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The phrase "estate planning," has come in each more specialized profession to connote the specialized activities of that profession. To the life insurance salesman estate planning means the purchase of life insurance; to the trust officer estate planning means the establishment of trusts; too many lawyers have regarded estate planning as merely writing a will. The attorney should and can regard the function from a broader viewpoint and have available not only the tools of specialists—life insurance, trusts, wills—but all of the other tools and devices which have been developed through the long history of the law as useful in the conduct of the affairs of man. His service is to coordinate and select the various tools best suited to the individual needs.

An estate, according to my understanding, is a pool of assets held and managed for particular uses and benefits. The planning of an estate includes its creation by accumulations of income or other means, its preservation and enchancement, and its ultimate expenditure for the purposes desired—the entire financial career of a man.

Taxes are not the primary consideration in estate planning and the purpose of estate planning is not to avoid either income or estate taxation. Its purposes are affirmative, as to provide a source of live-

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lihood for beneficiaries and to transfer values in accordance with the owner's desires. If his whole desire was merely to avoid taxation, this could be readily and easily accomplished. Rather, taxes are to be regarded as an obstacle or impediment to the accomplishment of the affirmative desires of our hypothetical estate planner. They represent burdens and restrictions upon his otherwise unfettered power and right to do with his earnings and property as he pleases.

I recall that in the Congressional debates concerning the desirability of imposing an income tax, it was objected that if Congress could impose a tax of one-half of one per cent, they might impose a tax as high as ten per cent. To this the reply was made that Congress would never be so communistic as to impose income tax at such a rate then deemed confiscatory. Needless to say, Congress has gone far beyond a ten per cent rate, both in income and estate tax, with the result that unless a man takes these taxes into consideration in his planning, his plans will likely fail.

The estate tax rates range from three per cent to seventy-seven per cent. An estate of 10,000,000 dollars pays estate tax a little above 6,000,000 dollars, leaving 4,000,000 dollars for the beneficiary. This, invested at five per cent would produce 200,000 dollars a year, on which the income tax might be about 150,000 dollars. The beneficiary derives 50,000 dollars a year spendable income from an unplanned 10,000,000 dollar estate.

To the best of my recollection, it was the chronicler Froissart who said of Henry VIII, "there he lay, dead, stinking and interstate". I think the beneficiary of the multi-millionaire might have a very similar attitude towards his testator who left him 10,000,000 dollars to produce 50,000 dollars a year disposable income. This would be an unplanned estate. The only thing worse would be a badly planned estate, which might reduce the 50,000 dollars a year to zero.

Hence the necessity of planning.

The preliminary requisite to estate planning, as to any planning, is the desire to look to the future, and we may dismiss forthwith those possibly more happy men who are satisfied with the sufficiencies of today. They will have, without planning, their old age benefits, for what they will be worth. They may have from their employers pension or retirement benefits, which are not within the scope of my discussion. There remain interested those worrisome individuals who desire to plan their own and their families' future. Their first problem is to acquire an estate—a pool of assets—for the fulfilment of their ultimate plans. Some fortunately inherit property or acquire it by fortuitous speculation. To those who will attempt these latter means I wish success, and of them I ask advice.

The conservative way to build or increase an estate is by systematic saving or accumulation of values. This is the method of so-called life insurance which, except for the frequently secondary aspect of insurance against untimely death, is not different from systematic deposits at compound interest. In this area the trust device is also available, permitting the accumulation of income. We may note that if income can be systematically accumulated at five per cent a year, it will double in approximately fourteen years. If however, only three and one half per cent can be procured, then it takes twenty years' accumulations to equal the original principal. The impediment to a program of systematic savings is the income tax. The yield to be reinvested and accumulated is the net yield after income taxes.

The first place in this field of accumulation, at least taxwise, goes to qualified employee benefit plans, which have two advantages: first, they permit accumulation of current earnings from personal services before income tax; and second, they permit cumulation of investment income free of income tax.

Next, at least in the past, the life insurance companies have had an advantage over trust companies and individuals operating for their own account, for, although premiums must be paid out of after-tax income, the investment income was not, and in most instances still is not subject to income tax. This advantage, however, is more than balanced by three advantages of trustees or individuals: first, their costs of administration are less; second, they can derive a higher yield from their investments; and, third, they can invest in equities or tangible property, which seem desirable in inflationary times. In this area, the "incorporated pocketbook" still offers some opportunities.

So our young planner, seeking to build up an estate, seeks to accumulate income by systematic savings. If his income on his accumulated fund can be free of income tax, his increase is that much greater.

Suppose a young man twenty-five years of age is ambitious to establish an estate for a prospective family or for himself. He might undertake a program of setting aside 1,200 dollars a year for twenty-five years. If this could be invested at six per cent accumulated annually, at the end of twenty-five years he would have approximately 65,000 dollars of value. Let us compare this with an insurance plan. An annual premium of about 1,400 dollars for twenty-five years will purchase an endowment, including estimated dividends, of about 45,000 dollars. The excess of the insurance premium over the proposed annual deposits—200 dollars a year—would purchase a declining balance term policy, which in the event of death would pay the difference between the accumulated fund and the 65,000 dollars to which the young man was building. Thus, we have the difference. An approximate 1,400 dollars a year will provide an insurance endowment in twenty-five years, or on death, of about 45,000 dollars. The same amount, if it can be accumulated at six per cent, will provide a fund in twenty-five years, or on death, of approximately 65,000 dollars without consideration (except to the extent included in the assumed yield) of the effects of the monetary inflation which we all expect to continue.

As previously noted, the impediment to accumulation of income at the rate of six per cent per annum is the income tax. Devices to meet this impediment may be available. Thus, there are investment trusts and corporations established for the accumulation of income. The corporation pays no substantial income tax on dividend income if it is not a personal holding company. Several other devices are suggested to prevent the imposition of substantial income tax, particularly appropriate to the people who know how to purchase and manage real estate. If farming operations are incorporated, the corporation can invest savings in dividend-paying stocks and the dividends received are substantially free of income tax. At the same time, the farm income could, at least to a large extent, be paid out in salaries, so that the income tax on this income would be the same with or without incorporation. Similarly, if future interests in lands could be purchased at a discount, the increase in value which would occur as the future estate approached possession would be free of income tax.

The problem of accumulation of an estate is an intensely personal problem, depending upon the business activities of the estate planner. For each kind of business activity, particular devices may be available, and for each individual particular selection of the tools must be made. Corporations, trusts, future interests, life insurance, and numerous other devices are afforded for selection. The net purpose and virtue of each is the accumulation of income.

So much for building an estate. Systematic accumulation of income through any of the available vehicles is the means. The income tax is a substantial but not insuperable impediment.

Next, the use of an estate to which the income tax remains an impediment and the disposition of an estate, which the gift and estate tax impede.

The remainder of this discussion is concerned with the man who has built his estate, and again of this class no man may be said to be typical for every situation is unique. There is variety in the kind of estate: Is it liquid or non-liquid? To what extent does the real value depend on the continuing efforts of the owner? What is the character of the man's wife and of his children? There are still in every case certain basic problems, the first of which is, how much should our hypothetical estate planner retain for his own and his wife's support during their lifetime? There is no exact answer, and in the most usual situation estate planning at this stage consists of testamentary disposition or its equivalent, as a revocable trust.

The advantages of a revocable trust over testamentary disposition are now well known. They consist of greater facility in administration and saving of probate costs.[1]

Observe, then, that an estate of 120,000 dollars or less can possibly, if not probably, be passed on free of estate tax. If the whole estate is bequeathed to the testator's widow, then one-half is within the marital deduction and the other half within the exemption. On the widow's presumably subsequent death, however, if the estate remains intact, there would be an estate tax to be paid.

Suppose, however, that the estate were so left that one-half would be used to buy an annuity for the widow; the other half to buy life insurance on her life. Obviously, (apart from insurance company costs) the annuity is going to be equal to the interest on the two premiums and the insurance is going to be the sum of the two premiums. So a trust plan is suggested: One half of the estate to the widow either outright or in a marital trust, that is, one qualifying for the marital deduction; the other half to accumulate the income subject to encroachment for the widow. Now, every time the non-marital trust accumulates 1,000 dollars, the widow can afford to encroach upon the marital trust or her own principal to an equal amount. Thus, the accumulation in a non-marital trust, if the widow survives by a

[1] Potter v. Winter, 280 S.W.2d 27 (Mo. 1955). See Annot., 164 A.L.R. 881 (1946).

substantial period of time, enables her to reduce or exhaust her own estate, still retaining a constant amount available.

The same principal is pertinent and to a greater extent beneficial in a larger estate. I would suggest that, where the marital deduction is taken, there is a little purpose in giving the widow current income in the non-marital portion of an estate; that in almost all cases the marital deduction should be taken, since the period of survivorship of the spouse affords a continuing opportunity for her to dispose of assets, reducing her estate; and if the non-marital portion affords security, she can give her own property, while without it she might reasonably or unreasonably fear the exhaustion of her estate.

Consider further, if you will, the investment implications of having two estates, one subject to further estate tax, the other free of such taxes; in the one, any growth of value inures in part to estate tax; in the other, the growth is all for private benefit of the remaindermen.

Now let me submit to you a thesis which may offer the easiest approach to an estate planning problem. The key to such planning —at least in relation to taxes—is division or separation of income and assets into two or more pools or estates. The basis of this thesis is the steep graduation in rates of the pertinent taxes; namely, income, gift, and estate taxes.

The young man desiring to accumulate an estate sets apart a fund, the income of which is separately taxed at low rates. The testator I have mentioned splits his estate into two parts—one exempt from further estate taxes, the other to be exhausted in his generation.

Consider, then, the several kinds of division available: For example, with reference to a tract of land: First, it may be split in two—the North Half in one parcel, and the South Half in another; and separate dispositions may be made of the two parcels. Second, it may be spilt in value. A mortgage placed upon it and one disposition made of the mortgage, while another disposition is made of the land subject to the mortgage. Third, it may be spilt in time—dividing the present use, whether for life or for any other period of time, from the future rights in the property.

The third method—division in time—is most appropriately discussed in connection with trusts, for it is the most usual purpose of a trust to divide present use of property from future rights in the same property. In substance, however, I see no difference between a trust providing successive beneficial interests and successive legal interests —as life estate and remainder—without a trust.

Suppose we explore some of the uses of the division of property with reference to estate planning. First, if the young man building an estate can purchase remainder interests, he can accumulate, tax free, the increase in value which occurs as the remainder comes closer to falling in with the passage of time. If an old man can purchase a life interest, he can realize the full income, but by amortizing his cost pay little in income tax. If the two can be brought together, there is the making of a mutually advantageous deal. If the young man can buy property subject to mortgage, and pay off the mortgage, he similarly increases the estate. The income used to pay off the mortgage is first taxable to him, and, unless he can achieve low income tax rates, the payment of the mortgage is difficult.

Next, we may imagine a man who has accumulated a substantial estate in non-liquid form and desires that it be retained intact for the benefit of his family. He is unable to save anything out of income. He has already made gifts which substantially exhaust his cash by payment of gift tax. His gift tax rate is such that he cannot readily raise the money with which to pay tax on further gifts. We may regard gift tax and estate tax in the same category, since from the point of view of the disposition of an estate the gift tax is but a prepayment of estate tax. It is true that the prepayment is within limits at a substantial discount. Hence, life insurance or similar liquid reserves may properly, after the need for insurance as such has passed, be used to prepay estate taxes, that is, to pay gift taxes.

Our planner's problem is, *first,* to provide cash for his own needs, and, *second,* to transfer his estate intact.

Assume that his estate is non-liquid; that he cannot readily sell a part of it. Assuming that his top income tax bracket is seventy-five per cent, it follows that within the applicable limitations he may realize three-fourths of the value of property by giving it to charity. If, then, his gift tax rate is twenty-five per cent, for every dollar in value which he gives to charity he may give three dollars to private beneficiaries, and the income tax reduction will pay his gift tax. He desires, however, to retain some liquid assets for himself. So for every dollar he gives to charity he may give to private beneficiaries one dollar and retain fifty cents.

The outright gift to charity permanently disposes of a part of his property. Thus, if he gives the north half of Blackacre to charity and the south half to his children, his children no longer own Blackacre intact.

Instead, suppose he gives Blackacre to charity for a term of twenty years with remainder to his children. Upon the assumed discount rates—three and one-half per cent—the twenty-year term in Blackacre is worth fifty cents on each dollar of its value. Hence, the tax effect is the same as if he had divided Blackacre into two parcels equal in value, but the economic effect is quite different. By giving up the use of Blackacre for twenty years, on each dollar of value of Blackacre he has placed fifty cents in his own pocket and also anticipated the estate tax on Blackacre at a discount by paying gift tax.

Upon this assumed yield of three and one-half per cent, the twenty-year term in Blackacre would have yielded him only seventy cents per dollar of value. After income taxes, he would clearly have had less than fifty cents. His living is therefore better provided for than if he had retained Blackacre, even if his fifty cents retained is held uninvested in cash and spent at the rate of two and one-half cents a year.

At the same time, Blackacre is retained intact and by waiting twenty years the use and enjoyment of it returned to private possession.

These results are susceptible to infinite variation. The Commissioner presumes a three and one-half per cent discount rate and, absent rather convincing showing that a different discount rate should be used, this rate will be used. The relative values of term estate and remainder may be varied by lengthening or shortening the term.

I suppose that we all believe that we live in inflationary times. We may differ in our opinions on the rate of inflation, but will fairly agree that over any extended period of time the purchasing power of the dollar will decline and that correspondingly well-selected assets will appreciate.

But this economic fact is hardly susceptible of consideration in the present valuation of property.

Suppose that our hypothetical estate planner is willing to take a little greater risk than is proposed above and place 1,000 dollars worth of property presently yielding thirty-five dollars a year in trust to pay thirty-five dollars a year for twenty years to charity. Now, obviously, the present value of thirty-five dollars a year for twenty years is the same as the present value of the use of 1,000 dollars for twenty years at the three and one-half per cent, and the tax results are the same in either case. Nevertheless, if the 1,000 dollars worth of property comes to yield fifty dollars a year, then there is an immediate benefit to the remaindermen.

Let me assure an extreme example: A certain tract of land worth 1,000 dollars will produce 100 dollars a year (probably before any wages or salaries). Our hypothetical estate planner, by trust or otherwise, charges this land with an annuity of 100 dollars for thirteen years in favor of charity. The present value of 100 dollars a year for thirteen years at three and one-half per cent is about 1,000 dollars, so that the annuity represents the entire value. By working this land without compensation for thirteen years, our estate planner will own the land free and clear, having deducted the entire cost.

Or, omitting charity, suppose we find an investor who will pay 900 dollars for the right to receive from this land 100 dollars a year for thirteen years or fourteen years, and our estate planner can buy the land, subject to the investor's beneficial interest, for 100 dollars. Now, of course, this is in economic substance the same as a mortgage. But it appears that the mortgagor discharges the debt out of before-tax income, and the mortgagee, by amortizing his cost, pays tax only on the interest element of his receipts.

These strange results follow from the fact that the income tax law has departed from economic reality in its concepts of trusts, debts, and property. For many years with respect to trusts the law was different and depended on whether the income was distributed as income; this, too, gave rise to strange and uneconomic distinctions, and accordingly the rule was changed so that to the extent that there is income all current distributions are considered income distributions. Income, as a subject of taxation, rests on the economic theories of Adam Smith. As we depart from those theories into the Keynesian circulation concept of wealth, no economic concept of income remains, and the attempted development of a notion of taxable income in the Keynesian economy leaves taxable income a formalistic concept without any basis in reality.

In fact and reality, the distributions of income from a trust estate and the payment of an annuity, or exhaustion of a life or term estate inure to the benefit of a remainderman, because with each year that passes his remainder, being that much closer to falling in, increases in value. There is in fact no difference from the point of view of a remainderman between the payment of income to his predecessor in interest, on the one hand, and the payment of principal and interest on a mortgage on his own property, on the other.

A man owning Blackacre mortgages it for 1,000 dollars and gives it away, subject to the mortgage. The income of Blackacre is then used to pay interest and principal on the mortgage. When the mortgage is paid off, the donee owns it free and clear.

It is quite apparent that the donee of Blackacre, subject to the mortgage, receives exactly the same as he would receive if Blackacre were placed in trust to pay the income to one person for the period which would be required for that income to discharge the mortgage, but the tax consequences are entirely different.

One of the usual problems in estate planning is to find cash. The obvious sources late in the game are *selling* and borrowing. *Borrowing* is but a stop-gap expedient, since the loan must be repaid in cash, but the income tax impediment to repaying may be controlled. Assuming the loan is to be repaid out of income, the trust device permits the repayment in a variety of ways: Out of trust income, subject to income tax at trust rates; out of beneficiary's income, taxable at his rates; out of the difference between the grantor's rates and 100 per cent; or, out of before-tax income. There is in economic substance no difference between an estate for a limited time, on the one hand, and a mortgage, on the other. The implications of this economic identity, in juxtaposition to the tax difference, are extensive and in the modern business world only slightly explored.

Different situations may well call for differing divisions. The division in time, of which I have been speaking, may be inappropriate under some forms where an interest in the property is to be retained, for in that situation the tax laws present an obstacle. If income is retained for life, the property is includible in the donor's gross estate; but note that, if the remainder only is given to charity, the donor enjoys an immediate income tax reduction and retains the estate tax benefit of the martial deduction of one-half of what he has given. If the reversion is retained, no deduction is allowed for a contribution of the term. So, here, the mortgage or term trust, now popularly so called, may be the more appropriate.

I have not exhausted the possible kinds of division of the inherent values in property. One of the most obvious is frequently useful; the division of corporate values between common and preferred stock, the preferred stock being similar economically to a mortgage or term for years and the common to an equity or remainder. But the tax effect is entirely different, for the retention of preferred stock is not such a reservation of income of corporate property as will render the common stock value, if disposed of, includible in the taxable estate;

nor will the retention of common stock be considered such a reversion that a gift of preferred stock to charity is non-deductible.

Tax planning involves something more than citing section numbers and pertinent court decisions. I am suggesting a "division of values" approach to estate planning—having found the objectives sought to be accomplished, to think of them in terms of the values sought to be attributed to various purposes—values for accumulation and retention, values for enjoyment, values for debt, and values for disposition to various people. Having, then, analyzed the result sought to be accomplished, the problem is to select from the available tools that most appropriate to effect the division. Trusts, corporations, notes, contracts, deeds, wills, mortgages, future estates, contingencies, insurance, and all the other tools are each most effective for specialized purposes. Taxation very often depends upon the tool used, rather than the economic substance of what is accomplished.

Let me in conclusion suggest one speculation. The combination of the income, gift, and estate tax has long been thought of as the iron ring of taxes encompassing an individual with property and burdening every use of his property. A chink begins to appear in this iron ring, as income tax comes to be more and more a tax on circulation of money and the concept of gain as the basis of tax grows fainter. The gift and estate tax remain imposed (with limited exceptions) only on transfers of property. The exhaustion or termination of values, with consequent enhancement of other values, appears not to have tax consequences. Suppose a father gives Blackacre to his son, reserving or taking back an estate in himself so long as a certain oak tree stands. The interest given is of little value; but does not the value of the reserved estate escape from the iron ring, especially if the father helps things along by girdling the oak? This may be an extreme case—I state it merely to illustrate that destruction, abandonment, or forfeiture of rights may in some cases enhance the value of property, without either being a transfer of property subject to gift tax or giving rise to taxable income in the owner of the benefitted property.