NORTH CAROLINA LAW REVIEW

Volume 27 | Number 1

Article 5

12-1-1948

Introduction to Tax Planning for Estates

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INTRODUCTION TO TAX PLANNING FOR ESTATES

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I. PRELIMINARY CONSIDERATIONS

A. Tax planning must be distinguished from estate planning.

1. Estate planning embraces all of the necessary steps involved in making a wise and prudent disposition of an estate. Tax planning is limited to one aspect of estate planning; keeping taxes connected with the disposition of the estate at a minimum. Althrough a sound tax plan is an integral part of a sound overall estate plan, tax considerations should never be allowed to dictate the disposition of an estate.

B. Tax plans should always be reduced to concrete computations. It is easy to be misled by generalities in tax planning. Tax plans should, therefore, always be reduced to specific figures and diagrammed in dollars and cents. For example:

1. Since the rates of the gift tax are fixed by the statute at three-fourths of those of the estate tax is would seem that you could save 25 per cent of the estate tax by giving away property during life. In their actual operation, however, the relation of the two taxes is entirely different from what it appears to be. In some situations the gift tax amounts to more than the estate tax; in others, intervivos gifts can be made without incurring any gift tax liability at all. In the usual case the gift tax is much closer to one-half of the estate tax, than three-fourths of the estate tax.
2. The new marital deduction provided by the 1948 Revenue Act offers far less scope for tax saving when you work it out in specific figures, than it appears to offer when you read the statute.

C. In tax planning for estates, the overall impact of the gift and income taxes, as well as the estate tax, must be considered. Income tax and gift tax dollars which are saved are worth just as much to the taxpayer as estate tax economies. In tax planning for an estate therefore, not death taxes alone, but the overall impact of estate, gift and income taxes must be considered.. In this connection it is particularly important to bear in mind, moreover, that there is no correlation between the three taxes. The same transfer may be subjected

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to both the gift and the estate tax. A transfer taxable under the gift tax will not necessarily relieve the taxpayer from income tax liability upon the income from the property transferred.

D. In tax planning for estates allowance must be made for future changes in the law. The best laid tax plans may be upset by changes in the law. Although there is no way of forecasting the future law with any degree of certainty, certain precautions may be taken against such changes:

1. Legislative and judicial trends may be studied and tax plans shaped to conform to probable future developments. For example:

    a. Prudent tax advisers held up husband and wife transfers as soon as it became evident that the community property system of taxing income, gifts and estates of married persons might be adopted generally by the federal tax law.

    b. In view of the possibility that the estate tax and the gift tax may be integrated and intervivos transfers will lose the advantages which they presently enjoy as a method of minimizing death taxes, any one contemplating intervivos transfers should be advised to complete them as soon as possible.

2. Tax plans should be kept as flexible as possible so that they may be adjusted to future changes in the law. Irrevocable transactions should be avoided or, at least, only undertaken after the most careful consideration.

3. Tax plans should be revised as soon as they become outmoded and clients should be conditioned to expect constant revision of tax plans.

E. Sound tax plans do not come in standard sizes; they must be tailor made to fit the particular situation. Sound tax planning requires a complete and detailed knowledge of a client's family and economic situation and a detailed acquaintance with the beneficiaries he wishes to take care of and his plans for taking care of them. The tax plan must be integrated with the overall estate plan and the same facts which are necessary for estate planning are in general necessary for tax planning. At a minimum these facts are:

1. A detailed inventory and description of the client's assets, liabilities and expections, including a complete analysis of his insurance program and policies.

2. A detailed description and analysis of any interests or powers which the client may have in any other estate.

3. A complete picture of the client's domestic situation, including not only an acquaintance with his relatives and those whom he wishes to benefit by his estate and the interests he wishes them to take, but complete familiarity with the character, business capabilities and financial situation of each beneficiary.

II. Mathematics of Tax Planning for Estates: Intervivos Transfers

Introductory Note: Although there are many ways of reducing taxes on an estate, major tax savings are usually achieved by the use of intervivos transfers or the creation of successive estates, or a combination of the two. An understanding of these devices is basic to an understanding of tax planning for estates. We shall, therefore, consider intervivos transfers first and then successive estates. In this connection it may be well to note that tax savings by means of intervivos transfers and successive estates rest upon certain mathematical as well as purely legal considerations and the formulation of a successful tax plan involves a good deal of careful arithmetic. We shall, therefore, try to consider some of the mathematics of tax planning by means of intervivos transfers and successive estates as well as the strictly legal aspects of such planning.

A. Estate and Gift Tax Aspects of Intervivos Transfers

1. The simplest way to reduce an estate tax is to give away property during life so that there is less in the estate to tax at death. An intervivos transfer which will avoid the estate tax is almost certain to incur a gift tax. It is, therefore, necessary, in order to determine the tax savings by means of intervivos transfers, to offset the savings in estate tax by any gift tax liability incurred in connection with the intervivos transfers. In order to determine the overall savings by intervivos transfers it is also necessary to consider their income tax effects.

2. In order to determine the tax savings possible by means of intervivos gifts it is necessary to compare the tax rates on testamentary and intervivos transfers. Although the statute fixes the rates of the gift tax at three-fourths of those of the estate tax, the statute does not reflect the true ratio between the two taxes.
   a. In the case of small estates the gift tax may be much higher than the estate tax. Thus if a single man had $70,000 and he gave this all away during his life the gift tax would be $2,815 or 563 per cent of the estate tax of $500, which could have have been incurred if he had passed the property at his death.
   b. At the other extreme because of the annual exclusion of

$3,000 and the specific exemption of $30,000 under the gift tax, it is possible by staying within these limits to give away substantial amounts of property during one's life without incurring any gift tax.

c. Under the 1948 Act the privilege which a married person has of dividing his or her gifts with his or her spouse in effect leads to doubling the specific exemption and annual exclusion under the gift tax. Thus a married man who had made no previous gifts and whose wife had made no previous gifts could give $66,000 to anyone other than his wife without incurring any gift tax. By stretching gifts over a period of years and taking full advantage of the annual exclusions and the privilege of dividing gifts married taxpayers can give away very substantial amounts without incurring any gift tax.

d. In the case of fairly substantial estates the gift tax is closer to one-half than it is to three-fourths of the estate tax, because the amount of the estate tax is included in the tax base in computing the estate tax, while the amount of the gift tax is excluded in computing the gift tax, which is imposed only on the net amount passing to the donee. Thus if a single man had $5,000,000 and gave it all away during his life, reserving enough to pay the gift tax, the gift tax would be 51.5 per cent of the estate tax. If he had $10,000,000 and gave it all away during his life, the gift tax would be 47.6 per cent of the estate tax.

e. Maximum estate and gift tax savings are not achieved, however, by giving away all of one's property during his life, but by giving away a proper proportion to take full advantage of the exemptions under both the estate and the gift tax and to keep the entire estate in the lowest possible brackets of the estate and gift taxes. A single man with $100,000 will achieve maximum gift and estate tax savings by divesting himself of everything except $62,000 during his life. If he had $1,000,000 the minimum estate—gift taxes would result from giving away everything except $100,000; and if he had $5,000,000 by giving away everything except $310,000.

3. Other factors beside tax rates must be taken into consideration to realistically appraise possible tax savings by means of intervivos gifts.

a. It is possible to exaggerate possible tax savings by means of intervivos gifts. For example, the gift tax must be paid at the time of the gift, while the estate tax is deferred until the death of the testator. Consequently any realistic comparison of savings by means of intervivos gifts must take into consideration not only the amount of the gift tax, but the loss of income during the remainder of the donor's life from the property used to pay the gift tax.

b. If property given away decreases in value before the donor's death, this reduces the apparent saving due to the intervivos gift, since the gift tax is imposed on the fair market value of the donated property at the time of the gift and the estate tax is imposed upon the fair market value of property subject to the tax at the decedent's death.

c. On the other hand, if donated property increases in value after the gift and before the donor's death, this will increase the apparent tax savings due to the intervivos gift. It does not necessarily follow, however, that a man should give away property which is apt to increase in value during his life, since there is an offsetting income tax disadvantage here, in that the property given away will take as its basis for income tax purposes, the basis of the donor, while property passing at death takes as its income tax basis the appreciated fair market value at the decedent's death, or one year after his death, if the optional valuation date is used under the estate tax.

d. If the gift tax on intervivos transfers must be paid by selling appreciated property, the income tax incurred in connection with this gain must be added to any gift tax in considering any possible saving due to the intervivos gift.

(1) If appreciated property passing at death had to be sold to pay an estate tax, ordinarily no income would be realized on the sale because the property would take a stepped up basis at the decedent's death.

4. Under the 1948 Act the tax advantages of intervivos gifts are complicated by the marital deductions allowed under the gift tax and under the estate tax.

a. If a married person intends to give his entire estate to one other than his spouse, substantial tax savings are possible by means of intervivos gifts, since there would be no marital deduction if he waited until his death to pass on the property, and he can get a lower gift tax rate by giving the property away during his life and treating this as the divided gift of himself and his spouse.

b. If a married person intends to give his entire estate to his spouse, he can also save taxes by giving part of his property away during his life, since under the marital deductions for the gift and estate taxes only half of the property given away during life and only half of the property given away at death will be taxed.

c. If a married person intends to give part of his estate to his spouse and part to one outside the marital community, any possible tax savings due to intervivos gifts seem to be so intimately related to the arithmetic of the particular situation, that generalizations appear valueless. Relevant factors which must be taken into consideration are: (1) The marital deduction under the gift tax for property given to a spouse is limited to one-half of such property, while the marital deduction under the estate tax extends to one-half of the adjusted gross estate. (2) Any intervivos gifts may reduce the marital deduction under the estate tax.

To illustrate the problems which may arise in connection with intervivos gifts where a married person wishes to dispose of part of his estate to his spouse and part to one other than his spouse, suppose that H has $2,000,000 and he wishes to give about half of his property to his wife, W, and half to his son, S:

(1) If H waits until his death to dispose of his property and leaves half of his estate to W and half to S (charging all death taxes against S's share to assure the maximum marital deduction) only half of his estate will be taxed and the tax will be $303,500.

(2) If H gives half of his estate to his wife during his life, because of the marital deduction under the gift tax only one-half of the property given away will be treated as a taxable gift. However, since no property will pass to W at H's death, his estate will not be allowed any marital deduction under the estate tax. H will incur an estate tax on half of his estate at his death of $303,500. He will also incur a gift tax on the gift to his wife of $81,738, and increase his total taxes by the amount of the gift tax.

(3) If H gives half of his property to his son during his life, he may treat this as the divided gift of himself and his wife and the gift tax will amount to only $163,576. However, at H's death the marital deduction accorded his estate will be limited to one-half of his adjusted

gross estate and he will have a taxable estate of approximately \$500,000 on which the estate tax will be \$126,500. The total estate and gift tax in this situation amounts to \$290,076, which is approximately \$13,000 lower than the estate tax would have been if no intervivos gifts had been made. In view of the fact, however, that the gift tax must be paid at once, while the estate tax is deferred until death, it is doubtful whether the tax saving due to the intervivos gifts would compensate for the loss of income from the property used to pay the gift tax.

d. To sum up the tax savings possibilities of intervivos gifts by married taxpayers under the 1948 Act, it would seem that such gifts may have tax advantages where a married person intends to leave all of his property to one other than his spouse, or intends to leave all of his property to his spouse. If, however, he intends to leave part of his property to his spouse and part to one other than his spouse, it is doubtful whether there are any substantial tax advantages connected with intervivos gifts.

B. Income Tax Aspects of Intervivos Transfers

1. In addition to estate tax economies, income taxes may be saved by intervivos transfers of income-producing property, which will split up a high bracket income into smaller incomes taxable in lower brackets.

   a. It is no longer profitable for husbands and wives to make such transfers to each other in order to split their incomes, since this privilege is allowed under the "community property" amendments of the 1948 Act.

   b. Unmarried persons may still reduce their income taxes by making intervivos transfers of income-producing property; and this is also true of married people who wish to transfer such property to one outside the marital community. For example, if H and W have an income of \$48,000, by filing a joint return and splitting their income, they will be taxed on two \$24,000 incomes, on which the tax (ignoring exemptions and deductions) is \$16,763.60. If H and W gave half of their property to their two sons, A and B, so that A and B each has an income of \$12,000, the family income would in effect be taxed as four \$12,000 incomes on which the total tax would be \$10,888.

   c. Although the lowest income tax results from intervivos gifts of half of a person's income producing property (if he intends to split his income with only one person who has no other income) since this equalizes the income of the donor and donee and brings the total income into the lowest possible brackets, *maximum income tax savings* usually will not result on such a division because of the income lost from the property used to pay the gift tax. Maximum income tax savings in terms of income available after taxes are usually achieved by giving away somewhat less than half of one's income producing property. Incidentally this should be contrasted with the division of property necessary to achieve maximum estate-gift tax savings. Maximum tax savings here usually follow from a gift of substantially more than half of the taxpayer's property.

C. Type of Transfer: Gifts in Contemplation of Death

1. The same transfer may be taxed under both the gift and estate taxes, and may not relieve the transferor from liability for the income tax upon the income from the property transferred. In order to avoid death and income taxes successfully by intervivos transfers, therefore, it is essential that the transfer should be an absolute and complete transfer, in connection with which the grantor retains no strings which may subject him to estate or income tax liability. A transfer in trust may be of this character, if the grantor retains no interest in the property transferred and it cannot in any way be used for his benefit.

2. Even if a man transfers property completely and divests himself of every "string" connecting him with the property, he may still be subjected to an estate tax upon the property if the transfer was made "in contemplation of death," since the test of such a transfer is the subjective state of mind of the transferor, rather than the existence of any objective property "strings." Ordinarily, a gift made by a man who has not reached an advanced age and who is in good health will not be taxed as a transfer in contemplation of death. There is some authority, however, which takes the view that the test of such a transfer is purely subjective and any transfer made with a view of avoiding death taxes is necessarily in contemplation of death.

   a. Although the Treasury seems committed to the position that a transfer to avoid death taxes is in contemplation of death, and has received some support from the tax court, it is usually assumed that a transfer which proceeds from a strong motive associated with life will not be taxed as a transfer in contemplation of death, although it was partly influenced by a desire to avoid death taxes.

b. Even though there is some doubt whether a transfer will or will not be taxed as a transfer in contemplation of death, a client may in many cases be well advised to make such a transfer, since there is a reasonable chance that the transfer will not be taxed as a transfer in contemplation of death, and the consequences are not usually catastrophic if it is.

c. Whether or not taxes will actually be saved by a transfer in contemplation of death depends upon the circumstances of the particular transaction. The amount of the gift tax which is paid upon the transfer (or the liability to pay the gift tax if it is not paid before the transferor's death) will be deducted from his estate and to this extent reduce the transferor's estate tax. A credit is allowed for the gift tax paid in connection with the transfer against the estate tax. This credit may not equal the full amount of the gift tax. Unless, however, the amount of the gift tax which cannot be credited against the estate tax exceeds the amount by which the estate tax is reduced because of the payment of the gift tax, no tax loss will be suffered because of the gift in contemplation of death.

III. Successive Estates: Avoiding the Second Tax

A. The device of successive estates to avoid a second, or for that matter even a third or fourth, death tax, as long as the successive estates stay within the Rule against Perpetuities, may be used to achieve very considerable tax savings. If, for example, A left $5,000,000 to B, who left it to C, who left it to D, who left it to E, assuming that there were no marital deductions involved and that the property remained unchanged in value, four estate taxes would be imposed. E would finally inherit $718,721 or less than 15 per cent of the original estate. If, on the other hand, B, C, and D had been given successive life estates with a final remainder to E, there would have been only one tax and E would have inherited $2,569,600, or over 50 per cent of the original estate.

B. Successive estates may not only be created in a will, but they may also be created in connection with intervivos gifts, not only to avoid a second tax upon the death of the first donee, but to prevent tax reduction plans by means of intervivos gifts being frustrated by the donee predeceasing the donor.

1. Plans to reduce death taxes by means of intervivos gifts are

often predicated upon the donee outliving the donor and may end up quite disastrously if the donee predeceases the donor. Suppose, for example, that A gives his son $1,000,000 in order to reduce A's death tax upon his death. If the son should happen to predecease A and A should inherit his son's property, the $1,000,000 would come back into his estate again where it would still be subject to a death tax upon his death. Moreover the gift tax on the gift by A to B, and an estate tax upon B's death would have been needlessly incurred. To make sure that property given away during the donor's life will not revert to his estate on the prior decease of the donee, successive estates may be created. Thus, in the hypothetical case if A had given the property to B for life, remainder to C, the property given to B would not have reverted to A upon B's death. Moreover, of course, a "second tax" upon B's death would have been avoided, regardless of whether B died before or after A.

2. Great care must be taken, in creating successive estates by inter-vivos transfers, to make sure that the grantor does not retain a possibility of reverter in the property which is transferred, which will make the property taxable to his estate under the rule of *Helvering v. Hallock,* 309 U.S. 106 (1939).
   a. Probably the safest way to avoid *Helvering v. Hallock* is to make an ultimate gift over to charity, which will rebut any possibilty of reverter in the grantor.
   b. Under the present regulations *Helvering v. Hallock* does not apply unless the grantor not only reserves an interest in the property, but, in addition, the persons taking the remainder in the property must, in order to take it, outlive the grantor. For example, if A gives property to B for life, remainder to A if A outlives B, and remainder to B's issue if A does not outlive B, *Helvering v. Hallock* applies and upon A predeceasing B, the entire value of the property (less B's life estate) will be taxed to A's estate. On the other hand, if A had limited the property to B for life, remainder to B's issue, remainder in default of issue to A, this transfer would not have been taxed to A's estate at A's death. The value of the possibilty of reverter which A had in the property might be taxed to his estate as property which he owned at his death. However, the value of this interest would ordinarily be insignificant and a far different proposition from taxing the entire property to his estate under *Helvering v. Hallock* upon the theory of a transfer taking effect upon death.

C. One of the practical disadvantages of successive estates is that they limit the life beneficiary to income and fix the ultimate disposition of the estate as of the time of the original testator's death, rather than the life tenant's death. If, for example, A leaves property outright to his wife, B, B can use the principal as well as the income from the property during her life for her support. Moreover at her death she can dispose of the property among the children of the marriage according to their needs and deserts at that time. On the other hand, if A left the property in trust for B for life, remainder to his children, B would be limited to the income from the property during her life and would not be able to dispose of the property as she saw fit at her death. These disadvantages can be largely overcome without incurring an extra tax by giving the trustee power to invade corpus for the support of the life beneficiary (which is a fiduciary power which is not subject to the estate tax) and giving the life beneficiary a power to appoint the property limited to the descendants of the donor of the power, the donee of the power and spouses of such descendants, excluding the donee of the power (which is a limited family power not subject to the estate tax).

D. The device of successive estates to avoid the second tax runs into difficulties under the 1948 Act because it conflicts with the marital deductions allowed for the first time by that Act. Under the 1948 Act there can be no marital deduction under either the estate tax or the gift tax unless property is transferred outright to a surviving or donee spouse. Outright does not mean that the property cannot be transferred in trust. It does mean, however, that no marital deduction will be allowed for a transfer in trust unless the surviving or donee spouse gets a sufficient interest in the property to make the property taxable to his or her estate at his or her death. In other words there will be no marital deduction for property transferred to a spouse by means of the creation of successive estates which will avoid a tax upon the death of the spouse. This raises the question of whether or not successive estates is a desirable method of disposing of property in view of the 1948 Act which denies the benefit of the marital deduction to such dispositions. This is a complicated question calling for several answers, some of which are clear and some of which are rather obscure.

1. It is clear that the creation of successive estates to avoid a second tax is as desirable a method of disposing of property as ever where no marital deduction is involved. Thus an unmarried person may profitably make such a disposition. And so may

a married person where the property disposed of is given to one other than his or her spouse.

2. It is also clear that in transfers between spouses there is no tax advantage in giving away outright more than is necessary to get the maximum marital deduction. Thus, since the marital deduction under the estate tax is limited to one-half of the adjusted gross estate, a spouse will ordinarily get no tax advantage by leaving more than one-half of his estate outright to his or her spouse. Any excess above that amount should be limited by way of successive estates to avoid a second tax upon the surviving spouse's death. Thus, for example, if H had $120,000 and he left all of this outright to his wife, W, who had no independent estate, no tax would be due upon H's death, because $60,000 of his estate would pass under the marital deduction and the remaining $60,000 would be covered by the estate tax exemption. However, upon W's death she would also have a taxable estate of $120,000 of which $60,000 would be taxed. If H had left $60,000 to his wife outright and $60,000 in trust for her life with a remainder to their children, no tax would have been due upon H's death. Nor would any tax have been incurred upon W's death, since her taxable estate of $60,000 would be covered by the estate tax exemption.

3. Whether or not it is desirable to take full advantage of the marital deduction, or whether part of the marital deduction should be sacrificed in favor of successive estates in a particular case depends upon the arithmetic of the particular case. The clue to the most economical use of the marital deduction lies in the fact that the marital deduction actually operates very much like successive estates. Both have the effect of avoiding one tax upon two deaths. Successive estates, however, avoid the tax upon the second death. The marital deduction avoids the tax upon the first death. Consequently, the marital deduction is not a method of escaping taxes entirely but of deferring a tax upon the death of the spouse who dies first to the death of the spouse who dies last. Because the marital deduction may be used to shift a tax from the first death to the second death and successive estates may be used to shift a tax from the second death to a subsequent death, they may be combined to equalize the estates of a married couple so that their estates will be taxed in the lowest possible brackets. In a jurisdiction where state death taxes are limited to the 80 per cent credit allowed against the basic federal estate tax, this is the way in which the marital deduction and successive estates should be used.

a. For example, if H and W both have estates of $500,000 they should forego any marital deduction entirely and leave their property to each other for life with remainders over to their children. The estates are already equal and there is no need to use the marital deduction to equalize them. By foregoing the marital deduction and creating successive estates for each other they will each leave a taxable estate of $500,000 on which the aggregate taxes upon both deaths will be $253,000. If, on the other hand, one or both of the spouses took advantage of the marital deduction this would increase their aggregate taxes. Thus, for example, if H left $250,000 outright to his wife to get the maxmium marital deduction for his estate and died first, he would be taxed on an estate of $250,000. However, W would be taxed on an estate of $750,000 and the total tax would be $259,900.

b. If spouses have estates of disproportionate sizes, they should use the marital deduction and successive estates to try to equalize their estates as nearly as possible. For example, if H had an estate of $1,000,000 and W an estate of $500,000, H should leave $250,000 to W outright and $750,000 to her for life, with a remainder to their children, since this would give both spouses taxable estates of $750,000. On the other hand, W should leave all fo her property to H for life, with a remainder to their children, since this will lead to taxable estates of $500,000 and $1,000,000, the most equal division under the circumstances.

4. Although generally maximum estate tax savings are achieved by combining the marital deduction with successive estates so as to equalize as nearly as possible the taxable estates at the deaths of a married couple, this general principle must be modified in two important particulars:

a. In a jurisdiction where state death taxes are not limited to the credit allowed against the federal tax for such taxes, much less will be saved by using the marital deduction than in a jurisdiction where state death taxes do not exceed the credit against the federal tax. In a jurisdiction of the former type, therefore, greater reliance should be placed upon successive estates. The reason is that ordinarily state taxes make no allowance for any marital deduction. Consequently, in a jurisdiction where state taxes may exceed the permissible federal credit, they must be computed as a separate burden on the estates of the spouses. In such a jurisdiction the marital deduction does not reduce the tax upon the estate of the spouse who dies first by the gross amount of the federal tax allocated to the marital deduction, but merely by the amount of the federal tax after subtracting the permissible credit for state taxes. Moreover, the amount by which the tax upon the second spouse's estate will be increased because of the marital deduction taken by the first spouse is not merely the additional federal tax, but the federal tax and any excess state tax which cannot be credited against the federal tax.

For example, if H has an estate of $1,560,000 and W has an estate of $560,000, the most economical way for H to dispose of his estate, apart from state taxes, would be to leave $500,000 to W outright and the residue of his estate to her for her life with a remainder to their children. This would result in two taxable estates of $1,060,000 each on which the aggregate tax would be $651,400. If H left all of his property to his wife for life with a remainder to their children, there would be taxable estates of $1,560,000 and $560,000 on which the aggregate tax would be $673,900, so that $22,500 is saved by utilizing the marital deduction. If, however, H and W live in North Carolina, where state taxes are not limited to the credit allowed by the federal tax, this would not be an economical division of H's estate. The saving for H's estate by taking a marital deduction of $500,000 would be limited to the difference between the gross federal tax on this amount and the credit allowed against the federal tax for state taxes on this part of the estate, or $170,820. The taxes on W's estate would be increased, however, not only by the amount of the gross federal tax but by any excess state tax which could not be credited against the federal tax. The total increase in taxes on W's estate would be approximately $190,000, even upon the assumption that the wife's property was left to children, so as to incur the lowest state tax. It would, therefore, cost about $20,000 more if the husband left his wife $500,000 outright, than it would if he left his entire estate to her for life, with a remainder to her children. Even if the husband left a much smaller amount to his wife outright and limited the marital deduction to that sum, the total tax would still be higher than if the entire estate had been left to the wife for life.

b. This is not, however, the whole picture with regard to the comparative advantages and disadvantages of the marital deduction and successive estates, even in a state where death taxes are not limited to the permissible credit for such taxes allowed by the federal estate tax. Since the marital deduction avoids the tax upon the death of the first spouse, it increases the amount which the second spouse receives. The second spouse gets more property and this may be an important consideration where the second spouse has a substantial life expectancy. For example, in the hypothetical case of the North Carolina residents who had estates of $1,560,000 and $560,000, if H left W $500,000 outright, this would increase the aggregate taxes on both their deaths by approximately $20,000. However, during her life W would have had $170,820 more capital (the amount of tax saved to the husband's estate by the marital deduction). If she had a life expectancy of 25 years and this was invested at simple interest of 4 per cent a year, this would yield income of $170,820 during her life expectancy, which is, of course, a good deal more than the additional tax incurred by using the marital deduction. It is also possible that when the marital deduction is taken advantage of and property is left outright, this may not increase the taxable estate of the second spouse by the amount of property left to her outright. She may consume it during her life, or get it out of her estate by intervivos gifts.

IV. State Death Taxes in Tax Planning an Estate

A. In the past it has been customary to ignore state death taxes in tax planning an estate on the theory that they would be absorbed in the credit for such taxes allowed against the federal tax. It is, of course, obvious that this is not true in the case of small estates which do not exceed the specific exemption allowed for the federal basic estate tax, since there is no federal credit in such cases. Moreover, unless the state taxes are limited to the amount of the federal credit, state death taxes become an important factor in tax planning an estate where a marital deduction is involved as we have already seen. Without attempting to go into any detail in this connection two suggestions may be offered for minimizing state death taxes.

1. In some states some transfers which are taxed under the federal estate tax are not taxed under the state death tax. State law should be carefully explored for situations of this kind. For example, in some states a power of appointment is not taxed at the death of the donee unless it is exercised. In such a state it would be possible for a husband to leave his wife property for

life, with a general power to appoint the remainder, which would entitle the property so left to a marital deduction. However, the wife by refraining from exercising the power at her death could avoid any additional state tax upon the property at her death.

2. Since state death taxes have become more burdensome due to the new marital deduction allowed under the federal act it is particularly important to avoid multiple state death taxes. Multiple state death taxes are most apt to occur in two cases: where intangible personal property is taxed by several states each of which claim to be the domicile of the decedent; or where intangible personal property is taxed at the domicile of the owner and by some other state which claims an independent taxable situs for the property.
   a. "Double domicile" can usually be avoided if a man takes care to avoid multiple residences and to establish a single jurisdiction irrefutably as his domicile. If, however, he maintains residences in several states and divides his activities between them and does not vote or pay taxes in any state, he runs a real risk of being stuck with a double domicile at his death.
   b. Most of the taxes on intangible personalty based upon multiple situs can be avoided by confining investments to corporations in states which have a reciprocal exemption arrangement with the domiciliary state.