Coordination of Facts and Wills

David L. Samuels

Follow this and additional works at: https://repository.uchastings.edu/hastings_law_journal

Part of the Law Commons

Recommended Citation
Available at: https://repository.uchastings.edu/hastings_law_journal/vol18/iss2/6
Coordination of Facts and Wills

By David L. Samuels

For many years Mr. Robert W. Harrison, a very fine gentleman and an excellent lawyer and professor of law at Hastings College of the Law, emphasized, "You cannot know your law until you know your facts! That is to say, you cannot know what principle of law to apply until you know the facts to which an application of a principle of law is required." This is one of the most important legal principles encountered by this writer in some 34 years spent in pursuit of a legal education.

This article will demonstrate that the above principle applies as fully to the drafting of wills as to any other phase of practice. No matter how carefully a will may be drawn, if there is a lack of rapport between the instrument and the factual situation of the client, there will be a poor result.

Joint Tenancy

 Probably the most commonly mentioned form of testamentary frustration involves joint tenancy. There are few practitioners who have not encountered instances where the intent of a testator failed, at least in part, because of the latter's ignorance of the survivorship aspects of joint tenancy or his failure to realize that title was held in joint tenancy.

It may not be practical for counsel to insist on the privilege of examining deeds or other evidence of title in each instance, although this seems the best procedure. It is certainly appropriate, however, to point out to clients the importance of determining whether or not title is held with another as joint tenants and to investigate the accuracy of his reply to the best as possible.

Aside from the unfortunate aspect of having property pass into unintended hands because of the survivorship attribute of joint tenancy, there are at least two tax aspects to be kept in mind when determining whether or not that form of ownership is appropriate. These will apply even if the surviving joint tenant is the person intended to be benefitted.

One of the most common forms of "estate planning" involves having the testator leave a testamentary trust for the benefit of his or her

* Member, Santa Clara Co. Bar.
surviving spouse so as to avoid a second tax at the death of that spouse. For example, if spouses H and W have a combined net estate of $200,000 in accumulations of community property earnings and investments, or if each has separate property with net worth of $100,000, the combined federal estate taxes on the two deaths can be reduced to less than $10,000 if the first spouse to die leaves his or her community share, or separate property estate, to a testamentary trust for the benefit of the survivor, with remainder interests to vest in their children at the death of the survivor.\(^1\) On the other hand, if the first decedent’s share passes to the survivor outright and free of trust, whether because of joint tenancy, intestacy or the provisions of the will of the decedent, the total federal taxes on the two deaths will amount to $37,500.\(^2\)

Of course, the provisions of the decedent’s will purporting to create a testamentary trust for the benefit of the survivor will be of no avail if the parties hold their assets as joint tenants. While one still hears comments from laymen to the effect that community property can be held in joint tenancy, the fact remains that they are two different forms of ownership.\(^3\) Despite the statements in *Tomaier v. Tomaier*\(^4\) and

---

1. The Federal estate tax on $100,000 is $4,800. *Int. Rev. Code of 1954*, § 2001. The assets which the first decedent leaves in trust will neither increase the size of the taxable estate of the survivor nor be subject to a tax a second time at the death of the survivor, unless the latter has an unlimited power of appointment over the principal trust assets and can consume them.

   A similar result will follow if the first decedent’s net estate has value of $200,000 in separate property and the survivor has nothing. Since the first decedent can leave a marital deduction share to the survivor, the result is the same as above. *Int. Rev. Code of 1954*, § 2056.

2. In addition to the tax of $4,800 on the first death, if a net value of $200,000 remains at the time of the second death, the Federal estate tax will be $32,700 less a possible small credit under *Int. Rev. Code of 1954*, § 2013 if both deaths occur within ten years. This credit cannot exceed the amount of the tax paid at the first death, may be less, and diminishes according to the number of years elapsing between the two deaths.

   The figures indicated include credit for state death taxes up to $1,200 in connection with the second death under *Int. Rev. Code of 1954*, § 2011, but the credit is usually smaller than the full amount of the state death tax. See *Cal. Rev. & Tax. Code* §§ 13307-10, 13404-07, showing that in California the tax depends on the number of devisees and legatees, their relationship to the decedent, and the amount which each devisee and legatee receives, rather than on the size of the estate. If the California Inheritance Tax is smaller than the maximum allowable credit a California Estate Tax makes up the difference, so as to assure that the state gets the maximum amount allowed by the *Int. Rev. Code of 1954*, *Cal. Rev. & Tax. Code* §§ 13441-43.

3. In *Tomaier v. Tomaier*, 23 Cal. 2d 754, 758, 146 P.2d 905, 907 (1944) the court stated, “If the evidence establishes that the property is held as community property, however, it cannot also be held in joint tenancy, for certain incidents of the latter would be inconsistent with the incidents of community property.” See also 4 *Witkin, California Law, Community Property* § 34, at 2738 (7th ed. 1980).

4. 23 Cal. 2d 754, 146 P.2d 905 (1944).
subsequent decisions to the effect that the record title may be overcome by evidence of the community property ownership, the fact remains that such evidence is necessary to overcome the presumption that the record title means just what it says.  

Joint tenancy can actually increase taxes unnecessarily With certain important exceptions concerning transfers between spouses the Internal Revenue Code provides that a transfer of separate property into joint tenancy constitutes a taxable gift. Thus, for example, if a parent uses separate property funds to purchase $30,000 worth of securities in the names of a child and himself as joint tenants, the parent is making a gift to the child of $15,000. Whether a tax results from such a gift depends upon the extent of prior gifts in the case of the federal tax law However, it should be noted that a state tax will often be incurred even though the sum of all past gifts is too small to involve a tax under the federal law. Too often one hears the federal.

6 Where joint tenancies or tenancies by the entirety involving real property are created by spouses after 1954, no gifts are involved, even though the contributions of the spouses are unequal, unless a timely election is filed for the year of acquisition, by which the spouses state an intent to make a gift. Int. Rev. Code of 1954, § 2515(a). In the absence of such election, a gift is created at the time of dissolution of the joint tenancy if the parties share the proceeds in different proportions than they contributed to its acquisition. Int. Rev. Code of 1954, § 2515(b). See also Treas. Reg. § 25.2515-1 (1958). Under Treas. Reg. § 25.2511-1(h)(4) (1958), if A creates a joint bank account for himself and B, or purchases an U.S. Savings Bond payable to “A or B”, there is no gift at the time of this action. There is, however, a resulting gift to B when B draws upon the bank account or surrenders the bond for cash, without any obligation to account for the proceeds to A. California gift tax provisions are to the same effect. Cal. Rev. & Tax. Code § 15104.5; Cal. Gift Tax Reg. § 15104(e) (1966).
8 Treas. Reg. § 25.2511-1(h)(5) (1958). If the gift is made to a spouse rather than to a child, the amount is reduced for gift tax purposes by reason of the Marital Deduction provisions of the Gift Tax. Int. Rev. Code of 1954, § 2523. However, there is no similar Marital Deduction in connection with the gift tax laws of California. Thus, in California, gift tax would have to be paid on the figures given in the example. The amount would depend upon whether the child was an adult (entitled to only a $5,000 lifetime exemption) or a minor (entitled to a $12,000 lifetime exemption). Cal. Rev. & Tax. Code § 15421. Except for the exemption for gifts to minor children, there are no specific exemptions (equivalent to lifetime exemptions under Int. Rev. Code of 1954 § 2521) in excess of $5,000, and even these lesser exemptions apply only to a spouse, ancestor or descendant of the donor. The specific exemptions become smaller as the relationship becomes more distant. Cal. Rev. & Tax. Code §§ 15421-24. So, although the annual exclusion is $4,000 under the California law, Cal. Rev. & Tax. Code § 15401, rather than the $3,000 allowed under the Federal law, gifts become taxable at a much lower figure in connection with the California Gift Tax law than in connection with the Internal Revenue Code of 1954.
law stated to the effect that $3,000 a year can be given to each donee "without counting" and, in addition, each donor has a $30,000 lifetime exemption, without any warning that smaller sums may incur state gift taxes.

It should also be noted that payment of a gift tax will not prevent death taxes from becoming payable later at death of a joint tenant.10 The estate tax provisions state that upon the death of a joint tenant the entire value of the property held in joint tenancy will be includible in the estate of the decedent, except that property originally belonging to the survivor which was not received or acquired from the decedent for less than full consideration.11 Using the figures mentioned above, note that on the death of the parent the entire value of the property placed in joint tenancy will be considered part of the parent's estate for death tax purposes, in spite of the fact that a gift tax may have been paid on half of the value of the property at the time of its transfer to joint tenancy 12

The point is, of course, that the combination of the gift in joint tenancy and the survivorship at the death of the parent have resulted in imposition of both gift and death taxes. The gift tax would have been eliminated entirely and the death taxes would not have been increased had the parent retained ownership until death. Similarly, if the parent had made the child a tenant in common or had caused half of the stock to be placed in the child's name as separate property, retaining the other half in the parent's name as separate property, there would have been no increase in the gift tax over the joint tenancy situation, and at the parent's death only his one-half would have constituted a part of his taxable estate.13 There is small comfort in knowing


12 However, if the joint tenants are husband and wife, a deduction is allowed by both the United States and California death taxes for the surviving spouse's "marital deduction" share if the source of the property was originally the decedent's separate property and was never community property. Int. Rev. Code of 1954, § 2056(c) 2 (B). Cal. Rev. & Tax. Code § 13605 is to the same effect, but refers to an "exemption" rather than a "deduction" because an inheritance tax rather than an estate tax is involved.

13 This is assuming that the transfer was not in contemplation of death within the meaning of Int. Rev. Code of 1954, § 2035. Furthermore, the parent could have bequeathed half of his stock to his wife free of tax by qualifying for the marital deduction of Int. Rev. Code of 1954, § 2056. The same results would have followed from a switch to community property except that there would have been no marital deduction at the death of the donor. However, in the community property situation both "halves"
that if, in the original example, the donee had died first, the donor would not have had to pay a tax on return of the decedent's share to him by reason of joint tenancy survival.\textsuperscript{14}

While these situations indicate the dangers of joint tenancy, care must be taken not to transfer assets out of joint tenancy without an investigation of possible incurrence of gift tax liability. The general rule is that acquisition of property in joint tenancy involves a taxable gift if the separate property funds of one of the joint tenants are used to pay for the assets in question. As previously indicated, there are exceptions, however, where separate funds of one spouse have been used since adoption of the Internal Revenue Code of 1954 to purchase real property in the names of the spouses as joint tenants or tenants by the entirety \textsuperscript{16} No taxable gift is involved at creation of the joint tenancy unless a timely election is filed, but upon inter vivos termination of the joint tenancy, if the property or proceeds are distributed in different proportions than those by which the parties contributed to the cost of acquisition, taxable gifts result.\textsuperscript{16} Thus, before any transfers out of joint tenancy to another form of ownership can be properly advised, an investigation of the background is necessary. If real property held by the spouses as joint tenants was acquired with separate property funds of one spouse prior to 1955, a gift was made at the time of acquisition and there will be no further gift upon transfer of title from joint tenancy to tenancy in common or community property. On the other hand, if real property was acquired after 1954, further investigation must be made to determine whether or not the parties “elected” to treat the joint tenancy acquisition as a gift for the year in which the property was acquired.\textsuperscript{17} Similarly, where joint bank accounts or jointly held government savings bonds are involved, an investigation should be made as to the source of the funds deposited or used in purchase of the bonds to determine whether or not a gift would be involved in a change of title and, if so, whether or not the gift would be large enough to create an objectionable tax.\textsuperscript{18}

would have received a “stepped-up” basis instead of merely the decedent’s half receiving such an increase in basis—assuming that decedent's cost would have been no less than the value at death. \textit{Int. Rev. Code} of 1954, § 1014(b) 6.

\textsuperscript{14} Tres. Reg. § 20.2040-1(c) (1958).

\textsuperscript{15} See note 5, \textit{supra}, and note that where real property joint tenancies or tenancies by the entirety are involved in connection with holdings of spouses, the taxpayer has an election as to whether or not to treat the transaction as constituting a gift.


\textsuperscript{17} Tres. Reg. 25.2515-1(b) (1958).

\textsuperscript{18} Tres. Reg. § 25.2511-1(h)(4) (1958). These instances differ from those where
Needless to say, there are many instances where joint tenancy may be advisable. If the estates of a married couple are small enough for death taxes to create less of a financial problem than probate expenses and the delays resulting from probate, it is quite possible that joint tenancy will continue to be the boon which it has often been in the past. Under such circumstances, wills are needed only to provide for disposition of the estate in question at death of the survivor.

Insurance and Other Contract Payments Made Outside of Probate

Quite often a testamentary plan evidenced in a will can be frustrated by failure to realize that a substantial part of the estate in question consists of life insurance. We have previously considered the tax economies possible where the combined assets of spouses have a value of $200,000 and each spouse executes a will providing a testamentary trust of the decedent’s one-half for the benefit of the survivor. However, in many instances, although the wills set forth this intent, there is a failure to note that the wife is named as primary beneficiary of all the life insurance and that there is little left to be disposed of by the will. If she survives the husband, the possible tax savings will be dissipated unless this is remedied, for at least “husband’s half” of the insurance proceeds will swell the wife’s taxable estate and will be taxed a second time at her later death unless spent or disposed of through gifts.19

Similar treatment is applicable with regard to contract payments to be made outside of probate and to named beneficiaries under non-real property joint tenancies or tenancies by the entirety are created between spouses, since there is no opportunity to “elect” to treat the creation of the co-ownership tenancy as giving rise to gift tax.

19 For example, assume spouses own insurance on husband’s life, with maturity value of $150,000, and other assets having net value of $50,000, and that all insurance proceeds are paid to wife on husband’s death. Even if all other assets feed a testamentary trust under husband’s will, at least $50,000 of life insurance proceeds will be subject to tax at his death, aside from the $100,000 passing to wife under the marital deduction. Int. Rev. Code of 1954, § 2056. This, added to the $50,000 value of assets going into trust, would produce an estate tax of $4,800. Int. Rev. Code of 1954, §§ 2001, 2052. If the wife dies later, with the entire $150,000 proceeds taxable in her estate, the estate tax will be $17,900. Int. Rev. Code of 1954, §§ 2001, 2052. However, if husband had provided that only half of the insurance proceeds be paid to the wife, and the balance be fed into the trust under his will, and had similarly divided other assets between wife and the testamentary trust, it would be possible to leave the taxable estate of husband at $100,000, and have only $100,000 balance pass to wife for taxation at her later death, unless otherwise disposed of. Each estate would have to pay a Federal tax of not over $4,800, making the total not over $9,600. Int. Rev. Code of 1954, §§ 2001, 2052.
insurance contracts where any substantial amounts are involved. In this category should be included payments under qualified profit-sharing and pension plans, as well as payments made at death to members of a union or similar membership organization.

A related problem involves insurance policies naming minor children as alternate beneficiaries, where the spouse of the insured is named primary beneficiary. In many instances where the combined assets of spouses have only a modest value, each will want to leave everything to the other, with a testamentary trust to be created for the benefit of minor children at the death of the survivor. Such a plan will avoid the rather cumbersome procedures of guardianships and will give the trustee broader discretion than that usually given a guardian. However, it must be remembered that, in addition to providing for the testamentary trust in the wills of the spouses, the insurance policies must be amended to name the testamentary trustee as alternate beneficiary, to take if the spouse of the insured does not survive.

Even where the non-insurance assets do not have sufficient value to warrant use of a testamentary trust, it may be well for a wife to create a testamentary trust in her will for the purpose of carrying her community property interest in insurance on her husband's life. Many people today are able to earn substantial incomes shortly after commencing their careers, and so can afford to carry large amounts of life insurance before being able to acquire other investment assets. If, for example, the husband is the breadwinner and the insurance is on his life, the non-insurance community property assets may be so small that the wife should leave them to her husband outright if she is the first to die. On the other hand, he may not wish to receive her community property interest in insurance policies on his life, since this will be of little value to him unless he anticipates borrowing money against the insurance policies, or surrendering them for their cash surrender value. Accordingly, it may be well to have the wife create a testamentary trust for the purpose of holding title to her community property share in such policies, so that if the wife predeceases the husband, at the husband's death the proceeds will escape taxation in his estate to the extent of that one-half interest. If the above plan is adopted, a portion of the proceeds may be treated as resulting from gifts in contemplation of death if the husband has continued to pay all of the premiums thereafter. However, it will probably be only those premiums paid within three years of the death of the husband that fall within this doctrine, which is discussed more thoroughly hereafter. This last arrangement may not be practical with regard to non-insur-
ance contract obligations, such as the aforementioned profit-sharing and pension plans, since these do not customarily permit transfer of ownership at the wife's death, where the husband is the employee covered by the plan, and he survives.

For many years, insurance companies were reluctant to name trustees of testamentary trusts as beneficiaries if the testator was still living at the time the insurance beneficiary clause was issued, because of the uncertainty of the will remaining in effect at the testator's death. Accordingly, inter vivos trusts were used so that at the time of issuing the beneficiary clause, the insurance company would know that a trust that could be identified in the beneficiary clause was in existence. Within the past five years, however, insurance companies have become willing to name trustees of testamentary trusts as beneficiaries even if the testator is still living at the time of issuance of the beneficiary clause if there is a proviso in the clause that if no such trust comes into existence at the death of the testator in question, the proceeds are to be paid to the executor or administrator of the estate of the testator.

In California there was also a reluctance to name a testamentary trustee as beneficiary of a life insurance policy because of the contention of the State Controller's office that proceeds so paid would not be eligible for the $50,000 exemption from inheritance tax provided by the California Revenue and Taxation Codes. This point was settled, however, by Estate of Anderson, which held that such proceeds would be eligible for the exemption if paid to a trustee under a previously executed will of a living person, if such will were specified in the beneficiary clause, but would be ineligible for the exemption if paid to a trustee under a will not designated in the beneficiary clause. Thus, to qualify for the exemption, the client may either create

\[\text{Prior to Estate of Anderson, 236 Cal. App. 2d 214, 45 Cal. Rptr. 852 (1965) the office of the State Controller contended that if proceeds were paid to a testamentary trust under the will of the insured, the exemption of $50,000 under CAL. REV. & TAX. Code § 13724 would be lost. Calif. Inher. Tax Reg. § 13722 (1959). While the wording of the California Regulation leaves it unclear as to whether all payments to a testamentary trustee are ineligible for the exemption, or whether the ineligibility applies only to those payments to a testamentary 'trustee who is under a legal obligation to use the funds to meet the taxes, charges, debts, or expenses legally enforceable against the insured's estate,' the office of the State Controller contended that all amounts paid to testamentary trustees were ineligible, regardless of how used.}

\[\text{21 Estate of Anderson, 236 Cal. App. 2d 214, 45 Cal. Rptr. 852 (1965).}

\[\text{22 The Anderson decision reaches this result by arguing that if proceeds are paid to a designated trustee under an identified and existing will, there is in fact a payment to an inter vivos trust, but that otherwise the payment is to a testamentary trust. This is apparently based on the theory that if the will is identified in the insurance beneficiary clause, the proceeds would be included in the estate.}

\[\text{Estate of Anderson, 236 Cal. App. 2d 214, 45 Cal. Rptr. 852 (1965).}
an inter vivos trust to receive a portion of the insurance proceeds or have such proceeds paid to a trust, the terms of which are set forth in his will—albeit an inter vivos trust. In either event, there is an opportunity to take care of the client who has substantial income and so is able to carry large amounts of insurance but has not acquired a proportionately large volume of other investment assets. In such a case, the beneficiary clause can provide that if the wife is the survivor she will receive half of the proceeds outright and free of any trust with the balance of the proceeds, or all of the proceeds if the wife does not survive, to be paid to the trustee in question.

Another example of partial planning involves suggestions that the spouses own insurance on each other's lives under a cross-insurance arrangement. In other words, if wife owns the policies insuring the life of husband and he, in turn, owns the policies insuring her life, it is suggested that on the death of either of them, the insurance on the life of that decedent will escape death taxes because the decedent owned "no incidents of ownership." Aside from the question considered hereafter, with regard to the "contemplation of death" doctrine where the insured pays the premiums on the policy on his own life owned by his spouse, the doctrine may be sound in those states which do not have community property. However, in a community property state such as California, there will be no presumption that policies issued in the name of the husband are his separate property. On the contrary, the presumption is that such policies owned by the husband are community property, and if the premiums have been paid with community property earnings, they will be deemed com-

---

23 Wife's community property one-half of the insurance proceeds is not taxed because it already belongs to her, and if the policy represents separate property of the husband, she may receive half of the proceeds outright as part of the marital deduction. Inv. Rev. Code of 1954, § 2056.

24 In those instances where there is no penalty under state tax law resulting from the use of testamentary trusts, these may be preferable because of simplicity, lack of expense in their creation, maintenance or termination inter vivos. While the practices of corporate trustees are far from uniform, some corporate trustees require an annual fee for maintenance of an inter vivos trust, even though it contains no assets other than life insurance policies, others make charges for creating the trusts initially, and some have a charge for termination of the trust inter vivos in the event that the trustor has a change of heart. Questions may arise as to the validity of the passive inter vivos trust, as noted in note 31, infra, and related portions of the text, unless great care is taken in the preparation and execution of the documents.

25 See note 27 infra and accompanying text.
community property in the absence of an agreement to the contrary. Accordingly, where this device is used, care must be taken to supplement the wills of the parties with an agreement stipulating that the policies insuring the life of the wife are to be deemed the separate property of husband, regardless of the fact that community property funds may be used in making premium payments.

The "contemplation of death" problem must also be considered. To the extent that funds belonging to the insured are used to pay premiums on such policies owned by his spouse within three years of the death of the insured, the Treasury Department argues that these are "gifts in contemplation of death." Furthermore, the Treasury Department is not satisfied with treating the total amount of the premiums paid as such gifts, but may insist that the entire proceeds, or at least that portion attributable to the premium payments made during the three years preceding death, be considered as the "gift in contemplation of death." Until the correctness of this has been determined by the courts, the validity of this contention may be subject to question. Nevertheless, it would be difficult to justify the subjecting of a client to this unnecessary risk without first warning him of the need for avoiding it.

As previously indicated, one common plan for testamentary disposition involves the creation of an inter vivos trust with the will of the testator "pouring over" into the inter vivos trust at death of the testator. This relieves the trustee from accounting to the probate court during the life of the trust and may also avoid publicity with regard to the terms of the trust since these need not be spelled out in the will and need never be made public. While California and several other states have adopted a "Uniform Testamentary Additions to Trusts Act," which greatly liberalizes the rules applying to testamentary pour-overs into inter vivos trusts, there are still many states where this Uniform Act has not been adopted and where the old trust

28 Each premium payment may constitute a taxable gift, in addition to bringing a portion of the proceeds into the taxable estate of the person paying the premium for estate tax purposes. Treas. Reg. § 25.2511-1(h)(3) (1958).
29 Wells Fargo Bank & Union Trust Co. v. Superior Court, 32 Cal. 2d 1, 193 P.2d 721 (1948); CALIF. CONTINUING EDUCATION OF THE BAR, CALIFORNIA WILL DRAFTING §§ 4.30-35 (1965); 1 SCOTT, TRUSTS §§ 54.2-.3 (2d ed. 1958).
29 CAL. PROB. CODE §§ 170-73.
rules apply. In these states, the existence of the trust corpus is essential to the creation of a valid trust,\textsuperscript{30} and it would seem quite clear that the attorney’s functions would involve being certain that the trust was in existence before executing a pour-over will. However, prior to adoption of the Uniform Act, several representatives of trust companies mentioned instances in which the attorneys had the client execute the will before the trust agreement had come into existence, in that it had not yet been executed on behalf of the trustee and thus was invalid.\textsuperscript{31}

Another problem affecting the client’s insurance, although not directly related to the drafting of wills, involves unintended gift tax liability resulting from someone other than the owner of the policy being named as beneficiary. For example, where a policy insuring the life of husband names wife as owner but leaves one of their children as beneficiary, on the death of the insured husband, wife will be deemed to have made a taxable gift to the child in the amount of the insurance proceeds payable to that child.\textsuperscript{32}

Finally, related to the problem previously considered in connection with transfers of title out of joint tenancy into other forms of ownership, are the problems arising where ownership of life insurance policies is changed. The policies are a form of property and changes of ownership with regard to them will involve the same gift tax problems as result from changes of ownership for other types of property. However, where intentional gifts are being considered, insurance policies have the advantage of being valued at less than their face values during the life of the insured,\textsuperscript{33} and so may constitute ideal gifts.

\textsuperscript{30} Scott, Trusts § 54.3, at 379 (2d ed. 1956).

\textsuperscript{31} A similar set of facts was involved in a recent Ohio case. Knowles v. Knowles, 4 Ohio Misc. 153, 3 Ohio Op. 2d 218, 212 N.E.2d 88 (1965). There, decedent entered into a trust agreement with his brother and had intended to name him beneficiary of decedent’s insurance policy in order to create corpus. However, there was an oversight and the brother was never named as beneficiary of the policy, with the result that no trust existed at the time of the testator’s death. Accordingly, his plan to have his will pour over into the trust was frustrated.

\textsuperscript{32} Goodman v. Commissioner, 156 F.2d 218 (2d Cir. 1946); Pleet v. Commissioner, 17 T.C. 77 (1951).

\textsuperscript{33} Treas. Reg. § 25.2512-6 (1958), as amended, T.D. 6680, 1963-2 Cum. Bull. 419 provides generally the value of an established policy is its interpolated terminal reserve at the date of the gift, adjusted for the portion of the last premium payment remaining unearned at that date, unless a different value is established by sales of comparable contracts. In practice the insurance company will provide the appropriate figure on request, set forth on U.S. Treasury Form 938 for submissin with U.S. Gift Tax Returns. CCH Fed. Est. & Gift Tax Rep. §§ 3360.35. California requires a similar statement on its form GT-4. Cal. Gift Tax Reg. §§ 15658(b) 5 (1959), 15658(g) 3 (1959).
Marital Deduction

More closely related to the drafting of wills are the problems involved in the drafting of marital deduction provisions to meet the requirements of the estate tax provisions of the Internal Revenue Code. Much has been written elsewhere with regard to the drafting of provisions designed to transmit the maximum Marital Deduction. Nothing would be gained by repeating such coverage here. However, it is often, and sometimes erroneously assumed, that the maximum tax benefit will result if the first spouse to die transmits as much value as possible on a tax free basis to the surviving spouse. It is submitted that this is not always the case, as, for example, where the surviving spouse already has a substantial separate property estate or contemplates receiving one in the future. We have already considered the example of the spouses whose combined assets have a value of $200,000, where all of these assets are community property, and have seen the tax economies available where the spouse first to die creates a testamentary trust for the benefit of the survivor. The same principles prevail where separate property is involved. If husband has a net estate of $200,000 in separate property and wife has nothing, the use of the marital deduction will enable husband to leave approximately $100,000 to wife, free of tax, while the remaining $100,000, which is, of course, taxable in his estate, can escape a second tax at wife's later death if paid to an appropriate trust. The result will be the same taxwise as if the assets had been held by them as community property.

On the other hand, if each of the spouses has a net estate of $100,000 in separate property, it may be disadvantageous for husband to use the marital deduction to pass $50,000 to wife free of tax, since on her later death, she will have an estate of $150,000. In other words, if husband had left his entire estate of $100,000 in separate property to a testamentary trust for wife's benefit, there would have been two estates of $100,000 each and the federal tax on each would amount to $4,800. But if, instead, he leaves a marital deduction share to her,  


35 The amount which can pass to a surviving spouse free of tax is 50% of the "adjusted gross estate" as that term is defined in Int. Rev. Code of 1954, § 2056. This is measured by decedent's separate property which was never converted into that from community property, and after deduction of appropriate portions of amounts allowable as Estate Tax deductions.
we have a net estate of only $50,000 on the death of husband (after deducting the marital deduction), and then have a taxable estate of $150,000 at wife's later death. We have avoided a federal tax at husband's death, but have increased the tax at wife's death to $17,900. The adverse tax effect, of course, increases as the figures grow larger, and also as the disparity increases.

While there is much to be said for the old adage about the respective values of one bird in the hand as opposed to two in the bush, there is also considerable merit in anticipating future conditions if taxes are to be minimized. If we assume that husband has $200,000 separate property and that wife has no substantial amount of property at the time in question, but that there is strong evidence that she can reasonably expect to inherit a million dollars from her parents at a later date, it must be quite obvious that if wife is the survivor, the total taxes may be increased if husband's will contains a marital deduction provision for the benefit of wife.

Limitations on Testamentary Powers

Without attempting to give full coverage to the instances in which there are statutory or public policy restrictions on testamentary dispositions, it is submitted that there are at least two instances in which the draftsman of a will may innocently run afoul of such restrictions unless a careful investigation is made. One involves the existence of pretermitted heirs. The other is a related problem involving information as to the existence of relatives whose lives result in restrictions upon charitable dispositions.

Shortly prior to the preparation of this paper, the writer had interviewed a married couple who gave the names and ages of their two children, explained that each of the spouses wished everything to go to the survivor of them, but wished a testamentary trust for the benefit of their children in the event of common disaster. It was only after an appropriate will had been drawn and discussed in detail that the wife mentioned apologetically the fact that in addition to the two children who were the issue of the marriage in question, she had a daughter by a prior marriage who was living with the child's father. The mother explained that she certainly did not want this child to benefit from the will since the child's father was well able to take care of her and willing to do so. Upon it being pointed out that it was appropriate to mention the child and show that the failure to provide for her was intentional, the husband-testator said that he did not want to do this and thought it would be cruel to cut off the child
of the prior marriage, although, admittedly, he did not want that child to get anything.

It is respectfully submitted that little can be done to avoid the occurrence of this type of situation from time to time. However, the example may emphasize the importance of making that "good try" at ascertaining the facts, even from a reluctant client.

Insofar as the limitations on charitable gifts are concerned, those set forth in the California Probate Code are typical of most jurisdictions. While there are exceptions to these rules with regard to certain types of recipients, the rule itself can be circumvented. Thus it is evident that there is a need for investigation when drafting charitable devises and bequests. Often a testator will indicate that he has "no family" and desires to leave more than one-third of the estate in question to charity, only to concede later that he misunderstood the term "family."

Related Non-Will Problems

Although not properly within the subject "Wills," there are certain related areas of interest which should be considered when discussing with a client his testamentary wishes. While the client may simply ask to have a will prepared for him, in most instances he is really interested in determining that his "affairs will be in order if anything happens to him." The possibility of avoiding probate altogether, or of at least minimizing his estate for tax purposes should certainly be pointed out before final decisions are reached.

An increasingly popular alternative to disposition of assets by will involves the use of revocable inter vivos trusts. These convenient creatures are the subject of an excellent film discussion by Professor James Casner of Harvard University 38 Without any attempt to duplicate the

38 Cal. Prob. Code §§ 41-43. See Calif. Continuing Education of the Bar, California Will Drafting § 3.19 (1965): Under § 42 the restriction on charitable gifts does not apply to devises or bequests in favor of the State of California, counties, municipalities or political subdivisions or institutions belonging to them, or to any educational institution exempt from tax under § 1a of Article XIII or § 10 of Article IX of the California Constitution. (Non-profit California colleges with a specific reference to Stanford University.)

37 Assume a devise or bequest in favor of a charitable institution would be restricted or banned by Cal. Prob. Code §§ 41 or 43, but for a stipulation that if the devise or bequest is ineffective as to any portion, it shall be deemed to be in favor of an eligible institution, such as Stanford University, to that extent. The provision will be enforced in favor of the institution originally named. In other words, because of the valid gift over to an eligible institution, the relatives named in the Probate Code sections would not receive anything in any event, and so they cannot bring themselves within the protection of the sections cited. Estate of Haines, 76 Cal. App. 2d 673, 173 P.2d 693 (1946); Estate of Davis, 74 Cal. App. 2d 357, 168 P.2d 789 (1946).

38 c/o Mr. Paul Wolkin, Director, Joint Committee on Continuing Education of
coverage provided by that film, it should be noted that the use of an
inter vivos trust permits the trustor to avoid probate at death and to
become familiar with the procedures of the trustee, while living, with
an opportunity to change trustee, since the trust is revocable. In addi-
tion to avoiding publicity, expense and delays of probate, during
the trustor's later years administration of his affairs can be provided by
the trustee, although the trustor can control the activities of the trustee
while he wishes to do so and has the necessary ability

Where stock in a closely held corporation constitutes a substantial
part of the estate, issuance of a second class of stock may enable the
client to greatly reduce the size of his estate for tax purposes without
diminishing his voting interest in the corporation or, in the alternative,
may enable him to turn over the running of the business to younger
hands without risking a loss of income through failure to pay
 dividends.39

When a business arrangement for purchase of a decedent's interest
in either a partnership or a corporation sets a price which is the full
amount to be received by the decedent's estate or heirs, it is generally
assumed that these prices will be binding upon the tax authorities
for purposes of estate and inheritance taxes. This is not always the
case. If the decedent's estate is not obligated to sell for the price fixed
by the agreement, that price will not necessarily control as to the
Treasury Department.40 Similarly, if the decedent is not restrained as
to inter vivos sales, the price applying at death will not necessarily
be deemed controlling by the Treasury Department.41

Except as previously noted in connection with the "contemplation
of death" problem, insurance on the life of a decedent is not included

---

39 If one class of stock is without voting rights, gifts of this stock will reduce the
taxable estate of the donor, with voting control kept intact through retention of voting
stock. If non-voting preferred stock is retained and the voting common stock is given
to younger members of the family, the donor will be assured of income as long as the
business prospers, regardless of the dividend policies of those in charge of the cor-
poration's management. Hea, Capitalization of The Close Corporation, 34 Notre Dame
Law. 335 (1959); Henderson, The Use of Different Classes of Stock in Maintaining
Control in The Close Corporation, N.Y.U. 24th INST. ON FED. TAX. 531 (1966);
Yoblin, Planning An Effective Gift Tax Program: What To Give and When To Give It,
24 J. TAXATION 355 (1966). If the second class of stock is not issued originally, the
provisions of INT. REV. CODE OF 1954, § 306 must be kept in mind, to prevent sale of
that stock from producing normal income rather than capital gain or loss. Generally
speaking, however, death will cure the "section 306 stock" status. Henderson, supra.

See CALIF. CONTINUING EDUCATION OF THE BAR, ADVISING CALIFORNIA BUSINESS ENTER-
PRISES 911 (1958).

41 See note 40 supra.
in his estate for Federal Estate Tax purposes unless the decedent possesses at the time of his death the "incidents of ownership" with regard to the policy. However, this exclusion of the insurance proceeds will be lost if the decedent's executor or estate is the beneficiary of the policy, a matter which should certainly be investigated when reviewing the client's affairs.

Similarly, the value of an annuity or other payment made to a beneficiary of a deceased employee under an exempt employees' trust or qualified non-trust annuity plan is excludable from his gross estate, except for the portion attributable to his own contributions and, for this purpose, contributions or payments made by the employer or former employer under a qualifying trust or plan are not considered to have been contributed by the decedent. However, here again the exemption from estate tax is lost if the payments are "receivable by or for the benefit of the decedent's estate." A discussion of the possibility of reducing the size of the estate of a surviving spouse through a grant of power to the testamentary trustee under the will of the first spouse to die to enter into a private annuity arrangement with the survivor, and the possibility of reduction through the use of the "widow's election" device properly belongs in articles on the drafting of wills. Additionally, the possibility of

CCH Pension Plan Guide § 3266.
45 If at husband's death his will authorizes his testamentary trustee to acquire property from the widow in exchange for a promise to have the trust pay her an annuity for life, and if the amounts involved are determined on an "arm's length" basis, the transfer by the widow to the trust will not be a transfer with income retained for life under Int. Rev. Code of 1954, § 2036, because it will constitute a "bona fide sale for an adequate and full consideration in money or money's worth" as the expression is used in the code section. At her death the value of the property transferred is no longer in her estate, but nevertheless remains in the family because it is a part of the corpus of the trust. In addition, there are certain income tax advantages to the widow during her life because of current income tax treatment of annuity payments. Fidelity-Philadelphia Trust Co. v. Smith, 356 U.S. 274, 280 n.8 (1958); Int. Rev. Code of 1954 § 72; Cohen, Drafting Tax Clauses in A Will—Acquisition of Surviving Spouse's Interest in An Estate, U. So. Cal. 1957 Tax Inst. 549, 553; Recent Developments in The Taxation of Private Annuities, U. So. Cal. 1964 Tax Inst. 491. To the extent that the widow must elect to have her community property share pass into the testamentary trust under his husband's will in order for her to benefit from the provisions of his will with regard to his own half of the community property, she is also deemed to have received consideration for the transfer. In other words, to the extent of the value of what she received in exchange for her electing to take under her husband's will, the value of what she transfers into the trust with income retained for life is reduced for purposes of Int. Rev. Code of 1954, § 2036. Vardell v. Commissioner, 307 F.2d 688 (5th Cir. 1962); Estate of Gregory, 39 T.C. 1012 (1963); Abel, Tax Conse-
reducing the client's estate through the use of inter vivos private annuities should not be overlooked.

Separate, Community and Quasi-Community Property

The need for segregating separate property from community property, and quasi-community property from other forms of separate property does not necessarily involve problems relating to the drafting of the will. On the other hand, such segregation may be essential in determining the sizes of the estates of the spouses and in planning gifts to reduce taxes.

The most difficult problems arise where community property has been co-mingled with separate property, regardless of whether or not the separate property consists of quasi-community property.

It is, of course, much easier to unscramble the confusion while both spouses are available to test their memories as to what transpired. In addition, if the tracing appears to be reasonably accurate, it is

46 If wife has nothing but her share of community property, and there is uncertainty as to the extent of husband's separate property, a marital deduction clause can be inserted in husband's will without any harm. If husband thus confirms to wife her one-half of the community property, leaving to her outright her marital deduction share of his separate property, and ties up the balance of his estate in a testamentary trust which will not be taxed at wife's later death, if she is the survivor, the tax results will be the same, regardless of what portion of the assets is husband's separate property and what is community property, and regardless of whether or not a portion of such assets may constitute quasi-community property.

47 See Marital Deduction supra.

48 The seeming contradiction in referring to quasi-community property as a form of separate property arises from the fact that quasi-community property was created by statute in California, for limited purposes only, and is not distinguishable from other forms of separate property for Federal tax purposes. In other words, the California legislature has seen fit to refer to “quasi-community property” in restricting the power of a spouse to dispose of separate property acquired in another state, which would have been community property because of the manner of its acquisition, if the spouses had been living in California at the time of such acquisition, and has also used the term in granting some relief as to California Inheritance and Gift Taxes. However, this does not give the surviving spouse any interest in such quasi-community property prior to the death of the original owner, and so there is no exemption from tax under the Internal Revenue Code, although, of course, such property may qualify for the Marital Deduction in the same manner and to the same extent as other separate property of the deceased original owner. See CAL. PROB. CODE §§ 201.5-8; CAL. REV. & TAX. CODE §§ 13.672, 15.300, 15.301, 15.301.5, 15.302.5, 15.303.5; Treas. Reg. § 20.2056(c)-2 (1958); Forster, et al., Tax, Legal, and Practical Problems Arising from the Way in Which Title to Property Is Held by Husband and Wife, U. So. CAL. 1966 TAX INST. 35, 100; Walker, Current Developments in Estate Planning, U. So. CAL. 1962 TAX INST. 825.
possible to avoid having the problem compounded in the future through an agreement by the parties stipulating as to their separate and community property holdings. Even where an income producing asset, such as an interest in a business, has been acquired partly with separate and partly with community funds, or community efforts of one of the spouses, it may be possible to stipulate that a certain portion of the increase in the value of the asset is attributable to the efforts of that spouse, and that other percentages are to be attributed to the different types of capital invested.

In attempting to learn the status of the holdings of spouses, it is important to go back to the sources through which assets were acquired, to determine whether or not there may have been taxable gifts involved in past transactions. Thus, for example, if separate property assets of one of the spouses were used to acquire securities in the names of both spouses as joint tenants, the transaction was apparently taxable for gift tax purposes at the time of the joint tenancy acquisition, and no further gifts will be involved in a conversion of the joint tenancy assets into community property. However, if gift tax returns were required, regardless of whether or not there was any tax to be paid at the time of the transaction, there may be a real advantage to the client in filing returns as soon as possible and attaching to the returns an affidavit explaining the delay in filing.49

Conclusion

The term “Estate Planning” has fallen into some disrepute because of the extent to which the phrase is used by nonlawyers in an attempt to claim professional status for their sales activities. Nevertheless, it is submitted that sales representatives of life insurance companies, investment firms, and similar organizations perform valuable services to their clients when encouraging and helping them to review their affairs as a whole. On the other hand, an attorney does a disfavor to his profession and to his client if he merely accepts the client’s statement that he wishes to have a will drawn up, and fails to investigate the client’s need for considering other aspects of his affairs in order to protect his family at the time of death, and in order to avoid conflicts between the various arrangements involved.

49 Int. Rev. Code of 1954 §§ 6019, 6651; Treas. Reg. § 301.6651(a)(3) (1957). As a practical matter, the Internal Revenue Service is quite reasonable in these matters if the delayed filing of a return is explained by an attached affidavit truthfully setting forth the taxpayers’ prior ignorance of the need for a return, and if the return is filed voluntarily and prior to any inquiry by the Internal Revenue Service, the penalty is customarily waived.