes tangible or intangible property, except intangibles of nonresidents dying in the state,400 devises and bequests, gifts made in contemplation of death or made or intended to take effect in possession or enjoyment at or after death, by transfer in trust with life enjoyment retained, and the exercise of a power of appointment.401 In the case of persons not residents of the United States or a territory thereof, the tax is also leviable upon certificates of stock, bonds, bills, notes, bank deposits physically situated in this state, or when the domicile of the donor is in the state of Washington.402 As to persons domiciled in this state, the tax is leviable upon all property within the jurisdiction of the state.403 It is likewise leviable upon jointly held property in general (but not entirely) to the extent owned by the deceased.404 Proceeds from insurance on the life of the decedent are taxable although such proceeds up to $40,000 are exempt if the policy or policies of insurance are payable to a person other than the insured's estate.405 Likewise, a devise to an executor in lieu of commissions is taxable to the extent that it exceeds the

898 See Oswald, The Legal Efficacy of Attempted Methods of Avoiding Probate, 5 WASH. L. REV. 1 (1930).
899 Re McGrath's Estate, 191 Wash. 496, 505, 71 P. (2d) 395 (1937), Re Henry's Estate, 189 Wash. 510, 66 P. (2d) 350 (1937), In re Fotheringham's Estate, 183 Wash. 579, 49 P. (2d) 480 (1935). The power of a state to impose an inheritance tax is not lost by reason of the fact that another state taxes the same property by reason of an interest therein. See Greenough v. Newport, 67 S. Ct. 1400 (1947), permitting multiple taxation of intangibles by upholding a statute taxing resident trustee of foreign trust.
400 REM. REV. STAT. § 11201 (a).
401 Id. §§ 11201, 11201 (a) (c). Formulatory credit is given for federal estate tax purposes and full credit for inheritance tax purposes for gift tax paid on gifts includable for estate or inheritance tax purposes. INT. REV. CODE §§ 813(a), 936(b), REM. REV. STAT. § 11202 (b).
402 REM. REV. STAT. § 11202—1 (p).
403 Id. § 11201.
404 Id.
405 Id. § 11211 (b).
reasonable value of such commissions. Charitable and religious gifts, bequests and transfers are also exempt.

The rates are relatively low, depending upon the size of the estate and the relationship to the decedent. As in the case of the state gift tax, beneficiaries are divided into three classes: Class A, B, and C. The rates for Class A beneficiaries start at 1 per cent of the first $25,000 and end with 10 per cent of all amounts in excess of $500,000. Class A beneficiaries are given a blanket $5,000 exemption (including all allowances in lieu of homestead and family allowances in excess of $1,000) plus $5,000 for the surviving spouse and $5,000 for each living child, stepchild or adopted child and $5,000 for living descendents of a deceased child, stepchild or adopted child per stirpes. If neither surviving spouse, child, stepchild, adopted child or children of any of these are living, then an additional $5,000 Class A exemption is allowed. The rates for Class B beneficiaries start with 3 per cent of the first $5,000 and end with 20 per cent of amounts in excess of $100,000. The class exemption is $1,000 taken from the first $5,000 with no individual exemption. Class C rates begin with 10 per cent of the first $10,000 and end with 25 per cent of amounts in excess of $50,000. No exemption is allowed for this class or the individual members thereof.

All rates are calculated on the net estate received. When the decedent owns property in and out of the state, all available exemptions are prorated in that proportion that the property within the state bears to the whole property of the estate. No exemption is allowed to a decedent not a resident of a state or territory of the United States.

In determining the amount of the net estate, there is deducted from the gross estate debts owing by the decedent at the date of death, local and state taxes due prior to death, reasonable funeral expenses, the reasonable cost of a monument or crypt, court costs, including inheritance tax appraisal, executor's or administrator's fees, reasonable attorney's fees, and family allowance not exceeding $1,000. No such limitation as to amount of family allowance exists for federal estate tax purposes. Federal administrative practice generally recognizes 15 months payment of family allowance.

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408 Id. § 11207
407 Id. §§ 11218, 11218-1. (Limited for use within Washington unless for use in a state exempting the transfer or providing for a reciprocal exemption.)
406 Id. § 11202.
409 Id. § 11201.
410 Id. § 11202-1(m).
411 Id. § 11202-1(p).
412 Id. § 11201. No such limitation as to amount of family allowance exists for federal estate tax purposes. Federal administrative practice generally recognizes 15 months payment of family allowance.
In addition, a credit for federal estate tax, if any paid, is allowed in ascertaining the taxable net estate. If, however, the total inheritance tax is less than the credit of 80 per cent of the federal estate tax allowed by the federal estate tax law, then the total inheritance tax must be increased to equal such 80 per cent credit. Should the estate be exempt for inheritance tax purposes but subject to the estate tax, the same result follows. If the inheritance tax increased as aforesaid and is later found to exceed the 80 per cent, a refund is due the estate.

An additional exemption should be noted. When property passes from lineal descendents including a stepchild or adopted child who died within five years prior to the death of the decedent and where such property now passes from the decedent to any member of the same class, and such property was taxed under the inheritance tax laws, the transfer is exempt. If its value has meanwhile increased, the increase is taxable. This exemption applies also to property exchanged for what would have been exempt had it still been in existence, the sum of the exemption not exceeding the value of the property that would have been exempt but for the exchange.

To assure collection of the tax, notice of the estimated value of the estate and other data must be filed with the State Tax Commission on the appointment of an executor or administrator, and a copy of the inventory and appraiasation filed with the federal government, and any amendment thereof, if any there be, must likewise be filed with the State Tax Commission. Should the values accepted by the personal representative for federal estate tax purposes exceed those used for state inheritance tax purposes, the value of the items must be raised for inheritance tax purposes to the same amount. This does not mean that if the entire community estate must be included for estate tax

\[413\] Id. § 11201(b).
\[414\] Id. § 11202(b).
\[415\] Ibid.
\[416\] Ibid.
\[417\] Ibid. § 11202(a).
\[418\] Ibid.

Id. § 11202(a). It should be noted that the net taxable estate (not the gross estate) on which the inheritance tax has been paid is exempt. In re Letchworth, 201 Cal. 1, 255 Pac. 195 (1927), In re Nilson, 201 Iowa 1033, 204 N. W 244 (1925). The federal law corresponds under Int. Rev. Code § 812(c). Wilkinson v. C. I. R., 5 T. C. 1246 (1945), Bahr v. C. I. R., 119 F. (2) 371 (C. C. A. 5th, 1941).

\[420\] REM. REV. STAT. § 11213. Procedure for determination of inheritance tax even in the absence of probate administration is provided by REM. REV. STAT. § 11216.
\[421\] REM. REV. STAT. § 11202(b).
\[422\] Id. § 11202-1(l).
purposes it must likewise be included for inheritance tax purposes.\textsuperscript{423} Indeed, despite the 1942 estate tax amendments, the Washington law remains the same as formerly, namely one-half of the community estate being subject to inheritance tax.\textsuperscript{424} In addition, the inheritance tax is a lien upon the property of the estate\textsuperscript{425} and is the liability of the personal representative, who is forbidden to distribute the property until the inheritance tax has been paid or provision made.\textsuperscript{426} The beneficiary must ultimately pay the tax, and the provision for withholding the amount thereof before legacy is distributed is to assure collection by the state.\textsuperscript{427}

As to valuation as of date of death of the estate left, provision is made for appraisement by three appraisers, to be appointed by the court\textsuperscript{428} and with right of the supervisor to fix a value and determine the tax after hearing.\textsuperscript{429} Estates subject to annuities, life estates and terms for years must be appraised according to statutory formula,\textsuperscript{430} as is also the case in trust or contingent estates subject to defeasance.\textsuperscript{431} Provision is also made for the valuation of a foreign estate located in this state and on which an inheritance tax is payable by taking into account the indebtedness of the entire estate, a proportionate share of which is deductible in arriving at the net estate located in this state and on which an inheritance tax is payable.\textsuperscript{432}

2. THE FEDERAL ESTATE TAX AND FEDERAL INCOME TAX DUTIES

The federal estate tax is imposed upon the privilege of transmitting property\textsuperscript{433} rather than as in the case of the inheritance tax upon the

\textsuperscript{423} Furthermore, Rem. Rev. Stat. § 11202-1(1) was enacted (Wash. Laws 1939, c. 202, § 3) before the 1942 amendments.


\textsuperscript{426} Id. §§ 11202-1(n) (o). Was Laws 1947, c. 21.

\textsuperscript{427} Id. §§ 11208, 11209.


\textsuperscript{430} Id. § 11205. A remainder is taxable as of date of death, even if it may be ultimately defeated by exercise of trustee's power to invade the corpus. Ivy's Estate, 4 Wn. (2d) 1, 101 P. (2d) 1074 (1940).

\textsuperscript{431} Rem. Rev. Stat. § 11206. For an application of this statute, see Re Waterman's Estate, 173 Wash. 101, 22 P. (2d) 53 (1933).

\textsuperscript{432} Rem. Rev. Stat. § 11204.

\textsuperscript{433} In re McGrath's Estate, 191 Wash. 496, 505; 71 P. (2d) 395 (1937).
privilege of receiving property. Accordingly, that tax is assessed on
the entire net estate without regard to benefits left or relationship
of the recipients to the testator. It applies to the entire net estate of a
citizen, wherever resident, or a resident regardless of nationality or
citizenship, exclusive of real estate outside the United States.

The gross estate includes the decedent’s interest in real and personal
property except realty outside the United States, dower, curtesy or
similar interest of a surviving spouse, transfers in contemplation of
death or to take effect in possession or enjoyment at or after death,
interests held in jointly owned or community property, property
passing under power of appointment, and insurance receivable by
executors and others with certain exceptions.

The net estate is determined by deducting from the gross estate
funeral expenses, administration expenses, claims against the estate
duly allowed by law, unpaid mortgages, amounts expended for the
support of dependents as allowed by local laws (including family
allowance), all limited by the amount of property subject to general
claims, losses incurred during the settlement of an estate through casu-
alty or theft not compensated by insurance, property previously taxed

484 In re Henry’s Estate, 189 Wash. 510, 66 P. (2d) 350 (1937), Re Pothering-
ham’s Estate, 183 Wash. 579, 49 P. (2d) 480 (1935).
485 See note 543 infra.
486 Int. Rev. Code § 811. National Service life insurance proceeds are includable
in gross estate, but estate tax payment can be enforced only from the other property
the Special Tax Study Committee to the Committee on Ways and Means” recom-
mends that the interests of employees in pension plans qualified under Int. Rev.
Code § 165 should be excluded from the operation of estate and gift taxes. 25 Taxes
1049 (1947)

487 As to deductibility of perpetual care of graves, see Gillespie v. C. I. R., 8
T. C. 93 (1947), Inglehart, 77 F. (2d) 704 (C. C. A. 5th, 1935), Cardeza, 5 T. C.
202 (1945).

488 See Lang’s Estate v. C. I. R. 97 F. (2d) 867 (C. C. A. 9th, 1938) applying
Washington law prior to 1942 estate tax amendments. The same rule has been ap-
plied with reference to community property in Texas. Schuhmacher v. C. I. R. 8
T. C. 56 (1947). Since the 1942 Amendments the federal administrative practice is
to permit deduction of probate administration expenses from the gross estate in
proportion to the community property includable for estate tax purposes. Attorneys’
fees incurred after estate tax return is filed are deductible if at the time of the
return they cannot be predicted with any degree of accuracy. Cf. Cleveland v. Hig-
United States, 149 F. 2d) 455 (C. C. A. 1st, 1945), Executor’s fees paid are deduc-
See 25 Taxes 1049 (1947) dealing with deductibility of administration expenses paid
by persons other than personal representative.

489 No deduction permitted for a widower not a dependent. Est. of Jacobs v.
under the five-year rule, and transfers for public, charitable and religious uses. From the net estate is also deducted a $100,000 exemption under the basic or 1926 Revenue Act and an exemption of $60,000 under the additional or 1932 Revenue Act as amended.

The estate property is valued by the executor, subject to federal audit, no formal appraisement being required. Valuation is as of the date of death, although, at the option of the personal representative, the date may be fixed at one year after the date of death.

The rates are basic on the net estate after all exemptions. The basic estate rates are from one to 20 per cent. The additional estate tax is the excess of the tax computed at the additional tax rates over the basic tax. The additional rates are from three to seventy-seven per cent after allowing the $60,000 exemption. Credits are allowed for payments made under the federal gift tax statute as to any property includable for estate tax purposes and on which a federal gift tax has been paid.

To insure collection, the personal representative must file a preliminary notice with the Collector of Internal Revenue within the district of the decedent's residence within two months after decedent's death.

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Footnotes:


443 Id. § 935.


446 Id. § 811(j). The exercise of this option effects tax savings if the estate has substantially decreased in value during the year. However, property sold or distributed within the year after death is valued as of the date of sale or distribution, and property the value of which is "affected by the mere lapse of time" is valued as of the date of death, with an adjustment for any difference in its value (on the optional date) not due to lapse of time. See Welliver, 8 T. C. 18 (1947). The option must be elected upon the tax return properly filed within fifteen months of death. Capital gain or loss holding period (Int. Rev. Code § 117) nevertheless begins with date of death. Spec. Rul., Oct. 18, 1946, I. T.:P.T.T.2 D.R2.


448 Id. §§ 936, 813. See Note 268, supra.
or within two months after such representative qualifies. A complete 
estate tax return must be filed by the personal representative with the 
Collector within fifteen months after the death of the decedent. The 
tax is then payable, unless the time is extended for reasons of undue 
hardship. Until paid, the tax is a lien and various statutory reme-
dies are available for its collection.

The collection of the tax liability of the deceased and of the estate 
is carefully safeguarded. Attention has already been called to the pre-
liminary notices and final returns for inheritance and estate tax pur-
poses. Income tax liability is also involved. Thus the personal repre-
sentative of the estate must file an income tax return on Form 1040 
for the decedent on or before the fifteenth day of the third full cal-
endar month following the close of the taxable year unless extended.

The estate whose gross income on a calendar or fiscal year basis is 
$500 per annum or over must file an income tax return on Form 1041,
and if its gross income is $5,000 or over, a sworn copy of the 
last will of the deceased must be attached if it has not been attached 
before. Although estates are not subject to the Current Tax Payment 
Act, the estate may elect to pay its tax in four quarterly installments 
beginning on the due date of the return. The executor or adminis-

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450 Int. Rev. Code §§ 821, 864. Failure to file tax return on time may result in the imposition of a 25 per cent penalty. See Estate of Werbelovsky, 9 T. C. 93 (1947). 
451 Int. Rev. Code § 822(a) (1). 
452 Id. § 822(a) (2). Undue hardship does not mean mere inconvenience. An extension of three months may be given interest-free and thereafter at the rate of 1.5 per cent per annum. Int. Rev. Code § 890(a). No single extension can be granted for more than one year, with total maximum extensions of ten years. If the tax is not paid within fifteen months from date of death and no extension is granted, interest at 6 per cent per annum is payable, beginning with fifteen months from date of death. Int. Rev. Code § 893(a). Such interest is chargeable to the income beneficiary of the testamentary trust. Behl, 7 T. C. 168 (1946). The “Report of the Special Tax Study Committee to the Committee on Ways and Means” recommends legislation permitting payment of federal estate tax over a period of ten years provided that interest at 3 percent per annum from a date following the date of death by twenty-four months be paid on and with each installment. It further recommends that the federal government offer noninterest bearing, nontransferable, special obligations redeemable at par on sixty days’ notice and acceptable at par in payment of federal estate taxes. Such bonds in the amount of the tax up to $50,000 would be free of estate tax and if tax is greater, then not to exceed 50 per cent of the tax or $50,000, whichever is greater. 25 Taxes 1049 (1947). 
453 Int. Rev. Code § 827 
454 Id. § 826. 
455 Reg. No. 111 § 29.53-1, as amended T. D. 5396. As to whether particular income should be included in decedent's or estate's return, see e.g. Estate of Basch v. C. I. R., 9 T. C. 88 (1947). 
457 Id. § 142(a), Reg. No. 111 § 29.142-1(c). 
458 Int. Rev. Code §§ 56(b), 58(a).
trator is personally liable for the tax if, prior to discharge, he knew or should have known thereof.\textsuperscript{469} Lien statutes,\textsuperscript{469} transferee liability provisions\textsuperscript{469} and many other statutes\textsuperscript{469} further insure collection.

During the pendency of the probate, all community income and the decedent’s separate income is reportable solely by the estate as a separate taxable entity,\textsuperscript{468} with an annual exemption of $500.\textsuperscript{464} The widow cannot split what would otherwise have been community income as hers\textsuperscript{465} and is subject to the Current Tax Payment Act with respect thereto.\textsuperscript{466} The widow’s allowance is probably not taxable income to the widow.\textsuperscript{467} A final income tax return must be filed by the estate on or before the fifteenth day of the third full calendar month after the estate is closed.\textsuperscript{468} For taxable years commencing with 1942, the residu-
ary legatee is taxable on the income of the estate for the taxable year in which the residuary legacy is paid over to him and it does not matter if for local law purposes the income is treated as principal. 469

D. TESTAMENTARY PLANNING

1. THE SUBSTANTIVE PROVISIONS

In the simplest type of testamentary disposition each spouse makes a will at the same time, appointing the other (and an alternate) as executor, to serve without bond, under a nonintervention will. The estate is left to the surviving spouse, and if the spouse is not living, or dies at the same or substantially the same time as the testator, then the property is left outright to child or children, share and share alike, per stirpes, or to others. If specific legacies are left, or life insurance proceeds left, provision may also be made to make the payment of these free of inheritance or other succession tax. Occasionally the spouses name a testamentary guardian for minor child or children in the event of the death of both spouses.

It is not always desirable, however, to leave a lump sum estate to a surviving spouse who may be inexperienced in business matters or even to a child, especially a minor child. Provision must then be made for the payment of periodic income from date of death to such beneficiaries with provision for invading the corpus or accumulated income in case of need. This can be best accomplished through the medium of a testamentary trust or trusts, naming a competent fiduciary to act with or without the surviving spouse and with very broad powers. There is an inheritance and estate tax advantage in the use of the testamentary trust providing a life estate with remainders over, because upon the death of the life tenant the remainder falls into possession of the remainderman free of estate or inheritance tax. 470 This tax advantage would not exist if the property were left outright to the surviving spouse and then, by the surviving spouse left to the child or children of the spouse, nor would an estate tax advantage exist if the property were left not in trust but to the surviving spouse for life with

469 Re Carlisle, 8 T. C. 66 (1947). Prior to 1942 amendment to Int. Rev. Code § 162(b) the rule was otherwise. Durkheimer, 41 B. T. A. 585 (1940).

power to consume the estate," the balance remaining upon the spouse's death to go to the children. Such a disposition is a taxable power of appointment for federal estate tax purposes, although not for inheritance tax purposes. There would accordingly still be the inheritance tax saving even in the latter type of disposition where no trust is used for the benefit of the life tenant and remainderman.

In any well-planned testamentary trust the payments to be made by the trustee should be integrated with payments to come from other sources such as life insurance and income from the separate estate of the surviving spouse. It is, therefore, possible to make provision that the total income to be paid by the testamentary trustee shall not exceed a definite amount after taking into account income receivable by the surviving spouse from all other sources, or it may be provided that the trustee shall not take into account insurance proceeds payable to the surviving spouse or shall not take into account the income from separate property. The whole matter can be regulated in a very flexible manner.

Again, it may be desirable to insert a spendthrift clause to protect the testamentary beneficiaries or any part of them, such as minor beneficiaries. Provision should also be made for a competent fiduciary and one financially responsible such as a corporate trustee or a corporate trustee to serve as a co-trustee with the surviving spouse, with provisions for alternates and provisions for resignation.

There are two problems, however, that should be noticed at this point in greater detail—the problem of the duration of the trust and the problem of leaving the designation of beneficiaries to a named beneficiary in the trust.

471 Illustrations of such a power will be found in Porter v. Wheeler, 131 Wash. 482, 230 Pac. 640 (1924), In re Eckert's Estate, 14 Wn.(2d) 497, 128 P.(2d) 656 (1942), Re Goochmou's Estate, 122 Wash. 92, 72 F.(2d) 1027 (1937).

472 Rev. Act 1942, § 811(f) (2) (A) (B), Reg. No. 105 § 81.24.

473 There is no Washington statute corresponding to the federal statute defining power of appointment. Rem. Rev. Stat. § 11201 (c) taxes the exercise of a power of appointment the definition of which is left to the common law.


475 When a surviving spouse is both trustee and beneficiary with power to invade the corpus, care should be taken so as to guard against such power constituting a taxable power of appointment (1) by depriving her of the right to vote on whether power to invade corpus should be exercised (2) by giving other trustee absolute power with respect thereto subject to no conditions and taking away the right of judicial review with respect thereto (3) as precautionary measure limiting the annual amount that can be taken from corpus so as to limit the value of the claimed "power of appointment."
With respect to the first problem, there is immediately encountered the rule against perpetuities and the rule against accumulations. At common law, the vesting of a future interest could not be postponed beyond a life or lives in being, plus twenty-one years, and the period of gestation. The purpose of this rule was to prevent the tying up of estates for excessive periods and to compel the use of estates within a reasonable period of time. Thus, if a father died leaving a child surviving, he could postpone the vesting of the estate for the lifetime of the child, plus twenty-one years and the period of gestation following the death of his child, this meant, in effect, that a father could postpone the vesting of an interest until his grandchild became of age. If, however, the interest did not vest for a period beyond the permitted period, then the whole provision became null and void. The rule against perpetuities was not, however, directed against a postponement of possession, use and enjoyment; it was directed solely against the postponement of the period of vesting.

Frequently it is a difficult matter to determine whether a perpetuity period is being exceeded in the creation of a future interest in a testamentary trust. It is, therefore, desirable as a matter of precaution to affirmatively provide that if any future interest created by the trust violates the rule against perpetuities, the provision should not on that account be void but that the perpetuity period should end at or one day before the end of such period, the property then to vest in the person enjoying the use of the property at that time.

A related rule is the common law rule against accumulations. At common law the trustee could be directed to accumulate and retain the trust estate during the perpetuity period. By the Thelluson Act (39 and 40 Geo. III, Chapter 98, enacted in the year 1800), the permissible period was cut down to the life of the settler or twenty-one years after his death or during designated minorities. There is no Wash-
The second problem above referred to raises the question of power of appointment. A testator is not always in a position to make an intelligent forecast of how his or her property should go upon the death of his spouse or child. In such case he may wish to leave the decision to such surviving spouse in light of the circumstances as they would be known to her many years hence. If so, this can be done by granting to his surviving spouse, or other person, the power to make this decision. Such a power is known as a power of appointment. Certain tax consequences should, however, be considered in connection with a power of appointment.

Under the Washington law, when a resident donee of a power of appointment exercises it, the appointed property is subject to inheritance tax as if the property were inherited from the donee of such power. If at the time the appointment takes effect the donor is a resident, but the donee is a nonresident, the appointed property is deemed inherited from the donor of such power.

Although there is no express statutory provision under the Washington law dealing with state gift tax liability in the case of powers of appointment, the broad sweep of the gift tax statute would undoubtedly result in taxing the exercise of a power of appointment, general or special, in favor of a person other than the donor of the power. Indeed, the statute may be broad enough to tax the donee of an unexercised power if the donee has the power to exercise the power of appointment in his favor or for his benefit.

With respect to the federal tax law, the statute is as follows: Prior to October 21, 1942, the federal estate tax and the federal gift tax were imposed on the exercise of general powers of appointment. General powers unexercised and special powers, whether exercised or not, were not taxed. Under the 1942 Act, property with respect to which a decedent had a power of appointment is included for estate tax purposes whether the power is general or special and whether or not exercised, unless exercisable in favor of certain relatives, namely, the

481 Restatement, Property § 318 (1944).
482 Rem. Rev. Stat. § 11201(c).
483 Id. § 11218-11.
spouse of the decedent, the spouse of the creator of the power, descend-
ants of the donee of the power or his spouse, descendants (other than donee) of the grantor of the power or his spouse, and spouses of such descendants. There is excluded, however, from taxable powers of appointment powers for charitable and public uses and a power to appoint within a restricted class if the decedent did not receive any beneficial interest in the property and the power is not exercisable in his favor or for his benefit.\textsuperscript{488}

The 1942 amendments do not apply, however, to special powers not exercisable in favor of the donee, his estate, or his creditors created on or before and not exercised after October 21, 1942.\textsuperscript{486} Nor do the amendments apply to general powers created on or before October 21, 1942 if the donee on October 21, 1942 was under legal disability to release the power. He has six months after the termination of the disability to effect such release. Service in the armed forces "until termination of the present war" is a disability.\textsuperscript{487} The 1942 amendments do not apply to powers existing on October 21, 1942 if released before July 1, 1948.\textsuperscript{488} However, the exercise or release of a power of appointment in contemplation of death, or if intended to take effect in possession or enjoyment at or after death, renders the appointed property taxable.\textsuperscript{489} If the disposition is one under which the donee retains for his life the possession or enjoyment of or the right to income from property appointed, the property is taxable.\textsuperscript{490} Dispositions for an adequate and full consideration in money or money's worth are not taxable.\textsuperscript{491}

In addition to federal estate tax liability, the 1942 amendments make a corresponding change in the federal gift tax law applicable with respect to powers of appointment. Generally, what is taxable for estate tax purposes is, in the case of \textit{inter vivos} created powers of appointment, taxable for gift tax purposes.\textsuperscript{492}

In connection with this matter of powers of appointment, it should

\textsuperscript{488} INT. REV. CODE § 811(f), Reg. No. 105, § 81.24.
\textsuperscript{486} Rev. Act 1942 § 403(d) (1).
\textsuperscript{487} Id. § 403(d) (2), INT. REV. CODE § 3797(a) (15).
\textsuperscript{489} INT. REV. CODE § 811(f), Reg. No. 105 § 81.24 (3). H. J. Res. 210 extending the time to July 1, 1948 was approved by the President June 25, 1947 and is designated Pub. Law 112 80th Cong. See C. C. H., FED. ESTATE AND GIFT TAX REP. §§ 3460A, 3460I, 3925, 3925A.
\textsuperscript{490} INT. REV. CODE § 811(f), Reg. No. 105 § 81.24 (3).
\textsuperscript{491} Ibid.
\textsuperscript{492} INT. REV. CODE § 1000 amended by 1942 Rev. Act § 452a, Reg. No. 108 § 86.2(b).
be pointed out that unless the decedent directs otherwise in his will, the recipient of the power is liable to the executor for a proportionate share of the estate tax where such property was included in the decedent's estate by reason of the exercise, nonexercise, or release of a power of appointment.\textsuperscript{468}

There are other rules which must be borne in mind in connection with this subject, but enough has here been stated to call attention to the problem involved.

The point that is a source of frequent concern, however, is whether the power to invade corpus by a trustee beneficiary or beneficiaries constitutes a taxable power of appointment. The regulations say that it does.\textsuperscript{469} Consequently, in any carefully drafted instrument, provision will be made that the power to invade the corpus should be vested solely in the trustee and that the beneficiary if at the time acting as co-trustee shall be disqualified from voting on making such additional benefits available.\textsuperscript{470} Frequently provision is made that the power to invade the corpus shall be invoked under certain named conditions such as illness or misfortune. In such cases, if the trustee did not invoke its discretionary power when the conditions therefor existed, the beneficiary could bring a suit to compel the trustee to make a distribution out of corpus.\textsuperscript{471} It has been suggested that the power of the beneficiary to bring such a suit is in substance a right in the beneficiary to invade corpus and that, therefore, a taxable power of appointment exists in favor of such beneficiary.\textsuperscript{472} If this result is to be avoided, it should be provided that the trustee's discretion should be absolute without right of judicial review and that the power of the trustee alone to invade the corpus should be without restriction or condition. It might also be provided as a matter of precaution that only a stated maximum amount can be obtained from the corpus in any one year. In such case, in the event that the other provisions should prove ineffectual to eliminate a taxable power of appointment, the liability on that account would be limited.\textsuperscript{473}

\textsuperscript{468} \textsc{Int. Rev. Code} § 826(d).
\textsuperscript{469} \textsc{Reg. No. 105} § 82.24(b)(3).
\textsuperscript{470} See \textsc{Looker, Estate and Gift Taxation of Trustees Powers to Distribute Principal}, \textsc{Col. L. Rev.} 60 (1945). It has been held that a trustee beneficiary is disqualified from voting on the distribution of additional principal to him. \textsc{Rogers v. Rogers}, 111 N. Y. 228, 18 N. E. 635 (1888).
\textsuperscript{471} \textsc{Estate of Van Deusen}, 77 A. C. A. (Cal. App.) 495.
\textsuperscript{472} See \textsc{Toeller v. C. I. R.}, 6 T. C. 832 (1946).
\textsuperscript{473} \textsc{Bankers Trust Co. v. Higgins}, 136 F. (2) 477 (C. C. A. 2d, 1943). See \textsc{Montgomery, Jr., Standard Clauses for Wills and Trusts}, \textsc{Trusts and Estates}, 462 (1946), Tractman, \textit{Use of Principal for Life Beneficiaries}, \textsc{Trusts and Estates
It is a common provision where there are reciprocal trusts by husband and wife for a wife to name her husband as trustee, giving her husband power to invade the corpus. In such case, however, the husband obtains a taxable power of appointment. It would be better to name a co-trustee with the husband, giving the co-trustee the sole and unlimited discretion to invade the corpus without right of judicial review as in the illustration above given.

2. RETAINING UNITARY MANAGEMENT OF MARITAL PROPERTY FOLLOWING DEATH OF A SPOUSE

a. INTRODUCTORY

The Washington community property system, in which each spouse has a present vested interest in one-half of the community property, creates special problems in estate planning when it is sought to preserve the community estate as a whole under a system of unitary management prevailing in the lifetime of the husband. In view of the fact that each spouse has free testamentary disposition of his or her half of the community estate it is possible for the husband to will his one-half to one set of beneficiaries, whether in trust or otherwise, and under one system of management, and the wife to will her one-half under an entirely different system of management and to beneficiaries wholly of her own choosing. Obviously if the spouses do not agree upon a common plan with respect to their estates, the benefits of unitary management which prevailed during the lifetime of the spouses are either dissipated or lost. Self-interest of the spouses, therefore, have frequently dictated a consideration of how the benefits of community property management may continue even though the death of the husband has put an end to the right of unitary management of community property. It is to a consideration of how this problem may be met that discussion is now directed.

b. METHODS

Fundamentally, there are four methods by which unitary management may be continued despite the death of the husband. These methods have variations, but fundamentally each, though different, has

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458 (1946). However, if there is a charitable remainder otherwise deductible for estate tax purposes, the inclusion of provisions giving a trustee the unrestricted right to invade the corpus for the benefit of the life tenant will defeat the deduction because its amount is not ascertainable. Newton Trust Company v. C. I. R., 160 F. 2d 175 (C. C. A. 1st, 1947).

499 Reg. No. 105, § 81.24(b) (1).

800 See Note 498, supra. For suggested testamentary clauses in general, see Shepherd & Pruyn, Some Federal Tax Aspects of Will Draftsmanship, Note 1, supra.
definite recognizable features. Briefly summarized at this point they are as follows:

**Plan A.** The husband and wife each leave their respective community estates in trust. The husband names his wife and another (such as a bank) co-trustees. The trust is to provide the wife with a life income, fixing a definite amount to come from the principal if the income is insufficient. Upon the death of the wife, the trust benefits are to go to the children. The wife names her husband as trustee; upon his death, the successor trustee is the trustee named by the husband in his will to act as co-trustee with his wife—such as the bank. The trust is to provide an income to the husband for life with a right to invade the corpus, and then, upon his death, the property is to go to the children, in trust or outright. In addition, the husband and wife enter into an agreement whereby, in consideration of the execution of their respective wills and their mutual agreement not to revoke the same during their joint lifetime or during their whole lifetime, the wife agrees to administer her half of the community estate in the same manner as the husband’s half is administered by his trustee. Sometimes under this plan the wife will agree not to spend from her half of the community estate any sum other than the amount payable under her husband’s trust.

**Plan B.** The husband and wife each leave one-half of the community estate in trust as in Plan A. At the same time, the husband and wife enter into a written agreement by which the wife agrees that upon the husband’s death she will transfer her half interest in the community estate to the trustees named in her husband’s will, the property so transferred to be administered as part of that trust estate. A variation of this plan is to make the transfer optional instead of mandatory.

**Plan C.** The husband by will leaves all of his property, including the community estate of himself and his wife, in trust as in Plan A. The wife by will leaves her community interest in trust as in Plan A. At the same time the wife executes a written election to take under her husband’s will, relinquishing her interest in community property effective on his death. The whole plan is accompanied by an agreement not to revoke any of the instruments.

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501 Mere fact that both wills are executed at same time and that both testators were present at time of execution and knew the contents of each other’s wills does not necessarily establish they acted pursuant to agreement. *McGinn v. Gilroy*, 165 P.(2d) 73 (1946) (Ore.).
PLAN D The husband and wife each by will leave their community estates in trust as in Plan A. At the same time the wife creates an inter vivos trust naming her husband as trustee and, as successor, the trustee named in his will. The parties agree not to revoke their respective wills.

The above four fundamental plans may be varied as to detail, but each plan is characteristically different and involves certain differences in their tax and practical consequences.

c. EVALUATION OF METHODS

Under Plan A, if the husband dies first the tax consequences will be as follows: (1) The wife may be required to pay a federal estate tax on the entire estate by virtue of the 1942 amendments;\(^\text{502}\) (2) the wife and other beneficiaries will have to pay a Washington inheritance tax upon half of the estate;\(^\text{503}\) (3) the income tax liabilities will be the same, namely, the estate paying the income tax during the period of probate,\(^\text{504}\) the trustee paying an income tax after the trust estate becomes operative,\(^\text{505}\) and the wife paying an income tax on the income she receives both from the trust and from the one-half community estate which she owns.\(^\text{506}\) The practical consequences are as follows: By way of advantage, (1) unity of administration is preserved because the wife in her capacity as owner of one-half of the community estate undoubtedly would manage that one-half in the same way that she and the other trustee will manage the husband's half as trustee under the husband's will. Furthermore, the community estate is preserved in view of the unitary management, the estate to go under the husband's will and the wife's estate to go under her will, under a plan which has theretofore been approved by the husband and under an agreement making her will irrevocable; (2) if no such irrevocable agreement exists, from the wife's standpoint the advantage is that she retains her right to make testamentary disposition of her one-half in light of conditions as they exist following her husband's death. By way of disadvantage, (1) if the wife does not work with the trustee, it is difficult

\(^{505}\) Like any other legatee or heir after acquiring income producing assets from the personal representative of the estate. Fiduciary returns on Form 1041 required as to distribution of $500 or more. Int. Rev. Code § 147, Reg. No. 111, § 29.147-1. See, in general, 2 Nossaman, Trust Administration and Taxation 191, § 680.
\(^{506}\) See Note 465, supra.
to enforce the agreement for unitary management, even if the power so to do is given to the other trustee. Things can get quite disagreeable even though a legal remedy to compel performance exists; (2) furthermore, unless there is irrevocable agreement, the wife may prove improvident with her one-half interest during her lifetime or unwise in the testamentary disposition she makes of her one-half interest.

Under Plan A, if the wife dies first the tax consequences will be as follows: (1) The husband will be required to pay a federal estate tax on at least one-half of the community estate under the 1942 amendments; 507 (2) he and the other beneficiaries will pay a Washington inheritance tax upon one-half of the community estate; 508 (3) the income tax liability will be the conventional one: first, the estate will pay the income tax during the period of probate; then the trust will pay an income tax; and the husband will pay an income tax on his income from his one-half interest in the community estate. The practical consequences are as follows: By way of advantage, (1) unity of administration is preserved because the husband as executor and trustee will undoubtedly manage the trust estate in the same way that he manages his individual half interest; (2) the estate is preserved because of unitary management and the beneficiaries of that estate under an irrevocable will agreement will be as desired by both husband and wife during their lifetime; (3) if there is no irrevocable agreement, the husband will retain his half subject to testamentary disposition in light of changed conditions following his wife's death. By way of disadvantage, (1) in the absence of an irrevocable agreement, the husband may prove to be improvident in his use of his one-half of the community estate either in his lifetime or by virtue of testamentary disposition.

Under Plan B, if the husband dies first the tax consequences will be as follows: (1) The executor may be required to pay a federal estate tax on the entire estate under the 1942 amendment; 509 (2) the wife and other beneficiaries will be required to pay an inheritance tax on one-half of the community estate; 510 (3) the income tax liability will be the conventional one except that the wife will not have the income from her one-half of the community estate except as it comes to her from the trust; (4) the wife may be required to pay a gift tax in so far

508 Note 503, supra.
509 Note 502, supra.
510 Note 503, supra.
as her transfer of her one-half interest in the community estate is for the benefit of a person other than herself, such as children or third persons who have rights under her husband’s trust; if the transfer is optional with her, she can then determine whether the gift tax should be incurred or not. Indeed, even if it was neither mandatory nor optional by virtue of the writing, she can transfer the property to the trustee anyhow and incur the gift tax liabilities if it is to her interest so to do. The practical consequences, both by way of advantage and disadvantage, are the same as those under Plan A.

Under Plan B, if the wife dies first the tax consequences will be the same as those under Plan A, and the practical consequences, both by way of advantage and disadvantage, will be the same as those under Plan A.

Under Plan C, if the husband dies first the tax consequences will be as follows: (1) The tax consequences of this plan are the least favorable to the preservation of the estate. The executor (wife) must pay the federal estate tax on the whole estate; the inheritance tax may have to be paid on the whole estate, because the wife takes under the will, not independently of it; the income tax consequences are the same as under Plan B where there is a mandatory transfer of her half of the community estate to the trustee. The practical consequences, both by way of advantage and disadvantage, are the same as those under Plan A.

Under Plan C, if the wife dies first the tax consequences and practical consequences are the same as under Plan A.

Under Plan D, if the husband dies first the tax consequences will be as follows: (1) The wife need not pay a gift tax on the transfer of her half interest to the husband as a separate estate; upon the husband's death his estate must pay an estate tax on the whole of the estate transferred by his wife to himself and upon the estate of the community property; (3) the inheritance tax must likewise be paid.

511 Int. Rev. Code § 1000; Reg. No. 108, § 86.1, 2.
512 Note 502, supra.
514 This is a peculiar consequence of Int. Rev. Code § 1000(d) making gifts of community property gifts by the husband with certain exceptions.
515 Except to the extent shown to have been received as compensation for per-
on the whole of the estate of the wife transferred to the husband as well as on one-half of the community property; (4) the income tax liability follows the conventional pattern, as in Plan B, where the transfer to the trustee is mandatory. The practical consequences are as follows: By way of advantage, (1) the advantages are the same as under Plan A, with the further assurance in the husband that everything has been done in his lifetime that was to be done after his death. By way of disadvantage, (1) there are no practical disadvantages of this plan, the disadvantages being purely taxwise.

Under Plan D, if the wife dies first the tax consequences will be as follows: (1) There is no estate tax on the wife's interest because that has been transferred to her husband, unless it be subject to the statute taxing transfers in contemplation of death; (2) there is no inheritance tax, unless it is a transfer in contemplation of death, (3) the income tax follows the conventional pattern as in Plan A. The practical consequences, both by way of advantage and disadvantage, will be the same as those under Plan A.

d. CONCLUSIONS AS TO BEST PLAN

It will be noted that in each of the plans unity of administration and the preservation of the estate is safeguarded. However, the tax consequences of the several plans differ. The most favorable plan, from the standpoint of minimizing taxes, is Plan A. Plan B, with an optional right of the wife to transfer her community estate to the trustee, is, however, a desirable plan because of its greater practical advantage in encouraging the wife to transfer her interest to the trustee if she is prepared to pay the gift tax. Actually, the same arrangement is possible under Plan A, the difference being merely that the idea is not suggested by the husband in his lifetime, but is left for suggestion to the trustee after his death. The matter might, however, be covered by a letter of advice to the wife. Plan C may have expensive tax consequences and achieves nothing greater than that which is achieved by Plan A or Plan B. If the wife is cooperative, it is not as desirable as Plan B, even when there is a mandatory requirement to transfer the interest to the trustee, because Plan B does not entail the tax consequences that Plan C entails. Plan D is not particularly desirable, especially if the husband dies first, because of the tax consequences actually rendered by the wife or derived originally from such compensation or from separate property of the wife. Rev. Act 1942 § 402. In re Neumann, 9 T. C. 146 (1947), construes "compensation for personal services" of wife.
sequences, namely, a gift tax *inter vivos* and his estate tax on the same property upon the husband's death. Furthermore, the wife loses all control over the half interest in the community property which she had prior to the *inter vivos* transfer to her husband.

Taking everything into account, Plan A is the best all-around plan to preserve the community estate after death. The plan may be varied to meet the particular needs of the spouses involved, but its essential outline should be retained.

**VII. LAW REFORM IN ESTATE PLANNING**

**A. CRITERIA OF EXCELLENCE**

Change in law is by no means synonymous with progress. Whether change is progress depends on the answer to the question—progress to what end? If the end is increased revenue, such an end could be achieved by lowering or eliminating tax exemptions and increasing tax rates; or by rendering the use of trusts subject to an extra tax or supplementary estate tax; or by taxing trust interests or future interests which would otherwise not now be taxable when such interests fall into possession or enjoyment,\(^5\) or by supplementary succession tax upon the recipient when he obtains possession, or by taxing all powers of appointment without the exception applicable to familial powers of appointment. On the other hand, if the end to be attained is the transmission of the maximum estate to estate beneficiaries,\(^6\) whether through *inter vivos*, quasi-testamentary or testamentary transfers, such an end can be accomplished by lowering tax rates, increasing tax exemptions, or abolishing gift, inheritance, or estate taxes or portions thereof.\(^7\) Any of the changes above suggested are essentially dependent on broad considerations of public policy and on the desirability

\(^5\) This is the law in Quebec, for example.

\(^6\) It has been pointed out that present income tax rates and succession tax rates are so high as to encourage waste of capital and to discourage saving. Such rates encourage spending because if the owner doesn't spend the estate, the taxing jurisdictions involved will. As a source of revenue, the succession tax will probably decline in importance as time goes on. See A TAX PROGRAM FOR A SOLVENT AMERICA (1945) by the Committee on Postwar Tax Policy, p. 159 et seq., advocating alternatively high exemptions and stable, moderate rates with no taxation of bequests to husband or wife of the testator.

\(^7\) It has been advocated by responsible sources that the federal government withdraw from the field of federal estate and gift taxes. See A TAX PROGRAM FOR A SOLVENT AMERICA (1945) by the Committee on Postwar Tax Policy, pp. 155-169. The taxation of transfers at death was resorted to by the federal government as a temporary war measure during the Civil War, Spanish-American War, and First World War. After First World War Congress finally decided to retain the tax as a permanent source of federal revenue. See A TAX PROGRAM FOR A SOLVENT AMERICA, supra, pp. 155, et seq.
of the ends to be achieved. It is obvious that some, though theoretically possible, are practically impossible, and others are both desirable and practicable. From the standpoint of the law of estate planning, however, our inquiry here must be limited to what is theoretically possible, and also what is desirable and practicable within the reasonably near future.\(^5\)

As to desirable reforms within practicable limits, the criteria of excellence that should be considered require that law reforms sought to be achieved be enacted by provisions that are *provident, fair* and *simple*. To bring about law reform that complies with these criteria of excellence, there are three classes of reform that might be considered, and illustrative suggestions made with reference to each. (1) Reforms dealing with local substantive law that should be operative in the absence of a specific trust or testamentary provision to the contrary; (2) reforms dealing with the elimination of gift and estate transfer tax inequities; (3) reforms seeking to simplify gift, income, and estate transfer tax applications. Without attempting an exhaustive or detailed consideration of possible reforms, but solely for the purpose of charting the possible direction of needed reforms, let us consider each such class further.

**B. REFORMS DEALING WITH PROVIDENT SUBSTANTIVE LAW**

It has become common practice in any carefully drawn *inter vivos* trust or will\(^6\) to insert clauses in standard phraseology to meet usual contingencies. Thus, it is usually provided that a will shall be a non-intervention will;\(^7\) or that the surviving spouse named as personal representative shall serve without bond;\(^8\) or that the trustee shall have the broadest possible powers, including the power to allocate income and principal;\(^9\) or to divide the estate in kind; to invest as

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\(^5\) See PAUL, *Taxation for Prosperity*, c. 37 ESTATE AND GIFT TAXES 308-316.


\(^8\) *Rem. Rev. Stat.* §§ 1437, 1439, 1457

\(^9\) *Wash. Laws* 1947, c. 160 provides for allocation in absence of contrary provision of trust or other instrument.
prudence requires; to retain as trust assets the business interest of deceased at the date of death; to purchase common stock; to compromise claims; to lend money to the estate; to carry trust securities in the name of nominees; and, in general, to give the trustee powers as broad as those enjoyed by the testator in his lifetime. Again, it is a common practice to insert a spendthrift clause in a testamentary trust or to provide protection against the operation of the rule against perpetuities by making the bequest valid up to the expiration of the permitted perpetuity period, or to provide that specific or demonstrative legacies shall be free of inheritance or other succession tax. If provisions such as these mentioned are deemed so beneficial that they are usually inserted for the protection of the testator, his estate, and estate beneficiaries, would it not be helpful to provide by statute that in the absence of a trust or testamentary provision to the contrary, provisions such as those above mentioned would be implied?

Analogies are helpful. Thus the Business Corporation Act in Washington contains many provisions that operate in the absence of a permissible charter or by-law provision to the contrary and that formerly were required to be embodied in the corporate by-laws if the corporation was to enjoy the protection of such provisions. Statutory deeds in Washington are deemed to contain certain covenants unless otherwise stated in the instrument. Trustees' investment powers, embodying the "prudent man" rule, govern unless otherwise stated in the trust instrument. The duty to account under the Trustees' Accounting Act exists unless otherwise stated. The power of a fiduciary to allocate to income or principal corporate dividends received

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524 The prudent man rule in fiduciary investments is now embodied in Wash. Laws 1947, c. 100.
525 The business interest might not be an eligible investment nor its retention prudent, yet its retention might be very important to the deceased's family.
526 But for the prudent man rule, common stocks are ordinarily improper investment of trust funds. See NosSaman, Trust Administration and Taxation 511, § 459.
527 Trust Companies may hold securities in name of nominee. Wash. Laws 1947, c. 146.
528 But for such provision, the legatee must pay inheritance tax, Rem. Rev. Stat. §§ 11208, 11209, 11202-1(n), 1(o). If it is intended to have the residuary estate pay inheritance taxes on inter vivos transfers such as transfers in contemplation of death the will should clearly so provide as by requiring payment of inheritance taxes payable "by reason of my death."
529 Id. § 3803-61.
530 Id. §§ 10552-3, 4. See also Rem. Rev. Stat. § 10555 (mortgages).
531 Wash. Laws 1947, c. 100.
532 Id. c. 229. Rem. Rev. Stat. §§ 11548-1 to 28 is inapplicable, however, to executors, administrators and guardians.
exists unless otherwise provided. The power of a fiduciary to carry securities in the name of a nominee exists unless otherwise provided. Even the statute governing wills embodies many provisions that apply unless otherwise stated in the testator's will. Analogies such as those above mentioned suggest the advisability of extending the application of the principles embodied in the analogies to the end that provisions which practice has found beneficial should be deemed inserted or implied in a will or trust unless there is specific provision to the contrary.

C. REFORMS DEALING WITH THE ELIMINATION OF GIFT AND ESTATE TRANSFER TAX INEQUITIES

Gift and estate transfer tax tends to embody the principle of caveat testator or caveat donor or caveat taxpayer. This is a decided change from the common law rule that tax statutes are construed strictly against the taxing authority and in favor of the taxpayer. Perhaps it has been necessary to depart from the common law rule because of the ingenuity displayed by taxpayers in so casting their affairs as to minimize tax liability. However, if this be the reason, then it circumscribes with increasing force the principle enunciated by the federal courts that there is nothing either legally or morally wrong in a taxpayer so arranging his affairs as to minimize tax liability. It is probably too late to expect a legislative restoration of the common law rule of strict construction in favor of the taxpayer, and it is probably impossible to enact legislation that will eliminate the doctrine of caveat taxpayer which now exists. It must be left to the courts, however, to exercise a sound discretion in so interpreting tax statutes as not to lead the taxpayer to feel that he has been unjustly treated and unjustly hindered in the realization of his normal and reasonably grounded expectations. Even more important is the necessity of emphasizing this approach upon administrative officials charged with the administration

534 Id. c. 146 applicable to trust companies.
535 E.g. RSM. Rev. Stat. § 1396 (interest on devises), § 1399 (revocation by subsequent marriage), § 1402 (intestacy as to unnamed child), § 1404 (death of devisee before testator). See also §§ 1405, 1409, 1411.
of the tax system. The unwillingness of administrative officials who deal with taxpayers to take responsibility and to make decisions embodying considerations of equity has long been a complaint of attorneys charged with the responsibility of dealing with such officials in the administration of tax matters. Tax statutes are undoubtedly technical, but the rigidity with which such statutes are administered should be tempered by considerations of fairness. These are matters which can hardly be enacted into legislation, but it should be taken into account in judicial and administrative enforcement.\textsuperscript{838}

In most trusts the trustee is given power to invade the corpus for the benefit of a beneficiary, who is frequently a spouse or child of the testator. If the spouse is both trustee and beneficiary the power of such a spouse to invade the corpus is, as above pointed out, treated as a taxable power of appointment.\textsuperscript{839} Such a provision has justly caused much criticism, as an unnecessary restriction upon a perfectly proper provision for the protection of the surviving spouse or child. Often the power is not used and yet the existence of the power operates to involve estate taxation of the property subject to the power upon the death of the beneficiary. Furthermore, by taxing the right to invade the corpus, it is no longer provident for a testator to leave his estate to his wife for life and the balance to their children,\textsuperscript{840} because the right of the wife to consume is a taxable power of appointment.\textsuperscript{841} As the law now stands, it is possible, by trust provision, to eliminate the right to invade corpus as a taxable power of appointment, but it is not possible to do so where a legal life estate and remainder exists.\textsuperscript{842}


\textsuperscript{839} Reg. No. 105, § 81.24(b) (1).

\textsuperscript{840} See McLucas, Tax Status of Powers of Appointment. Trusts and Estates Magazine (Sept. 1944) makes a number of suggestions (including the one discussed) in three principal respects (1) Making the federal statute prospective only in operation, (2) making the test of taxation or exemption dependent on the persons who receive the property subject to the power rather than dependent upon the persons in whose favor the power may be exercised, and (3) exclusion of certain pre-existing powers as taxable powers of appointment, including power to invade trust corpus. A life estate with remainder over with power in life tenant to consume the estate is a valid estate for local law purposes. Porter v. Wheeler, 131 Wash. 482, 230 Pac. 640 (1924), In re Eckert's Estate, 14 Wn.(2d) 497, 128 P.(2d) 656 (1922), In re Goochnour's Estate, 192 Wash. 92, 72 P.(2d) 1027 (1937), holding remainder not subject to inheritance tax upon death of life tenant. See Annotation 36 A. L. R. 1180; 76 A. L. R. 1154.

\textsuperscript{841} Prior to the statute taxing the right of a beneficiary to invade corpus as a taxable power of appointment, no federal tax was incurred in a life estate followed by a remainder, the life tenant having power to consume. Royce v. C. I. R., 46 B. T. A. 1090 (1942), Davis v. U. S., 27 Fed. Supp. 698 (1939), Frew v. Bowers, 12 F.(2d) 625 (C. C. A. 2nd, 1926).

consequence, it is necessary to pay a trustee for the privilege of exercising the right to invade the corpus which, under a properly drawn trust, would not be taxable. The whole subject of taxing powers of appointment is now being studied in Congress with a view to revision.

More important than either of the tax inequities so far discussed is the discriminatory treatment of gifts and testamentary transfers of community property. Under the federal law, the local law treatment of community property, giving the spouses equal and vested interests in community property, are ignored. Thus, upon the death of either spouse leaving community property, the entire community estate is taxed except such part thereof as can be shown to have been derived from amounts received by the survivor as compensation for personal services actually rendered or from such spouse's separate property, provided that one-half in any case of such community property is taxable. The same theory is carried out in connection with inter vivos transfers. In common law jurisdictions where the wife does not have a vested interest, it is understandable that any contingent interest that she may have in common law marital property should be ignored; consequently, upon her death, there is nothing to tax, and upon her husband's death the whole estate is taxed. But in view of the fact that under the local law the wife has a present vested interest, it is difficult to justify the taxation of community property as if that interest were nothing more than a contingent interest owned by a wife in a common law state. There is also a practical injustice resulting from the operation of the statute. A husband normally earns the community estate; the community estate normally does not result from the personal services actually rendered by the wife. Consequently, upon the death of the husband, the wife must pay a tax upon the entire community estate; but upon the death of the wife, the husband need pay a tax only on one-half of the community estate. The result of this is
that the wife, who normally does not have much earning power, must pay a tax at least twice as much as that payable by the husband who normally continues to have earning power. This practical inequity should be eliminated from our taxing scheme. In addition, under the present federal gift tax law, gifts of community property are deemed made by the husband. Consequently, a gift by the wife of her community interest to the husband, whether made inter vivos or in contemplation of death, would seem to be tax-free. While such a provision frees taxpayers, it is not a fair provision. If transfers are to be taxed, there is no more reason for excluding that type of transfer than there would be to exclude any other. It is of interest to note that the section of taxation of the American Bar Association has recently prepared a draft of a bill to repeal the 1942 federal estate and gift tax amendments as a part of a plan to equalize taxes as between community property and common law states. Furthermore, the “Report of the Special Tax Study Committee to the Committee on Ways and Means” of the House has recommended that no estate tax be imposed on what is legally the wife’s community share and that for estate tax purposes all property left outright by one spouse to another up to one-half of his estate be exempted from estate tax.468

D. REFORM SEEKING TO SIMPLIFY GIFT, INCOME AND ESTATE TRANSFER TAX APPLICATIONS

It has long been a criticism of federal excise tax structure that gift, estate, and income taxes are not correlated. The result, for example, is that a transfer taxable as a gift may still result in income tax liability on the subject of the gift to the donor, and that a transfer taxable as a gift is nevertheless includible in the estate of the donor for estate tax purposes. Anyone making a gift in trust must carefully thread

468 INT. REV. CODE § 1000(d), Reg. No. 108, § 85.2(c), see also § 811(d) (5). See Francis, 8 T. C. 91 (1947), upholding constitutionality of INT. REV. CODE § 1000(d).
469 Cf. REM. REV. STAT. § 11218-11(b). No such exception exists under Washington Gift Tax Law. The “Report of the Special Tax Study Committee to the Committee on Ways and Means” of the House recommends that for gift tax purposes one half of any transfers between husband and wife be exempted from the gift tax. 25 TAXES 1048 (1947).
470 25 TAXES 1048 (1947).
473 E.g. Gifts with possibility of reverter. See Note 261, supra. In the joint study issued September 10, 1947, prepared by the Treasury Department entitled “Federal Estate and Gift Taxes—A Proposal for Integration and for Correlation with the Income Tax” approximately nine instances of transfers incomplete or possibly
his way through a labyrinth of statutes and regulations in an effort to assure himself that the gift is a gift for estate and income tax purposes as well as one for gift tax purposes.552

There is no reason for the continuance of such a state of the law. It is unfair, and unnecessarily complicated, to require a taxpayer to treat a transfer as subject to a gift tax and at the same time as subject to income tax or estate tax. The taxing scheme should correlate these three taxes so that a transfer subject to a gift tax is really and truly to be treated as a gift so that there will be no income tax payable on the subject of the gift and the gift subject matter not includible in the donor's estate.553

It will also be noted from what has heretofore been said that a taxpayer engaged in planning an estate must take into consideration at least two separate systems of taxation—state and federal. Transfers that are gifts under local law may or may not be gifts under federal law 554. Transfers that are subject to exemptions under federal law may or may not be subject to similar exemptions under state law 555. The taxing scheme of taxing the recipient under state law is quite different from the taxing scheme of taxing the transferor under federal law. The result is that the state and federal taxes are not coordinated or correlated, when they might well be.

In addition, the concept of transfers in contemplation of death or transfers to take effect in possession or enjoyment at or after death is an extremely difficult concept to work with in practice. If, therefore, a taxing scheme can be devised that will tax donative transfers and yet eliminate the necessity of utilizing the concept of transfers in contemplation of death or transfers to take effect in possession or enjoyment at or after death, the taxing scheme will be considerably simplified.556

Reforms have been suggested from time to time as to changing our taxing scheme. A well thought-out plan is the so-called "Accession Tax," which is "a progressive tax on each recipient of money or other incomplete for estate tax purposes but complete for income tax purposes, and eight transfers complete for estate tax purposes but incomplete or possibly incomplete for income tax purposes, are mentioned.

552 See discussion supra, under heading "Gifts with Permissible Strings."
553 See supra. See PAUL, TAXATION FOR PROSPERITY, 309, et seq. Such is the relief sought by the Treasury Department's proposal referred to in Note 551, supra.
554 The statutory definitions are not the same. Cf. REM. REV. STAT. § 11218-11 with INT. REV. CODE §§ 1000, 1002.
555 Cf. REM. REV. STAT. §§ 11218-12, 14, 15 with INT. REV. CODE §§ 1003, 1004.
556 This is advocated inter alia, PAUL, TAXATION FOR PROSPERITY, 309, et seq.
property by way of inheritance or *inter vivos* gift" according to the aggregate taxable acquisitions of the donee, no matter from whom. 557

Another plan embodying the present federal transfer tax theory of taxing the donor or transferor is the plan of imposing a single transfer tax on the donor of donative transfers, whether before or after death, with a single exemption. The latter plan is probably the more easily adopted because involving a less substantial departure from the present federal taxing scheme. 558

Aware of the need of reform, the Treasury Department, after a three-year study, has issued a pamphlet entitled "Federal Estate and Gift Taxes—A Proposal for Integration and for Correlation with the Income Tax" (September 10, 1947). The study appraises critically the existing federal estate, gift, and income tax structures. 559

The Treasury Department then recommends that the federal estate and gift taxes be integrated into a single transfer tax and that this tax in turn be correlated with the income tax so that the transferor's income tax liability ceases once the transfer tax is imposed. Integration is accomplished by utilizing the cumulative basis of computation used in the present federal gift tax statutes. Accordingly dispositions effected at death would be the final transfer taxable at a rate determined by adding the property transferred at death to the property transferred during life and subject to tax at that time. In addition, there would be a single exemption, regardless of whether the transfer was *inter vivos* or at death. Thus, using the present exemptions as illustrative, at death the decedent's estate would be entitled to an exemption of $60,000, plus any unused balance of the present $30,000 lifetime exemption allowed for *inter vivos* transfers. As for annual exclusions, while it is suggested that they be put on a per donor basis (regardless of whether a future interest is created) rather than as at present on a per donee basis with an annual $3,000 exclusion (except for future interests), there is no objection raised to a continuance of a per donee basis in an amount to be fixed by Congress.

As for correlation with the federal income tax, the method proposed is this: The income tax will generally continue to be imposed upon
the transferor of property until he has relinquished sufficient controls or contacts to render the transfer complete, whereupon the income tax ceases. If, however, there is an incomplete transfer in trust, the grantor’s liability for income tax is to be accompanied by a right to recapture from the trustee part of the trust income taxable to the grantor, to the end that the grantor may be reimbursed—for the most part, at least—for the tax which he is required to pay on income which the trust, but not he, receives.

If adopted, the proposal will not only correlate estate, gift, and income taxes, it will also do away with contemplation of death problems and transfer tax advantages in cases of inter vivos gifts. The advantage of inter vivos trusts with respect to the nontaxability of remainders on the death of a life tenant would remain; it would still be advisable to make gifts to split income, with features of certainty added as to what is a completed transfer and with provisions for tax reimbursement in cases of gifts in trust the income of which is taxable to the trustor. It is to be noted, however, that the present estate and gift tax treatment of community property is to be retained, and is not to be correlated with income tax treatment of community property. The reason for not correlating these taxes, according to the Treasury Department, is to impose substantially similar burdens on jointly held and community property. There can be little question that the proposed transfer tax integrated with income tax (even if only to the extent proposed) will be a decided improvement over the present law.

The state of Washington, in the interest of simplicity and for the purpose of correlating its inheritance tax with the estate tax of the federal government, might adopt the federal system of taxing the right to transmit property (rather than the right to receive property). The state might then provide that whenever a federal estate or gift tax is payable, the state shall receive a percentage of such tax. To take into account relationship of the beneficiaries, specific additional deductions or exemptions can be provided. As to transfers too small to be subject to federal legislation, the state may fix rates on an equitable basis embodying the theory of taxing the right to transmit with appropriate deductions and exemptions based on relationship of donor and donee or testator and beneficiary. The merit of the plan suggested is its relative simplicity, namely, a single donative transfer tax adopted for the benefit of both state and federal governments, the time of the

560 REM. REV. STAT. §§ 11202-1(1) and 11202-b as analogies.
CONCLUSION

The foregoing review of the problems of estate planning shows that the attorney's obligation is not necessarily discharged by drawing a will as requested by a client. If the testator is to succeed in transmitting in as provident and economical a manner as possible the estate he owns, it is necessary to understand and consider (1) the nature of the individual and marital property involved; (2) the tax effect, both state and federal, of transfers proposed both _inter vivos_ and testamentary; (3) the use of life insurance, both personal and business, in connection with the plan, (4) social security benefits, if any; (5) the substantive testamentary provisions, including possible trust transfers; (6) the problem of unitary management in the case of community property; and (7) an assessment of possible or probable law changes as it may affect the plan used.

In addition to the needs of the particular client, and from the standpoint of helping to guide the direction of estate planning law reform, an attorney will want to do what he can to influence such law reform in the direction of securing the enactment of statutes that will achieve the proper objectives of such law reform, namely, providence, fairness, and simplicity.

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561 **In A Tax Program for a Solvent America, 232 et seq., proposals for dealing with overlapping taxes are discussed under the following headings (1) separation of sources, (2) shared taxes, (3) state and local supplements to federal taxes, (4) credit for state tax against Federal tax, (5) grants in aid. The methods (3) and (4) are disapproved as a threat to the fiscal independence of states and as not eliminating the necessity of duplicate returns. It is submitted that fiscal independence of the state will not be impaired under the proposal here made and that the state return and audit problems attendant thereon for state purposes will be much simplified.**